FORTUNE BRANDS INC
Form 10-K
March 09, 2006
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

# Form 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2005

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) | (IRS Employer Identification No.) |

**520 Lake Cook Road, Deerfield, IL 60015-5611**

(Address of principal executive offices) (Zip Code)

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

**Securities registered pursuant to Section 12(b) of the Act:**

| Title of each class | Name of each exchange on which registered |
|---|---|
| Common Stock, par value $3.125 per share | New York Stock Exchange, Inc. |
| $2.67 Convertible Preferred Stock, without par value | New York Stock Exchange, Inc. |

| | |
|---|---|
| 8 5/8% Debentures Due 2021 | New York Stock Exchange, Inc. |
| 7 7/8% Debentures Due 2023 | New York Stock Exchange, Inc. |

**Securities registered pursuant to Section 12(g) of the Act: None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer.

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 Act). Yes ¨ No x

The aggregate market value of registrant s voting stock held by non-affiliates of registrant, at June 30, 2005 (the last day of our most recent second quarter), was $12,145,629,876.43. The number of shares outstanding of registrant s common stock, par value $3.125 per share, at February 10, 2006, was 146,345,448.

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DOCUMENTS INCORPORATED BY REFERENCE

Certain information contained in the Proxy Statement for the Annual Meeting of Stockholders of registrant to be held on April 25, 2006 (to be filed not later than 120 days after the end of registrant s fiscal year) ( the 2006 Proxy Statement ) is incorporated by reference into Part III hereof.

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**PART I**

**Item 1. Business.**

(a) General development of business.

Fortune Brands, Inc. is a holding company with subsidiaries engaged in the manufacture, production and sale of Home and Hardware products, Spirits and Wine, and Golf products. 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 Company was incorporated under the laws of Delaware in 1985 and until 1986 conducted no business. Prior to 1986, the businesses of the Company s subsidiaries were conducted by American Brands, Inc., a New Jersey corporation organized in 1904 (American New Jersey), and its subsidiaries. American New Jersey was merged into The American Tobacco Company (ATCO) on December 31, 1985, and the shares of the principal first-tier subsidiaries formerly held by American New Jersey were transferred to the Company. In addition, the Company assumed all liabilities and obligations in respect of the public debt securities of American New Jersey outstanding immediately prior to the merger. On May 30, 1997, the Company s name was changed from American Brands, Inc. to Fortune Brands, Inc.

As a holding company, the Company is a legal entity separate and distinct from its subsidiaries. Accordingly, the right of the Company, and thus the right of the Company s creditors (including holders of debt securities and other obligations) and stockholders, to participate in any distribution of the assets or earnings of any subsidiary is subject to the claims of creditors of the subsidiary, except to the extent that claims of the Company itself as a creditor of such subsidiary may be recognized, in which event the Company s claims may in certain circumstances be subordinate to certain claims of others. In addition, as a holding company, a principal source of the Company s unconsolidated revenues and funds is dividends and other payments from subsidiaries. The Company s principal subsidiaries currently are not limited by long-term debt or other agreements in their abilities to pay cash dividends or to make other distributions with respect to their capital stock or other payments to the Company.

Fortune Brands success is driven by leading consumer brands in three categories: Home and Hardware products, Spirits and Wine, and Golf products. We seek to grow sales and earnings by investing in the profitable growth of our leading consumer brands. Our brand investments include support for marketing, advertising and the development of innovative new products. We also seek to gain market share by developing and expanding customer relationships.

Another aspect of our strategy is to continuously improve the productivity, as well as cost and asset structures, of our businesses. We did not record any restructuring charges in 2005. Cost-reduction opportunities resulted in pre-tax restructuring charges of $9.8 million and $2.2 million in 2004 and 2003, respectively. Refer to Note 16, Restructuring Charges, to the Consolidated Financial Statements, Item 8 to this Form 10-K.

While our first priority is internal growth, we add to that growth with acquisitions and joint ventures that position our businesses for even stronger growth and higher returns. We have made the following acquisitions and divestitures in recent years:

On February 10, 2006, we announced an agreement to acquire SBR, Inc. and its leading brands of vinyl-frame windows and composite millwork. The acquisition is expected to close in the second quarter. Refer to Note 24, Subsequent Events, to the Consolidated Financial Statements, Item 8 to this Form 10-K.

In 2005:

> We acquired more than 25 spirits and wine brands as well as certain distribution assets in key markets from Pernod Ricard S.A. Brands acquired include Sauza tequila, Maker s Mark bourbon, Courvoisier cognac, Canadian Club whisky, Laphroaig single-malt Scotch and Clos du Bois super-premium wines (July 2005).

> We completed the spin-off of the Office products business, ACCO World Corporation, to the Company s shareholders. In addition to retaining their shareholdings in Fortune Brands, each Fortune Brands shareholder received one share of ACCO Brands Corporation for each 4.255 shares of Fortune Brands stock held (August 2005).

In 2004:

> Therma-Tru Holdings, Inc. acquired Sentinel Doors Ltd., a leading U.K. manufacturer and installer of complete composite entry door systems, and Master Lock Company acquired the assets of

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> Dudley Inc., a leading brand of school locker locks in Canada. The aggregate purchase price of these two acquisitions was $30.9 million (June 2004).

In 2003:

> Our Home and Hardware business acquired Therma-Tru Holdings, Inc. Therma-Tru is the leading brand of residential entry doors in the United States. The cost of the acquisition was $924.0 million (November 2003).

We also completed the following acquisitions for an aggregate cost of $123.7 million:

Home and Hardware acquired:

> Capital Cabinet Corporation, a cabinet supplier to builders in the Southwestern U.S. (June 2003).

> American Lock Company, a manufacturer of commercial locks (April 2003).

Spirits and Wine acquired:

> Wild Horse Winery, a maker of ultra-premium California wines (July 2003).

Acquisitions, divestitures and joint ventures from 2001-2002 were:

> Omega Holdings, Inc., a leading manufacturer of custom and semi-custom cabinetry, acquired by our Home and Hardware business in 2002 for $538.0 million.

> Future Brands LLC (Future Brands), a joint venture established in 2001 by our Spirits and Wine business and V&S Vin & Sprit AB (V&S), the maker of ABSOLUT vodka, for the distribution of both companies spirits brands in the United States.

> We have also sold a number of nonstrategic businesses and product lines, including the sale of the Spirits and Wine segment s U.K. based Scotch whisky business in 2001 for $280 million.

On an ongoing basis, we review the portfolio of brands owned by our operating companies and evaluate our options for increasing shareholder value. Although no assurance can be given as to whether or when any acquisitions or dispositions will be made, we might finance acquisitions by issuing additional debt or equity securities. The possible additional debt from any completed acquisitions would increase the Company s debt-to-equity ratio and these debt or equity securities might, at least in the near term, have a dilutive effect on earnings per share. We also consider other corporate strategies intended to enhance shareholder value, including share repurchases and higher dividend payments. We cannot predict whether or when any particular strategy might be implemented or what the financial effect thereof might be upon the Company s debt or equity securities.

**Cautionary Statement**

Except for the historical information contained in this Annual Report on Form 10-K, certain statements in this document, including without limitation, certain matters discussed in Part I, Item 1 Business and Item 3 Legal Proceedings and in Part II, Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations, are forward-looking statements, as defined in the Private Securities Litigation Reform Act of 1995, that involve a number of risks and uncertainties. Readers are cautioned that these forward-looking statements speak only as of the date hereof, and the Company does not assume any obligation to update, amend or clarify them to reflect events, new information or circumstances occurring after the date of this Report. Actual results may differ materially from those projected as a result of certain risks and uncertainties including, but not limited to:

- competitive market pressures (including product and pricing pressures),
- consolidation of our trade customers and increased private-label products, particularly in the home and hardware industry,
- successful development of new products and processes,
- ability to secure and maintain rights to intellectual property,
- risks pertaining to strategic acquisitions and joint ventures, including the Spirits and Wine acquisition and the related integration of internal controls over financial reporting,
- ability to attract and retain qualified personnel,
- various external conditions, including general economic conditions, weather and business conditions,
- risks associated with doing business outside the United States, including currency exchange rate risks,
- interest rate fluctuations,
- commodity and energy price volatility,

- costs of certain employee and retiree benefits and returns on pension assets,
- dependence on performance of wholesale distributors and other marketing arrangements,
- the impact of excise tax increases on distilled spirits and wines,
- changes in golf equipment regulatory standards and other regulatory developments,
- potential liabilities, costs and uncertainties of litigation,
- impairment in the carrying value of goodwill or other acquired intangibles,
- our historical consolidated financial statements may not be indicative of future conditions and results due to our recent portfolio realignment,
- any possible downgrades of the Company s credit ratings,

as well as other risks and uncertainties detailed from time to time in the Company s Securities and Exchange Commission filings, including those described in Item 1A. Risk Factors in this Report.

(b) Financial information about industry segments.

See Note 17, Information on Business Segments, to the Consolidated Financial Statements, Item 8 to this Form 10-K.

(c) Narrative description of business.

The following is a description of the business of the subsidiaries of the Company in the Home and Hardware, Spirits and Wine, and Golf business segments. For financial information about these business segments, see Note 17, Information on Business Segments, to the Consolidated Financial Statements, Item 8 to this Form 10-K.

**Home and Hardware**

Fortune Brands Home & Hardware LLC (Home and Hardware) is a holding company for subsidiaries in the Home and Hardware business. Subsidiaries include MasterBrand Cabinets, Inc. (MasterBrand Cabinets), Moen Incorporated (Moen), Therma-Tru Corp. (Therma-Tru), Master Lock Company LLC (Master Lock) and Waterloo Industries, Inc. (Waterloo). The home and hardware industry is highly competitive. Home and Hardware s operating companies compete on the basis of product quality, price, service and responsiveness to distributor and retailer needs and end-user consumer preferences. Factors that affect the Home and Hardware business results of operations include levels of home improvement and residential construction activity, principally in the U.S. Approximately 10% of Home and Hardware s sales are to international markets.

MasterBrand Cabinets manufactures custom, semi-custom, stock and ready-to-assemble cabinetry for the kitchen, bath and home. MasterBrand Cabinets sells under brand names including Aristokraft, Decorá, Schrock, Diamond, Kemper, Omega, Kitchen Craft and HomeCrest. MasterBrand Cabinets sells directly to kitchen and bath specialty dealers, home centers, wholesalers and large builders. In June 2003, MasterBrand Cabinets acquired Capital Cabinet Corporation. In April 2002, MasterBrand Cabinets acquired Omega Holdings, Inc., a manufacturer of custom and semi-custom cabinetry. MasterBrand Cabinets competitors include Masco, American Woodmark Corporation and Armstrong World Industries. MasterBrand Cabinets is the second largest cabinet manufacturer in North America.

Moen manufactures faucets, bath furnishings, accessories, parts and kitchen sinks in North America and China. Sales are made through Moen s own sales force and independent manufacturers representatives primarily to wholesalers, mass merchandisers, home centers and industrial distributors. Products are sold principally in the U.S. and Canada and also in China, Mexico and Latin America. Moen s chief competitors include Masco, Black & Decker, Kohler, American Standard and imported private-label brands. Moen is the #1 faucet brand in North America.

In November 2003, the Home and Hardware business acquired Therma-Tru Holdings, Inc., the #1 residential entry door brand in the United States. Therma-Tru manufactures fiberglass and steel residential entry door and patio door systems, primarily for sale in the United States, Canada and Western Europe. Therma-Tru s principal customers are home centers, builders and millwork building products distributors that provide products to the residential new construction market and home centers, as well as to the remodeling and renovation markets. Therma-Tru s competitors include Masonite, Jeld-Wen and Plastpro. In June 2004, Therma-Tru acquired Sentinel Doors Ltd., a leading U.K. manufacturer and installer of complete composite entry door systems.

Master Lock manufactures and sells key-controlled and combination padlocks, bicycle and cable locks, built-in locker locks, automotive, trailer and towing locks and other specialty security devices. Sales of products designed for consumer use are sold to wholesale distributors, home centers and hardware and other retail outlets. Sales of lock systems are sold to industrial and institutional users, original equipment manufacturers and retail outlets. Master Lock competes with Abus, Kryptonite, Hampton and various imports in the padlock segment. In April 2003, Master Lock acquired American Lock Company, a U.S.- based manufacturer of solid body commercial padlocks. In June 2004, Master Lock acquired the assets of Dudley Inc., a leading brand of school locker locks in Canada. Master Lock is the # 1 padlock worldwide.

Waterloo manufactures tool storage products, principally high-quality steel toolboxes, tool chests, workbenches and related products. Waterloo sells to Sears for resale under the Craftsman brand owned by Sears, to Lowe s under the Kobalt brand name, and under the Waterloo brand name to specialty industrial and automotive dealers, mass merchandisers, home centers and hardware stores. Waterloo competes with Snap-On, Kennedy, Stanley, Stack-On and others in the metal storage segment, and with Contico, Zag, Rubbermaid and others in the plastic hand box category. Waterloo is the # 1 tool storage manufacturer worldwide.

Raw materials used for the manufacture of products offered by Home and Hardware s operating companies are primarily red oak, maple and pine lumber, particleboard, rolled steel, brass, zinc, copper, nickel, and various plastic resins. These materials are available from a number of sources. Volatility in the prices of these commodities, and energy used in making and distributing our products, could increase the costs of our products. In 2005, the Home and Hardware business experienced increases in lumber product and fuel-related costs. While in the past we have been able to pass on much of these increased costs to our customers, there is no assurance that they can be passed on in the future.

**Spirits and Wine**

Beam Global Spirits & Wine, Inc. (BGSW), formerly Jim Beam Brands Worldwide, Inc. (JBBW), with its affiliates, is a holding company in the distilled spirits and wine business. The Company s operating subsidiaries include Jim Beam Brands Co. (JBBCo.), Future Brands LLC, a majority owned subsidiary (Future Brands), Jim Beam Brands Australia Pty. Limited, Jim Beam España S.L., Jim Beam Brands U.K. Limited (JBB UK Ltd.), Beam Spirits and Wine Canada Limited and Beam Wine Estates, Inc.

In July 2005, the Company purchased more than 25 spirits and wine brands as well as certain distribution assets (the Acquired Businesses) 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. The revenues from sale of all of the Acquired Businesses in 2004 were approximately $1.2 billion, which will more than double our Spirits and Wine business sales.

In July 2003, the Spirits and Wine business acquired Wild Horse Winery, a California-based producer of premium and ultra-premium wines. In December 2003, the Spirits and Wine business extended the rights to manufacture and distribute Gilbey s gin and vodka for an additional 20 years.

On October 16, 2001, the Spirits and Wine business sold the U.K.-based Scotch whisky business. The sale of the business consisted of the Invergordon private-label and bulk Scotch operations and several regional brands in the U.K. The Company recorded an after-tax gain of $21.8 million related to the sale.

On May 31, 2001, the Spirits and Wine business completed transactions with V&S Vin & Sprit AB (V&S), maker of ABSOLUT vodka, creating the Future Brands LLC joint venture to distribute both companies  spirits brands in the United States. V&S paid $270 million to gain access to JBBCo. s U.S. distribution network and to acquire a 49% interest in Future Brands, and paid $375 million to purchase a 10% equity interest in JBBW in the form of convertible preferred stock. V&S also acquired a three-year option to increase its equity stake in JBBW by up to an additional 9.9%, which expired unexercised. V&S may require the Company to purchase the JBBW preferred stock in whole or in part at any time after May 31, 2004 or upon a change in control of JBBW, JBBCo., or certain other events.

With the integration of the Acquired Businesses, principal markets for the products of the Spirits and Wine business are the U.S., Canada, Australia, the U.K., Spain and Mexico. Approximately 40% of our Spirits and Wine business  sales will be to international markets.

The Spirits and Wine business owns its leading brands, except that DeKuyper cordials are produced and sold in the U.S. under a perpetual license, and Gilbey s gin and Gilbey s vodka are produced and sold in the U.S. under a license expiring September 30, 2027.

The Company s Spirits and Wine business has changed significantly with the acquisition of the Acquired Businesses. Previously the Spirits and Wine business had strong market positions in the U.S. and Australia, a relatively small business in Europe (primarily the U.K. and Germany), and a small U.S. wine business. With the Acquired Businesses, our Spirits and Wine business has become much

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larger in scale and scope, more balanced globally in key growth markets, more focused on premium products, and broader in range of product offerings with significant positions in categories such as tequila, cognac and scotch whisky. We also now have significant business in leading regional and national spirits categories such as in German liqueurs and Spanish brandies, and a large portfolio of premium and super-premium U.S. wines.

Leading businesses and brands include the following:

> JBBCo., whose operations are located in the U.S., currently produces or imports, and markets a broad line of distilled spirits, including bourbon and other whiskeys, cordials, gin, vodka and rum. JBBCo. and its predecessors have been distillers of bourbon whiskey since 1795. Leading brand names are Jim Beam bourbon whiskey, Knob Creek, Booker s, Baker s and Basil Hayden s small batch bourbons, DeKuyper cordials, Windsor Canadian whisky and Starbucks Liqueurs.

> Courvoisier, with operations in the cognac region of France, offers premium, super- and ultra-premium cognacs in key markets worldwide. Primary markets are the U.S. and the U.K.

> Maker s Mark, a super-premium bourbon whisky, is made in Kentucky and marketed primarily in the U.S. and North America markets.

> Sauza tequila, made in the Jalisco tequila region of Mexico, is the #2 worldwide tequila.

> Laphroaig, a super-premium single malt scotch, is made on Islay, Scotland.

> Canadian Club whisky is manufactured in Canada and sold to key markets worldwide.

> Strong national and regional brands, including Teacher s Scotch whisky, Harveys sherries and Cockburn s port in the U.K., Larios gin and Whisky DYC in Spain and Kuemmerling bitters in Germany.

> Our wine business includes premium and super-premium brands among the Acquired Businesses such as Clos du Bois, Buena Vista, Gary Farrell and William Hill as well as Geyser Peak and Wild Horse wines.

> Our spirits and wine products are sold through recognized industry channels including the Future Brands and Maxxium Worldwide joint ventures in which the Spirits and Wine business is a partner and shareholder, independent distributors and global or regional duty free customers. Products are also sold through government-controlled liquor authorities in the 18 control states (and one county) in the U.S. that have established government control over certain aspects of the purchase and distribution of alcoholic beverages.

In October 2003, JBBW signed a development and distribution agreement with Starbucks Corporation to develop, manufacture and market a new product, Starbucks Coffee Liqueur, in the U.S. The product launched nationwide in the first quarter of 2005 and a line extension, Starbucks Cream Liqueur, was launched in initial markets during the 4$^{th}$ quarter of 2005.

The distilled spirits business is highly competitive, with many brands sold in the consumer market. Our Spirits and Wine business is the largest U.S.-based producer and marketer of distilled spirits and is the 4$^{th}$ largest spirits company in the world. We compete on the basis of product quality, price, service and innovation in response to consumer preferences. Major competitors include Diageo, Pernod Ricard, Bacardi, Rémy Cointreau, Brown-Forman and Constellation Brands. Our Spirits and Wine business has the #1 bourbon (Jim Beam), #1 super-premium bourbon (Maker s Mark), #2 tequila worldwide (Sauza), #2 Canadian whisky worldwide (Canadian Club), #1 cordial line in the U.S. (DeKuyper), #1 Islay malt whisky (Laphroaig), one of the world s leading cognacs (Courvoisier) and #2 super-premium U.S. wine (Clos du Bois).

The peak season for the Spirits and Wine business is the fourth quarter due to seasonal holiday buying.

Because whiskeys/whiskies, cognacs, brandies, ports and some tequila varieties are aged for various periods (from three to ten years for whiskies, for example), the Spirits and Wine business maintains, in accordance with industry practice, substantial inventories of aging bulk product in warehouse facilities. Production of aging inventory is generally scheduled to meet demand years into the future, and production schedules are adjusted from time to time to bring inventories into balance with estimated future demand. In addition, the Spirits and Wine business may, from time to time, seek to purchase bulk aging spirit if necessary to meet estimated future demand.

The principal raw materials for the production, storage and aging of distilled products, especially whiskeys/whiskies, including Scotch, are primarily corn, other grains, new or used oak barrels, grapes for cognac and wines, and agave for tequila. These materials are generally readily available from a number of sources except that new oak barrels are available from only a limited number of major sources, one of which is owned by a competitor. JBBCo. has a long-term supply agreement for new oak barrels.

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The principal raw materials used in the production of cognacs and wines are grapes, barrels and packaging materials. Grapes are obtained from company-owned vineyards, purchased from independent growers under long-term supply contracts or purchased on the spot market, and, from time to time, are affected by weather and other forces that may impact production and quality.

The production, storage, transportation, distribution and sale of the products of the Spirits and Wine business are subject to regulation by federal, state, local and foreign authorities. Various countries and local jurisdictions prohibit or restrict the marketing or sale of distilled spirits and wine in whole or in part.

In many of the key markets for our Spirits and Wine business, distilled spirits and wine are subject to federal excise taxes and/or customs duties as well as state/provincial, local and other taxes. Beverage alcohol sales are sensitive to higher excise tax rates. Although no federal excise tax increase is presently pending in the U.S., our largest market, many states are considering possible excise tax increases and the possibility of future increases cannot be ruled out. Excise or other tax increases are also considered from time to time in other key markets such as the U.K., Spain and Mexico. The effect of any future excise tax increases in any jurisdiction cannot be determined, but it is possible that any future excise tax increases would have an adverse effect on unit sales and increase existing competitive pressures. The Company s Spirits and Wine business competes on the basis of quality, product innovation, responsiveness to consumer preferences, price, and service.

**Golf**

Acushnet Company (Acushnet), together with its subsidiaries, is a leading manufacturer and marketer of golf balls, golf clubs, golf shoes and golf gloves. Other products include golf bags, golf outerwear and accessories. Acushnet s leading brands are Titleist and Pinnacle golf balls; Titleist and Cobra golf clubs; Scotty Cameron by Titleist putters; FootJoy golf shoes; FootJoy and Titleist golf gloves; and FootJoy outerwear. Acushnet products are sold primarily to on-course golf pro shops and selected off-course golf specialty and sporting goods stores throughout the United States. Sales are made in the U.S., Canada, and other key international markets through subsidiaries and outside these areas through distributors or agents. Approximately 30% of Acushnet s sales are to international markets.

Acushnet and its subsidiaries compete on the basis of product quality, product innovation, price, service and responsiveness to consumer preferences. Acushnet has leading market positions in golf balls (Titleist), as well as golf shoes and golf gloves (FootJoy). Acushnet also is a leading U.S. competitor in golf clubs (Titleist & Cobra). In golf balls, Acushnet s main competitors are Top Flite, Nike, Bridgestone, Callaway and Maxfli. In golf clubs, Callaway, TaylorMade, Ping, Cleveland and Nike are the main competitors. In golf shoes, Nike and Adidas are the main competitors. In golf gloves, Nike and Callaway are the main competitors. Acushnet s business is seasonal and approximately 60% of its sales occur in the first half of the year and less than 20% in the fourth quarter.

The principal raw materials used in manufacturing are synthetic rubbers, polymers, steel, titanium, and natural and synthetic leathers.

Acushnet s advertising and promotional campaigns rely in part on a large number of touring professionals and club professionals using and endorsing its products. The market for the endorsement and promotional services of touring professionals has been and will continue to be increasingly competitive.

There is currently a substantial market in knock-off and counterfeit golf clubs, which imitate or copy the protected features of original equipment manufacturers golf club products. Acushnet has an active program of enforcing intellectual property rights against those who make or sell these products.

Despite favorable demographics of an aging population (rounds of play increasing with age), rounds of play in the U.S. decreased from 2000 to 2003 as a result of a combination of less golf-related travel, economic conditions, lower corporate spending and weather conditions. U.S. rounds of play were flat in 2004 and 2005. The future success of the Golf business will depend upon continued innovation, product quality and successful marketing across product categories. International market opportunities, especially in the Pacific Basin region, have provided and are expected to provide growth for the Golf business.

The United States Golf Association (USGA) and the Royal and Ancient Golf Club (R&A) establish standards for golf equipment used in the United States and outside the United States, respectively. In recent years, each of the USGA and the R&A has enacted new rules restricting golf club head size and golf club shaft length, and changing the overall distance standard for golf balls. In March and April of 2005, the USGA and R&A each issued notices to golf equipment manufacturers 1) expressing their intent to further investigate issues regarding spin, moment of inertia and club adjustability and 2) requesting that manufacturers participate in a golf ball research project by manufacturing and submitting balls that would conform to an overall distance standard that is 15 and 25 yards shorter than

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the current standard of 317 yards. The research being conducted could result in further ball and/or club regulation, including a distance rollback of either or both. Existing rules and any new rules resulting from this research could change the golf products industry s ability to innovate and deploy new technologies, potentially impacting our Golf business. Although we continue to see opportunities to develop and introduce innovative golf products, the recent trend in equipment regulation has been to narrow or reduce those opportunities.

**Other Matters**

*Employees*

As of December 31, 2005, the Company and its subsidiaries had the following number of employees:

| | |
|---|---|
| Home and Hardware | 21,480 |
| Spirits and Wine | 3,682 |
| Golf | 5,032 |
| Corporate | 104 |
| Total | 30,298 |

**Environmental Matters**

The Company and its subsidiaries are subject to federal, state and local laws and regulations concerning the discharge of materials into the environment and the handling, disposal and clean-up of waste materials and otherwise relating to the protection of the environment. It is not possible to quantify with certainty the potential impact of actions regarding environmental matters, particularly remediation and other compliance efforts that the Company s subsidiaries may undertake in the future. Management of the Company does not expect compliance with the present environmental protection laws, before taking into account estimated recoveries from third parties, to have a material adverse effect upon our capital expenditures, financial condition, results of operations or competitive position.

(d) Financial information about geographic areas.

We sell products primarily in the United States, Canada, Europe (primarily the U.K, Germany, France and Spain), Australia and Mexico. A change in the value of the currencies of these countries can impact our financial statements when translated into U.S. dollars. The exchange rates between some of the foreign currencies in which our subsidiaries operate and the U.S. dollar have fluctuated significantly in recent years and may do so in the future. We manufacture and source our products in the United States, Europe, Canada, Mexico, China, Thailand and other countries. We are subject to risks associated with changes in political, economic and social environments, local labor conditions, changes in laws, regulations and policies of foreign governments, as well as U.S. laws affecting activities of U.S. companies abroad, including tax laws and enforcement of contract and intellectual property rights. See Note 17, Information on Business Segments, to the Consolidated Financial Statements, Item 8 to this Form 10-K.

**Web Site Access to SEC Reports**

The Company s website address is www.fortunebrands.com. The Company s annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to these reports are available free of charge on the Company s website as soon as reasonably practicable after the reports are filed or furnished electronically with the Securities and Exchange Commission.

The public may read and copy any materials we file with the SEC at the SEC s Public Reference Room at 100 F Street, N.E., Washington D.C. 20549. The public may obtain information about the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site (http://www.sec.gov) that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC.

**Item 1A. Risk Factors.**

We believe that the following risks and uncertainties may be material to our business. Additional risks and uncertainties that we currently consider to be immaterial may also adversely affect our business. If any of the following risks actually occur, our business, results of operations and financial condition could be materially and adversely affected.

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*We operate in highly competitive markets.*

We compete with large national, international and regional companies on the basis of product quality, price, service and innovation in response to consumer preferences. Our success depends in part on our ability to anticipate and offer products that appeal to the changing needs and preferences of our customers in the various markets we serve. If we are not able to anticipate, identify, develop and market products that respond to changes in customer preferences, demand for our products could decline and our operating results would be adversely affected. While the competitive importance of product quality, price, service and innovation varies from product to product, price is a factor, and we experience pricing pressures from competitors in our markets.

*Continued consolidation of our trade customers and increased competition in private-label products, particularly in the home & hardware industry, could adversely affect our business.*

There has been consolidation of our trade customers and growth in the sales of private-label products in portions of our markets, particularly in the home and hardware industry. Consolidation increases the size and importance of individual customers, and these larger customers can make significant changes in their volume of purchases, require price reductions and even become competitors for some products. Further consolidation could adversely affect our margins and profitability, particularly if we were to lose a significant customer. Similarly, growth in the sales of private-label products could reduce our margins and profits.

*Our financial results and demand for our products are dependent on the successful development of new products and processes.*

Our success depends on anticipating changes in consumer preferences and on successful new product and process development and product relaunches in response to such changes. We aim to introduce products or new or improved production processes on a timely basis in order to counteract obsolescence and decreases in sales of existing products. While we devote significant focus to the development of new products and to the research, development and technology process functions of our business, we may not be successful in developing new products or processes or our new products or processes may not be commercially successful. Our future results and ability to maintain or improve our competitive position will depend on our ability to gauge the direction of our key markets and successfully identify, develop, manufacture, market and sell new or improved products in these changing markets.

*The inability to secure and maintain rights to intellectual property could adversely affect our business.*

We have many patents, trademarks, brand names and trade names that are important to our business. Our business could be adversely affected by the loss of any major brand or by infringement of our intellectual property rights. We are also subject to risks in this area because existing patent, trade secret and trademark laws offer only limited protection, and the laws of some countries in which our products are or may be developed, manufactured or sold may not fully protect our products. In addition, others may assert intellectual property infringement claims against us or our customers.

*Risks associated with our strategic acquisitions could adversely affect our business.*

We have completed a number of acquisitions in recent years, including more than 25 spirits and wine brands and distribution assets acquired last year from Pernod Ricard S.A. We will continue to consider acquisitions as a means of enhancing shareowner value. Acquisitions involve risks and uncertainties, including:

> difficulties integrating the acquired company, retaining the Acquired Businesses customers, and achieving the expected benefits of the acquisition, such as revenue increases, cost savings, and increases in geographic or product presence, in the desired time frames, if at all;

> loss of key employees from the acquired company;

> implementing and maintaining consistent standards, controls, procedures, policies and information systems; and

> diversion of management s attention from other business concerns.

Future acquisitions could cause us to incur additional debt, contingent liabilities, increased interest expense and higher amortization expense related to intangible assets, as well as experience dilution in earnings per share. Impairment losses on goodwill and intangible assets with an indefinite life, or restructuring charges, could also occur as a result of acquisitions.

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*Our failure to attract and retain qualified personnel would adversely affect our business.*

Our success depends in part on the efforts and abilities of our senior management team and key employees. Their skills, experience and industry contacts significantly benefit our operations and administration. The failure to attract and retain members of our senior management team and key employees would have a negative effect on our operating results.

*Various external conditions, including economic, weather and business conditions may result in a decrease in our sales and profitability.*

Demand for our products is sensitive to certain external factors, including economic conditions; weather conditions; with respect to the golf business, destination travel and corporate spending; and with respect to home and hardware, mortgage and other interest rates affecting the housing market, as well as the number of new housing starts and existing home sales. The impact of these external factors is difficult to predict, and one or more of these factors could adversely affect our business.

*We sell products internationally and are exposed to currency exchange rate risks.*

We sell products in the United States, Europe and other areas (principally Canada, Mexico and Australia). While we hedge certain foreign currency transactions, a change in the value of the currencies can impact our financial statements when translated into U.S. dollars. The exchange rates between some of the foreign currencies in which our subsidiaries operate and the U.S. dollar have fluctuated significantly in recent years and may do so in the future.

*We manufacture and source our products internationally and are exposed to risks associated with doing business globally.*

We manufacture and source our products in the United States, Europe, Canada, Mexico, China, Thailand and other countries. Accordingly, we are subject to risks associated with changes in political, economic and social environments, local labor conditions, changes in laws, regulations and policies of foreign governments, as well as U.S. laws affecting activities of U.S. companies abroad, including tax laws and enforcement of contract and intellectual property rights. Exchange rate fluctuations may impact the cost of sourced products and our financial results.

*Risks associated with interest rate fluctuations and commodity and energy price volatility could adversely affect our business.*

We are exposed to risks associated with interest rate fluctuations and commodity price volatility arising from weather, supply conditions, geopolitical and economic variables, and other unpredictable external factors. We buy commodities, including steel, copper, brass, titanium, glass, plastic, resins, wood, particle board, grains and grapes. Volatility in the prices of these commodities, and energy used in making and distributing our products, could increase the costs of our products. We may not be able to pass on these increased costs to our customers, and this could have an adverse effect on our results of operation and financial condition.

*Costs of certain employee and retiree benefits may continue to rise.*

Increases in the costs of medical and pension benefits to our business could continue and negatively affect our business as a result of:

> continued increases in medical costs related to current and retired employees due to increased usage of medical benefits and medical inflation in the United States;

> the effect of any decline in the stock and bond markets on the performance of our pension plan assets;

> potential reductions in the discount rate used to determine the present value of our benefit obligations; and

> changes in law and accounting standards that may increase the funding of, and the expense reflected for, employee benefits.

*Our Spirits and Wine business relies on the performance of wholesale distributors and other marketing arrangements and could be adversely affected by poor performance of major distributors or other disruptions in our distribution channels.*

Our spirits and wine products are sold principally through wholesale distributors for resale to retail outlets. The replacement, poor performance or financial default of a major distributor or one of its major customers could adversely affect our Spirits and Wine business. Any unplanned disruption to the existing channel could adversely affect our revenues and profitability. A disruption could be caused by

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the sale of a distributor to a competitor, financial instability of the distributor, or other unforeseen events.

*Increased excise taxes on distilled spirits and wine could adversely affect our Spirits and Wine business.*

Distilled spirits and wine are subject to excise tax in many countries where we operate. No federal excise tax increase is presently pending in the United States, our largest market. However, many states and other jurisdictions are considering possible excise tax increases. The effect of any future excise tax increases in any jurisdiction cannot be determined, but increased excise taxes could have an adverse effect on our business.

*Changes in golf equipment regulatory standards could adversely affect our Golf business.*

Our ability to develop and market new golf products may be limited by rules governing equipment standards set by industry associations, such as restrictions on golf club head size and shaft length, and the overall distance standard for golf balls, which could adversely impact our golf business.

*Potential liabilities and costs from litigation could adversely affect our business.*

Our business is subject to risks related to litigation with respect to various matters, including with respect to alcohol-related liability and tobacco products made and sold by former operations. It is not possible to predict the outcome of pending litigation, and, as with any litigation, it is possible that some of the actions could be decided unfavorably.

*An impairment in the carrying value of goodwill or other acquired intangibles could negatively affect our operating results and net worth.*

The carrying value of goodwill represents the fair value of acquired businesses in excess of identifiable assets and liabilities as of the acquisition date. The carrying value of other intangibles represents the fair value of trademarks, trade names and other acquired intangibles as of the acquisition date. Goodwill and other acquired intangibles expected to contribute indefinitely to our cash flows are not amortized, but must be evaluated by our management at least annually for impairment. If carrying value exceeds current fair value as determined based on the discounted future cash flows of the related business, the intangible is considered impaired and is reduced to fair value via a charge to earnings. Events and conditions that could result in impairment include changes in the industries in which we operate, as well as competition and advances in technology, a significant product liability or intellectual property claim, or other factors leading to reduction in expected sales or profitability. If the value of goodwill or other acquired intangibles is impaired, our earnings and net worth could be adversely affected.

*Historical financial statements may not be reflective of our future financial condition and results of operation due to our recent portfolio realignment or other reasons.*

We made significant changes in our business last year, as discussed in this report, including spinning off our Office products business, buying more than 25 spirits and wine brands and other assets of Allied Domecq PLC and borrowing to finance that acquisition. Although we believe that this report contains all material information that is necessary to make an informed assessment of our assets and liabilities, financial position, profit and losses and prospects, historical financial statements do not necessarily provide all the financial information investors may consider relevant in evaluating our business after these changes or represent what our results of operations or financial position will be for any future periods.

*Downgrades of our credit ratings could adversely affect us.*

If Moody s, S&P or Fitch were to downgrade our credit rating, such a downgrade could result in loss of access to the commercial paper market and increase our cost of capital. Downgrades of our credit ratings could also affect the value or marketability of our outstanding notes.

**Item 1B. Unresolved Staff Comments.**

None

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**Item 2. Properties.**

The Company leases principal executive offices in Deerfield, Illinois. The following table indicates the principal properties of the Company and its subsidiaries:

| Segment | Manufacturing Plants | | Distribution Centers | | Warehouses | | Other | |
|---|---|---|---|---|---|---|---|---|
| | Owned | Leased | Owned | Leased | Owned | Leased | Owned | Leased |
| Home and Hardware | | | | | | | | |
| U.S. | 32 | 9 | 2 | 15 | 1 | 7 | 3 | 2 |
| Canada | 2 | 2 | | 3 | | 1 | | |
| Mexico | 4 | | 1 | 1 | | 1 | | |
| Central America | | | | 1 | | | | |
| Europe | 1 | 2 | | | | 1 | | |
| Asia | 1 | | | 1 | | | | |
| Spirits and Wine | | | | | | | | |
| U.S. | 12 | 4 | 2 | 2 | 11 | 2 | 8 | 4 |
| Europe | 15 | | | | | | 1 | 1 |
| Canada | 1 | | | | 1 | | 1 | |
| Mexico | 2 | | | | 1 | 12 | 1 | |
| Asia | 1 | | | | | 8 | | 4 |
| Golf | | | | | | | | |
| U.S. | 4 | 1 | 1 | 2 | | | 2 | 5 |
| Europe | | | 1 | 2 | | | | 2 |
| Canada | | | | 1 | | | | |
| Asia | 2 | 3 | 1 | 8 | | | | |
| Corporate | | | | | | | | |
| U.S. | | | | | | | | 1 |
| Asia | | | | | | 1 | | 3 |
| Total U.S. | 48 | 14 | 5 | 19 | 12 | 9 | 13 | 12 |
| Total Non-U.S. | 29 | 7 | 3 | 17 | 2 | 24 | 3 | 10 |
| TOTAL | 77 | 21 | 8 | 36 | 14 | 33 | 16 | 22 |

We are of the opinion that the properties are suitable to our respective businesses and have production capacities adequate to meet the needs of our businesses.

**Item 3. Legal Proceedings.**

**Tobacco Overview**

On December 22, 1994, the Company sold The American Tobacco Company ( ATCO ) 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 (together, the Indemnitor ), agreed, under an Indemnification Agreement, to indemnify the Company 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 the Company is not aware of any inability on the part of the Indemnitor to satisfy its indemnitor obligations.

Numerous legal actions, proceedings and claims are pending in various jurisdictions against leading tobacco manufacturers, including B&W both individually and as successor by merger to ATCO, based upon allegations that cancer and other ailments have resulted from tobacco use. The Company has been named as a defendant in some of these cases. These claims have generally fallen within three categories: (i) smoking and health cases alleging personal injury brought on behalf of individual plaintiffs, (ii) smoking and health cases alleging personal injury and other damages and purporting to be brought on behalf of classes of individual plaintiffs, and (iii) health care cost recovery cases, including class actions, brought by foreign governments, unions, health trusts, taxpayers and others seeking reimbursement for health care expenditures allegedly caused by cigarette smoking. Damages claimed in some of the cases range into the billions of dollars.

**Individual Cases**

As of February 10, 2006, there were approximately 16 smoking and health cases pending on behalf of individual plaintiffs in which the Company has been named as one of the defendants, compared to 19 cases as reported in our Annual Report on Form 10-K for the year ended December 31, 2004. See List of Pending Cases below.

**Class Actions**

As of February 10, 2006, there were approximately three purported smoking and health class actions pending in which the Company has been named as one of the defendants, compared to five cases as reported in our Annual Report on Form 10-K for the year ended December 31, 2004. See List of Pending Cases below.

**Health Care Cost Recovery Actions**

As of February 10, 2006, there was one health care recovery action pending in which the Company has been named as one of the defendants. This number of cases has not changed from the number reported in our Annual Report on Form 10-K for the year ended December 31, 2004. See List of Pending Cases below.

**Certain Developments Affecting the Indemnitor**

On July 14, 2000, in Engle v. R.J. Reynolds Tobacco Company, et. al., a Florida state case brought against B&W (individually and as successor to ATCO) and other U.S. tobacco manufacturers on behalf of a class of Florida residents allegedly injured as a result of their alleged addiction to cigarettes containing nicotine, a jury awarded a total of $144.87 billion in punitive damages against the defendants, including $17.59 billion against B&W. On November 6, 2000, Florida Circuit Judge Robert Kaye upheld this jury award, and held that the class of plaintiffs eligible to recover damages should be extended to smokers with illnesses diagnosed more than four years before the lawsuit was filed in 1994. On May 21, 2003, a Florida appellate court reversed the jury s verdict and damages award and decertified the class. On October 22, 2003, plaintiffs counsel sought review of this decision in the Florida Supreme Court. The Florida Supreme Court s ruling is pending. The Company is not a party to the Engle litigation.

In September 1999, the United States government filed a recoupment lawsuit in Federal Court in Washington, D.C. against the leading tobacco manufacturers (including B&W individually and as a successor to ATCO) seeking recovery of costs paid by the Federal government for claimed smoking-related illness. In this action, the U.S. District Court for the District of Columbia has dismissed certain counts of the lawsuit, but has also ruled that the government may proceed with two counts under the federal RICO statute. On February 4, 2005, the U.S. Circuit Court of Appeals for the District of Columbia held that the government may not, however, seek a disgorgement of defendants profits from the sale of tobacco as a part of its RICO claim. The U.S. Supreme Court denied the government s petition to review the case on October 17, 2005. The trial was concluded in June 2005 and a decision of the trial court is pending. The Company is not a party to this action.

On March 21, 2003, a judgment for $7.1 billion in compensatory and $3 billion in punitive damages was entered by an Illinois state court against Philip Morris, Inc. in Price, et al. v. Philip Morris, Inc., a class action alleging that certain advertising for light or low tar cigarettes was deceptive under the Illinois Consumer Fraud Act. On December 15, 2005, the Illinois Supreme Court reversed the judgment and remanded the case to the lower court with instruction to dismiss the case. Class actions involving similar allegations (Howard, et al. v. Brown & Williamson Tobacco Corp. and Turner v. R.J. Reynolds Tobacco Co.) are pending against B&W and R.J. Reynolds Tobacco, respectively, in the same court. Trials in the Howard and Turner cases have been stayed pending appeal by Philip Morris in Price. The Company is not a party to the Price, Howard or Turner litigation.

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**Resolution of Health Care Cost Recovery Actions by State, U.S. Territories and the District of Columbia**

In 1998, certain U.S. tobacco companies, including B&W, entered into a Master Settlement Agreement (the MSA ) with certain state attorneys general that resulted in the dismissal of all remaining health care reimbursement lawsuits brought by 52 government entities, including 46 States, American Samoa, Guam, Puerto Rico, the U.S. Virgin Islands, the Northern Mariana Islands and the District of Columbia. Although the Company is not a party to the MSA and is not bound by any of its payment obligations or other restrictions, the Company understands that it is a released party under the terms of the MSA, which provides for the release of claims not only against participating manufacturers, but also against their predecessors, successors, and past, present and future affiliates.

Under the MSA, participating manufacturers were required to make initial payments through 2003, with additional payments to the settling parties required to continue in perpetuity (starting at $4.5 billion in 2000 and increasing to $9 billion in 2018 and thereafter). Payments to a strategic contribution fund for individual states beginning in 2008 through 2017, and a public health foundation until 2008, are also required. Ongoing payments are to be allocated according to market share and are subject to various credits and adjustments, depending on industry volume. The MSA also calls for the participating manufacturers to pay attorneys fees for the States attorneys in the settled litigation.

Prior to the MSA, health care cost recovery actions filed by the states of Minnesota, Texas, Florida and Mississippi were settled separately on terms that included monetary payments of several billion dollars. The Company was not a party to the Minnesota or Texas action and was voluntarily dismissed from the Florida and Mississippi actions. The Company is not a party to any of these settlements nor is it required to pay any money under these settlements.

**Pending Cases**

For a list of pending cases, see Exhibit 99.1 to this Annual Report on Form 10-K.

**Terminated Cases**

For a list of terminated cases, see Exhibit 99.1 to this Annual Report on Form 10-K.

**Conclusion**

It is not possible to predict the outcome of the pending litigation, and it is possible that some of these actions could be decided unfavorably. Management is 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, management believes 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. Management believes that the pending actions will not have a material adverse effect upon the results of operations, cash flows or financial condition of the Company because it believes it has meritorious defenses and the Company is indemnified under the Indemnification Agreement.

**Spirits and Wine Litigation**

The Company, its Spirits and Wine business and numerous other manufacturers and importers of beer, spirits and wine are named as defendants in purported class action lawsuits in Michigan, New York and West Virginia seeking damages and injunctive relief regarding alleged marketing of beverage alcohol to people under the legal purchase age for alcohol. The Michigan lawsuit, Alston v. Advanced Brands & Importing Co., et al., was filed March 30, 2005 in the Circuit Court for the Third Judicial Circuit, Michigan. The New York lawsuit, Sciocchetti v. Advanced Brands & Importing Co., et al., was filed February 16, 2005 in the Supreme Court, Albany County, New York. The Company and its Spirits and Wine business have not yet been served in the New York lawsuit. The West Virginia lawsuit, Bertovich v. Advanced Brands & Importing Co., et al., was filed February 17, 2005 in the Circuit Court of Hancock County, West Virginia, and was removed to the U.S. District Court for the Northern District of West Virginia on May 22, 2005. The lawsuits are similar in that each alleges that the defendants have engaged in deceptive marketing practices and schemes targeted at people under the legal purchase age, negligently marketed their products to the underage and fraudulently concealed their alleged misconduct. Plaintiffs seek the disgorgement of unspecified profits earned by the Company s Spirits and Wine business in the past and other unspecified damages and equitable relief. Other purported class actions are pending against other producers of alcoholic beverages for alleged marketing to persons under the legal purchase age. The Company denies that its Spirits and Wine business markets beverage alcohol products to persons under the legal purchase age and denies that the advertising practices of its Spirits and Wine business are illegal or in violation of industry codes concerning responsible marketing practices. It is not possible to predict the outcome of these actions or give an

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estimate of a possible loss or range of loss, if any, that may result from these actions. The Company believes, however, and counsel has advised that the Company and its Spirits and Wine business have meritorious defenses against plaintiffs claims. The Company is vigorously contesting these actions and believes that ultimately they will not have a material adverse effect on the results of operations, cash flow and financial condition of the Company.

The Company and its Spirits and Wine business were previously named as defendants in a Florida lawsuit, Konhauzer vs. Adolph Coors Company, et al., pending in the Circuit Court of the Seventeenth Judicial Circuit, Broward County, Florida. That case was voluntarily dismissed by plaintiff on October 19, 2005. The Company and its Spirits and Wine business were also previously named as defendants in an Ohio lawsuit, Eisenberg vs. Anheuser Busch, et al., pending in the U.S. District Court of the Northern District of Ohio. On February 6, 2006, the court granted defendants motion and dismissed the entire case. The Company and its Spirits and Wine business were previously named as defendants in a Wisconsin lawsuit, Tomberlin vs. Adolph Coors Company, et al., pending in the Circuit Court, Dane County, Wisconsin. That case was dismissed by the court in its entirety on February 16, 2006.

For a discussion of other pending litigation, see Note 22, Pending Litigation, to the Consolidated Financial Statements, Item 8 to this Form 10-K.

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

None.

**Supplementary Item. Executive Officers of the Company.**

The name, present positions and offices with the Company, principal occupations during the past five years and age of each of the Company s present executive officers are as follows:

| Name | Present positions and offices with the Company and principal occupations during the past five years | Age |
|---|---|---|
| Mark Hausberg | Senior Vice President Finance and Treasurer since January 2000; Vice President and Treasurer prior thereto. | 56 |
| Nadine A. Heidrich | Vice President and Corporate Controller since September 2001; Chief Financial Officer of Specialty Elastomers Group, Inc. from 2000 to 2001; Vice President Finance for John Crane, Inc. prior thereto. | 51 |
| Christopher J. Klein | Senior Vice President Strategy and Corporate Development since April 2003; Executive Vice President Payment Strategies and Acquisitions for Bank One Corporation from 2001 to 2003; Managing Director of Financial Services for Internet Capital Group from 2000 to 2001; Partner, McKinsey & Company, a management consulting firm, prior thereto. | 42 |
| Craig P. Omtvedt | Senior Vice President and Chief Financial Officer since January 2000; Senior Vice President and Chief Accounting Officer prior thereto. | 56 |
| Mark A. Roche | Senior Vice President, General Counsel and Secretary since January 2000; Senior Vice President and General Counsel prior thereto. | 51 |
| Norman H. Wesley | Chairman of the Board and Chief Executive Officer since December 1999; President and Chief Operating Officer prior thereto. | 56 |

In the case of each of the above-listed executive officers, the occupations given were the principal occupation and employment during the periods indicated. No executive officers are related to any other executive officer. No executive officer was selected pursuant to any arrangement or understanding between the executive officer and any other person. All executive officers are elected annually by the Board of Directors.

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**PART II**

**Item 5. Market for the Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.**

**Quarterly Common Stock Cash Dividend Payments**

| | *2005* | 2004 |
|---|---|---|
| Payment date | *Per share* | Per share |
| March | $0.33 | $0.30 |
| June | 0.33 | 0.30 |
| September | 0.36 | 0.33 |
| December | 0.36 | 0.33 |
| Total | $1.38 | $1.26 |

**Quarterly Composite Common Stock Prices**

| | *2005* | | 2004 | |
|---|---|---|---|---|
| | *High* | *Low* | High | Low |
| First Quarter | $85.22 | $75.11 | $77.10 | $66.10 |
| Second Quarter | $91.75 | $81.27 | $80.50 | $70.80 |
| Third Quarter | $96.18 | $79.69 | $75.21 | $68.47 |
| Fourth Quarter | $81.54 | $73.50 | $79.15 | $70.35 |

On August 16, 2005, Fortune Brands spun off its Office products business. In the table above, market prices include the value of the Office products business through the date of spin-off.

The common stock is listed on the New York Stock Exchange, which is the principal market for this security. The high and low prices are as reported in the consolidated transaction reporting system.

On February 10, 2006, there were 23,269 record holders of the Company s common stock, par value $3.125 per share.

See Item 12 Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters Equity Compensation Plan Information for information with respect to securities authorized for issuance under the Company s equity compensation plans.

**Recent Sales of Unregistered Securities; Use of Proceeds from Unregistered Securities**

In January 2006, we issued long-term debt securities totaling 800 million (approximately $1 billion) pursuant to an exemption from registration under Regulation S of the Securities Act of 1933, as amended. The notes consist of 300 million of 3½% notes due January 2009 and 500 million of 4% notes due January 2013. The Joint Bookrunners and Joint Lead Managers were ABN AMRO Bank N.V., Citigroup Global Markets Limited and J.P. Morgan Securities Ltd. Proceeds were used to paydown commercial paper issued in connection with the Spirits and Wine acquisition and borrowings under our then outstanding $3.0 billion bridge credit agreement. Net proceeds of 794.5 million are less price discounts of 3.1 million and underwriting fees of 2.4 million.

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**Purchases of Equity Securities by Issuer and Affiliated Purchasers**

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 December 31, 2005:

| Three Months Ended December 31, 2005 | Total number of shares purchased[(1)(2)] | Average price paid per share | Total number of shares purchased as part of publicly announced programs[(1)] | Maximum number of shares that may yet be purchased under the programs[(1)] |
|---|---|---|---|---|
| October 1 October 31 | 134 | $ 80.80 | | 10,000,000 |
| November 1 November 30 | 1,116 | 79.43 | | 10,000,000 |
| December 1 December 31 | 2,460 | 76.72 | | 10,000,000 |
| Total | 3,710 | $ 77.68 | | |

(1) The Company did not repurchase any shares between October 1, 2005 and December 31, 2005 pursuant to the Company s share repurchase program approved by the Company s Board of Directors on February 28, 2005 and publicly announced through the filing of a Form 8-K that same day. The share repurchase program authorized the Company to purchase up to 5,000,000 shares from March 1, 2005 to February 28, 2006. The Board of Directors also granted authority to the Board s Executive Committee to authorize the purchase of up to an additional 5,000,000 shares (10,000,000 shares in total) on or prior to February 28, 2006 to the extent the Executive Committee determines it appropriate.

(2) The Company purchased all of the 3,710 shares between October 1, 2005 and December 31, 2005 from the Company s employees in connection with the exercise of stock options issued under the Company s long-term incentive plans. The employees sold these shares to the Company in payment of the exercise price of the options exercised and the related tax withholding amounts.

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**Item 6. Selected Financial Data.**

**Five-year Consolidated Selected Financial Data**

Fortune Brands, Inc. and Subsidiaries
For the year ended December 31,

| *(In millions, except per share amounts)* | *2005* | *2004* | 2003 | 2002 | 2001 |
|---|---|---|---|---|---|
| **Operating Data**[(a)] | | | | | |
| Net sales | $ 7,061.2 | $ 6,145.2 | $ 5,112.6 | $ 4,472.3 | $ 4,383.3 |
| Gross profit | 2,891.7 | 2,503.4 | 2,124.1 | 1,885.6 | 1,704.6 |
| Depreciation and amortization | 224.4 | 191.5 | 157.6 | 139.7 | 171.6 |
| Operating income | 1,163.9 | 1,024.6 | 868.3 | 765.2 | 621.8 |
| Interest expense | 158.9 | 77.3 | 63.9 | 60.4 | 75.3 |
| Income taxes | 324.5 | 261.1 | 275.3 | 186.6 | 114.5 |
| Income from continuing operations | 581.6 | 716.0 | 552.1 | 546.4 | 461.1 |
| Income (loss) from discontinued operations | 39.5 | 67.8 | 27.1 | 15.8 | (65.7) |
| Net income | 621.1 | 783.8 | 579.2 | 562.2 | 395.4 |
| Basic earnings per common share | | | | | |
| Continuing operations | $ 3.99 | $ 4.93 | $ 3.78 | $ 3.65 | $ 3.04 |
| Net income | $ 4.26 | $ 5.40 | $ 3.97 | $ 3.76 | $ 2.60 |
| Diluted earnings per common share | | | | | |
| Continuing operations | $ 3.87 | $ 4.78 | $ 3.68 | $ 3.55 | $ 2.97 |
| Net income | $ 4.13 | $ 5.23 | $ 3.86 | $ 3.65 | $ 2.55 |
| **Common Share Data**[(b)] | | | | | |
| Dividends paid | $ 201.6 | $ 182.9 | $ 166.2 | $ 152.7 | $ 147.2 |
| Dividends paid per share | $ 1.38 | $ 1.26 | $ 1.14 | $ 1.02 | $ 0.97 |
| Average number of basic shares outstanding | 145.6 | 145.1 | 145.6 | 149.4 | 151.7 |
| Book value per share | $ 24.88 | $ 21.65 | $ 18.00 | $ 15.15 | $ 13.37 |
| **Balance Sheet Data**[(a)] | | | | | |
| Inventories | $ 1,663.1 | $ 915.7 | $ 800.0 | $ 699.7 | $ 686.2 |
| Current assets | 3,192.7 | 2,641.9 | 2,281.6 | 1,903.1 | 1,969.6 |
| Working capital | 374.8 | 605.9 | 148.1 | 388.4 | 741.6 |
| Property, plant and equipment, net | 1,679.6 | 1,219.5 | 1,187.9 | 993.4 | 923.7 |
| Intangibles, net | 6,880.5 | 3,237.2 | 3,212.1 | 2,204.4 | 1,660.6 |
| Total assets | 13,201.5 | 7,883.6 | 7,444.9 | 5,822.2 | 5,270.5 |
| Short-term debt | 934.1 | 670.2 | 728.1 | 290.6 | 35.3 |
| Long-term debt | 4,889.9 | 1,239.5 | 1,242.6 | 841.7 | 949.3 |
| Minority interest in consolidated subsidiaries | 374.8 | 358.0 | 356.5 | 387.0 | 387.9 |
| Stockholders equity | 3,645.6 | 3,130.7 | 2,640.6 | 2,234.3 | 1,987.2 |
| Capital expenditures | 221.9 | 214.2 | 177.6 | 172.3 | 187.6 |

(a) Data have been restated to present the Office products business as a discontinued operation. Refer to Note 3, Discontinued Operation, to the Consolidated Financial Statements, Item 8 of this Form 10-K for additional information.

(b) On December 31, 2005, there were 23,494 common stockholders of record.

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**Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations.**

| | Net Sales | | | | |
|---|---|---|---|---|---|
| | Year Ended December 31, | | | | |
| *(In millions)* | *2005* | *% Change vs. Prior Year* | 2004 | % Change vs. Prior Year | 2003 |
| Home and Hardware | $4,153.4 | 10.4% | $3,763.7 | 29.8% | $ 2,899.9 |
| Spirits and Wine | 1,642.0 | 40.4 | 1,169.3 | 7.2 | 1,091.0 |
| Golf | 1,265.8 | 4.4 | 1,212.2 | 8.1 | 1,121.7 |
| **NET SALES** | $7,061.2 | 14.9% | $6,145.2 | 20.2% | $ 5,112.6 |

| | Net Income | | | | |
|---|---|---|---|---|---|
| *(In millions)* | Year Ended December 31, | | | | |
| | *2005* | *% Change vs. Prior Year* | 2004 | % Change vs. Prior Year | 2003 |
| **OPERATING INCOME:** | | | | | |
| Home and Hardware | $ 655.1 | 9.5% | $ 598.5 | 24.4% | $ 481.3 |
| Spirits and Wine | 401.0 | 20.2 | 333.7 | 10.2 | 302.8 |
| Golf | 171.5 | 11.5 | 153.8 | 10.6 | 139.1 |
| Less: Corporate expenses | 63.7 | 3.7 | 61.4 | 11.8 | 54.9 |
| **OPERATING INCOME** | $ 1,163.9 | 13.6% | $ 1,024.6 | 18.0% | $ 868.3 |
| **LESS:** | | | | | |
| Interest expense | 158.9 | 105.6 | 77.3 | 21.0 | 63.9 |
| Other income, net | 78.9 | 267.9 | (47.0) | (23.0) | (38.2) |
| Income taxes | 324.5 | 24.3 | 261.1 | (5.2) | 275.3 |
| Minority interests | 20.0 | 16.3 | 17.2 | 13.2 | 15.2 |
| **INCOME FROM CONTINUING OPERATIONS** | $ 581.6 | (18.8%) | $ 716.0 | 29.7% | $ 552.1 |
| **INCOME FROM DISCONTINUED OPERATIONS** | 39.5 | (41.7) | 67.8 | 150.2 | 27.1 |
| **NET INCOME** | $ 621.1 | (20.8%) | $ 783.8 | 35.3% | $ 579.2 |

**Consolidated**

**Summary**

Fortune Brands, Inc. is a holding company with subsidiaries that make and sell leading consumer branded products in the following industries: home and hardware, spirits and wine, 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 repurchase shares and pay attractive dividends.

In 2005, we sharpened our focus as a high-performance consumer brands company. In August 2005, we completed the spin-off of the Office products business, in connection with which we received a cash dividend of $613 million. In addition, in July 2005, we acquired more than 25 spirits and wine brands as well as distribution assets from Pernod Ricard S.A., enhancing our Spirits and Wine business and strengthening our distribution capabilities in international markets. While we had the economic benefit of the acquired assets as of the closing of the acquisition, we substantially completed the final legal transfer of assets on January 27, 2006. As a result of this acquisition, in January 2006, we refinanced a portion of the short-term debt utilized for the acquisition and issued both dollar- and euro-denominated long-term debt in the amount of $2 billion and 800 million (approximately $1 billion). Refer to Notes 5, Acquisitions, Disposals and Joint Ventures and 6, Long-Term Debt, to the Consolidated Financial Statements, Item 8 of this Form 10-K.

In February 2006, we announced an agreement to acquire SBR, Inc., a privately held company, which owns the #3 vinyl-framed window brand in North America. No assurance can be given that the

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acquisition will close on the terms contemplated or at all. Refer to Note 24, Subsequent Events, to the Consolidated Financial Statements.

2005 was a year of broad-based performance for Fortune Brands. Net income and diluted earnings per share both decreased 21% in 2005 to $621.1 million and $4.13, respectively. The decrease in profits was due primarily to currency hedge accounting expense related to the exchange rate on the day the Spirits and Wine acquisition closed ($0.72 per diluted share), substantial tax credits recorded in 2004 ($0.69 per diluted share) and the absence of income due to the spin-off of the Office products business. Profit benefited from strong operating performance in all business segments and the incremental impact of the Spirits and Wine acquisition. On a continuing operations basis, income and diluted earnings per share both decreased 19% in 2005 to $581.6 million and $3.87, respectively. Net sales increased 15% to $7.1 billion, as a result of strong underlying growth, successful new products and line extensions, expanding customer relationships, the benefit of the Spirits and Wine acquisition, favorable foreign exchange and price increases implemented in 2004 to help offset commodity cost increases.

Each of our business segments achieved excellent performance in 2005:

> Our Home and Hardware business achieved double-digit growth in both operating income (9%) and sales (10%), resulting from successful line extensions and new product introductions, expanding customer relationships in cabinets and residential entry doors, partly offset by weak tool storage sales volume at Sears.

> Our Spirits and Wine business achieved 20% growth in operating income and 40% growth in sales primarily on the impact of the Spirits and Wine acquisition, as well as due to worldwide volume growth in premium and super-premium spirits and favorable foreign exchange.

> On the strength of successful new products in golf clubs, golf shoes and gloves; continued share gain in golf balls; and the absence of restructuring- related charges, our Golf brands achieved a 12% increase in operating income on 4% growth in sales.

In 2006, we believe that the Company is well positioned for another year of strong performance. We believe the Company will benefit from the following trends in our businesses:

> aging population trends in the U.S. that favorably impact conditions in the home improvement, golf and spirits & wine industries;

> additional favorable long-term demographics of the home improvement and housing industries, particularly in the kitchen and bath segment, including rising household formations and increasing household wealth;

> record existing home sales in 2004 and 2005 and the effect of replace/remodel projects that often trail existing home sales by up to 12 to 18 months;

> new products in existing and new markets;

> expanding customer relationships, particularly in Home and Hardware;

> the incremental benefit of the Spirits and Wine acquisition;

> continued growth of premium spirits and wine markets worldwide; and

> continuous innovation and international growth opportunities in our golf business.

The Company has also identified the following risks and challenges that may impact our businesses:

> continued consolidation of the Company s trade customers, particularly in the Home & Hardware business;

> potential impact of moderation in the growth rate in the housing market;

> possible continuing increases in commodity costs, particularly particleboard and fuel-related costs;

> challenges in the integration of the Spirits and Wine acquisition; and

> impact of external conditions (economic conditions, weather, destination travel and corporate spending) on overall demand for golf products.

**RESULTS OF OPERATIONS**

**2005 Compared to 2004**

Fortune Brands achieved a 15% increase in net sales and a 14% increase in operating income. Net income was down 21% primarily due to currency hedge accounting expense related to the Spirits and Wine acquisition purchase price, substantial tax credits recorded in 2004 and the absence of income due to the spin-off of the Office products business. Net income benefited from strong broad-based operating performance in all three business segments. The sales increase was driven by:

> growth in the Home and Hardware, Spirits & Wine and Golf businesses,

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> successful new products and line extensions and expanding customer relationships,

> the impact of the Spirits and Wine Acquired Businesses,

> price increases, primarily those implemented last year to help offset energy and raw material cost increases and

> favorable foreign exchange.

Net income benefited from increased sales volume.

However, the benefit was more than offset by:

> currency hedge accounting expense related to the Spirits and Wine acquisition purchase price,

> tax credits recorded in 2004 and

> the absence of income due to the spin-off of the Office products business.

Our operating units will face challenges and opportunities unique to each of their industries, as discussed in this report.

*Net Sales*

Net sales from continuing operations increased $916.0 million, or 15%, to $7.1 billion. Sales benefited from:

> newly introduced products and line extensions across all businesses ($564 million in total),

> the net impact ($472 million in aggregate) of acquisitions (primarily the Spirits and Wine acquisition  $444 million) and minor dispositions,

> price increases (approximately $64 million, primarily in the Home & Hardware and Golf businesses) to help offset energy and raw material cost increases,

> expanding customer relationships, particularly in the cabinet and entry door businesses and

> favorable foreign exchange ($27 million).

The increase in net sales was partly offset by lower sales ($260 million) of certain products being discontinued and replaced by new products in the Golf business, as well as a decrease in sales of Home and Hardware tool storage products as a result of weak volumes at Sears.

*Cost of products sold*

Cost of products sold increased $500.8 million, or 15%, on the impact of the Spirits and Wine Acquired Businesses ($205.0 million), higher net sales, increased year-over-year costs for energy and raw material costs (in the range of $80 to 85 million), which were largely offset by price increases and an unfavorable inventory adjustment in the Home and Hardware tool storage business.

*Excise taxes on spirits and wine*

U.S. excise taxes on spirits and wine decreased as a percentage of sales by approximately 25 basis points due to higher international sales (including the Spirits and Wine Acquired Businesses that have a higher concentration of sales in international markets). In the U.S., excise taxes are levied based on the proof content of spirits and wine products. Consistent with industry practice, U.S. excise taxes collected from customers are reflected in sales and the corresponding payments to the government in cost of sales.

*Advertising, selling, general and administrative expenses*

Advertising, selling, general and administrative expenses increased $260.9 million, or 18%, primarily as a result of the Spirits and Wine acquisition ($128.1 million). In addition, increases were due to higher sales, increased advertising for new product introductions and higher brand investment expenses in Home & Hardware and Spirits & Wine, including for the new Starbucks Coffee Liqueur, as well as due to restructuring-related integration costs associated with the Spirits and Wine acquisition ($18.4 million).

*Amortization of intangibles*

Amortization of intangibles decreased $2.0 million to $33.4 million primarily due a 2004 first quarter amortization adjustment related to the finalization of purchase accounting associated with the 2003 Therma-Tru acquisition ($2.6 million), partly offset by amortization of finite-lived intangible assets associated with the Spirits and Wine Acquired Businesses ($0.5 million).

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*Restructuring charges*

For the twelve months ended December 31, 2005, we did not record any restructuring charges. For the twelve months ended December 31, 2004, we recorded pre-tax restructuring charges of $9.8 million. The charges principally related to consolidation of manufacturing facilities and employee termination costs, mainly in the Home and Hardware business.

*Interest expense*

Interest expense increased $81.6 million, or 105.6% to $158.9 million primarily as a result of higher debt associated with the Spirits and Wine Acquired Businesses.

*Other expense (income), net*

Other expense (income), net increased $125.9 million to a net expense of $78.9 million primarily due to the unfavorable impact of currency hedge accounting expense related to the Spirits and Wine acquisition purchase price ($120.9 million).

*Income taxes*

Income taxes increased $63.4 million, or 24% to $324.5 million. The reported effective income tax rate for the twelve months ended December 31, 2005 and December 31, 2004 was 35.0% and 26.3%, respectively. The higher effective rate primarily related to a low tax benefit associated with acquisition-related currency hedge accounting expense this year, as well as lower tax credits this year compared to last year.

*Net income*

Net income was $621.1 million, or $4.26 per basic share and $4.13 per diluted share, for the year ended December 31, 2005 compared to net income of $783.8 million, or $5.40 per basic share and $5.23 per diluted share, for the year ended December 31, 2004. Income from continuing operations was $581.6 million, or $3.99 per basic share and $3.87 per diluted share, for the year ended December 31, 2005 compared to income from continuing operations of $716.0 million, or $4.93 per basic share and $4.78 diluted per share, for the year ended December 31, 2004. The decrease in income from continuing operations of $134.4 million, or 19%, was primarily due to currency hedge accounting expense related to the Spirits and Wine acquisition purchase price ($109.0 million or $0.72 per diluted share), lower tax credits ($7.7 million this year compared to $103.7 million last year, or a decrease of $0.64 per diluted share) and the absence of income due to the spin-off of the Office products business. Income from continuing operations benefited from higher sales volume. Income from discontinued operations, net of tax, decreased $28.3 million, or 42%, primarily as a result of the absence of income after the spin-off of the Office products business on August 16, 2005.

**2004 Compared to 2003**

Fortune Brands achieved strong results, as net sales from continuing operations increased 20%. Income from continuing operations increased 30% and net income grew 35%. Net sales grew as a result of:

> strong growth for our consumer brands driven by share gains in key markets resulting from successful new products and expanded customer relationships,

> the benefit of acquisitions,

> solid market growth in Home & Hardware and Spirits & Wine markets, and

> favorable foreign exchange.

Net income increased on:

- strong operating performance,
- the benefit of acquisitions,
- favorable foreign exchange, and
- higher tax-related benefits,

partly offset by increased commodity costs.

Our operating units will face challenges and opportunities unique to each of their industries, as discussed in this report.

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*Net Sales*

Net sales from continuing operations increased $1,032.6 million, or 20%, to $6.1 billion. Sales benefited from:

> newly introduced products and line extensions in the Home & Hardware and Golf businesses ($494 million in total), partly offset by lower sales of certain products being discontinued in the Golf and the Home & Hardware businesses,

> the net impact ($388 million) of acquisitions (primarily Therma-Tru) and dispositions,

> expanded customer relationships driving increased volume, primarily in the cabinet and entry door businesses, and

> favorable foreign exchange ($81 million).

*Cost of products sold*

Cost of products sold increased $655.6 million, or 24%, on higher net sales and increased costs for major commodities (approximately $65 million), particularly steel and particleboard, primarily in our Home & Hardware business.

*Excise taxes on spirits and wine*

U.S. excise taxes on spirits and wine decreased as a percentage of sales due to greater international sales, as well as a favorable mix shift from mid-tier brands to premium and super-premium spirits and wines. In the U.S., excise taxes are levied based on the proof content of spirits and wine products. Consistent with industry practice, U.S. excise taxes collected from customers are reflected in sales and the corresponding payments to the government in cost of products sold.

*Advertising, selling, general and administrative expenses*

Advertising, selling, general and administrative expenses increased $197.2 million, or 16%, as a result of higher sales and acquisitions, as well as increased advertising and marketing expenditures.

*Amortization of intangibles*

Amortization of intangibles increased $18.2 million, or 106%, primarily due to amortization of identifiable intangibles associated with the acquisition of Therma-Tru.

*Restructuring charges*

In 2004, we recorded pre-tax restructuring charges of $9.8 million, compared to $2.2 million in 2003. Charges in 2004 principally related to the consolidation of manufacturing facilities, primarily in the Home & Hardware business.

*Other income, net*

Other income, net, increased $8.8 million to $47.0 million, primarily due to a $12.0 million gain recorded in 2004 as the result of insurance proceeds related to a Kentucky bourbon warehouse fire in 2003, partly offset by the lower tax-related interest income.

*Income taxes*

Income taxes decreased $14.2 million, or 5%, on higher net income as we recorded higher tax-related benefits in 2004 ($101.6 million) compared with 2003 ($35.0 million). The reported effective income tax rates for the twelve months ended December 31, 2004 and 2003 were

26.3% and 32.7%, respectively. The items set forth below impacted the effective income tax rate.

During the third quarter of 2004, the Internal Revenue Service concluded its field examination phase of the routine review of our 1997-2001 tax returns. As a result of the audit, we recorded a net tax reserve reversal of $45.5 million in continuing operations. This net reversal accounts for the release of reserves for items resolved more favorably than anticipated, partly offset by the disallowance of a deduction for which no reserve had been established.

In the fourth quarter of 2004, the Congressional Joint Committee on Taxation completed its review of the results of the routine IRS examination of our 1997-2001 tax returns. In continuing operations, we recorded a total tax benefit of $51.5 million, or $0.35 per diluted share, reflecting the completion of the Joint Committee review. This resulted in a reversal of tax reserves of $39.5 million and a net tax adjustment of $12.0 million. As a result of the conclusion of the IRS examination of our 1997-2001 tax

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years, in 2005 we received a tax refund of approximately $59 million. During the fourth quarter of 2004, we also recorded a one-time non-operating adjustment for interest income on taxes receivable related to these tax-related benefits of $2.1 million (after tax), or $0.01 per diluted share, which was recorded in other income.

In the fourth quarter of 2004, we recorded a tax benefit of $4.6 million, or $0.03 per diluted share, associated with foreign earnings repatriation under provisions of the American Jobs Creation Act of 2004.

In 2003, the audit of our 1993-1996 tax returns resulted in a reduction in tax expense of $35 million, or $0.23 per diluted share. As a result, we also recorded a one-time non-operating adjustment of $6.9 million in interest income (after tax), which was recorded in other income.

*Net income*

Net income increased $204.6 million, or 35%, to $783.8 million due primarily to strong broad-based operating performance, higher tax-related benefits ($107.7 million in 2004 compared to $41.9 million in 2003), the benefit of favorable foreign exchange $18 million) and the impact of acquisitions. Income from continuing operations increased $163.9 million, or 30%, to $716.0 million due primarily to strong broad-based operating performance, higher tax-related benefits ($103.7 million in 2004 compared to $41.9 million in 2003), the benefit of favorable foreign exchange ($13 million) and the impact of acquisitions. Income from discontinued operations, net of tax, increased $40.7 million, or 150%, primarily on the benefit of the business ongoing repositioning program, including successful supply chain realignment and cost reduction initiatives, favorable foreign exchange and higher sales volume.

Diluted earnings per share were $5.23 in 2004, up 35% from 2003. Diluted earnings per share from continuing operations were $4.78 in 2004, up 30% from 2003. Diluted earnings per share from discontinued operations were $0.45 in 2004, up 150% from 2003.

**QUARTERLY FINANCIAL DATA**
*Unaudited*

Fortune Brands, Inc. and Subsidiaries

*(In millions, except per share amounts)*

| 2005 | 1st | 2nd | 3rd | 4th |
|---|---|---|---|---|
| Net sales | $ 1,517.8 | $ 1,782.8 | $ 1,801.6 | $ 1,959.0 |
| Gross profit | 616.5 | 751.5 | 729.4 | 794.3 |
| Operating income | 231.6 | 332.5 | 294.5 | 305.3 |
| Income from continuing operations | 142.6 | 183.8 | 79.3 | 175.9 |
| Income from discontinued operations | 10.1 | 16.5 | 12.9 | |
| Net income | 152.7 | 200.3 | 92.2 | 175.9 |
| Earnings per common share | | | | |
| Basic | | | | |
| Income from continuing operations | $ 0.98 | $ 1.26 | $ 0.54 | $ 1.20 |
| Net income | $ 1.05 | $ 1.38 | $ 0.63 | $ 1.20 |
| Diluted | | | | |
| Income from continuing operations | $ 0.95 | $ 1.22 | $ 0.52 | $ 1.17 |
| Net income | $ 1.02 | $ 1.33 | $ 0.61 | $ 1.17 |

| 2004 | 1st | 2nd | 3rd | 4th |
|---|---|---|---|---|
| Net sales | $ 1,436.9 | $ 1,620.7 | $ 1,508.3 | $ 1,579.3 |
| Gross profit | 586.4 | 674.7 | 618.0 | 624.2 |
| Operating income | 215.6 | 296.1 | 249.3 | 263.6 |
| Income from continuing operations | 131.0 | 174.0 | 188.8 | 222.2 |
| Income from discontinued operations | 8.7 | (6.2) | 38.0 | 27.3 |
| Net income | 139.7 | 167.8 | 226.8 | 249.5 |
| Earnings per common share | | | | |

| | | | | |
|---|---|---|---|---|
| Basic | | | | |
| Income from continuing operations | $ 0.89 | $ 1.19 | $ 1.31 | $ 1.54 |
| Net income | $ 0.95 | $ 1.15 | $ 1.57 | $ 1.73 |
| Diluted | | | | |
| Income from continuing operations | $ 0.87 | $ 1.15 | $ 1.27 | $ 1.49 |
| Net income | $ 0.92 | $ 1.11 | $ 1.52 | $ 1.68 |

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**RESULTS OF OPERATIONS BY SEGMENT**

**Home and Hardware**

***2005 Compared to 2004***

Net sales increased $389.7 million, or 10%, to $4,153.4 million. The increase was primarily due to underlying volume growth fueled by line extensions and new products ($346 million in total, mainly in faucets, cabinets and exterior doors), expanding customer relationships (particularly in the cabinet and residential entry door businesses), and raw material-related price increases on select products, as well as benefits from acquisitions made in 2005 and 2004 ($28 million increase in sales net of a disposition last year) and favorable foreign exchange ($13 million). The increase in net sales was partially offset by lower tool storage sales due to weak volumes at Sears.

Operating income increased $56.6 million, or 9%, to $655.1 million on the higher sales and the absence of restructuring-related charges this year ($14.5 million), partially offset by an unfavorable inventory adjustment in the tool storage business, higher energy-related costs and costs for capacity and global supply chain initiatives for cabinets.

In June 2004, Therma-Tru acquired Sentinel Doors Ltd., a leading U.K. manufacturer and installer of complete composite entry door systems, and Master Lock acquired the assets of Dudley Inc., a leading brand of school locker locks in Canada.

Although the U.S. housing market is forecasted to moderate over the near-term, we anticipate that our Home and Hardware business will continue to benefit from expanding customer relationships as well as long-term demographic trends supporting the home repair and remodeling and new home construction markets, particularly for kitchen and bath products and residential entry door systems. These trends include factors such as growth in the number of households, increases in household wealth and aging of the housing stock.

Our Home and Hardware business may be impacted by U.S. economic conditions, including the level of new construction and sales of existing homes and their potential impact on the U.S. housing and remodeling markets. Our business may also be affected by increases in the costs of certain commodities including higher fuel-related costs, although these higher costs have been, and we believe will continue to be, largely offset by select price increases. In addition, we continue to face pricing pressure associated with consolidation of the industry customer base. Such consolidation may also present opportunities for our business, due to our leading brands and customer service.

***2004 Compared to 2003***

Net sales increased $863.8 million, or 30%, to $3,763.7 million. The increase was attributable to the impact of acquisitions (Therma-Tru, Capital Cabinets, American Lock, Dudley and Sentinel, in aggregate $382 million excluding internal growth), line extensions and new products ($317 million), expanded customer relationships (particularly in cabinets and entry doors), a robust housing market, and price increases on select products, as well as favorable foreign exchange ($24 million).

Operating income increased $117.2 million, or 24%, to $598.5 million on the benefit of acquisitions, higher sales and productivity improvements, partially offset by higher commodity costs, particularly steel and particleboard, and restructuring and restructuring-related charges this year.

**Spirits and Wine**

***2005 Compared to 2004***

Net sales increased $472.7 million, or 40%, to $1,642.0 million principally due to the impact of the Spirits and Wine Acquired Businesses ($444 million). Sales also benefited from higher U.S. sales of premium and super-premium spirits, including the new Starbucks Coffee Liqueur, strong case volume growth in international markets and favorable foreign exchange ($5 million), partly offset by lower sales of non-premium brands in the U.S.

Operating income increased $67.3 million, or 20%, to $401.0 million on higher sales, partly offset by brand spending to support the launch of Starbucks Coffee Liqueur and restructuring-related integration costs ($18.4 million). Operating income was affected by accounting under Financial Accounting Standards Board Interpretation No. 46(R) (FIN 46(R)), Consolidation of Variable Interest Entities. Since many of the assets we acquired were owned by entities that also owned assets acquired by Pernod Ricard (Pernod Ricard), in accordance with FIN 46(R), we fully consolidated entities for which we were the primary beneficiary even for the brands and assets which Pernod Ricard ultimately owned. We were the primary beneficiary if we had the obligation to absorb the majority of the expected losses and the

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right to receive the majority of the expected residual returns of an entity. In addition, if the fair value of the assets acquired by us was less than 50% of the fair value of the entity, we accounted for the investment using the cost method, meaning that sales and expenses related to the brands and assets to be acquired by Fortune Brands in those entities were not included in our statement of income on a fully consolidated basis. Therefore, the reported sales and operating income are not representative of future results of operations. Refer to Note 4, Acquisitions, Disposals and Joint Ventures, to the Consolidated Financial Statements for a full description of the accounting treatment of this acquisition.

Factors that could adversely affect results include the possibility of federal excise and state tax increases, international trade policies, increased regulation, class actions and/or other litigation, and competitive pricing activities. In addition, the spirits and wine industry could be impacted by further consolidation of suppliers, distributors and retailers, which also may present opportunities for our business, due to our leading brands and customer service.

***2004 Compared to 2003***

Net sales increased $78.3 million, or 7%, to $1,169.3 million principally on favorable foreign exchange ($27 million), strong worldwide growth in Jim Beam bourbon, higher pricing for Jim Beam bourbon and mid-tier brands in the U.S. and the acquisition of Wild Horse Winery.

Operating income increased $30.9 million, or 10%, to $333.7 million on the higher sales and favorable foreign exchange, partly offset by increased investment in key brand-building initiatives.

**Golf**

***2005 Compared to 2004***

Net sales increased $53.6 million, or 4%, to $1,265.8 million. The increase was attributable to sales growth in all product categories, new product introductions in golf clubs, and a favorable mix shift toward the premium Titleist brand balls and clubs, as well as favorable foreign exchange ($9 million).

Operating income increased $17.7 million, or 12%, to $171.5 million on higher sales, a favorable mix shift toward higher margin Titleist branded golf balls and clubs, favorable foreign exchange and the absence of restructuring- related charges ($6 million).

Even though new competitors have entered the category in recent years, our Golf business has significantly grown sales, market share and profit with innovative new products. Despite favorable demographics of an aging population (rounds of play generally increase with age), rounds of play in the U.S. decreased from 2000 to 2003 as a result of a combination of decreased golf-related travel, economic conditions, lower corporate spending and weather conditions. U.S. rounds of play were flat in 2004 and 2005. The future success of our Golf business will depend upon continued strong innovation and marketing across its product categories, brands and selling regions. International market opportunities, especially in the Pacific Basin region, have provided and are expected to continue to provide growth for the Golf business.

***2004 Compared to 2003***

Net sales increased $90.5 million, or 8%, to $1,212.2 million. The increase was attributable to continued volume growth across categories (golf clubs, golf balls, golf footwear, gloves and accessories $66 million) driven by the introduction of successful new golf products and line extensions, as well as favorable foreign exchange ($31 million).

Operating income increased $14.7 million, or 11%, to $153.8 million on higher sales, favorable foreign exchange and increased sales of higher margin Titleist golf balls.

**LIQUIDITY AND CAPITAL RESOURCES**

Our primary liquidity needs are to fund dividends, acquisitions, share repurchases, capital expenditures, service indebtedness and support working capital requirements. Our principal sources of liquidity are cash flows from operating activities, commercial paper, borrowings under our credit agreements and long-term notes. Our operating income is generated by our subsidiaries. As a result, we are dependent on their earnings and cash flows, and distributions or advances from them to provide the funds necessary to meet our obligations. There are no significant restrictions on the ability of our subsidiaries to pay dividends or make other distributions to Fortune Brands. Our priority for cash flow over the near term, after internal growth and dividends, is the reduction of debt that increased as a result of the Spirits and Wine acquisition. For a description of the debt, see Capitalization below and Notes 6, Long-Term Debt, and 13 Financial Instruments to the Consolidated

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description of the Spirits and Wine acquisition, see Note 5, Acquisitions, Disposals and Joint Ventures, to the Consolidated Financial Statements.

**Cash Flows**

Net cash provided from operating activities was $802.7 million for the year ended December 31, 2005 compared with $791.9 million for the year ended December 31, 2004. The increase of $10.8 million was principally due to a 2005 income tax refund, the timing of sales and receivables collections, as well as the benefit of lower steel prices (in inventory) and inventory management programs. The benefit from receivables and inventory include the impact of the Spirits and Wine acquisition subsequent to acquisition. The improvement in cash flow provided from operations was partly offset by increased payments for customer programs (primarily volume-related) and employee performance incentives accrued in 2004 (non-acquisition-related). Cash flow from operating activities was unfavorably impacted by acquisition-related interest expense.

Working capital (current assets net of current liabilities) decreased $231.1 million to $374.8 million at December 31, 2005, primarily due to the absence of discontinued operations and an increase in the current portion of long-term debt, partly offset by assets and liabilities of the Acquired Businesses.

Net cash used by investing activities for the year ended December 31, 2005 was $4,664.2 million, compared with $245.3 million for the year ended December 31, 2004. The increase of $4.4 billion was primarily due to the Spirits and Wine acquisition ($5 billion), partly offset by the dividend received from ACCO World Corporation in conjunction with the spin-off of the Office products business ($613.3 million).

We focus our capital spending on growth initiatives and becoming the lowest cost producers of the highest quality products. Capital expenditures in 2005 of $221.9 million were $19.8 million lower than 2004, primarily due to completion of capacity expansion projects in 2004. We currently estimate 2006 capital expenditures will be in the range of $225 to $250 million. We expect to generate these funds internally.

Net cash provided by financing activities for the year ended December 31, 2005 was $3,783.7 million, as compared to net cash used of $515.6 million in 2004. The change of $4.3 billion was primarily attributable to proceeds from debt incurred to finance the Spirits and Wine Acquired Businesses, partly offset by the lack of share repurchases this year.

**Capitalization**

Total debt increased $3.9 billion to $5.8 billion during the year ended December 31, 2005. The ratio of total debt to total capital increased to 59.2% at December 31, 2005 from 35.4% at December 31, 2004 primarily as a result of the debt associated with the Spirits and Wine acquisition. See Note 5, Acquisitions, Disposals and Joint Ventures, to the Consolidated Financial Statements for additional informat