Magyar Bancorp, Inc.
Form 10-K
December 27, 2012

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

þ ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended September 30, 2012

OR

o TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _________________ to _________________

Commission File Number: 000-51726

Magyar Bancorp, Inc.

(Exact Name of Registrant as Specified in its Charter)

Delaware	20-4154978
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)
400 Somerset Street, New Brunswick, New Jersey	**08901**
(Address of Principal Executive Office)	(Zip Code)

(732) 342-7600

(Issuer’s Telephone Number including area code)

Securities Registered Pursuant to Section 12(b) of the Act:

Title of Class	Name of Each Exchange On Which Registered
Common Stock, par value $0.01 per share	The NASDAQ Stock Market, LLC

Securities Registered Pursuant to Section 12(g) of the Act:

None

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes o No þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act.

Yes o No þ

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding twelve 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 þ No o

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

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 amendments to this Form 10-K. þ

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No þ

The aggregate value of the voting stock held by non-affiliates of the registrant, computed by reference to the closing price of the Common Stock as of March 31, 2012 was $13.4 million. As of December 15, 2012, there were 5,923,742 shares issued and 5,807,344 outstanding of the registrant's Common Stock, including 3,200,450 shares owned by Magyar Bancorp, MHC, the registrant's mutual holding company.

DOCUMENTS INCORPORATED BY REFERENCE

1. Proxy Statement for the 2012 Annual Meeting of Stockholders (Part III)

Magyar Bancorp, Inc.

Annual Report On Form 10-K

For The Fiscal Year Ended

September 30, 2012

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PART I

ITEM 1. Business

Forward Looking Statements

We have included or incorporated by reference in this Annual Report on Form 10-K, and from time to time our management may make, statements that may constitute "forward-looking statement" within the meaning of the safe harbour provisions of the U.S. Private Securities Litigation Reform Act of 1995. Forward-looking statements are not historical facts but instead represent only our beliefs regarding future events, many of which, by their nature, are inherently uncertain and outside our control. These statements include statements other than historical information or statements of current condition and may relate to our future plans and objectives and results, as well as statements about the objective and effectiveness of our risk management and liquidity policies, statements about trends in or growth opportunities for our business, statements about our future status, and activities or reporting under U.S. banking and financial regulation. Forward-looking statements generally are identified by the words "believe," "project," "expect," "anticipate," "estimate," "intend," "strategy," "future," "opportunity," "plan," "may," "should," "will," "would," "wi "will likely result," and similar expressions. By identifying these statements for you in this manner, we are alerting you to the possibility that our actual results and financial condition may differ, possibly materially, from the anticipated results and financial condition indicated in these forward-looking statements. Important factors that could cause our actual results and financial condition to differ from those indicated in the forward-looking statements include, among others, those discussed below and under "Risk Factors" in Part 1, Item 1A of this Annual Report on Form 10-K.

Magyar Bancorp, MHC

Magyar Bancorp, MHC is the New Jersey-chartered mutual holding company of Magyar Bancorp, Inc. Magyar Bancorp, MHC's only business is the ownership of 54.03% of the issued shares of common stock of Magyar Bancorp, Inc. So long as Magyar Bancorp, MHC exists, it will be required to own a majority of the voting stock of Magyar Bancorp, Inc. The executive office of Magyar Bancorp, MHC is located at 400 Somerset Street, New Brunswick, New Jersey 08901, and its telephone number is (732) 342-7600. Magyar Bancorp, MHC is subject to comprehensive regulation and examination by the Board of Governors of the Federal Reserve System and the New Jersey Department of Banking and Insurance.

Magyar Bancorp, Inc.

Magyar Bancorp, Inc. is the mid-tier stock holding company of Magyar Bank. Magyar Bancorp, Inc. is a Delaware-chartered corporation and owns 100% of the outstanding shares of common stock of Magyar Bank. Magyar Bancorp, Inc. has not engaged in any significant business activity other than owning all of the shares of common stock of Magyar Bank. At September 30, 2012, Magyar Bancorp, Inc. had consolidated assets of $508.8 million, total deposits of $416.5 million and stockholders' equity of $45.0 million. The executive offices of Magyar Bancorp, Inc. are located at 400 Somerset Street, New Brunswick, New Jersey 08901, and its telephone number is (732) 342-7600. Magyar Bancorp, Inc. is subject to comprehensive regulation and examination by the Board of Governors of the Federal Reserve System and the New Jersey Department of Banking and Insurance.

On January 23, 2006, Magyar Bancorp, Inc. sold 2,618,550 shares of its common stock at a price of $10.00 per share, issued an additional 3,200,450 shares of its common stock to Magyar Bancorp, MHC, and contributed 104,742 shares to Magyar Bank Charitable Foundation.

Magyar Bank

Magyar Bank is a New Jersey-chartered savings bank headquartered in New Brunswick, New Jersey that was originally founded in 1922 as a New Jersey building and loan association. In 1954, Magyar Bank converted to a New Jersey savings and loan association, before converting to the New Jersey savings bank charter in 1993. We conduct business from our main office located at 400 Somerset Street, New Brunswick, New Jersey, and our six branch offices located in New Brunswick, North Brunswick, South Brunswick, Branchburg, Bridgewater, and North Edison, New Jersey. The telephone number at our main office is (732) 342-7600.

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General

Our principal business consists of attracting retail deposits from the general public in the areas surrounding our main office in New Brunswick, New Jersey and our branch offices located in Middlesex and Somerset Counties, New Jersey, and investing those deposits, together with funds generated from operations and wholesale funding, in residential mortgage loans, home equity loans, home equity lines of credit, commercial real estate loans, commercial business loans, Small Business Administration (“SBA”) loans, construction loans and investment securities. We also originate consumer loans, which consist primarily of secured demand loans. We originate loans primarily for our loan portfolio. However, from time to time we have sold some of our long-term fixed-rate residential mortgage loans into the secondary market, while retaining the servicing rights for such loans. Our revenues are derived principally from interest on loans and securities. Our investment securities consist primarily of mortgage-backed securities and U.S. Government and government-sponsored enterprise obligations. We also generate revenues from fees and service charges. Our primary sources of funds are deposits, borrowings and principal and interest payments on loans and securities. We are subject to comprehensive regulation and examination by the New Jersey Department of Banking and Insurance and the Federal Deposit Insurance Corporation.

Market Area

We are headquartered in New Brunswick, New Jersey, and our primary deposit market area is concentrated in the communities surrounding our headquarters branch and our branch offices located in Middlesex and Somerset Counties, New Jersey. Our primary lending market area is broader than our deposit market area and includes all of New Jersey.

The economy of our primary market area is largely urban and suburban with a broad economic base that is typical for counties surrounding the New York metropolitan area. The median household income in Middlesex and Somerset county rank among the highest in the nation.

Competition

We face intense competition within our market area both in making loans and attracting deposits. Our market area has a high concentration of financial institutions including large money center and regional banks, community banks and credit unions. Some of our competitors offer products and services that we currently do not offer, such as trust services and private banking. According to the Federal Deposit Insurance Corporation’s annual *Summary of Deposit* report, at June 30, 2012 our market share of deposits was 1.51% and 0.58% in Middlesex and Somerset Counties, respectively. Our market share of deposits was 1.60% and 0.48%, respectively, at June 30, 2011.

Our competition for loans and deposits comes principally from commercial banks, savings institutions, mortgage banking firms and credit unions. We face additional competition for deposits from short-term money market funds, brokerage firms, mutual funds and insurance companies. Our primary focus is to build and develop profitable customer relationships across all lines of business while maintaining our role as a community bank.

Lending Activities

We originate residential mortgage loans to purchase or refinance residential real property. Residential mortgage loans represented $157.5 million, or 40.5% of our total loans at September 30, 2012. Historically, we have not originated a significant number of loans for the purpose of reselling them in the secondary market. In the future, however, to help manage interest rate risk and to increase fee income, we may increase our origination and sale of residential mortgage loans. No loans were held for sale at September 30, 2012. We also originate commercial real estate, commercial business and construction loans. At September 30, 2012, these loans totaled $148.8 million, $29.9 million and $18.0 million, respectively. We also offer consumer loans, which consist primarily of home equity lines of credit and stock-secured demand loans. At September 30, 2012, home equity lines of credit and stock-secured demand loans totaled $23.4 million and $11.3 million, respectively.

Loan Portfolio Composition. The following table sets forth the composition of our loan portfolio by type of loan, at the dates indicated.

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	September 30,								
	2012		2011		2010		2009		200
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Am
	(Dollars in thousands)								
One-to four-family residential	$157,536	40.50 %	$159,228	41.37 %	$165,462	40.50 %	$172,415	38.76 %	$15
Commercial real estate	148,806	38.30 %	120,994	31.44 %	116,222	28.45 %	105,764	23.78 %	92
Construction	17,952	4.60 %	34,144	8.87 %	57,086	13.97 %	93,217	20.96 %	92
Home equity lines of credit	23,435	6.00 %	22,352	5.81 %	22,823	5.59 %	22,528	5.07 %	15
Commercial business	29,930	7.70 %	36,195	9.41 %	33,676	8.24 %	37,372	8.40 %	35
Other	11,265	2.90 %	11,945	3.10 %	13,277	3.25 %	13,484	3.03 %	15
Total loans receivable	$388,924	100.00%	$384,858	100.00%	$408,546	100.00%	$444,780	100.00%	$41
Net deferred loan costs	204		208		106		24		(7
Allowance for loan losses	(3,858)		(3,812)		(4,766)		(5,807)		(4,
Total loans receivable, net	$385,270		$381,254		$403,886		$438,997		$40

Loan Portfolio Maturities and Yields. The following table summarizes the scheduled repayments of our loan portfolio at September 30, 2012. Demand loans, loans having no stated repayment schedule or maturity, and overdraft loans are reported as being due in one year or less.

Due During the Fiscal Years Ending September 30,	One-to-Four Family Residential		Commercial Real Estate		Construction		Home Equity Lines of Credit	
	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate
	(Dollars in thousands)							
2013	$5,250	5.51 %	$18,027	5.23 %	$16,900	5.99 %	$5,735	4.49 %
2014	7,811	4.60 %	5,734	5.04 %	254	4.25 %	8	5.00 %
2015	126	5.96 %	3,568	5.84 %	—	—	—	—
2016 to 2017	2,526	5.16 %	5,663	5.53 %	—	—	—	—
2018 to 2022	14,802	4.84 %	14,915	4.51 %	—	—	844	5.15 %
2023 to 2027	15,643	4.17 %	11,484	6.20 %	—	—	807	3.28 %
2028 and beyond	111,378	4.98 %	89,415	5.59 %	798	6.00 %	16,041	3.66 %
Total	$157,536	4.89 %	$148,806	5.47 %	$17,952	5.96 %	$23,435	3.91 %

Due During the Fiscal Years Ending September 30,	Commercial Business		Other		Total	
	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate
	(Dollars in thousands)					

2013	$21,163	4.23	%	$10,862	2.29	%	$77,937	4.68	%
2014	3,146	5.05	%	31	6.03	%	16,984	4.83	%
2015	1,032	6.07	%	40	8.99	%	4,766	5.92	%
2016 to 2017	1,376	5.89	%	109	7.56	%	9,674	5.51	%
2018 to 2022	2,241	5.86	%	63	5.00	%	32,865	4.77	%
2023 to 2027	972	4.04	%	—	—		28,906	4.95	%
2028 and beyond	—	—		160	3.55	%	217,792	5.13	%
Total	$29,930	4.57	%	$11,265	2.41	%	$388,924	5.00	%

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The following table sets forth the scheduled repayments of fixed- and adjustable-rate loans at September 30, 2012 that are contractually due after September 30, 2013.

	Due After September 30, 2013		
	Fixed	Adjustable	Total
	(Dollars in thousands)		
One-to four-family residential	$104,873	$47,413	$152,286
Commercial real estate	18,023	112,756	130,779
Construction	—	1,052	1,052
Home equity lines of credit	11	17,689	17,700
Commercial business	2,140	6,627	8,767
Other	63	340	403
Total	$125,110	$185,877	$310,987

Residential Mortgage Loans. We originate residential mortgage loans, most of which are secured by properties located in our primary market area and most of which we hold in portfolio. At September 30, 2012, $157.5 million, or 40.5% of our total loan portfolio, consisted of residential mortgage loans (including home equity loans). Residential mortgage loan originations are generally obtained from our in-house loan representatives, from existing or past customers, through advertising, and through referrals from local builders, real estate brokers and attorneys, and are underwritten pursuant to Magyar Bank's policies and standards. Generally, residential mortgage loans are originated in amounts up to 80% of the lesser of the appraised value or purchase price of the property, with private mortgage insurance required on loans with a loan-to-value ratio in excess of 80%. We generally will not make residential mortgage loans with a loan-to-value ratio in excess of 95%, which is the upper limit that has been established by the Board of Directors. Mortgage loans have been primarily originated for terms of up to 30 years. Magyar Bank has not participated in "sub-prime" (mortgages granted to borrowers whose credit history is not sufficient to get a conventional mortgage) or option ARM mortgage lending. At September 30, 2012, non-performing residential mortgage loans totaled $7.6 million, or 4.8% of the total residential loan portfolio. Interest income of $624,000 was not recorded on non-performing residential mortgage loans for the year ended September 30, 2012. During the year ended September 30, 2012, $326,000 had been charged-off against the allowance for loan loss for four impaired residential real estate loans.

We also originate home equity loans secured by residences located in our market area. The underwriting standards we use for home equity loans include a determination of the applicant's credit history, an assessment of the applicant's ability to meet existing obligations, the ongoing payments on the proposed loan and the value of the collateral securing the loan. The maximum combined (first and second mortgage liens) loan-to-value ratio for home equity loans and home equity lines of credit is 80%. Home equity loans are generally offered with fixed rates of interest with the loan amount not to exceed $500,000 and with terms of up to 30 years.

Generally, all fixed-rate residential mortgage loans are underwritten according to Federal Home Loan Mortgage Corporation ("Freddie Mac") guidelines, policies and procedures. Historically, we have not originated a significant number of loans for the purpose of reselling them in the secondary market. However, to help manage interest rate risk and to increase fee income during fiscal year 2012, thirty-five fixed-rate loans totaling $8.3 million were sold to Freddie Mac. In the future we may increase our origination and sale of fixed-rate residential mortgage loans to help

manage interest rate risk and to increase fee income. No loans were held for sale at September 30, 2012.

We generally do not purchase residential mortgage loans, except for loans to low-income borrowers to enhance our Community Reinvestment Act performance. At September 30, 2012, we had $2.1 million of purchased one-to four-family residential mortgage loans. No loans were purchased in the fiscal year ended September 30, 2012.

At September 30, 2012, we had $106.9 million of fixed-rate residential mortgage loans, which represented 67.8% of our total residential mortgage loan portfolio. At September 30, 2012, our largest fixed-rate residential mortgage loan was $4.4 million. The loan was performing in accordance with its terms at September 30, 2012.

We also offer adjustable-rate residential mortgage loans with interest rates based on the weekly average yield on U.S. Treasuries or the London Interbank Offering Rate ("LIBOR") adjusted to a constant maturity of one year, which adjusts either annually from the outset of the loan or which adjusts annually after a one-, three-, five-, seven-, and ten-year initial fixed-rate period. Our adjustable-rate mortgage loans generally provide for maximum rate adjustments of 2% per adjustment, with a lifetime maximum adjustment up to 5%, regardless of the initial rate. We also offer adjustable-rate mortgage loans with an interest rate based on the prime rate as published in *The Wall Street Journal* or the Federal Home Loan Bank of New York advance rates.

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Adjustable-rate mortgage loans decrease the risk associated with changes in market interest rates by periodically repricing. However, these loans have other risks because, as interest rates increase, the underlying payments by the borrower increase, which increases the potential for default by the borrower. At the same time, the marketability of the underlying collateral may be adversely affected by higher interest rates. The maximum periodic and lifetime interest rate adjustments also may limit the effectiveness of adjustable-rate mortgage loans during periods of rapidly rising interest rates.

At September 30, 2012, adjustable-rate residential mortgage loans totaled $50.7 million, or 32.2% of our total residential mortgage loan portfolio. Of these loans, $17.4 million were interest-only loans originated with an average loan-to-value ratio of 73.9%. Interest-only loans allow the borrower to make interest–only payments during an initial fixed-rate period. Following the initial period, the borrower is required to make principal and interest payments. At September 30, 2012, our largest adjustable-rate residential mortgage loan was for $3.0 million. The loan was performing in accordance with its terms at September 30, 2012.

In an effort to provide financing for low-and moderate-income home buyers, we offer low-to-moderate income residential mortgage loans. These loans are offered with fixed rates of interest and terms of up to 40 years, and are secured by one-to four-family residential properties. All of these loans are originated using underwriting guidelines of U.S. government-sponsored enterprises such as Freddie Mac or Federal National Mortgage Association (“Fannie Mae”). These loans are originated with maximum loan-to-value ratios of 95%.

All residential mortgage loans we originate include “due-on-sale” clauses, which give us the right to declare a loan immediately due and payable if the borrower sells or otherwise disposes of the real property securing the mortgage loan. All borrowers are required to obtain title insurance, fire and casualty insurance and, if warranted, flood insurance on properties securing real estate loans.

Commercial Real Estate Loans. As part of our strategy to add to and diversify our loan portfolio, we have continued our focus on increasing our originations of commercial real estate loans. At September 30, 2012, $148.8 million, or 38.3%, of our total loan portfolio consisted of these types of loans. Commercial real estate loans are generally secured by five-or-more-unit apartment buildings, industrial properties and properties used for business purposes such as small office buildings and retail facilities primarily located in our market area. We generally originate adjustable-rate commercial real estate loans with a maximum term of 25 years with adjustable rate periods every five years. The maximum loan-to-value ratio for our commercial real estate loans is 75%, based on the appraised value of the property.

We consider a number of factors when we originate commercial real estate loans. During the underwriting process we evaluate the business qualifications and financial condition of the borrower, including credit history, profitability of the property being financed, as well as the value and condition of the mortgaged property securing the loan. When evaluating the business qualifications of the borrower, we consider the financial resources of the borrower, the borrower’s experience in owning or managing similar property and the borrower’s payment history with us and other financial institutions. In evaluating the property securing the loan, we consider the net operating income of the mortgaged property before debt service and depreciation, the ratio of the loan amount to the appraised value of the mortgaged property and the debt service coverage ratio (the ratio of net operating income to debt service) to ensure it is at least 120% of the monthly debt service. We require personal guarantees on all commercial real estate loans made to individuals. Generally, commercial real estate loans made to corporations, partnerships and other business entities require personal guarantees by the principals. All borrowers are required to obtain title, fire and casualty insurance and, if warranted, flood insurance.

Loans secured by commercial real estate generally are larger than residential mortgage loans and involve greater credit risk. Commercial real estate loans often involve large loan balances to single borrowers or groups of related

borrowers. Repayment of these loans depends to a large degree on the results of operations and management of the properties securing the loans or the businesses conducted on such property, and may be affected to a greater extent by adverse conditions in the real estate market or the economy in general. Accordingly, the nature of these loans makes them more difficult for management to monitor and evaluate.

The maximum amount of a commercial real estate loan is limited by our Board-established loans-to-one-borrower limit, which is currently 15% of Magyar Bank's capital, or $7.0 million. At September 30, 2012, our largest commercial real estate loan was $6.5 million and was secured by four office buildings located in Parsippany, New Jersey. The loan was performing in accordance with its terms at September 30, 2012. At September 30, 2012, eight commercial real estate loans totaling $6.4 million were non-performing. During the year ended September 30, 2012, $110,000 had been charged-off against the allowance for loan loss for one impaired commercial real estate loans. Interest income of $371,000 was not recorded on non-performing commercial real estate loans for the year ended September 30, 2012. All other loans secured by commercial real estate were performing in accordance with their terms.

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Construction Loans. We also originate construction loans for the development of one-to four-family homes, town homes, condominiums, apartment buildings and commercial properties. Construction loans are generally offered to experienced local developers operating in our primary market area and to individuals for the construction of their personal residences. The Bank ceased originating new construction loans for the development of non-owner occupied real estate in 2008. At September 30, 2012, our construction loans totaled $18.0 million, or 4.6% of total loans

At September 30, 2012, construction loans for the development of one-to four-family residential properties totaled $10.5 million, or 2.7% of total loans. These construction loans generally have a maximum term of 24 months. We provide financing for land acquisition, site improvement and construction of individual homes. Land acquisition funds are limited to 50% to 75% of the sale price of the land. Site improvement funds are limited to 100% of the bonded site improvement costs. Construction funds are limited to 75% of the lesser of the contract sale price or appraised value of the property (less funds already advanced for land acquisition and site improvement).

At September 30, 2012, construction loans for the development of town homes, condominiums and apartment buildings totaled $1.9 million, or 0.5% of total loans. These construction loans also generally have a maximum term of 24 months. The maximum loan-to-value ratio limit applicable to these loans has been 75% of the appraised value of the property, but was decreased to 70% in 2007 to reduce Magyar Bank's potential exposure to a downturn in the real estate market. Properties must maintain a debt service coverage ratio of 125%. Finally, we may retain up to 10% of each loan advance until the property attains a 90% occupancy level.

At September 30, 2012, construction loans for the development of commercial properties totaled $5.6 million, or 1.4% of total loans. These construction loans have a maximum term of 24 months. The maximum loan-to-value ratio limit applicable to these loans is 75% of the appraised value of the property. In addition, the property must maintain a debt service coverage ratio of 125%.

The maximum amount of a construction loan is limited by our loans-to-one-borrower limit, which is currently 15% of Magyar Bank's capital, or $7.0 million. At September 30, 2012, our largest outstanding construction loan balance was for $1.9 million. The loan was secured by a retail construction site located in Woodbridge, New Jersey. The loan was performing in accordance with its terms at September 30, 2012. At September 30, 2012, six construction loans totaling $5.1 million were non-performing. During the year ended September 30, 2012, $880,000 had been charged-off against the allowance for loan loss for eleven impaired construction loans and $51,000 was recovered from a prior year charge-off. No interest income was recorded on non-performing construction loans for the year ended September 30, 2012.

Before making a commitment to fund a construction loan, we require an appraisal of the property by an independent licensed appraiser. We generally also engage an outside engineering firm to review and inspect each property before disbursement of funds during the term of a construction loan. Loan proceeds are disbursed after inspection based on the percentage of completion method. We require a personal guarantee from each principal of all of our construction loan borrowers.

Construction lending is generally considered to involve a higher degree of credit risk than long-term financing on improved, owner-occupied real estate. Risk of loss on a construction loan depends largely upon the accuracy of the initial estimate of the value of the property at completion of construction compared to the estimated cost (including interest) of construction and other assumptions. If the estimate of construction cost is inaccurate, we may be required to advance funds beyond the amount originally committed in order to protect the value of the property. Additionally, if our estimate of the value of the completed property is inaccurate, our construction loan may exceed the value of the collateral.

Commercial Business Loans. At September 30, 2012, our commercial business loans totaled $29.9 million, or 7.7% of total loans. We make commercial business loans primarily in our market area to a variety of professionals, sole proprietorships and small and mid-sized businesses. Our commercial business loans include term loans and revolving lines of credit. The maximum term of a commercial business loan is 25 years. Such loans are generally used for longer-term working capital purposes such as purchasing equipment or furniture. Commercial business loans are made with either adjustable or fixed rates of interest. The interest rates for adjustable commercial business loans are typically based on the prime rate as published in *The Wall Street Journal*.

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Included in commercial business loans are SBA 7(a) loans, on which the SBA has historically provided guarantees of up to 90 percent of the principal balance. These loans are made for the purposes of providing working capital and financing the purchase of equipment, inventory or commercial real estate, and may be made inside or outside the Company's market place. Generally, an SBA 7(a) loan has a deficiency in its credit profile that would not allow the borrower to qualify for a traditional commercial loan, which is why the government provides the guarantee. The deficiency may be a higher loan to value ratio, lower debt service coverage ratio or weak personal financial guarantees. In addition, many SBA 7(a) loans are for start-up businesses where there is no history of financial information. Finally, many SBA borrowers do not have an ongoing and continuous banking relationship with the Bank, but merely work with the Bank on a single transaction. The guaranteed portions of the Company's SBA loans are generally sold in the secondary market.

When making commercial business loans, we consider the financial strength of the borrower, our lending history with the borrower, the debt service capabilities of the borrower, the projected cash flows of the business and the value and type of the collateral. Commercial business loans generally are secured by a variety of collateral, primarily accounts receivable, inventory, equipment, savings instruments and readily marketable securities. In addition, we generally require the business principals to execute personal guarantees.

Commercial business loans generally have greater credit risk than residential mortgage loans. Unlike residential mortgage loans, which generally are made on the basis of the borrower's ability to repay the loan from his or her employment income, and which are secured by real property with ascertainable value, commercial business loans generally are made on the basis of the borrower's ability to repay the loan from the cash flow of the borrower's business. As a result, the repayment of commercial business loans may depend substantially on the success of the borrower's business. Further, any collateral securing commercial business loans may depreciate over time, may be difficult to appraise and may fluctuate in value. We try to minimize these risks through our underwriting standards.

The maximum amount of a commercial business loan is limited by our loans-to-one-borrower limit, which is 15% of Magyar Bank's capital, or $7.0 million currently. At September 30, 2012, our largest commercial business loan was a $4.0 million loan to a company that provides janitorial services and was secured by the accounts receivable of the company. This loan was performing according to its terms at September 30, 2012. At September 30, 2012, two commercial business loans totaling $57,000 were non-performing. Interest income of $16,000 was not recorded on non-performing commercial business loans for the year ended September 30, 2012. During the year ended September 30, 2012, $69,000 had been charged-off against the allowance for loan loss for one impaired commercial business loans.

Home Equity Lines of Credit and Other Loans. We originate home equity lines of credit secured by residences located in our market area. At September 30, 2012, these loans totaled $23.4 million, or 6.0% of our total loan portfolio. The underwriting standards we use for home equity lines of credit include a determination of the applicant's credit history, an assessment of the applicant's ability to meet existing obligations, the ongoing payments on the proposed loan and the value of the collateral securing the loan. The maximum combined (first and second mortgage liens) loan-to-value ratio for home equity lines of credit is 80%. Home equity lines of credit have adjustable rates of interest, indexed to the prime rate, as reported in *The Wall Street Journal*, with terms of up to 25 years.

The maximum amount of a home equity line of credit loan is limited by our loans-to-one-borrower limit, which is 15% of Magyar Bank's capital, or $7.0 million currently. At September 30, 2012, our largest home equity line of credit loan was a $833,000. The loan is performing according to its terms at September 30, 2012. At September 30, 2012, all home equity lines of credit were performing in accordance with their terms with the exception of seven non-performing loans totaling $863,000. During the year ended September 30, 2012, $81,000 had been charged-off against the allowance for loan loss for one impaired home equity line of credit. Interest income of $73,000 was not recorded on non-performing home equity lines of credit for the year ended September 30, 2012.

We also originate loans secured by the common stock of publicly traded companies, provided their shares are listed on the New York Stock Exchange, the American Stock Exchange or the NASDAQ Stock Market, and provided the company is not a banking company. Stock-secured loans are interest-only and are offered for terms up to twelve months and for adjustable rates of interest indexed to the prime rate, as reported in *The Wall Street Journal.* The loan amount is not to exceed 70% of the value of the stock securing the loan at any time.

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At September 30, 2012, stock-secured loans totaled $10.8 million, or 2.0% of our total loan portfolio. Generally, we limit the aggregate amount of loans secured by the common stock of any one corporation to 15% of Magyar Bank's capital, with the exception of Johnson & Johnson, for which the collateral concentration limit is 150% of Magyar Bank's capital. At September 30, 2012, $10.7 million, or 2.0% of our loan portfolio, was secured by the common stock of Johnson & Johnson, a New York Stock Exchange company that operates a number of facilities in our market area and employs a substantial number of residents. Although these loans are underwritten based on the ability of the individual borrower to repay the loan, the concentration of our portfolio secured by this stock subjects us to the risk of a decline in the market price of the stock and, therefore, a reduction in the value of the collateral securing these loans. As of September 30, 2012, the aggregate loan-to-value ratio of the stock-secured portfolio was 37.0%.

Loan Originations, Purchases, Participations and Servicing of Loans. Lending activities are conducted primarily by our loan personnel operating at our main and branch office locations. All loans originated by us are underwritten pursuant to our policies and procedures. We originate both adjustable rate and fixed rate loans. Our ability to originate fixed or adjustable rate loans is dependent upon the relative customer demand for such loans, which is affected by the current and expected future levels of market interest rates.

Generally, we retain in our portfolio substantially all loans that we originate. Historically, we have not originated a significant number of loans for the purpose of reselling them in the secondary market. In the future, however, to help manage our interest rate risk and to increase fee income, we may increase our origination and sale of fixed-rate residential loans and commercial business loans guaranteed by the SBA. All one-to four-family residential mortgage loans that we sell in the secondary market are sold with servicing rights retained pursuant to master commitments negotiated with Freddie Mac. We sell our loans to Freddie Mac without recourse. No loans were held for sale at September 30, 2012.

At September 30, 2012, we were servicing loans sold to Freddie Mac in the amount of $20.8 million and SBA guaranteed loans sold in the amount of $6.3 million. Loan servicing includes collecting and remitting loan payments, accounting for principal and interest, contacting delinquent mortgagors, supervising foreclosures and property dispositions in the event of unremedied defaults, making certain insurance and tax payments on behalf of the borrowers and generally administering the loans.

From time-to-time, we will also participate in loans, sometimes as the "lead lender." Whether we are the lead lender or not, we underwrite our participation portion of the loan according to our own underwriting criteria and procedures. At September 30, 2012, we had $7.7 million of loan participation interests in which we were the lead lender, and $6.6 million in loan participations in which we were not the lead lender. We have entered into loan participations when the aggregate outstanding balance of a particular customer relationship exceeds our loan-to-one-borrower limit. All loan participations are loans secured by real estate that adhere to our loan policies. At September 30, 2012, all participation loans were performing in accordance with their terms.

During the fiscal year ended September 30, 2012, we originated $26.0 million of fixed-rate and adjustable-rate one-to four-family residential mortgage loans. The fixed-rate loans are primarily of loans with terms of 30 years or less. We also originated $30.6 million of commercial real estate loans, $2.4 million of owner-occupied construction loans, $4.6 million of commercial business loans, and $1.7 million of home equity lines of credit and other loans during the fiscal year ended September 30, 2012.

We generally do not purchase residential mortgage loans, except for loans to low-income borrowers as part of our Community Reinvestment Act lenders program. At September 30, 2012, we had $2.1 million of one-to four-family residential mortgage loans that were purchased from other lenders. No loans were purchased in the fiscal year ended September 30, 2012.

Loan Approval Procedures and Authority. Our lending activities follow written, non-discriminatory underwriting standards and loan origination procedures established by our Board of Directors. In the approval process for loans, we assess the borrower's ability to repay the loan and the value of the property securing the loan. To assess an individual borrower's ability to repay, we review income and expense, employment and credit history. To assess a business entity's ability to repay, we review financial statements (including balance sheets, income statements and cash flow statements), rent rolls, other debt service, and projected income and expense.

We generally require appraisals for all real estate securing loans. Appraisals are performed by independent licensed appraisers who are approved annually by our Board of Directors. We require borrowers to obtain title, fire and casualty, general liability, and, if warranted, flood insurance in amounts at least equal to the principal amount of the loan. For construction loans, we require a detailed plan and cost review, to be reviewed by an outside engineering firm, and all construction-related state and local approvals necessary for a particular project.

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Our loan approval policies and limits are established by our Board of Directors. All loans are approved in accordance with the loan approval policies and limits. Lending authorities are approved annually by the Board of Directors, and Magyar Bank lending staff members are authorized to approve loans up to their lending authority limits, provided the loan meets all of our underwriting guidelines.

Loan requests for aggregate borrowings up to $1.5 million must be approved by Magyar Bank’s Chief Lending Officer or President. Other members of our lending staff have lesser amounts of lending authority based on their experience as lending officers. Loan requests for aggregate borrowings up to 35% of Magyar Bank’s loans-to-one-borrower limit, or $2.5 million, must be approved by Magyar Bank’s Management Loan Committee. The Management Loan Committee is comprised of the President, Chief Lending Officer, Chief Financial Officer and various bank officers appointed by the Board of Directors. A quorum of three members including either the President or the Chief Lending Officer is required for all Management Loan Committee meetings. The Directors Loan Committee must approve all loan requests for aggregate borrowings in excess of 35% of Magyar Bank’s loans-to-one-borrower limit, or $2.5 million. The Board of Directors must approve all loan requests for aggregate borrowings in excess of 80% of Magyar Bank’s loans-to-one-borrower limit, or $5.6 million.

Asset Quality

We commence collection efforts when a loan becomes 15 days past due with system-generated reminder notices. Subsequent late charge and delinquent notices are issued and the account is monitored on a regular basis thereafter. Personal, direct contact with the borrower is attempted early in the collection process as a courtesy reminder and later to determine the reason for the delinquency and to safeguard our collateral. When a loan is more than 60 days past due, the credit file is reviewed and, if deemed necessary, information is updated or confirmed and collateral re-evaluated. We make every effort to contact the borrower and develop a plan of repayment to cure the delinquency. Loans are placed on non-accrual status when they are delinquent for more than three months. When loans are placed on non-accrual status, unpaid accrued interest is fully reversed, and further income is recognized only to the extent received.

A summary report of all loans 30 days or more past due is provided to the Board of Directors on a monthly basis. If no repayment plan is in process, the file is referred to counsel for the commencement of foreclosure or other collection efforts.

Non-Performing Assets. The table on the following page sets forth the amounts and categories of our non-performing assets at the dates indicated. The table includes troubled debt restructurings (loans for which a portion of interest or principal has been forgiven and loans modified at interest rates materially less than current market rates) for each date presented.

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	September 30,				
	2012	2011	2010	2009	2008
	(Dollars in thousands)				
n-accrual loans:					
e-to four-family residential	$7,577	$3,523	$ 2,451	$4,565	$772
mmercial real estate	6,424	7,156	8,228	7,439	3,400
nstruction	5,141	15,464	13,969	19,515	8,224
me equity lines of credit	863	788	1,304	1,086	731
mmercial business	57	255	1,465	879	176
her	12	—	—	—	—
al	20,074	27,186	27,417	33,484	13,303
cruing loans three months or more past due:					
e-to four-family residential	—	533	—	—	65
mmercial real estate	—	441	—	—	—
nstruction	—	—	583	—	6,700
me equity lines of credit	—	—	—	—	—
mmercial business	—	—	—	—	—
her	—	—	—	—	—

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erating income	1,376.3	1,447.9	1,151.3	1,020.1	872.2
rest expense	293.6	308.8	153.6	74.6	62.2
ome taxes	346.3	299.3	321.8	262.1	275.9
ome from continuing operations	749.5	812.1	577.5	713.2	557.1
ome from discontinued operations	13.1	18.0	43.6	70.6	22.1
income	762.6	830.1	621.1	783.8	579.2
ic earnings per common share					
tinuing operations	$ 4.89	$ 5.44	$ 3.96	$ 4.91	$ 3.82
income	$ 4.98	$ 5.56	$ 4.26	$ 5.40	$ 3.97
ted earnings per common share					
tinuing operations	$ 4.79	$ 5.31	$ 3.84	$ 4.76	$ 3.70
income	$ 4.87	$ 5.42	$ 4.13	$ 5.23	$ 3.86
mmon Share Data[b]					
dends paid	$ 248.6	$ 224.0	$ 201.6	$ 182.9	$ 166.2
dends paid per share	$ 1.62	$ 1.50	$ 1.38	$ 1.26	$ 1.14
rage number of basic shares outstanding	153.1	149.1	145.6	145.1	145.6
k value per share	$ 36.90	$ 31.08	$ 24.88	$ 21.65	$ 18.00
ance Sheet Data[a]					
entories	$ 2,047.6	$ 1,937.8	$ 1,404.8	$ 874.5	$ 754.0
rent assets	3,780.9	3,930.1	3,192.7	2,641.9	2,281.6
rking capital	1,687.0	1,414.7	374.8	605.9	148.1
perty, plant and equipment, net	1,698.2	1,708.2	1,405.2	1,170.5	1,139.1
ngibles, net	8,063.2	8,038.7	6,487.5	3,174.2	3,146.5
al assets	13,956.9	14,668.3	13,201.5	7,883.6	7,444.9
rt-term debt	431.0	789.3	934.1	670.2	728.1
g-term debt	3,942.7	5,034.9	4,889.9	1,239.5	1,242.6
ority interest in consolidated subsidiaries	558.5	559.7	374.8	358.0	356.5
ckholders equity	5,685.5	4,728.0	3,645.6	3,130.7	2,640.6

[a] Data have been restated to present the U.S. Wine business and Office products business as discontinued operations. Refer to Note 3, Discontinued Operations, to the Consolidated Financial Statements, Item 8 of this Form 10-K for additional information.

(b) On December 31, 2007, there were 20,503 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)	*2007*	*% Change vs. Prior Year*	2006	% Change vs. Prior Year	2005
Spirits	$ 2,606.8	3.7%	$ 2,513.4	70.8%	$ 1,471.8
Home and Hardware	4,550.9	(3.1)	4,694.2	13.0	4,153.4
Golf	1,405.4	7.0	1,313.4	3.8	1,265.8
NET SALES	$ 8,563.1	0.5%	$ 8,521.0	23.7%	$ 6,891.0

	Operating Income and Net Income				
	Year Ended December 31,				
(In millions)	*2007*	*% Change vs. Prior Year*	2006	% Change vs. Prior Year	2005
OPERATING INCOME:					
Spirits	$ 766.7	16.1%	$ 660.6	70.1%	$ 388.4
Home and Hardware	503.0	(27.7)	695.4	6.2	655.1
Golf	165.5	(0.3)	166.0	(3.2)	171.5
Less: Corporate expenses	58.9	(20.5)	74.1	16.3	63.7
OPERATING INCOME	$ 1,376.3	(4.9)%	$ 1,447.9	25.8%	$ 1,151.3
LESS:					
Interest expense	293.6	(4.9)	308.8	101.0	153.6
Other (income) expense, net	(37.5)	(6.7)	(40.2)	(151.3)	78.4
Income taxes	346.3	15.7	299.3	(7.0)	321.8
Minority interests	24.4	(64.1)	67.9	239.5	20.0
INCOME FROM CONTINUING OPERATIONS	$ 749.5	(7.7)%	$ 812.1	40.6%	$ 577.5
INCOME FROM DISCONTINUED OPERATIONS	13.1	(27.2)	18.0	(58.7)	43.6
NET INCOME	$ 762.6	(8.1)%	$ 830.1	33.6%	$ 621.1

Consolidated

Summary

Fortune Brands, Inc. is a holding company with subsidiaries that make and sell leading consumer branded products worldwide in the following markets: spirits, home & hardware, and golf products. First, we enhance shareholder value by profitably building leading consumer brands to drive sales and earnings growth, as well as to enhance long-term returns. We drive growth by positioning our brands and businesses to outperform their respective markets. We do this by developing innovative new products and effective marketing campaigns, expanding customer relationships, extending brands into adjacent categories and developing international growth opportunities. Second, we pursue business improvements by operating lean and flexible supply chains and business processes. Third, we promote organizational excellence by developing winning cultures and associates. Fourth, we seek to enhance returns by leveraging our breadth and balance and financial strength to drive shareholder value. While our first priority is internal growth, we also strive to achieve growth and high returns through acquisitions, dispositions and joint ventures. Finally, over time, we enhance shareholder value through other initiatives, such as using our financial resources to repurchase shares and pay attractive dividends.

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In 2007, net income decreased 8% and diluted earnings per share decreased 10% to $762.6 million and $4.87, respectively, compared to 2006. Income from continuing operations decreased 8% and diluted earnings per share from continuing operations decreased 10%. The decrease in profits was due primarily to the impact of the downturn in the U.S. housing products market, higher restructuring and restructuring-related charges (incremental $0.30 per diluted share) and the absence in 2007 of tax credits recorded in 2006 ($86.5 million or $0.57 per diluted share). These decreases were partially offset by the benefit of new product sales, price increases (implemented to offset higher commodity costs in the Home & Hardware and the Spirits businesses), productivity improvements, global sourcing initiatives, cost reduction efforts, lower Corporate expenses and the absence in 2007 of a 2006 minority interest charge related to an increase in the fair value of the Spirits business.

The following summarizes the performance of each of our business segments in 2007:

> Our Spirits business achieved 4% growth in sales and 16% growth in operating income compared to 2006. Net sales increased primarily on worldwide volume growth in premium and super-premium spirits, higher pricing and favorable foreign exchange. A significant portion of the increase in operating income was due to the gain on the sale of The Dalmore Scotch Whisky U.S. distribution rights and related assets (The Dalmore), as well as higher sales and cost containment. Excluding the gain on the sale of The Dalmore, operating income increased 9%.

> Sales of our Home and Hardware business declined 3%, primarily as a result of the downturn in the U.S. home products market, partly offset by the addition of Simonton, successful line extensions and new product introductions, and expanded customer relationships in cabinetry and residential entry doors. Even with the challenging market conditions, our home products brands continued to gain share in cabinetry, faucets, entry doors and security products. Operating income was down 28% as a result of lower underlying sales and related unfavorable coverage of manufacturing and overhead costs, as well as higher restructuring and restructuring-related costs related to supply-chain initiatives. These decreases were partly offset by higher pricing, productivity improvements and aggressive cost management.

> Our Golf brands achieved a 7% increase in sales compared to 2006 on the strength of sales growth in all product categories, successful new products in golf clubs and golf shoes, strong growth in international markets, continued share gains in key product categories, a favorable shift in golf ball demand to premium models and favorable foreign exchange. Operating income was essentially the same as the prior year on higher sales, offset by increased brand support expenses, higher oil-based commodity costs, and patent litigation and related costs.

In December 2007, we sold our remaining U.S. wine assets to Constellation Brands, Inc. for $884.5 million, subject to purchase price adjustments for cash and working capital levels, after selling two wine brands and related assets to E. & J. Gallo Winery in August 2007. The sale to Constellation Brands, Inc. resulted in a net after-tax gain on the sale of $5.2 million. In addition, in December 2007, we sold the U.S. distribution rights and related assets for The Dalmore for $58.0 million, resulting in a gain on the sale of $28.5 million, net of tax.

In January 2006, we substantially completed the final legal transfer of the spirits and wine assets we acquired in July 2005. 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 Note 4, Acquisitions and Disposals and Note 8, Long-Term Debt, to the Consolidated Financial Statements, Item 8 of this Form 10-K.

In June 2006, we acquired SBR, Inc. (now Simonton Holdings, Inc.), a privately held company, which owns a leading vinyl-framed window brand in North America. Refer to Note 4, Acquisitions and Disposals, to the Consolidated Financial Statements.

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In 2008, we believe the Company will benefit from the following trends in our businesses:

> continued growth of premium spirits worldwide,

> sustained development of innovative and new products across all of our segments,

> international growth opportunities in all of our segments,

> expanding customer relationships, particularly in Home and Hardware, and

> aging population trends in the U.S. that favorably impact conditions in the home products and golf industries.

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

> adverse impact of the downturn in the overall U.S. home products market, which most economists project will decline at a low double-digit rate in 2008,

> potential continuing increases in commodities costs, particularly copper, zinc and petroleum, and

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

RESULTS OF OPERATIONS

2007 Compared to 2006

Fortune Brands net sales were slightly higher in 2007. Operating income was 5% lower and net income decreased 8%, primarily due to the impact of the downturn in the U.S. home products markets, higher restructuring and restructuring-related charges, and the absence of 2006 tax credits.

Net Sales

Net sales were up $42.1 million, or 0.5%, benefiting from:

> newly introduced products and line extensions across all businesses (approximately $510 million in total, net of discontinued products),

> the impact of the Simonton acquisition ($182 million),

> strong international growth,

> favorable foreign exchange ($135 million), and

> targeted price increases (implemented to offset higher commodity costs in the Home and Hardware business, and for certain premium spirits brands).

Net sales were negatively impacted by the downturn in the U.S. home products market.

Cost of products sold

Cost of products sold increased $87.8 million, or 2%, primarily on the acquisition of Simonton ($127 million) and increased commodity costs, partly offset by the benefits of productivity improvements, global sourcing initiatives and facility consolidation/downsizing in the Home and Hardware business.

Excise taxes on spirits

Excise taxes on spirits were essentially the same as the prior year as a percentage of sales. Excise taxes are generally levied based on the alcohol content of spirits products. Consistent with industry practice, excise taxes collected from customers are reflected in net sales and the corresponding payments to governments in expenses.

Advertising, selling, general and administrative expenses

Advertising, selling, general and administrative expenses increased $9.2 million, or 0.5%, primarily as a result of higher brand investment in the Spirits business to support our global premium brands and in the Golf business to support new product introductions, as well as due to the impact of the Simonton acquisition. Increases were partly offset by the benefit of cost reduction initiatives, particularly in the Home and Hardware business, and lower Corporate expenses (reflecting a projected reduction in incentive compensation program payouts).

Amortization of intangibles

Amortization of intangibles increased $4.7 million to $47.6 million, primarily due to amortization of intangible assets associated with the June 2006 Simonton acquisition.

Restructuring charges

For the twelve months ended December 31, 2007, we recorded pre-tax restructuring charges of $73.5 million. These charges were predominantly related to supply chain initiatives in the Home and Hardware business (including tangible and intangible asset impairment charges resulting from the consolidation of facilities in cabinetry, window and tool storage, closure of a cabinetry component operation, and the planned exits from the entry door market in the United Kingdom and decorative column product lines in the U.S.). In the Home and Hardware business, we closed or downsized several facilities to optimize supply chains and better align our cost structures and capacity to navigate the current downturn in the U.S. housing product market and to support long-term growth. The 2007 charges consisted primarily of $16.3 million for workforce reduction costs, $49.6 million for asset write-downs, and $7.6 million for contract termination and other related costs. For additional information on the Home and Hardware restructuring, refer to Results of Operations by Segment Home and Hardware 2007 compared to 2006. In the twelve months ended December 31, 2006, we recorded pre-tax restructuring charges of $21.2 million, primarily related to supply-chain initiatives in the Home and Hardware business.

Gain on the sale of The Dalmore Scotch Whisky U.S. distribution rights

In 2007, we recorded pretax gain on the sale of The Dalmore Scotch Whisky U.S. distribution rights and related assets of $45.6 million.

Operating income

Operating income decreased $71.6 million, or 5%, to $1,376.3 million, primarily due to lower sales in the Home and Hardware business and resulting unfavorable coverage of manufacturing and overhead costs, greater brand investment and higher restructuring and restructuring-related charges. Operating income benefited from new product sales, price increases (implemented to offset higher commodity costs in the Home and Hardware business and in the Spirits business), a mix shift to premium products (in the Golf and Spirits businesses), a gain on the sale of The Dalmore Scotch Whisky U.S. distribution rights and related assets ($45.6 million), productivity improvements, global sourcing initiatives, cost reduction efforts, lower Corporate expenses and favorable foreign exchange.

Interest expense

Interest expense decreased $15.2 million, or 5%, to $293.6 million due to lower average debt, partly offset by an increase in commercial paper rates.

Other income, net

Other income, net decreased $2.7 million to $37.5 million. Other income, net, includes non-operating income and expense, such as amortization of deferred income related to Future Brands LLC (our

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Spirits business s U.S. sales and distribution joint venture), interest income and foreign currency transaction gains or losses.

Income taxes

The effective income tax rates for the twelve months ended December 31, 2007 and 2006 were 30.9% and 25.4%, respectively. The increase in the effective rate primarily resulted from the absence of 2006 tax credits of $85.9 million primarily associated with the favorable resolution of routine federal and state tax audits and changes in foreign tax laws that lowered income tax rates as they apply to foreign deferred income taxes. In addition, the 2007 effective tax rate was impacted by higher foreign income generally taxed at lower statutory rates and changes in foreign tax laws that lowered income tax rates as they apply to foreign deferred taxes.

Minority interests

Minority interest expense decreased $43.5 million to $24.4 million, primarily due to an adjustment of minority interest expense of $47.8 million recorded in the third quarter of 2006 representing an increase in the estimated fair value of V&S Group s aggregate 10% ownership in the convertible redeemable preferred stock of the Spirits business. The estimated fair value of V&S Group s minority interest in BGSW did not change in 2007. Refer to Note 5, Minority Interest Held by V&S Group, to the Consolidated Financial Statements, Item 8 to this Form 10-K.

Net income

Net income was $762.6 million, or $4.98 per basic share and $4.87 per diluted share, for the twelve months ended December 31, 2007. This compared to net income of $830.1 million, or $5.56 per basic share and $5.42 per diluted share, for the twelve months ended December 31, 2006. Income from continuing operations (excluding the U.S. Wine business) was $749.5 million, or $4.89 per basic share and $4.79 per diluted share, compared to income from continuing operations in 2006 of $812.1 million, or $5.44 per basic share and $5.31 per diluted share. The 8% ($62.6 million) decrease in income from continuing operations was primarily due to lower operating income and the absence in 2007 of tax credits recorded in 2006 ($86.5 million), partially offset by lower minority interest expense related to the Spirits business ($47.8 million). Income from discontinued operations declined $4.9 million, or 27%, primarily due to lower U.S. wine sales and higher operating expenses.

2006 Compared to 2005

Fortune Brands achieved a 24% increase in net sales and a 26% increase in operating income. Income from continuing operations was up 41% and net income was up 34%. Net income benefited from:

- the full-year benefit of the 2005 Spirits Acquisition (acquired July 2005),
- underlying growth in the Home and Hardware, Spirits, and Golf businesses,
- successful new products and line extensions, expanding customer relationships and extending brands into new markets,
- brand investments and share-gain initiatives,
- price increases, including those implemented to help offset energy and raw material cost increases,
- the absence of currency hedge accounting expense incurred related to the 2005 Spirits Acquisition purchase price, and

> higher tax credits in 2006.

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These benefits were partially offset by the impact of recording stock option compensation cost due to the adoption of Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (FAS 123R), higher restructuring and restructuring-related costs in 2006 compared to 2005, and the absence of income due to the spin-off of the Office products business.

Net Sales

Net sales increased $1.6 billion, or 24%, to $8.5 billion. Sales benefited from:

- newly introduced products and line extensions across all businesses,
- the net impact of the Simonton acquisition and 2005 Spirits Acquisition ($1.1 billion in aggregate),
- select price increases, across all of our businesses, but particularly in Home and Hardware, including those to help offset energy and raw material cost increases,
- expanding customer relationships, particularly for the cabinetry and entry door brands,
- extending brands into new markets, and
- favorable foreign exchange ($42 million).

The increase in net sales was tempered by the impact of the downturn in the U.S. housing market, particularly in the second half of 2006.

Cost of products sold

Cost of products sold increased $745.8 million, or 20%, primarily as a result of the Spirits and Simonton acquisitions, higher net sales, productivity improvements, and increased year-over-year costs for energy and raw materials (approximately $45 million), partially offset by price increases and productivity improvements.

Excise taxes on spirits

U.S. excise taxes on spirits increased as a percentage of sales by approximately 120 basis points due to a higher percentage of Spirits sales in Fortune Brands total revenues as a result of the 2005 Spirits Acquisition. In the U.S., excise taxes are levied based on the proof content of spirits products. Consistent with industry practice, U.S. excise taxes collected from customers are reflected in sales and the corresponding payments to governments in cost of sales.

Advertising, selling, general and administrative expenses

Advertising, selling, general and administrative expenses increased $371.1 million, or 22%, primarily as a result of the 2005 Spirits Acquisition. In addition, increases were due to higher sales, increased advertising for new product introductions, and higher brand investment expenses in all business segments, as well as stock option compensation cost.

Amortization of intangibles

Amortization of intangibles increased $10.0 million to $42.9 million primarily due to amortization of finite-lived intangible assets associated with the 2005 Spirits Acquisition ($4.9 million), as well as amortization associated with the Simonton acquisition ($4.6 million).

Restructuring charges

For the twelve months ended December 31, 2006, we recorded pre-tax restructuring charges of $21.2 million. These charges principally related to consolidation of manufacturing facilities and workforce reductions in the Home & Hardware and Spirits businesses. For the twelve months ended

December 31, 2005, we did not record any restructuring charges. Restructuring projects provide a return in excess of our cost of capital with an expected payback of less than three years.

Operating Income

Operating income in 2006 increased $296.6 million, or 26%, compared to 2005. The increase was primarily due to the benefit of the 2005 Spirits Acquisition, as well as underlying growth in all businesses, partly offset by higher restructuring and restructuring-related costs (incremental $15.7 million) and stock option compensation cost as a result of the adoption of FAS 123R ($25.1 million).

Interest expense

Interest expense increased $155.2 million, or 101%, to $308.8 million, primarily as a result of debt associated with the Spirits and Simonton acquisitions, as well as higher interest rates.

Other (income) expense, net

Other (income) expense, net increased $118.6 million to $40.2 million of income. The increase was primarily due to the absence of 2005 s unfavorable impact of currency hedge accounting expense related to the 2005 Spirits Acquisition purchase price ($120.9 million).

Income taxes

Income taxes decreased $22.5 million, or 7%, to $299.3 million. The effective income tax rate for the twelve months ended December 31, 2006 and December 31, 2005 was 25.4% and 35.0%, respectively. The lower effective rate primarily related to higher tax credits in 2006 associated with reductions of foreign income tax rates applied to foreign deferred income taxes, as well as favorable resolution of routine federal and state tax audits.

Minority interests

Minority interest expense increased $47.9 million to $67.9 million, primarily due to an adjustment of minority interest expense of $47.8 million representing an increase in the estimated fair value of V&S Group s aggregate 10% ownership in the convertible redeemable preferred stock of the Spirits business. Refer to Note 5, Minority Interest Held by V&S Group, to the Consolidated Financial Statements, Item 8 to this Form 10-K.

Net income

Net income was $830.1 million, or $5.56 per basic share and $5.42 per diluted share, for the year ended December 31, 2006, compared to net income of $621.1 million, or $4.26 per basic share and $4.13 per diluted share for the year ended December 31, 2005. Income from continuing operations was $812.1 million, or $5.44 per basic share and $5.31 per diluted share for the year ended December 31, 2006. These results compared to income from continuing operations of $577.5 million, or $3.96 per basic share and $3.84 per diluted share, for the year ended December 31, 2005. The increase in income from continuing operations of $234.6 million, or 41%, was primarily due to higher operating income as well as substantial tax credits recorded in 2006 ($86.5 million in 2006 compared to $7.7 million in 2005, or an increase of $0.52 per diluted share). These benefits were partly offset by higher restructuring and restructuring-related costs (incremental $15.7 million or $0.07 per diluted share), stock option compensation cost ($25.1 million or $0.16 per diluted share), and the absence of income due to the spin-off of the Office products business ($0.26 per diluted share for discontinued operations in 2005). Income from discontinued operations decreased to $18.0 million in 2006 from $43.6 million in 2005 primarily because 2005 included income from the Office business that was spun-off in 2005.

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QUARTERLY FINANCIAL DATA
Unaudited

Fortune Brands, Inc. and Subsidiaries

(In millions, except per share amounts)

2007	1st	2nd	3rd	4th
Net sales	$ 1,909.1	$ 2,293.3	$ 2,145.3	$ 2,215.4
Gross profit	750.3	958.6	890.3	888.4
Operating income	256.3	415.8	368.0	336.2
Income from continuing operations	121.3	229.5	208.0	190.7
(Loss) income from discontinued operations	(1.1)	2.5	0.9	10.8
Net income	120.2	232.0	208.9	201.5
Earnings per common share				
Basic				
Income from continuing operations	$ 0.80	$ 1.50	$ 1.36	$ 1.24
Net income	$ 0.79	$ 1.52	$ 1.36	$ 1.31
Diluted				
Income from continuing operations	$ 0.78	$ 1.47	$ 1.33	$ 1.22
Net income	$ 0.77	$ 1.48	$ 1.33	$ 1.28

2006	1st	2nd	3rd	4th
Net sales	$ 1,966.8	$ 2,198.6	$ 2,156.2	$ 2,199.4
Gross profit	792.2	946.2	883.7	916.5
Operating income	297.7	423.2	366.9	360.1
Income from continuing operations	172.1	245.0	147.2	247.8
Income from discontinued operations	1.3	2.8	4.1	9.8
Net income	173.4	247.8	151.3	257.6
Earnings per common share				
Basic				
Income from continuing operations	$ 1.17	$ 1.66	$ 0.97	$ 1.63
Net income	$ 1.18	$ 1.68	$ 1.00	$ 1.70
Diluted				
Income from continuing operations	$ 1.14	$ 1.62	$ 0.95	$ 1.59
Net income	$ 1.15	$ 1.63	$ 0.98	$ 1.65

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RESULTS OF OPERATIONS BY SEGMENT

Spirits

2007 Compared to 2006

Net sales increased $93.4 million, or 4%, to $2,606.8 million primarily due to a mix shift toward higher priced premium brands (particularly Sauza tequila, and Jim Beam and Maker s Mark bourbons), favorable foreign exchange ($83 million), growth in international markets (especially Australia, global travel retail and emerging markets) and select price increases on premium spirits brands. These increases were partly offset by the negative impact of the wind-down of a transitional bottling agreement with Pernod Ricard S.A. (Pernod Ricard) to produce certain products at cost subsequent to the 2005 Spirits Acquisition, as well as the adverse first quarter 2007 impact from the 2006 transition of distribution in Spain to our Maxxium Worldwide B.V. joint venture (no net impact on operating income), which decreased net sales by $44.2 million in aggregate. For more information on the 2005 Spirits Acquisition, refer to Note 4, Acquisitions and Disposals, to the Consolidated Financial Statements, Item 8 of this Form 10-K.

Operating income increased $106.1 million, or 16%, to $766.7 million primarily due to the increase in net sales, the gain on the sale of The Dalmore Scotch Whisky U.S. distribution rights and related assets ($45.6 million), favorable foreign exchange, faster growth of higher margin premium and super-premium brands, and cost synergies resulting from the 2005 Spirits Acquisition, partly offset by higher raw material costs.

Global case volumes increased low-single digits in 2007 compared to last year, primarily due to higher consumer demand for the Company s premium brands. The Company measures global case volumes based primarily on case shipments by the Company s distributors to retailers.

The Spirits business is a partner in an international sales and distribution joint venture named Maxxium Worldwide B.V. (Maxxium) that distributes and sells spirits in select markets outside the United States, representing approximately one-third of our international Spirits sales. The Company retains a 25% ownership interest in Maxxium and accounts for its investment using the equity method. The Company s other 25% partners in Maxxium are Rémy Cointreau S.A. (Rémy), The Edrington Group Ltd. and V&S Group (V&S). In November 2006, Rémy gave notice to Maxxium that it will terminate its distribution agreement with Maxxium effective March 30, 2009. In connection with Rémy s termination, it is expected that Rémy will pay a substantial termination penalty to Maxxium. Based on the expected impact of Rémy s termination of the distribution agreement on Maxxium s financial position and results of operations, the Company currently estimates that its investment in Maxxium of $96.3 million is recoverable. For additional information, refer to Note 6, Related Party Transactions, to the Consolidated Financial Statements, Item 8 of this Form 10-K.

The government of Sweden has commenced a process that is expected to result in the privatization of V&S. V&S is one of our joint venture partners in Maxxium Worldwide B.V. (international sales and distribution) and, through its U.S. subsidiary, is our joint venture partner in Future Brands LLC (U.S. sales and distribution). In addition, V&S owns a 10% interest in the convertible preferred stock of Beam Global Spirits and Wine, Inc., our Spirits business. At this time, we cannot predict what impact a change in the ownership of V&S would have on V&S s participation in our sales and distribution joint ventures. We remain interested in acquiring V&S.

Factors that could adversely affect results include potential changes to distribution, competitive pricing activities, changes in U.S. wholesale distributor inventory levels, and the possibility of excise and other tax increases, including internationally.

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2006 Compared to 2005

Net sales increased $1,041.6 million, or 71%, to $2,513.4 million principally due to incremental net sales from the 2005 Spirits Acquisition ($763 million), as well as year-over-year sales growth in the combined business and favorable foreign exchange ($22 million). Growth for brands including Jim Beam bourbon, Sauza tequila and Maker s Mark bourbon, as well as super-premium brands and several regional/national brands, contributed to the increase. Reported net sales in 2005 were impacted by accounting for the acquisition in accordance with Financial Accounting Standards Board Interpretation No. 46(R) (FIN 46R), Consolidation of Variable Interest Entities. Prior to the legal transfer of acquired brands and assets (refer to Note 4, Acquisitions and Disposals to the Consolidated Financial Statements, Item 8 to this Form 10-K), we consolidated variable interest entities where we were deemed to be the primary beneficiary. Certain entities consolidated at December 31, 2006 were not consolidated as of December 31, 2005, and certain assets or liabilities consolidated as of December 31, 2005 are no longer owned by entities consolidated as of December 31, 2006.

Operating income increased $272.2 million, or 70%, to $660.6 million on the benefit of higher sales, synergy benefits from the 2005 Spirits Acquisition and lower transition costs, partly offset by the inclusion of stock option compensation cost beginning in 2006. Operating income margin was unfavorably impacted by approximately $90 million recorded as revenues that generated no operating income, primarily related to short-term cost-only transitional bottling agreements with Pernod Ricard. In addition, operating income was affected by accounting under FIN 46R.

Home and Hardware

2007 Compared to 2006

Net sales decreased $143.3 million, or 3%, to $4,550.9 million. The decrease was primarily attributable to the adverse impact of an estimated low double-digit decline in the U.S. home products market. Sales benefited from the acquisition of Simonton ($182 million), new products and line extensions (approximately $428 million in total, particularly in faucets and related products, cabinetry and entry doors), share gains (including cabinetry, faucets, entry doors and security products), expansion with key customers, the impact of select commodity cost-related price increases, and favorable foreign exchange.

Operating income decreased $192.4 million, or 28%, to $503.0 million. Operating income was negatively impacted by lower underlying sales and the resulting unfavorable coverage of manufacturing and overhead costs, as well as higher restructuring and restructuring-related costs related to supply chain initiatives (incremental $70 million). Price increases offset the effect of higher commodity costs (approximately $80 million, including the absence of commodity hedge gains in 2007). Operating income benefited from productivity improvements, global sourcing initiatives, reduction in overhead and administrative costs, and facility closures/downsizing.

In 2007, the Home and Hardware business recorded pre-tax restructuring charges of $70.2 million and restructuring-related charges of $26.1 million ($14.7 million recorded in cost of sales and $11.4 million recorded in advertising, selling, general and administrative costs). These charges were related to supply chain initiatives including the consolidation of facilities in cabinetry, window and tool storage production, closure of a cabinetry component operation, and planned exit from the entry door market in the United Kingdom and decorative column product lines in the U.S. We closed or downsized facilities to optimize supply chains and better align our cost structures and capacity to navigate the current downturn in the U.S. housing products market and to support long-term growth. The 2007 Home and Hardware restructuring charges of $70.2 million consisted primarily of $13.5 million for workforce reduction costs, $49.5 million for tangible and intangible asset write-downs, $7.2 million for

contract termination and other related costs. We expect to incur additional charges of approximately $10-15 million in 2008 related to the completion of Home and Hardware restructuring programs initiated in the fourth quarter of 2007. Restructuring-related charges in 2007 of $26.1 million were comprised of cost of sales charges for inventory write-downs, as well as advertising, selling, general and administrative charges for accounts receivable reserves for doubtful accounts, warranty reserves and retention costs related to the exit from the entry door market in the U.K. and the decorative column products line in the U.S. During 2008, we expect to record as incurred cash outlays of approximately $25-30 million related to the completion of these programs. During 2008 and 2009, we expect cash proceeds from the sale of assets related to the restructuring programs will be approximately $20 million. We anticipate these programs, which commenced in the second half of 2006, will generate annual cost savings of $20 to $30 million beginning in 2008, in addition to savings achieved in 2007 of approximately $10 million. In 2006, the Home and Hardware business recorded pre-tax restructuring and restructuring-related charges of $16.9 million and $9.4 million, respectively, also primarily related to supply-chain initiatives.

In June 2006, the Home and Hardware business acquired SBR, Inc., including Simonton Windows, a leading brand of vinyl-framed windows.

The downturn in the overall U.S. home products market, which is projected by most economists to decline low-double-digits again in 2008, will continue to negatively impact the results of operations for our Home and Hardware business. We will strive to mitigate the impact of the downturn on our net sales through market share gain initiatives, successful extension of brands into new markets, expanding existing customer relationships, and building on our substantial presence in the more stable replace-and-remodel segment of the U.S. home products market. Through previously announced restructuring activities and ongoing cost control initiatives, we will work to align supply-chain and administrative costs with expected demand in order to mitigate the impact of the downturn on our operating income and operating margins. We anticipate that 2008 will benefit from lower restructuring and restructuring-related charges.

Our business may also continue to be affected by competitive pricing, as well as further increases in the costs of certain commodities.

2006 Compared to 2005

Net sales increased $540.8 million, or 13%, to $4,694.2 million. The increase was primarily attributable to continued growth and share gains for cabinetry, faucet and padlock brands, as well as the benefit of acquisitions ($344 million), primarily the Simonton acquisition. Sales also benefited from new products and line extensions ($43 million in total), expanding customer relationships with home centers and major builders, expansion into adjacent categories (e.g., bath accessories, patio doors, impact-resistant windows and automotive towing accessories), growth in international markets and favorable foreign exchange ($23 million). In addition, sales benefited from price increases implemented to help offset higher costs for raw materials and energy. The net sales increase was tempered by the impact of the downturn in the overall U.S. home products market, particularly in the fourth quarter of 2006.

Operating income increased $40.3 million, or 6%, to $695.4 million. Operating income benefited from sales growth, productivity improvements and reversal of a legal reserve (approximately $7 million), as well as absence of both expenses in 2006 related to a lower cost sourcing initiative in cabinets in 2005 and an unfavorable steel purchase-price variance for LIFO inventory in the tool storage category in 2005 ($7.9 million). These benefits were partially offset by higher commodity and energy costs (net impact approximately $30-35 million), restructuring and restructuring-related charges ($26.3 million) and the inclusion of stock option compensation cost beginning in 2006 upon the adoption of FAS 123R.

Golf

2007 Compared to 2006

Net sales increased $92.0 million, or 7%, to $1,405.4 million. The net sales increase was largely due to new product introductions, strong international growth, continued share gains in key product categories, and a favorable shift in golf ball demand to premium models. Net sales also benefited from higher sales in all product categories (golf balls, golf clubs, shoes, gloves and accessories), as well as favorable foreign exchange ($28 million).

Operating income decreased $0.5 million to $165.5 million primarily on expenses related to international market expansion and investments in research and development, as well as higher patent litigation and related costs. These decreases were nearly offset by higher sales, as well as growth of premium golf balls and clubs.

We expect the golf industry to benefit from favorable long-term demographic trends, including an aging U.S. population (rounds of play increase with retirement), and the increasing popularity of golf internationally. In the near term, participation levels are impacted by factors including weather, economic conditions, golf-related travel and corporate spending. The future success of the Golf business will depend upon continued innovation, product quality and successful marketing across product categories, as well as continued market growth.

2006 Compared to 2005

Net sales increased $47.6 million, or 4%, to $1,313.4 million. Higher sales resulted from sales growth in all product categories, driven in part by successful new products in golf clubs and golf shoes, and continued growth in international markets (Europe and Asia).

Operating income decreased $5.5 million, or 3%, to $166.0 million primarily due to higher commodity and energy costs and the inclusion of stock option compensation cost beginning this year.

Corporate

2007 Compared to 2006

Corporate expenses, which include salaries, benefits and expenses related to corporate office employees, as well as public company expenses, decreased $15.2 million, or 21%, to $58.9 million. These expenses decreased primarily due to lower incentive compensation expense mainly resulting from lower expected payouts for long-term incentive compensation programs.

2006 Compared to 2005

Corporate expenses increased $10.4 million, or 16%, to $74.1 million primarily due to the required expensing of stock option compensation cost beginning in 2006 upon adoption of FAS 123R.

LIQUIDITY AND CAPITAL RESOURCES

Our primary liquidity needs are to support working capital requirements, fund capital expenditures, service indebtedness and pay dividends, as well as finance acquisitions and share repurchases when deemed appropriate. 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. There are no significant restrictions on the ability of our

subsidiaries to pay dividends or make other distributions to Fortune Brands. Our focus for the use of our free cash flow and proceeds from divestitures, after internal growth, had been the paydown of debt incurred as a result of the 2005 Spirits Acquisition, resulting in a reduction in total debt in 2007 of $1.5 billion. The sale of the U.S. Wine business significantly improved our financial flexibility. We periodically review our portfolio of brands and evaluate strategic options to increase shareholder value. We cannot predict whether or when we may enter into an acquisition, disposition, joint venture or other strategic options, including a share repurchase program, nor what impact any such transaction could have on our results of operations, cash flows or financial condition, whether as a result of the issuance of debt or equity securities, or otherwise. For a description of the 2005 Spirits Acquisition and the debt incurred in connection with the acquisition, refer to Note 4, Acquisitions and Disposals, to the Consolidated Financial Statements, in Item 8 of this Form 10-K.

Cash Flows

Net cash provided by operating activities was $965.3 million for the year ended December 31, 2007 compared with $982.7 million for the year ended December 31, 2006. The decrease in cash provided of $17.4 million was principally due to the timing of interest payments on debt issued in 2006 ($70 million), higher first quarter 2007 payments for 2006 customer programs (primarily volume-related) and employee performance incentives accrued in 2006, increased pension contributions ($31 million) and lower net income. The decrease in cash provided by operating activities was favorably impacted by the absence of a build-up in acquisition-related spirits inventory in 2006.

Net cash provided by investing activities for the year ended December 31, 2007 was $744.2 million, compared with net cash used by investing activities of $762.3 million for the year ended December 31, 2006. The increase in cash of $1,506.5 million was primarily due to net proceeds of $948.3 million from the sale of the U.S. Wine business, as well as the absence of 2006 acquisition spending for the 2005 Spirits Acquisition ($309.5 million) and the 2006 acquisition of Simonton ($271.4 million).

We focus our capital spending on growth initiatives and becoming the lowest cost producers of the highest quality products. Capital spending in 2007 was $267.1 million, $1.1 million higher than 2006. We currently estimate 2008 net capital expenditures will be in the range of $175 to $225 million. We expect to generate these funds internally.

Net cash used by financing activities for the year ended December 31, 2007 was $1,713.0 million, compared with $145.5 million in the year ended December 31, 2006. The increase of $1,567.5 million was primarily due to the paydown of debt this year from cash flow from operating activities and the sale of the U.S. Wine business. These cash outflows were partly offset by the absence in 2007 of proceeds received in 2006 from V&S Group to maintain its 10% interest in the Spirits Business ($153.0 million).

Capitalization

Total debt decreased $1,450.5 million during the year ended December 31, 2007 to $4.4 billion primarily due to proceeds received from the sale of the U.S. Wine business ($948.3 million) and The Dalmore Scotch Whisky U.S. distribution rights and related assets ($58 million), as well as due to cash from operating activities. The ratio of total debt to total capital decreased to 41.2% at December 31, 2007 from 52.4% at December 31, 2006 primarily due to paydown of debt, 2007 net income and increased foreign translation adjustments in stockholders equity.

We have two revolving credit agreements with various banks. These agreements include a $2.0 billion, 5-year revolving credit agreement, which matures in 2010, and a $500 million, 364-day

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revolving credit agreement, under which there were no amounts outstanding. On October 4, 2007 we renewed our 364-day, $500 million revolving credit facility to mature in 2008. The agreement includes the option to extend payment for one year at the Company s discretion for an incremental fee of 0.125% of the outstanding amount. This facility replaces the previous 364-day facility. The interest rates, which are variable, are based on market interest rates at the time of the borrowing and the Company s long-term credit rating. Facility fees of 0.08% per annum are subject to increases up to maximum fees of 0.15% per annum in the event our long-term debt rating falls below specified levels. The facility supports the Company s commercial paper borrowings in the commercial paper market.

In May 2006, we filed with the Securities and Exchange Commission a new universal shelf registration statement, covering the offer and sale of an undetermined amount of various securities.

Minority Interest Held by V&S Group

The minority interest in our Spirits business (BGSW) is in the form of shares of redeemable and convertible preferred stock held by V&S Group (The BGSW Minority Interest). V&S may require the Company to purchase the BGSW Minority Interest at fair value in whole or in part upon one year s notice, or at any time upon a change in control of BGSW, Jim Beam Brands Co., or certain other events. The Company has the right to acquire the BGSW Minority Interest at fair value in whole or in part upon a change in control of the Absolut Spirits Company, Incorporated, sale of the Absolut brand, or the dissolution of Future Brands LLC (our U.S. sales and distribution joint venture). The BGSW Minority Interest cannot be transferred or sold to a third party by V&S without the Company s consent. We account for the redemption feature in accordance with EITF Topic D-98 Classification and Measurement of Redeemable Securities, and measure this minority interest at fair value with changes in fair value reflected in net income from continuing operations. BGSW is not a publicly traded entity and therefore there is no quoted market price for its common or preferred shares. At each reporting period, we estimate fair value based on a combination of market-based earnings multiples and discounted cash flow techniques. The ultimate fair value upon redemption will be based upon numerous factors that will be subject to assessment by the BGSW board or by an independent appraiser if the board is unable to reach a consensus. The fair value of the minority interest recorded at December 31, 2007 was $542.9 million.

Dividends

In July 2007, we increased the dividend on common stock 8% to an annual rate of $1.68 per common share. A summary of 2007 dividend activity for the Company s common stock is shown below:

Dividend Amount	Declaration Date	Record Date	Payment Date
$0.39 per share	January 25, 2007	February 7, 2007	March 1, 2007
$0.39 per share	April 24, 2007	May 9, 2007	June 1, 2007
$0.42 per share	July 31, 2007	August 15, 2007	September 4, 2007
$0.42 per share	September 25, 2007	November 7, 2007	December 3, 2007

A summary of 2007 dividend activity for the Company s $2.67 Convertible Preferred stock is shown below:

Dividend Amount	Declaration Date	Record Date	Payment Date
$0.6675 per share	January 25, 2007	February 7, 2007	March 10, 2007
$0.6675 per share	April 24, 2007	May 9, 2007	June 10, 2007
$0.6675 per share	July 31, 2007	August 15, 2007	September 10, 2007
$0.6675 per share	September 25, 2007	November 7, 2007	December 10, 2007

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Adequacy of Liquidity Sources

We believe that our internally generated funds, together with access to global credit markets, are adequate to meet our long-term and short-term capital needs. Our cash flows from operations, borrowing availability and overall liquidity are subject to certain risks and uncertainties, including those set forth under Item 1. Business Forward-Looking Statements.

Pension Plans

On a periodic basis, we evaluate the assumptions used in determining our pension liabilities and assets as well as pension expense based on historical returns on plan assets and current economic conditions at the time the assumptions are set.

Our December 2007 review of the economic assumptions, and our cash flow spot rate yield curve analysis, led to an increase in our weighted-average discount rate from 5.9% to 6.4% and the weighted-average expected rate of return increased from 8.2% to 8.3%. Management believes that these assumptions are appropriate. Our December 2006 review of the economic assumptions, and our cash flow spot rate yield curve analysis, led to an increase in our weighted-average discount rate from 5.7% to 5.9% and the weighted-average expected rate of return decreased from 8.3% to 8.2%.

Total pension plan cash contributions were $48.9 million and $18.1 million, respectively, in 2007 and 2006. The Company maintains pension plans at many of its operations. The pension plans in aggregate are funded in excess of the Current Liability, as defined in the Internal Revenue Code. In 2008, we expect to make cash contributions of approximately $30 to $50 million to fund existing pension liabilities for our defined-benefit plans. We believe that our internally generated funds will be adequate to make these pension plan cash contributions.

Foreign Exchange

We have investments in various foreign countries, principally Australia, Canada, Mexico, Spain, the U.K. and France. Therefore, changes in the value of the related currencies affect our balance sheet and cash flow statements when translated into U.S. dollars. In addition, in 2006 we issued euro-denominated long-term debt. See Note 8, Long-Term Debt, to the Consolidated Financial Statements, Item 8 of this Form 10-K.

Interest Rates

We may, from time to time, enter into interest rate swap agreements to manage our exposure to interest rate changes. Swap agreements involve the exchange of fixed and variable interest rate payments without exchanging the notional principal amount. We record the payments or receipts under the agreements as adjustments to interest expense. There were no interest rate swaps outstanding during 2007.

We also may, from time to time, enter into treasury rate locks and interest rate swaps to hedge the risk associated with fluctuation in interest rates related to anticipated issuance of new long-term debt. In the second quarter of 2005, we entered into treasury rate locks with an aggregate notional value of $1.25 billion in order to hedge the risk to earnings associated with fluctuations in interest rates relating to the anticipated issuances of the dollar-denominated debt associated with the 2005 Spirits Acquisition. In the fourth quarter of 2005, we entered into additional treasury rate locks with an aggregate notional value of $500 million. We terminated these treasury rate locks on January 5, 2006 when we issued the dollar-denominated long-term debt. In addition, in the fourth quarter of 2005, we entered into interest rate swaps with an aggregate notional value of 800 million. We terminated these

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swap agreements on January 27, 2006 when we issued the new euro-denominated long-term debt. We classified these treasury rate locks and interest rate swaps as cash flow hedges since they hedged against fluctuations in interest rates relating to the anticipated issuance of debt associated with the 2005 Spirits Acquisition. For more information on the new dollar- and euro-denominated long-term debt issued in connection with the 2005 Spirits Acquisition, see Note 8, Long-Term Debt to the Consolidated Financial Statements, Item 8 of this Form 10-K. For more information regarding the treasury rate locks and interest rate swaps, including the accounting for, and the gains and losses with respect to, these locks and swaps, see Note 15, Financial Instruments, to the Consolidated Financial Statements, Item 8 of this Form 10-K.

The fair market value of long-term fixed interest rate debt is subject to interest rate risk. Generally, the fair market value of fixed interest rate debt will increase as interest rates fall and decrease as interest rates rise. The estimated fair value of our $4,142.7 million and $5,036.6 million total long-term debt (including current portion) at December 31, 2007 and 2006 was approximately $4,005.6 million and $4,918.9 million, respectively. The fair value is determined from quoted market prices, where available, and from investment bankers using current interest rates considering credit ratings and the remaining terms to maturity.

Guarantees and Commitments

Third-party guarantees of the debt of Maxxium Worldwide B.V. (Maxxium), our Spirits business s international sales and distribution joint venture, totaled $91.2 million. We are required to perform under these guarantees in the event that Maxxium fails to make contractual payments. On December 12, 2005, we renewed the guarantees of Maxxium s credit facilities. The renewal extended the expiration date of the committed portion of the credit facilities to December 12, 2010. In accordance with Financial Accounting Standards Board Interpretation No. 45 (FIN 45), Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, we recorded a liability of $0.4 million as of December 31, 2007 to reflect the fair value of the guarantees to Maxxium.

In addition, as a part of the formation of the Future Brands LLC (Future Brands) joint venture with V&S Group in 2001, Jim Beam Brands Co. (JBBCo.) has guaranteed any financial obligations of Future Brands that may arise in the event of a Future Brands default in which it fails to fulfill its operating obligations and which results in a claim. These financial obligations include, but are not limited to, making payments to suppliers, employees and other parties with which Future Brands conducts business. We cannot estimate the possible future obligations under the Future Brands agreement. At December 31, 2007, JBBCo. did not have any outstanding obligations as a result of this arrangement.

We also guaranteed various leases for ACCO World Corporation, the Office products segment divested on August 16, 2005. We will continue to guarantee payment of certain real estate leases with lease payments totaling approximately $36.1 million through April 2013. Accordingly, we have recorded the fair value of these guarantees on our financial statements in accordance with FIN 45. As of December 31, 2007, we recorded a liability of $1.0 million. Refer to Note 3, Discontinued Operations, to the Consolidated Financial Statements, Item 8 of this Form 10-K for additional information on the spin-off of the Office products segment.

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Contractual Obligations and Other Commercial Commitments

The following table and discussion represent our obligations and commitments to make future payments under contracts, such as debt and lease agreements, and under contingent commitments, such as debt guarantees, as of December 31, 2007.

(In millions)	Payments Due by Period as of December 31, 2007				
Contractual Obligations	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
Short-term borrowings	$ 231.0	$ 231.0	$	$	$
Long-term debt	4,142.7	200.0	448.0	750.0	2,744.7
Operating leases	204.6	55.3	78.8	47.8	22.7
Interest payments on long-term debt	1,952.8	206.6	385.4	312.1	1,048.7
Purchase obligations[a]	785.8	301.6	167.8	117.1	199.3
Pension contributions[b]	3.7	3.7			

[a] Purchase obligations include contracts for raw material and finished goods purchases; advertising, selling and administrative services; and capital expenditures.

[b] Minimum required pension contributions cannot be determined beyond 2008.

Due to the uncertainty of the timing of settlement with taxing authorities, we are unable to make reasonably reliable estimates of the period of cash settlement of unrecognized tax benefits. Therefore, $411.4 million of unrecognized tax benefits as of December 31, 2007 have been excluded from the Contractual Obligations table above. See Note 14, Income Taxes, to the Consolidated Financial Statements, Item 8 to this Form 10-K.

In addition to the contractual obligations listed above, we also had other commercial commitments for which we are contingently liable as of December 31, 2007. These include the guarantee of certain credit facilities and bank loans entered into by Maxxium up to an amount totaling $77.3 million, of which $6.1 million expires in less than one year with the remaining $71.2 million due in two to three years; a Shareholder Loan Facility executed by BGSW and Maxxium amounting to $21.9 million, of which no amounts were outstanding and which expires in three to four years; Standby Letters of Credit of $94.8 million, of which $60.7 million expires in less than one year with the remaining $34.1 million expiring in one to three years; and Surety Bonds of $23.9 million of which $23.8 million expires in less than one year with the remaining $0.1 million expiring in one to three years. These contingent commitments are not expected to have a significant impact on our liquidity.

Derivative Financial Instruments

In accordance with Statement of Financial Accounting Standards No. 133 (FAS 133), Accounting for Derivative Instruments and Hedging Activities and its related amendment Financial Accounting Standards No. 138 (FAS 138), Accounting for Certain Derivative Instruments and Certain Hedging Activities, all derivatives are recognized as either assets or liabilities on the balance sheet and the measurement of those instruments is at fair value. If the derivative is designated as a fair value hedge and is effective, the changes in the fair value of the derivative and of the hedged item attributable to the hedged risk are recognized in earnings in the same period. If the derivative is designated as a cash flow hedge, the effective portions of changes in the fair value of the derivative are recorded in other comprehensive income (OCI) and are recognized in the income statement when the hedged item affects earnings. Ineffective portions of changes in the fair value of cash flow hedges are recognized in earnings.

Derivative gains or losses included in OCI are reclassified into earnings at the time the forecasted revenue or expense is recognized. During the year ended December 31, 2007, $15.4 million in

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deferred currency losses were reclassified to cost of sales. During the year ended December 31, 2006, $1.9 million in deferred currency gains were reclassified to cost of sales. During the year ended December 31, 2005, deferred currency losses of $7.2 million were reclassified to cost of sales. We estimate that $3.4 million of currency derivative losses included in OCI as of December 31, 2007 will be reclassified to earnings within the next twelve months.

Foreign Currency Risk

Certain forecasted transactions, assets and liabilities are exposed to foreign currency risk. Principal currencies hedged include the Canadian dollar, Australian dollar, Euro, Mexican peso and British pound sterling. We are also exposed to foreign currency risk as a result of our new euro-denominated debt. We continually monitor our foreign currency exposures in order to maximize the overall effectiveness of our foreign currency hedge positions.

Interest Rate Risk

We may, from time to time, enter into interest rate swap agreements to manage our exposure to interest rate changes. We also may, from time to time, enter into treasury rate locks and interest rate swaps to hedge the risk associated with fluctuation in interest rates related to anticipated issuances of new long-term debt. See Note 15, Financial Instruments, to the Consolidated Financial Statement, Item 8 to this Form 10-K, for more information about the management of our interest rate risk.

Recently Issued Accounting Standards

Fair Value Measurement

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

Fair Value Option

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

Business Combinations

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007) (FAS 141R), Business Combinations. FAS 141R replaces FAS No. 141, Business Combinations. FAS 141R establishes principles and requirements for how an acquirer, a) recognizes and measures the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree, b) recognizes and measures the goodwill acquired and c) determines what information to disclose. FAS 141R also requires that all acquisition-related costs, including restructuring, be recognized separately from the acquisition. FAS 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period

beginning on or after December 15, 2008 (calendar 2009 for Fortune Brands). This Statement eliminates adjustments to goodwill for changes in deferred tax assets and uncertain tax positions after the acquisition accounting measurement period (limited to one year from acquisition), including for acquisitions prior to adoption of FAS 141R.

Noncontrolling Interests in Consolidated Financial Statements

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160 (FAS 160), Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51. FAS 160 amends Accounting Research Bulletin No. 51, establishing accounting and reporting standards for the noncontrolling interest (currently referred to as minority interest) in a subsidiary and for the deconsolidation of a subsidiary. This Statement changes the consolidated balance sheet presentation of noncontrolling interests from the mezzanine level (between liabilities and stockholders equity) to a component of stockholders equity, however because the minority interest in the Spirits business held by V&S Group is in the form of redeemable preferred stock, it will continue to be classified in the mezzanine level (between liabilities and stockholders equity). As of December 31, 2007, the carrying value of the minority interest held by V&S Group was $542.9 million and the carrying value of other minority interests/noncontrolling interests (which will be reclassified to equity upon adoption of FAS 160) was $15.6 million. FAS 160 requires expanded disclosures in the consolidated financial statements that clearly identify and distinguish between the interests of the parent s owners and the interests of the noncontrolling owners of a subsidiary. FAS 160 is effective for financial statements issued for fiscal years beginning after December 15, 2008 (calendar 2009 for Fortune Brands). This statement applies prospectively except presentation and disclosure requirements are applied retrospectively for all periods presented. FAS 160 will have an impact on the presentation of noncontrolling interests on the Fortune Brands statements of income, financial position and stockholders equity.

Critical Accounting Policies and Estimates

Our significant accounting policies are described in Note 1 of Notes to Consolidated Financial Statements. The Consolidated Financial Statements are prepared in conformity with U.S. generally accepted accounting principles. Preparation of the financial statements requires us to make judgments, estimates and assumptions that affect the amounts of assets and liabilities in the financial statements and revenues and expenses during the reporting periods. We believe the following are the Company s critical accounting policies due to the more significant, subjective and complex judgments and estimates used when preparing our consolidated financial statements. We regularly review our assumptions and estimates.

Allowances for Doubtful Accounts

Trade receivables are recorded at the stated amount, less allowances for discounts, doubtful accounts and returns. The allowances represent estimated uncollectible receivables associated with potential customer defaults on contractual obligations (usually due to customers potential insolvency), or early payment of accounts receivables by our customers. The allowances include amounts for certain customers where a risk of default has been specifically identified. In addition, the allowances include a provision for customer defaults on a general formula basis when it is determined the risk of some default is probable and estimable, but cannot yet be associated with specific customers. The assessment of the likelihood of customer defaults is based on various factors, including the length of time the receivables are past due, historical experience and existing economic conditions. In accordance with this policy, our allowance for discounts, doubtful accounts and returns for continuing operations was $53.8 million and $49.1 million as of December 31, 2007 and 2006, respectively.

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Inventories

The first-in, first-out inventory method is our principal inventory method. In accordance with generally recognized trade practice, maturing spirits inventories are classified as current assets, although the majority of these inventories ordinarily will not be sold within one year due to the duration of aging processes. Inventory provisions are recorded to reduce inventory to the lower of cost of market value for obsolete or slow moving inventory based on assumptions about future demand and marketability of products, the impact of new product introductions, inventory turns and specific identification of items, such as product discontinuance or engineering/material changes.

Long-lived Assets

In accordance with Statement of Financial Accounting Standards No. 144 (FAS 144), Accounting for the Impairment or Disposal of Long-lived Assets, a long-lived asset (including amortizable identifiable intangibles) or asset group is tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. When such events occur, the Company compares the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset or asset group to the carrying amount of a long-lived asset or asset group. The cash flows are based on our best estimate of future cash flows derived from the most recent business projections. If this comparison indicates that there is an impairment, the amount of the impairment is calculated using a quoted market price, or if unavailable, using discounted expected future cash flows.

In 2007, we recorded in restructuring expense non-cash impairments of identifiable definite-lived intangibles of $12.6 million, as well as property, plant and equipment of $37.0 million.

Goodwill and Indefinite-lived Intangibles

In accordance with Statement of Financial Accounting Standards No. 142 (FAS 142), Goodwill and Other Intangible Assets, goodwill is tested for impairment at least annually, and written down when impaired. An interim impairment test is required if an event occurs or conditions change that would more likely than not reduce the fair value of the reporting unit below the carrying value.

We evaluate the recoverability of goodwill by estimating the future discounted cash flows of the businesses to which the goodwill relates. Estimated cash flows and related goodwill are grouped at the reporting unit level. A reporting unit is an operating segment or under certain circumstances, a component of an operating segment that constitutes a business. When estimated future discounted cash flows are less than the carrying value of the net assets (tangible and identifiable intangible assets) and related goodwill, we perform an impairment test to measure and recognize the amount of the impairment loss, if any. Impairment losses, limited to the carrying value of goodwill, represent the excess of the carrying amount of a reporting unit s goodwill over the implied fair value of that goodwill. In determining the estimated future cash flows, we consider current and projected future levels of income as well as business trends, prospects and market and economic conditions.

FAS 142 requires that purchased intangible assets other than goodwill be amortized over their useful lives unless these lives are determined to be indefinite. Certain of our tradenames have been assigned an indefinite life as we currently anticipate that these tradenames will contribute cash flows to the Company indefinitely. Indefinite-lived intangible assets are not amortized, but are evaluated at each reporting period to determine whether the indefinite useful life is appropriate. We review indefinite-lived intangible assets for impairment annually, and whenever market or business events indicate there may be a potential impact on that intangible. Impairment losses are recorded to the extent that the carrying value of the indefinite-lived intangible asset exceeds its fair value. Our

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predominant method of approximating fair value in determining whether an impairment exists is to use cash flow projections. We measure impairment based on discounted expected future cash flows attributable to the tradename compared to the carrying value of that tradename. When separate cash flow information is not available, we use the relief-from-royalty approach. Fair value is represented by the present value of hypothetical royalty income over the remaining useful life. Where information is not available to determine an appropriate royalty rate, we utilize a profit split methodology, which is a customary valuation practice, to establish a reasonable royalty rate. Profit split analyses allocate economic income (EBITDA less returns on working capital and fixed assets employed) between a tradename and residual assets of the economic unit to determine the expected profit margin associated with commercialization of the tradename.

There were no write-downs of goodwill or indefinite-lived identifiable intangible assets in 2007, 2006 or 2005.

The Company cannot predict the occurrence of certain events that might adversely affect the carrying value of goodwill and indefinite-lived intangible assets. Such events may include, but are not limited to, the impact of the economic environment, particularly related to our Home and Hardware companies; a material negative change in relationships with significant customers; or strategic decisions made in response to economic and competitive conditions.

Minority Interest Held by V&S Group

V&S Group (V&S) owns a 10% minority interest in our Spirits business (BGSW). The minority interest is in the form of shares of redeemable and convertible preferred stock (The BGSW Minority Interest). The carrying value of the minority interest at December 31, 2007 was $542.9 million. V&S may require the Company to purchase the BGSW Minority Interest at fair value in whole or in part upon one year s notice, or at any time upon a change in control of BGSW, Jim Beam Brands Co., or certain other events. The Company has the right to acquire the BGSW Minority Interest at fair value in whole or in part upon a change in control of the Absolut Spirits Company, Incorporated, sale of the Absolut brand, or the dissolution of Future Brands LLC (our U.S. sales and distribution joint venture). The BGSW Minority Interest cannot be transferred or sold to a third party by V&S without the Company s consent. We account for the redemption feature in accordance with EITF Topic D-98 Classification and Measurement of Redeemable Securities, and measure this minority interest at fair value with changes in fair value reflected in income from continuing operations. BGSW is not a publicly traded entity and therefore there is no quoted market price for its common or preferred shares. At each reporting period, we estimate fair value based on a combination of market-based earnings multiples and discounted cash flow techniques. The ultimate fair value upon redemption will be based upon numerous factors that will be subject to assessment by the BGSW board or by an independent appraiser if the board is unable to reach a consensus.

Pension and Postretirement Benefit Plans

We provide a range of benefits to our employees and retired employees, including pension, postretirement, post-employment and health care benefits. We record annual amounts relating to these plans based on calculations specified by U.S. generally accepted accounting principles, which include various actuarial assumptions, including discount rates, assumed rates of return, compensation increases, turnover rates and health care cost trend rates. We review our actuarial assumptions on an annual basis and make modifications to the assumptions based on current rates and trends when it is deemed appropriate to do so. The expected return on plan assets is determined based on our historical experience, the nature of the plans investments and our expectations for long-term rates of return. The discount rate used to measure obligations is based on a spot-rate yield curve that matches projected future benefit payments with the appropriate interest rate applicable to

the timing of the projected future benefit payments. The bond portfolio used for the selection of the interest rates is from the top quartile of bonds rated by nationally recognized statistical rating organizations, and includes only non-callable bonds and those that are deemed to be sufficiently marketable with a Moody s credit rating of Aa or higher. The discount rate as of December 31, 2007 and 2006 was 6.4% and 5.9%, respectively. The weighted average remaining service period for the pension plans at December 31, 2007 was approximately 11.0 years. Compensation increases reflect expected future compensation trends. As required by U.S. generally accepted accounting principles, the effects of our modifications are generally accumulated and, if over a specified corridor, amortized over the average remaining service period of the employees. The cost or benefit of plan changes, such as increasing or decreasing benefits for prior employee service (prior service cost), is deferred and included in expense on a straight-line basis over the average remaining service period of the related employees. The total net actuarial losses for all pension and postretirement benefit plans were $177 million at December 31, 2007, a reduction of $86 million from December 31, 2006, primarily as a result of actuarial gains during 2007 ($70 million primarily due to the increase in the discount rate), as well as loss recognition in pension expense ($16 million). We believe that the assumptions utilized in recording our obligations under the Company s plans are reasonable based on our experience and advice from our independent actuaries; however, difference in actual experience or changes in the assumptions may materially affect the Company s financial position or results of operations. For postretirement benefits, our health care trend rate assumption is based on historical cost increases and expectations for long-term increases. As of December 31, 2007, for postretirement medical, our assumption was an assumed rate of increase of 7.5% in the next year, declining 75 basis points a year until reaching an ultimate assumed rate of increase of 5% per year, and, for postretirement prescription drugs, an assumed rate of increase of 10.5% in the next year, declining 75 basis points a year until reaching an ultimate assumed rate of increase of 5% per year. Our assumption as of December 31, 2006 for postretirement medical was an assumed rate of increase of 8.25% in the next year, declining 75 basis points a year until reaching an ultimate assumed rate of increase of 5% per year, and, for postretirement prescription drugs, an assumed rate of increase of 11.25% in the next year, declining 75 basis points a year until reaching an ultimate assumed rate of increase of 5% per year.

Pension expenses were $41.8 million, $43.3 million and $39.0 million, respectively, in the years ended December 31, 2007, 2006 and 2005. Postretirement expenses were $9.3 million, $16.8 million and $14.0 million, respectively, for the years ended December 31, 2007, 2006 and 2005. A 25 basis point change in our discount rate assumption would lead to an increase or decrease in our pension expense and postretirement benefit expense of approximately $4.0 million and $0.2 million, respectively, for 2008. A 25 basis point change in the long-term rate of return used in accounting for the Company s pension plans would have a $2.1 million impact on pension expense.

Income Taxes

In accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes, we establish deferred tax liabilities or assets for temporary differences between financial and tax reporting bases and subsequently adjust them to reflect changes in tax rates expected to be in effect when the temporary differences reverse. The Company records a valuation allowance reducing deferred tax assets when it is more likely than not that such assets will not be realized.

We record liabilities for uncertain income tax positions in accordance with FASB Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109. On January 1, 2007, we adopted FIN 48. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, disclosure and transition. The evaluation of a tax position in accordance with FIN 48 is

a two-step process. The first step is recognition, where we evaluate whether an individual tax position has a likelihood of greater than 50% of being sustained upon examination based on the technical merits of the position, including resolution of any related appeals or litigation processes. For tax positions that are currently estimated to have a less than 50% likelihood of being sustained, zero tax benefit is recorded. For tax positions that have met the recognition threshold in the first step, we perform the second step of measuring the benefit to be recorded. The actual benefits ultimately realized may differ from the Company s estimates. In future periods, changes in facts, circumstances, and new information may require the Company to change the recognition and measurement estimates with regard to individual tax positions. Changes in recognition and measurement estimates are recorded in results of operations and financial position in the period in which such changes occur. As of December 31, 2007, the Company has liabilities for unrecognized tax benefits pertaining to uncertain tax positions totaling $411.4 million. It is reasonably possible the unrecognized tax benefits may decrease in the range of $205 to $230 million in the next 12 months primarily as a result of the conclusion of U.S. federal, state and foreign income tax proceedings.

Customer Program Costs

Customer programs and incentives are a common practice in many of our businesses. These businesses incur customer program costs to obtain favorable product placement, to promote sell-through of that business s products and to maintain competitive pricing. Customer program costs and incentives, including rebates and promotion and volume allowances, are generally accounted for in either net sales or the category advertising, selling, general and administrative expenses at the time the program is initiated and/or the revenue is recognized. The costs recognized in net sales include, but are not limited to, general customer program-generated expenses, cooperative advertising programs, volume allowances and promotional allowances. The costs typically recognized in advertising, selling, general and administrative expenses include point of sale materials. These costs are recorded at the time of sale based on management s best estimates. Estimates are based on historical and projected experience for each type of program or customer. Management periodically reviews accruals for these rebates and allowances, and adjusts accruals, when circumstances indicate (typically as a result of a change in volume expectations).

Cost Initiatives

We continuously evaluate the productivity of our supply chains and existing asset base, and actively seek to identify opportunities to improve our cost structure. Future opportunities may involve, among other things, the reorganization of operations, the relocation of manufacturing or assembly to locations generally having lower costs and the efficient sourcing of products or components from third-party suppliers. Implementing any significant cost reduction and efficiency opportunities could result in charges.

Pending Litigation

See Note 23 to the Consolidated Financial Statements, Item 8 to this Form 10-K.

Environmental Matters

We are involved in numerous remediation activities to clean up hazardous wastes as required by federal and state laws. Liabilities for remediation costs of each site are based on our best estimate of undiscounted future costs, excluding possible insurance recoveries or recoveries from other third parties. Uncertainties about the status of laws, regulations, technology and information related to individual sites make it difficult to develop estimates of environmental remediation exposures. Some of the potential liabilities relate to sites we own, and some relate to sites we no longer own or never

owned. As of February 1, 2008, various of our subsidiaries had been designated as potentially responsible parties (PRP) under Superfund or similar state laws in 48 instances. Of these instances, 27 have been dismissed, settled or otherwise resolved. In calendar year 2007, we were identified as a PRP in four new instances. In most instances where we are named as a PRP, we enter into cost-sharing arrangements with other PRPs. We give notice to insurance carriers of potential PRP liability, but very rarely, if ever, receive reimbursement from insurance. We believe that the cost of complying with the present environmental protection laws, before considering estimated recoveries either from other responsible parties or insurance, will not have a material adverse effect upon our results of operations, cash flows or financial condition. At December 31, 2007 and 2006, we had accruals of $32.1 million and $33.1 million, respectively, to cover environmental compliance and clean up including, but not limited to, the above mentioned Superfund sites.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

Market Risk

We are exposed to various market risks, including changes in interest rates, foreign currency exchange rates and commodity prices. Market risk is the potential loss arising from adverse changes in market rates and prices, such as interest rates, foreign currency exchange rates and commodity prices. We do not enter into derivatives or other financial instruments for trading or speculative purposes. We enter into financial instruments to manage and reduce the impact of changes in interest rates, foreign currency exchange rates and commodity prices. The counterparties are major financial institutions.

Interest Rate Risk

The disclosure about interest rate risk required to be provided under this item is set forth under Item 7 Management s Discussion and Analysis Liquidity and Capital Resources Interest Rates and is incorporated herein by reference.

A hypothetical 100 basis point change in interest rates affecting the Company s variable rate borrowings would not have a material effect on results of operations.

Foreign Exchange Rate Risk

We enter into forward foreign exchange contracts principally to hedge currency fluctuations in transactions denominated in foreign currencies, thereby limiting our risk that would otherwise result from changes in exchange rates. The periods of the forward foreign exchange contracts correspond to the periods of the hedged transactions. We periodically enter into forward foreign exchange contracts to hedge a portion of our net investments in foreign subsidiaries.

As indicated in the analysis that follows, the estimated potential loss under foreign exchange contracts from movement in foreign exchange rates would not have a material impact on current results of operations or financial condition. As part of our risk management procedure, we use a value-at-risk (VAR) computation to estimate the potential economic loss that we could incur from adverse changes in foreign exchange rates. The VAR estimations are intended to measure the maximum amount of our loss from foreign exchange contracts due to adverse market movements in foreign exchange rates, given a specified confidence level, over a given period of time. The VAR model uses historical foreign exchange rates to estimate the volatility and correlation of these rates in future periods. It estimates a loss in fair market value using statistical modeling techniques. Also, the use of the VAR model should not be construed as an endorsement of the VAR model or the accuracy of the related assumptions.

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The following table summarizes our estimated loss under the VAR model as of December 31, 2007 and 2006, respectively.

(In millions)		Estimated Amount of Loss	Period	Confidence Level
2007 foreign exchange	$	1.6	1 day	95%
2006 foreign exchange	$	2.7	1 day	95%

The 95% confidence interval signifies our degree of confidence that actual losses under foreign exchange contracts would not exceed the estimated losses shown above. The amounts shown here disregard the possibility that foreign currency exchange rates could move in our favor. The VAR model assumes that all movements in the foreign exchange rates will be adverse. These amounts should not be considered projections of future losses, since actual results may differ significantly depending upon activity in the global financial markets.

The estimated fair value of foreign currency contracts represents the amount required to enter into offsetting contracts with similar remaining maturities based on quoted market prices.

Commodity Price Risk

We are subject to price volatility caused by weather, supply conditions, geopolitical and economic variables, and other unpredictable external factors. We use derivative contracts to manage our exposure to commodity price volatility. The exposures under these contracts could be material to our financial statements.

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Item 8. Financial Statements and Supplementary Data.

Consolidated Statement of Income

Fortune Brands, Inc. and Subsidiaries

(In millions, except per share amounts)	For years ended December 31 *2007*	2006	2005
NET SALES	$ 8,563.1	$ 8,521.0	$ 6,891.0
Cost of products sold	4,564.6	4,476.8	3,731.0
Excise taxes on spirits	510.9	505.6	320.3
Advertising, selling, general and administrative expenses	2,035.8	2,026.6	1,655.5
Amortization of intangibles	47.6	42.9	32.9
Restructuring charges	73.5	21.2	
Gain on the sale of The Dalmore Scotch assets	(45.6)		
OPERATING INCOME	1,376.3	1,447.9	1,151.3
Interest expense	293.6	308.8	153.6
Other (income) expense, net	(37.5)	(40.2)	78.4
Income from continuing operations before income taxes and minority interests	1,120.2	1,179.3	919.3
Income taxes	346.3	299.3	321.8
Minority interests	24.4	67.9	20.0
Income from continuing operations	$ 749.5	$ 812.1	$ 577.5
Income from discontinued operations, net of tax	13.1	18.0	43.6
NET INCOME	$ 762.6	$ 830.1	$ 621.1
EARNINGS PER COMMON SHARE			
Basic			
Continuing operations	$ 4.89	$ 5.44	$ 3.96
Discontinued operations	0.09	0.12	0.30
Net earnings	$ 4.98	$ 5.56	$ 4.26
Diluted			
Continuing operations	$ 4.79	$ 5.31	$ 3.84
Discontinued operations	0.08	0.11	0.29
Net earnings	$ 4.87	$ 5.42	$ 4.13
DIVIDENDS PAID PER COMMON SHARE	$ 1.62	$ 1.50	$ 1.38
AVERAGE NUMBER OF COMMON SHARES OUTSTANDING			
Basic	153.1	149.1	145.6
Diluted	156.5	153.0	150.5

See Notes to Consolidated Financial Statements.

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Consolidated Balance Sheet Fortune Brands, Inc. and Subsidiaries

	December 31	
(In millions, except per share amounts)	*2007*	2006
ASSETS		
Current assets		
Cash and cash equivalents	$ 203.7	$ 182.7
Accounts receivable from customers less allowances for discounts, doubtful accounts and returns (2007 $53.8 and 2006 $49.1)	924.4	935.7
Accounts receivable from related parties	177.5	194.4
Inventories		
Maturing spirits	1,152.8	1,018.8
Other raw materials, supplies and work in process	424.4	449.3
Finished products	470.4	469.7
Total inventories	2,047.6	1,937.8
Other current assets	427.7	390.2
Current assets of discontinued operations		289.3
TOTAL CURRENT ASSETS	3,780.9	3,930.1
Property, plant and equipment		
Land and improvements	176.8	160.0
Buildings and improvements to leaseholds	834.4	783.2
Machinery and equipment	2,008.8	1,904.2
Construction in progress	84.0	143.8
	3,104.0	2,991.2
Less accumulated depreciation	1,405.8	1,283.0
Property, plant and equipment, net	1,698.2	1,708.2
Goodwill resulting from business acquisitions	4,196.5	4,266.4
Other intangible assets, net of accumulated amortization (2007 $353.0 and 2006 $298.6)	3,866.7	3,772.3
Investments in unconsolidated subsidiaries	87.5	82.8
Investments in related parties	109.4	97.1
Other assets	217.7	166.1
Non-current assets of discontinued operations		645.3
TOTAL ASSETS	$ 13,956.9	$ 14,668.3

See Notes to Consolidated Financial Statements.

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Consolidated Balance Sheet

Fortune Brands, Inc. and Subsidiaries

	December 31	
(In millions, except per share amounts)	*2007*	2006
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Notes payable to banks	$ 32.5	$ 25.6
Commercial paper	198.5	762.0
Current portion of long-term debt	200.0	1.7
Accounts payable to vendors	420.3	372.1
Accounts payable to related parties	48.6	97.2
Accrued taxes	376.7	250.2
Accrued customer programs	141.4	158.1
Accrued salaries, wages and other compensation	167.5	168.5
Accrued expenses and other current liabilities	508.4	582.3
Current liabilities of discontinued operations		97.7
TOTAL CURRENT LIABILITIES	2,093.9	2,515.4
Long-term debt	3,942.7	5,034.9
Deferred income	65.2	92.2
Deferred income taxes	951.3	1,058.2
Accrued pension and postretirement benefits	301.6	362.0
Other non-current liabilities	358.2	237.2
Non-current liabilities of discontinued operations		80.7
TOTAL LIABILITIES	7,712.9	9,380.6
Minority interest in consolidated subsidiaries	558.5	559.7
Stockholders equity		
$2.67 Convertible Preferred stock	5.7	6.3
Common stock, par value $3.125 per share, 234.9 shares issued	734.0	734.0
Paid-in capital	684.3	615.7
Accumulated other comprehensive income	349.1	37.9
Retained earnings	6,999.3	6,496.3
Treasury stock, at cost	(3,086.9)	(3,162.2)
TOTAL STOCKHOLDERS EQUITY	5,685.5	4,728.0
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 13,956.9	$ 14,668.3

See Notes to Consolidated Financial Statements.

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Consolidated Statement of Cash Flows

Fortune Brands, Inc. and Subsidiaries

	For years ended December 31		
(In millions)	*2007*	2006	2005
OPERATING ACTIVITIES			
Net income	$ 762.6	$ 830.1	$ 621.1
Gain on sale of discontinued U.S. Wine operations (pre-tax)	(63.2)		
Gain on sale of The Dalmore Scotch assets (pre-tax)	(45.6)		
Restructuring non-cash impairment charges	49.6	15.0	
Depreciation and amortization	280.4	254.7	224.4
Stock-based compensation	27.9	37.0	
Deferred taxes	(140.2)	(9.9)	6.0
Deferred income	(27.0)	(27.0)	(27.1)
Currency hedge expense related to the 2005 Spirits Acquisition purchase price			120.9
Changes in assets and liabilities including effects subsequent to acquisitions:			
Decrease (increase) in accounts receivable	36.1	183.6	(16.7)
Increase in inventories	(4.7)	(214.1)	(79.3)
(Increase) decrease in other assets	(1.4)	9.1	(11.0)
(Decrease) increase in accounts payable	(6.2)	(197.7)	28.6
Increase (decrease) in accrued taxes	189.2	(132.6)	(49.0)
(Increase) decrease in accrued expenses and other liabilities	(91.7)	267.8	(40.9)
Tax benefit on the exercise of stock options			26.0
Other operating activities, net	(0.5)	(33.3)	(0.3)
NET CASH PROVIDED BY OPERATING ACTIVITIES	965.3	982.7	802.7
INVESTING ACTIVITIES			
Capital expenditures	(267.1)	(266.0)	(221.9)
Proceeds from the disposition of assets	69.3	84.6	6.3
Proceeds from the sale of U.S. Wine business	948.3		
Acquisitions, net of cash acquired	(6.3)	(580.9)	(4,936.0)
Currency hedge expense related to the 2005 Spirits Acquisition purchase price			(120.9)
Dividend from the spin-off of ACCO World Corporation			613.3
Other investing activities, net			(5.0)
NET CASH PROVIDED (USED) BY INVESTING ACTIVITIES	744.2	(762.3)	(4,664.2)
FINANCING ACTIVITIES			
(Decrease) increase in short-term debt and commercial paper, net	(1,559.1)	(2,938.7)	3,918.0
Issuance of long-term debt	1.0	2,939.9	
Repayment of long-term debt	(4.7)	(148.9)	(0.4)
Dividends to stockholders	(248.6)	(224.0)	(201.6)
Cash purchases of common stock for treasury		(0.9)	
Proceeds received from exercise of stock options	80.8	62.1	72.1
Tax benefit on exercise of stock options	22.8	10.8	
Proceeds from the sale of subsidiary preferred stock		153.0	
Other financing activities, net	(5.2)	1.2	(4.4)
NET CASH (USED) PROVIDED BY FINANCING ACTIVITIES	(1,713.0)	(145.5)	3,783.7
Effect of foreign exchange rate changes on cash	24.5	14.2	6.5
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	$ 21.0	$ 89.1	$ (71.3)
Cash and cash equivalents at beginning of year	$ 182.7	$ 93.6	$ 164.9
Cash and cash equivalents at end of year	203.7	182.7	93.6
Cash paid during the year for (including discontinued operations)			
Interest	$ 307.4	$ 243.8	$ 172.5
Income taxes	313.3	353.7	313.5

See Notes to Consolidated Financial Statements.

Consolidated Statement of Stockholders Equity Fortune Brands, Inc. and Subsidiaries

(In millions except per share amounts)	$2.67 Convertible Preferred Stock	Common Stock	Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Treasury Stock, At Cost	Total
Balance at December 31, 2004	$ 7.1	$ 717.4	$ 155.8	$6.4	$ 5,447.2	$ (3,203.2)	$ 3,130.7
Comprehensive income							
Net income					621.1		621.1
Foreign exchange adjustments, net of effect of hedging activities				1.7			1.7
Minimum pension liability adjustments				(30.3)			(30.3)
Total comprehensive income				(28.6)	621.1		592.5
Dividends ($1.38 per Common share and $2.67 per Preferred share)					(201.6)		(201.6)
Tax benefit on exercise of stock options			26.0				26.0
Conversion of preferred stock (<0.1 shares) and delivery of stock plan shares (1.9 shares)	(0.5)		1.0			74.0	74.5
Spin-off of ACCO World Corporation					23.5		23.5
Balance at December 31, 2005	$ 6.6	$ 717.4	$ 182.8	$(22.2)	$ 5,890.2	$ (3,129.2)	$ 3,645.6
Comprehensive income							
Net income					830.1		830.1
Foreign exchange adjustments, net of effect of hedging activities				153.3			153.3
Minimum pension liability adjustments				26.7			26.7
Total comprehensive income				180.0	830.1		1,010.1
Dividends ($1.50 per Common share and $2.67 per Preferred share)					(224.0)		(224.0)
Stock issued for SBR acquisition		16.6	372.8			(91.5)	297.9
Stock-based compensation			45.0			56.0	101.0
Tax benefit on exercise of stock options			17.3				17.3
Conversion of preferred stock (0.1 shares)	(0.3)		(2.2)			2.5	
Adjustment to initially apply FASB Statement no. 158, net of tax				(119.9)			(119.9)
Balance at December 31, 2006	$ 6.3	$ 734.0	$ 615.7	$37.9	$ 6,496.3	$ (3,162.2)	$ 4,728.0
Comprehensive income							
Net income					762.6		762.6
Foreign exchange adjustments, net of effect of hedging activities				258.1			258.1
Pension and postretirement benefit adjustments, net of tax				53.1			53.1
Total comprehensive income				311.2	762.6		1,073.8
Adjustment to initially apply FASB Interpretation No. 48					(3.6)		(3.6)
Dividends ($1.62 per Common share and $2.67 per Preferred share)					(248.6)		(248.6)
Stock-based compensation			46.5		(7.4)	70.8	109.9
Tax benefit on exercise of stock options			26.0				26.0
Conversion of preferred stock (0.1 shares)	(0.6)		(3.9)			4.5	
Balance at December 31, 2007	$ 5.7	$ 734.0	$ 684.3	$349.1	$ 6,999.3	$ (3,086.9)	$ 5,685.5

See Notes to Consolidated Financial Statements.

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Notes to Consolidated Financial Statements Fortune Brands, Inc. and Subsidiaries

1. Significant Accounting Policies

Basis of Presentation The consolidated financial statements include the accounts of Fortune Brands, Inc. (after elimination of intercompany transactions), majority-owned subsidiaries and a subsidiary, Acushnet Lionscore Limited, in which it holds a minority interest but has substantive control as a result of the Company having operational decision-making powers over the entity. In addition, we consolidate variable interest entities (VIEs) where we are deemed to be the primary beneficiary. Refer to Note 4 Acquisitions and Disposals, for a discussion of VIEs. Certain of the Company s subsidiaries operate on a 52 or 53-week fiscal year.

In accordance with Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, the results of operations related to the 2007 sale of the U.S. Wine business and 2005 spin-off of ACCO World Corporation were reclassified and separately stated as discontinued operations in the accompanying consolidated statements of income for the years ended December 31, 2007, 2006 and 2005. The cash flows from discontinued operations for the years ending December 31, 2007, 2006 and 2005 were not separately classified on the accompanying consolidated statements of cash flows.

The presentation of financial statements in accordance with U.S. generally accepted accounting principles requires us to make estimates and assumptions that affect reported amounts and related disclosures. Actual results in future periods could differ from those estimates.

Cash and Cash Equivalents Highly liquid investments with an original maturity of three months or less are included in cash and cash equivalents.

Allowances for Doubtful Accounts Trade receivables are recorded at the stated amount, less allowances for discounts, doubtful accounts and returns. The allowances represent estimated uncollectible receivables associated with potential customer defaults on contractual obligations (usually due to customers potential insolvency), or early payment of accounts receivables by our customers. The allowances include amounts for certain customers where a risk of default has been specifically identified. In addition, the allowances include a provision for customer defaults on a general formula basis when it is determined the risk of some default is probable and estimable, but cannot yet be associated with specific customers. The assessment of the likelihood of customer defaults is based on various factors, including the length of time the receivables are past due, historical experience and existing economic conditions. In accordance with this policy, our allowance for discounts, doubtful accounts and returns for continuing operations was $53.8 million and $49.1 million as of December 31, 2007 and 2006, respectively.

Inventories The first-in, first-out (FIFO) inventory method is our principal inventory method across all segments. In accordance with generally recognized trade practice, maturing spirits inventories are classified as current assets, although the majority of these inventories ordinarily will not be sold within one year, due to the duration of aging processes. Inventory provisions are recorded to reduce inventory to the lower of cost or market value for obsolete or slow moving inventory based on assumptions about future demand and marketability of products, the impact of new product introductions, inventory turns and specific identification of items, such as product discontinuance or engineering/material changes.

In our Home and Hardware segment, we use the last-in, first-out (LIFO) inventory method in those product groups in which metals inventories comprise a significant portion of our inventories. LIFO inventories at December 31, 2007 and 2006 were $166.2 million (with a current cost of $187.9 million)

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Notes to Consolidated Financial Statements Fortune Brands, Inc. and Subsidiaries
1. Significant Accounting Policies (Continued)

of the total inventories of $2,047.6 million and $177.6 million (with a current cost of $199.1 million) of the total inventories of $1,937.8 million, respectively.

A minor amount of similar types of inventory within the Home and Hardware business is accounted for utilizing either FIFO and average cost based on the method in place at the time of acquisition. The impact on our statement of income and balance sheet of accounting for the inventories using the average cost method versus the FIFO inventory method is inconsequential.

Property, Plant and Equipment Property, plant and equipment are carried at cost. Depreciation is provided, principally on a straight-line basis, over the estimated useful lives of the assets. Gains or losses resulting from dispositions are included in operating income. Betterments and renewals, which improve and extend the life of an asset, are capitalized; maintenance and repair costs are expensed as incurred. Estimated useful lives of the related assets are as follows:

Buildings and leasehold improvements	15 to 40 years
Machinery and equipment	3 to 10 years
Software	3 to 7 years

Long-lived Assets In accordance with Statement of Financial Accounting Standards No. 144 (FAS 144), Accounting for the Impairment or Disposal of Long-lived Assets, a long-lived asset (including amortizable identifiable intangible assets) or asset group is tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. When such events occur, we compare the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset or asset group to the carrying amount of a long-lived asset or asset group. The cash flows are based on our best estimate of future cash flows derived from the most recent business projections. If this comparison indicates that there is an impairment, the amount of the impairment is calculated using a quoted market price, or if unavailable, using discounted expected future cash flows. In 2007, we recorded in restructuring expense non-cash impairments of definite-lived identifiable intangible assets of $12.6 million, as well as property, plant and equipment of $37.0 million.

Goodwill and Indefinite-lived Intangibles In accordance with Statement of Financial Accounting Standards No. 142 (FAS 142), Goodwill and Other Intangible Assets, goodwill is tested for impairment at least annually, and written down when impaired. An interim impairment test is required if an event occurs or conditions change that would more likely than not reduce the fair value of the reporting unit below the carrying value.

We evaluate the recoverability of goodwill by estimating the future discounted cash flows of the businesses to which the goodwill relates. Estimated cash flows and related goodwill are grouped at the reporting unit level. A reporting unit is an operating segment or under certain circumstances, a component of an operating segment that constitutes a business. When estimated future discounted cash flows are less than the carrying value of the net assets (tangible and identifiable intangible assets) and related goodwill, we perform an impairment test to measure and recognize the amount of the impairment loss, if any. Impairment losses, limited to the carrying value of goodwill, represent the excess of the carrying amount of a reporting unit s goodwill over the implied fair value of that goodwill. In determining the estimated future cash flows, we consider current and projected future levels of income based on management s plans for that business, as well as business trends, prospects and market and economic conditions.

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Notes to Consolidated Financial Statements Fortune Brands, Inc. and Subsidiaries
1. Significant Accounting Policies (Continued)

FAS 142 requires purchased intangible assets other than goodwill to be amortized over their useful lives unless these lives are determined to be indefinite. Certain of our tradenames have been assigned an indefinite life as we currently anticipate that these tradenames will contribute cash flows to the Company indefinitely. Indefinite-lived intangible assets are not amortized, but are evaluated at each reporting period to determine whether the indefinite useful life is appropriate. We review indefinite-lived intangibles for impairment annually, and whenever market or business events indicate there may be a potential impact on that intangible. Impairment losses are recorded to the extent that the carrying value of the indefinite-lived intangible assets exceeds its fair value. Our predominant method of approximating fair value in determining whether an impairment exists is to use cash flow projections. We measure impairment based on discounted expected future cash flows attributable to the tradename compared to the carrying value of that tradename. When separate cash flow information is not available, we use the relief-from-royalty approach. Fair value is represented by the present value of hypothetical royalty income over the remaining useful life. Where information is not available to determine an appropriate royalty rate, we utilize a profit split methodology, which is a customary valuation practice, to establish a reasonable royalty rate. Profit split analyses allocate economic income (EBITDA less returns on working capital and fixed assets employed) between a tradename and residual assets of the economic unit to determine of the expected profit margin associated with commercialization of the tradename.

There were no write-downs of goodwill or indefinite-lived identifiable intangible assets in 2007, 2006 or 2005.

The Company cannot predict the occurrence of certain events that might adversely affect the carrying value of goodwill and other intangible assets. Such events may include, but are not limited to, the impact of the economic environment, particularly related to our Home and Hardware companies; a material negative change in relationships with significant customers; or strategic decisions made in response to economic and competitive conditions.

Investments The Company makes investments that include long-term investments and/or joint ventures that either complement or expand our existing businesses. In accordance with Accounting Principles Bulletin No. 18, The Equity Method of Accounting for Investments in Common Stock, the equity method of accounting is used to account for investments in which the Company has the ability to exercise significant influence over the operating and financial policies of the investee. The equity method requires impairment losses to be recognized for other than temporary losses of investment value below carrying value.

Warranty Reserves We offer customers various warranty terms based upon the type of product that is sold. We determine warranty expense in accordance with the policy established at each operating company. The main consideration is historic claim experience, which is company-specific based upon the nature of the product category. Warranty expense is generally recorded in cost of products sold at the time of sale. Refer to Note 17, Product Warranties.

Pension and Postretirement Benefit Plans We provide a range of benefits to employees and retired employees, including pension, postretirement, post-employment and health care benefits. We record amounts relating to these plans based on calculations specified by U.S. generally accepted accounting principles, which include various actuarial assumptions, including discount rates, assumed rates of return, compensation increases, turnover rates and health care cost trend rates. We review our actuarial assumptions on an annual basis and make modifications to the

assumptions based on current rates and trends when it is deemed appropriate to do so. The discount rate used to measure obligations is based on a spot-rate yield curve that matches projected future benefit payments with the appropriate interest rate applicable to the timing of the projected future benefit payments. The expected rate of return on plan assets is determined based on historical experience, the nature of the plans investments and our expectations for long-term rates of return. Compensation increases reflect expected future compensation trends. For postretirement benefits, our health care trend rate assumption is based on historical cost increases and expectations for long-term increases. As required by U.S. generally accepted accounting principles, the effects of the modifications are generally accumulated and, if over a specified corridor, amortized over the remaining service period of the employees. The cost or benefit of plan changes, such as increasing or decreasing benefits for prior employee service (prior service cost), is deferred and included in expense on a straight-line basis over the average remaining service period of the related employees. We believe that the assumptions utilized in recording obligations under the Company s plans, which are presented in Note 12, Pension and Other Retiree Benefits, are reasonable based on experience and on advice from our independent actuaries; however, difference in actual experience or changes in the assumptions may materially affect the Company s financial position or results of operations. We will continue to monitor these assumptions as market conditions warrant.

Environmental The Company is subject to laws and regulations relating to the protection of the environment. The Company provides for expenses associated with environmental remediation obligations when such amounts are probable and can be reasonably estimated. We adjust accruals as new information develops or circumstances change, and accruals are not discounted. At December 31, 2007 and 2006, environmental accruals amounted to $32.1 million and $33.1 million, respectively, and are included in non-current liabilities on the balance sheet. In our opinion, compliance with current environmental protection laws (before taking into account estimated recoveries from third parties, including insurers) will not have a material adverse effect upon our results of operations, cash flows or financial condition.

Income Taxes In accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes, we establish deferred tax liabilities or assets for temporary differences between financial and tax reporting bases and subsequently adjust them to reflect changes in tax rates expected to be in effect when the temporary differences reverse. The Company records a valuation allowance reducing deferred tax assets when it is more likely than not that such assets will not be realized.

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

and new information may require the Company to change the recognition and measurement estimates with regard to individual tax positions. Changes in recognition and measurement estimates are recorded in results of operations and financial position in the period in which such changes occur. As of December 31, 2007, the Company has liabilities for unrecognized tax benefits pertaining to uncertain tax positions totaling $411.4 million. It is reasonably possible the unrecognized tax benefits may decrease in the range of $205 to $230 million in the next 12 months primarily as a result of the conclusion of U.S. federal, state and foreign income tax proceedings.

We do not provide deferred income taxes on undistributed earnings of foreign subsidiaries that we expect to permanently reinvest or on foreign subsidiary earnings that will be remitted without incremental taxes. The undistributed earnings of foreign subsidiaries that are considered aggregated $778.7 million at December 31, 2007.

Revenue Recognition We recognize revenue either upon shipment or upon delivery based on contractual terms. Criteria for recognition of revenue, in accordance with Staff Accounting Bulletin No. 104, Revenue Recognition, are when title and risk of loss have passed to the customer, persuasive evidence that an arrangement exists, delivery has occurred, the price is fixed or determinable and collectibility is reasonably assured. Revenue is recorded net of applicable provisions for discounts, returns and allowances. We record estimates for doubtful accounts receivable resulting from the inability of customers to make payment. We record estimates for reductions to revenue for customer programs and incentives, including price discounts, volume-based incentives, promotions and advertising allowances, and cooperative advertising. Sales returns are based on historical returns, current trends and forecasts of product demand.

Amounts billed for shipping and handling are classified in net sales in the consolidated income statement. Costs incurred for shipping and handling are classified in advertising, selling, general and administrative expenses. Shipping and handling costs included in advertising, selling, general and administrative expenses were $224.7 million, $257.3 million and $219.4 million for 2007, 2006 and 2005, respectively.

Customer Program Costs Customer programs and incentives are a common practice in many of our businesses. These businesses incur customer program costs to obtain favorable product placement, to promote sell-through of that business s products and to maintain competitive pricing. Customer program costs and incentives, including rebates and promotion and volume allowances, are generally accounted for in either net sales or the category advertising, selling, general and administrative expenses. The costs recognized in net sales include, but are not limited to, general customer program-generated expenses, cooperative advertising programs, volume allowances and promotional allowances. The costs typically recognized in advertising, selling, general and administrative expenses include point of sale materials and shared media. These costs are recorded at the latter of the time of sale or the implementation of the program based on management s best estimates. Estimates are based on historical and projected experience for each type of program or customer. Volume allowances are accrued based on management s estimates of customer volume achievement and other factors incorporated into customer agreements, such as new product purchases, store sell-through, merchandising support, level of returns and customer training. Management periodically reviews accruals for these rebates and allowances, and adjusts accruals, when circumstances indicate (typically as a result of a change in volume expectations).

Advertising Costs Advertising costs, which amounted to $700.1 million, $703.9 million and $480.7 million for 2007, 2006 and 2005, respectively, are principally expensed as incurred.

Notes to Consolidated Financial Statements Fortune Brands, Inc. and Subsidiaries

1. Significant Accounting Policies (Continued)

Advertising costs include media costs, point of sale materials, cooperative advertising and product endorsements. Advertising costs recorded as a reduction to net sales, primarily cooperative advertising, were $57.0 million, $53.9 million and $53.5 million for 2007, 2006 and 2005, respectively. Advertising costs recorded in advertising, selling, general and administrative expenses were $643.1 million, $650.0 million and $427.2 million for 2007, 2006 and 2005, respectively.

Research and Development Research and development expenses include product development, product improvement, product engineering and process improvement costs. Research and development expenses, which were $80.7 million, $72.7 million and $65.9 million in 2007, 2006 and 2005, respectively, are expensed as incurred.

Stock-based Compensation On January 1, 2006, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (FAS 123R), supplemented by Securities and Exchange Commission Staff Accounting Bulletin No. 107, Share-Based Payment. We used the modified prospective transition method as defined in FAS 123R, which requires compensation cost to be recorded for all unvested stock options over the remaining service period beginning January 1, 2006. Subsequent to adoption of FAS 123R, we recognized share-based compensation expense, measured as the fair value of an award on the date of grant, in the financial statements over the period that an employee provides service in exchange for the award. The fair value of each option award is estimated on the date of grant using the Black-Scholes option-pricing model. Prior to 2006, we elected to apply Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees and related interpretations in accounting for our stock plans as allowed under Financial Accounting Standards No. 148 (FAS 148), Accounting for Stock-Based Compensation Transition and Disclosure. Prior to adoption of FAS 123R, we applied the nominal vesting period approach, recognizing pro forma compensation cost over the three-year vesting period, including for awards held by individuals who are eligible for the retirement provisions under the applicable plan. When we adopted FAS 123R on January 1, 2006, we changed the approach to recognize expense for retirement eligible employees over a twelve-month period (since retiree options vest in their entirety if held at least one year before retirement) or the period until retirement eligible, if longer. The impact of the change on pro forma net income and diluted earnings per share for the year ended December 31, 2005 would not have been material.

Foreign Currency Translation Foreign currency balance sheet accounts are translated into U.S. dollars at the actual rates of exchange at the balance sheet date. Income and expenses are translated at the average rates of exchange in effect during the period. The related translation adjustments are made directly to a separate component of the Accumulated other comprehensive income (loss) caption in stockholders equity. Transactions denominated in a currency other than the functional currency of a subsidiary are translated into functional currency with resulting transaction gains or losses recorded in other income/expense.

Derivative Financial Instruments In accordance with Financial Accounting Standards Statement No. 133 (FAS 133), Accounting for Derivative Instruments and Hedging Activities and its related amendment Financial Accounting Standards Statement No. 138 (FAS 138), Accounting for Certain Derivative Instruments and Certain Hedging Activities, all derivatives are recognized as either assets or liabilities on the balance sheet and measurement of those instruments is at fair value. If the derivative is designated as a fair value hedge and is effective, the changes in the fair value of the derivative and of the hedged item attributable to the hedged risk are recognized in earnings in the same period. If the derivative is designated as a cash flow hedge, the effective portions of changes in

the fair value of the derivative are recorded in other comprehensive income (OCI) and are recognized in the statement of income when the hedged item affects earnings. Ineffective portions of changes in the fair value of cash flow hedges are recognized in earnings.

In connection with the 2005 Spirits Acquisition purchase price which was paid in British pounds sterling, we entered into call options to hedge the currency exposure related to the purchase price. We terminated the call options in early July 2005. We also entered into forward contracts to buy British pounds to hedge the currency exposure related to the purchase price. We settled the forward contracts upon consummation of the acquisition in July 2005. In connection with the acquisition, we also entered into treasury rate locks and interest rate swaps to hedge the risk associated with fluctuation in interest rates related to anticipated issuance of new long-term debt to finance the acquisition. We terminated these locks and swaps upon issuance of new long-term debt in January 2006. For additional information, see Note 15, Financial Instruments.

Derivative gains or losses included in OCI are reclassified into earnings at the time the forecasted revenue or expense is recognized. During the year ended December 31, 2007, $15.4 million in deferred currency losses were reclassified to cost of products sold. During the year ended December 31, 2006, $1.9 million in deferred currency gains were reclassified to cost of products sold. We estimate that $3.4 million of currency derivative losses included in OCI as of December 31, 2007 will be reclassified to earnings within the next twelve months.

Recently Issued Accounting Standards

Fair Value Measurement

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

Fair Value Option

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

Business Combinations

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007) (FAS 141R), Business Combinations. FAS 141R replaces FAS No. 141, Business Combinations. FAS 141R establishes principles and requirements for how an acquirer, a) recognizes and measures the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree, b) recognizes and measures the goodwill acquired and c) determines what information to

Notes to Consolidated Financial Statements Fortune Brands, Inc. and Subsidiaries
1. Significant Accounting Policies (Continued)

disclose. FAS 141R also requires that all acquisition-related costs, including restructuring, be recognized separately from the acquisition. FAS 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008 (calendar 2009 for Fortune Brands). This Statement eliminates adjustments to goodwill for changes in deferred tax assets and uncertain tax positions after the acquisition accounting measurement period (limited to one year from acquisition), including for acquisitions prior to adoption of FAS 141R.

Noncontrolling Interests in Consolidated Financial Statements

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160 (FAS 160), Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51. FAS 160 amends Accounting Research Bulletin No. 51, establishing accounting and reporting standards for the noncontrolling interest (currently referred to as minority interest) in a subsidiary and for the deconsolidation of a subsidiary. This Statement changes the consolidated balance sheet presentation of noncontrolling interests from the mezzanine level (between liabilities and stockholders equity) to a component of stockholders equity, however because the minority interest in the Spirits business held by V&S Group is in the form of redeemable preferred stock, it will continue to be classified in the mezzanine level (between liabilities and stockholders equity). As of December 31, 2007, the carrying value of the minority interest held by V&S Group was $542.9 million and the carrying value of other minority interests/noncontrolling interests (which will be reclassified to equity upon adoption of FAS 160) was $15.6 million. FAS 160 requires expanded disclosures in the consolidated financial statements that clearly identify and distinguish between the interests of the parent s owners and the interests of the noncontrolling owners of a subsidiary. FAS 160 is effective for financial statements issued for fiscal years beginning after December 15, 2008 (calendar 2009 for Fortune Brands). This statement applies prospectively except presentation and disclosure requirements are applied retrospectively for all periods presented. FAS 160 will have an impact on the presentation of noncontrolling interests on the Fortune Brands statements of income, financial position and stockholders equity.

2. Goodwill and Other Identifiable Intangibles

We had net goodwill of $4,196.5 million as of December 31, 2007. The decrease in goodwill during the twelve months ended December 31, 2007 of $69.9 million from $4,266.4 million as of December 31, 2006 was primarily due to acquisition-related adjustments related to the purchase of spirits and wine brands as well as certain distribution assets (the 2005 Spirits Acquisition), principally related to income taxes, partly offset by foreign currency translation adjustments and the finalization in 2007 of purchase accounting adjustments for the acquisition of SBR, Inc. Refer to Note 4, Acquisitions and Disposals.

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

(In millions)	Balance at December 31, 2005	Acquisitions and Translation Adjustments	Balance at December 31, 2006	Acquisitions and Translation Adjustments	Balance at December 31, 2007
Spirits	$ 1,809.9	$ 527.0	$ 2,336.9	$ (72.3)	$ 2,264.6
Home and Hardware	1,732.7	185.0	1,917.7	2.4	1,920.1
Golf	11.8		11.8		11.8
Total goodwill, net	$ 3,554.4	$ 712.0	$ 4,266.4	$ (69.9)	$ 4,196.5

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Notes to Consolidated Financial Statements Fortune Brands, Inc. and Subsidiaries

2. Goodwill and Other Identifiable Intangibles (Continued)

We also had indefinite-lived intangible assets, principally tradenames, of $3,136.1 million as of December 31, 2007 compared to $3,029.7 million as of December 31, 2006. The increase of $106.4 million was primarily due to changes in foreign currency rates.

Amortizable identifiable intangible assets, principally tradenames and customer relationships, are subject to amortization over their estimated useful life, 5 to 30 years, based on the assessment of a number of factors that may impact useful life. These factors include historical and tradename performance with respect to consumer name recognition, geographic market presence, market share, plans for ongoing tradename support and promotion, financial results and other relevant factors. The gross carrying value and accumulated amortization of amortizable intangible assets were $1,011.6 million and $281.0 million, respectively, as of December 31, 2007, compared to $969.2 million and $226.6 million, respectively, as of December 31, 2006. The gross carrying value increase of $42.4 million was principally due to the acquisition of a license for certain golf patents and changes in foreign currency rates, partially offset by 2007 amortization and $12.6 million in impairment charges associated with restructuring programs in the Home and Hardware business.

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

	As of December 31, 2007			As of December 31, 2006		
	Gross Carrying	Accumulated	Net Book	Gross Carrying	Accumulated	Net Book
(In millions)	Amounts	Amortization	Value	Amounts	Amortization	Value
Indefinite-lived intangible assets tradenames	$ 3,208.1	$ (72.0)[(a)]	$ 3,136.1	$ 3,101.7	$ (72.0)[(a)]	$ 3,029.7
Amortizable intangible assets						
Tradenames	485.6	(148.4)	337.2	474.7	(133.5)	341.2
Customer and contractual relationships	399.1	(103.6)	295.5	397.3	(71.9)	325.4
Patents/proprietary technology	81.6	(22.8)	58.8	81.9	(16.6)	65.3
Licenses and other	45.3	(6.2)	39.1	15.3	(4.6)	10.7
Total	1,011.6	(281.0)	730.6	969.2	(226.6)	742.6
Total identifiable intangibles	$ 4,219.7	$ (353.0)	$ 3,866.7	$ 4,070.9	$ (298.6)	$ 3,772.3

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

Intangible amortization was $47.6 million, $42.9 million and $32.9 million for the years ended December 31, 2007, 2006 and 2005, respectively. The increase in amortization for the twelve months ended December 31, 2007 compared to December 31, 2006 was primarily due to amortization associated with the Simonton acquisition ($4.6 million). The Company expects to record intangible amortization ranging from approximately $45 million to $50 million for each of the next five fiscal years ending December 31, 2008 through December 31, 2012.

We performed our annual impairment test as of December 31 of each fiscal year. For 2007, 2006 and 2005, no impairment of goodwill or indefinite-lived intangible assets was recognized as a result of these tests.

Notes to Consolidated Financial Statements Fortune Brands, Inc. and Subsidiaries

2. Goodwill and Other Identifiable Intangibles (Continued)

In 2007, we recorded in restructuring expense non-cash impairments of identifiable intangibles of $12.6 million. These impairment charges were associated with the planned exit from the entry door market in the United Kingdom and decorative column product lines in the U.S.

The Company cannot predict the occurrence of certain events that might adversely affect the carrying value of goodwill and other intangible assets. Such events may include, but are not limited to, the impact of the economic environment, particularly related to the U.S. home products industry; a material negative change in relationships with significant customers; or strategic decisions made in response to economic and competitive conditions.

3. Discontinued Operations

In the third quarter of 2007, we sold the William Hill and Canyon Road wine brands and related assets to E. & J. Gallo Winery. In December 2007, we sold the remaining U.S. wine assets to Constellation Brands, Inc. (Constellation Brands) for $884.5 million, subject to purchase price adjustments for cash and working capital levels. The sale to Constellation Brands, Inc. resulted in an after tax gain of $5.2 million.

On August 16, 2005, the Company completed the spin-off of the Office business segment, ACCO World Corporation (ACCO), to the Company s shareholders, and ACCO merged with General Binding Corporation, creating ACCO Brands Corporation, a leading supplier of branded office products.

The statements of income for the twelve months ended December 31, 2007, 2006 and 2005 were adjusted to reflect our U.S. Wine and Office businesses as discontinued operations. The results of these discontinued operations include expenses that were paid by Fortune Brands on behalf of ACCO based on actual direct costs incurred. Interest expense associated with the outstanding debt of Fortune Brands was allocated to each of the discontinued operations assuming the discontinued operations had a debt to equity ratio consistent with the debt to equity ratio of Fortune Brands in accordance with the provisions of EITF 87-24, Allocation of Interest to Discontinued Operations.

The following table summarizes the results of the discontinued operations for the years ended December 31, 2007, 2006, and 2005.

	For the Year ended December 31,		
(In millions)	*2007*	2006	2005
Net sales	$ 239.2	$ 248.0	$ 934.0
Income from discontinued operations before income taxes	$ 84.7	$ 29.8	$ 72.6
Income taxes	71.6	11.8	29.0
Income from discontinued operations, net of income taxes[a]	$ 13.1	$ 18.0	$ 43.6

[a] Income from discontinued operations includes an after tax gain on the sale of the U.S. Wine assets to Constellation Brands in 2007 of $5.2 million.

The effective income tax rate in 2007 was higher than in 2006 due to taxes associated with the gain on the sale of the U.S. Wine business.

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4. Acquisitions and Disposals

Acquisition of Simonton

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

Acquisition of Spirits Brands and Assets

In July 2005, the Company purchased more than 25 spirits and wine brands as well as certain distribution assets (the 2005 Spirits Acquisition) 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 (sold December 2007), leading regional and national brands, and distribution networks in the U.K., Germany and Spain.

In July 2005, an affiliate of the Company received tracker shares issued by Goal Acquisitions Limited (Goal), the Pernod Ricard subsidiary formed to acquire Allied Domecq PLC (Allied Domecq). The tracker shares gave the Company certain economic rights with respect to the 2005 Spirits Acquisition prior to the actual legal transfer to the Company. The Company also had certain rights to manage the operations of the 2005 Spirits Acquisition that had not yet been legally transferred to the Company. As of January 26, 2006, substantially all of the 2005 Spirits Acquisition assets were legally transferred to Fortune Brands.

The acquisition was structured this way as a result of our negotiations with Pernod Ricard, after considering various factors, including 1) our commercial desire to obtain the economic benefits associated with owning and operating the 2005 Spirits Acquisition as soon as possible after funding the purchase price for those assets; 2) assets being transferred from Pernod Ricard were commingled or shared assets involving significant reorganization of business operations; and 3) the actual legal transfer of all the 2005 Spirits Acquisition assets required that we evaluate alternative ways to separate the 2005 Spirits Acquisition from those to be retained by Pernod Ricard, obtain required consents, and structure, negotiate, document and complete the transfer of the 2005 Spirits Acquisition assets.

At the time the net assets of any particular 2005 Spirits Acquisition assets were actually transferred to the Company, the number of Goal tracker shares held by the Company was reduced in proportion to the value ascribed to the net assets transferred, using a methodology prescribed by the Company s agreement with Pernod Ricard. Our agreement with Pernod Ricard provided that the net assets of the 2005 Spirits Acquisition assets would be legally transferred to one or more subsidiaries of Fortune Brands over a six month period that began on July 26, 2005. As of December 31, 2005, the net assets of Courvoisier and Maker s Mark, as well as certain California wine assets, had been transferred. As of January 27, 2006, substantially all of the acquired net assets had been legally transferred to Fortune Brands.

4. Acquisitions and Disposals (Continued)

The total recorded investment for the 2005 Spirits Acquisition, which included the initial payment, the purchase of Larios, supplemental brands purchased, purchase price adjustments and other settlements, as well as transactions costs, was approximately $5.25 billion.

The purchase price of the assets formerly owned by Allied Domecq was subject to change based on adjustments in accordance with the purchase agreement. The final purchase price was based on specified multiples of historic profit (for the Allied Domecq fiscal year ended August 31, 2004) of the brands purchased, as well as working capital levels as of July 26, 2005 and other adjustments. The Company s agreement with Pernod Ricard provided for an assessment by Pernod Ricard of historic profitability of the brands the Company purchased, with a subsequent review by the Company of the historic profits, and a binding determination by a third party if the Company and Pernod Ricard could not agree. We reached an agreement with Pernod Ricard on May 19, 2006 to adjust the global consideration for the 2005 Spirits Acquisition as a result of higher actual historical profits than anticipated, working capital adjustments and additional adjustments to achieve economic results consistent with the parties intention to complete the Company s acquisition of the 2005 Spirits Acquisition on a cash-free and debt-free basis. The net payment was £134.3 million (approximately $252 million).

Until assets were legally transferred, reporting was in accordance with Financial Accounting Standards Board Interpretation No. 46(R), Consolidation of Variable Interest Entities (FIN 46R). Since many of the Allied Domecq assets to be acquired by Fortune Brands were commingled in entities that owned assets also acquired by Pernod Ricard, in accordance with FIN 46R, our interest in the Goal subsidiaries was deemed to be a variable interest in those entities only if the fair value of the specified assets was more than half of the total fair value of the entity s assets. Those variable interest entities for which we were the primary beneficiary, bearing the obligation to absorb the majority of the expected losses and the right to receive the majority of the expected residual returns, were consolidated and accounted for in accordance with FIN 46R and FAS 141. We recognized minority interest for any Pernod Ricard assets at fair value. Once the Pernod Ricard assets were legally transferred, we ceased recognizing the minority interest.

If the fair value of the assets acquired by Fortune Brands was less than 50% of the fair value of the entity and we were not the primary beneficiary, we accounted for the investment using the cost method. In addition, since the tracker shares gave the Company ownership rights for the income/losses generated by the Fortune Brands assets from the date of acquisition through the legal transfer of assets, we recorded income in the amount of $57.3 million for these unconsolidated subsidiaries for the period July 26, 2005 through December 31, 2005. Once the Fortune Brands assets were legally transferred, the cost investments were replaced by the actual Fortune assets acquired on a fair value basis as of the date of acquisition in accordance with FAS 141. As of December 31, 2005, the Fortune Brands assets accounted for under the cost method were $1.1 billion and were included in Investments in unconsolidated subsidiaries on the consolidated balance sheet as of December 31, 2005. These investments included assets for which the Company paid approximately $1.0 billion out of the total purchase price of approximately $5 billion. For those VIEs in which we had an investment but we were not considered to be the primary beneficiary, the maximum exposure to loss as of December 31, 2005 was $1.1 billion. Net assets pertaining to this investment were legally transferred between January 1, 2006 and January 27, 2006. We are not aware of any losses that occurred during this transfer period.

4. Acquisitions and Disposals (Continued)

We initially financed the acquisition of the 2005 Spirits Acquisition with borrowings under bank credit agreements and subsequently financed it in the commercial paper market. On April 20, 2005, we executed a bridge credit agreement for up to $6.0 billion with an 18-month term from the initial drawdown. In January 2006, we issued dollar- and euro-denominated long-term debt securities of $2 billion and 800 million (approximately $1 billion) and repaid and terminated the bridge credit agreement. See Note 8, Long-Term Debt, for additional information on the financing of the 2005 Spirits Acquisition.

In accordance with FAS 141 disclosure requirements, the unaudited pro forma results for the twelve months ended December 31, 2005 are presented as if the 2005 Spirits Acquisition and legal transfer of assets occurred on January 1, 2005. This information is based on historical results of operations and is adjusted for the impact of acquisition costs. Pro forma results include allocations of selling and marketing and general and administrative expenses that are not representative of expenses on an ongoing basis. In addition, pro forma results give effect only to events that are expected to have a continuing impact on the business; therefore, arrangements with Pernod Ricard of limited duration are not reflected.

Given the significant factors and adjustments impacting the pro forma disclosure, the pro forma results presented below should not be deemed to be representative of either historical results or future results had the 2005 Spirits Acquisition assets been actually transferred to Fortune Brands as of January 1, 2005.

	Unaudited
(In millions, except per share data)	2005
Net sales	$ 7,781.9
Net income	628.5
Earnings per share	
Basic	$ 4.31
Diluted	$ 4.18

The transfer to Fortune Brands of certain of the 2005 Spirits Acquisition assets was accomplished through various stock sales, mergers or asset sales, which resulted in the assumption by or transfer to Fortune Brands of liability for certain litigation and other contingent liabilities and contingent indemnity rights. Such assumption or transfer might ultimately require establishment of additional reserves. No such liabilities or contingent liabilities that would be material to our total Spirits business have been identified to date.

Disposal of The Dalmore Scotch Whisky U.S. Distribution Rights

In December 2007, we sold the U.S. distribution rights and related assets to The Dalmore Scotch Whisky for $58 million. The sale resulted in a pre-tax gain of $45.6 million ($28.5 million after tax gain).

Disposal of Cockburn s Port Wine Assets

In the third quarter of 2006, we sold the Cockburn s port wine production assets but retained the ownership of the brand. The cash proceeds from the sale were $66.4 million. No gain or loss was recorded as the proceeds were equal to the book value of the assets.

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Notes to Consolidated Financial Statements Fortune Brands, Inc. and Subsidiaries

5. Minority Interest Held by V&S Group

V&S Group (V&S) owns a 10% minority interest in our Spirits business (BGSW). The minority interest is in the form of shares of redeemable and convertible preferred stock (The BGSW Minority Interest). The carrying value of the minority interest at December 31, 2007 was $542.9 million. Fortune Brands continues to own 90% of the capital stock of this business. V&S Group may require the Company to purchase the BGSW minority interest at fair value in whole or in part upon one year s notice, or at any time upon a change in control of BGSW, Jim Beam Brands Co., or certain other events. The Company has the right to acquire the BGSW minority interest owned by the V&S Group at fair value in whole or in part upon a change in control of the Absolut Spirits Company, Incorporated, sale of the Absolut brand, or the dissolution of Future Brands LLC (our U.S. sales and distribution joint venture). The BGSW minority interest cannot be transferred or sold to a third party by V&S without the Company s consent.

The shares of BGSW convertible preferred stock issued to V&S are convertible into 10% of the BGSW common stock and have voting power equivalent to a 10% interest in BGSW common stock. The dividend on preferred stock is equal to the greater of 10% of the dividend paid on BGSW common stock or the dividends paid on preferred stock. The Series A-1 Preferred Stock is entitled to a dividend of 3.2647% of the preferred stock s face value ($344.6 million) plus unpaid accrued dividends. The Series A-2 Preferred Stock is entitled to a dividend of 4% of the preferred stock s face value ($153.0 million) plus unpaid accrued dividends. No dividends may be paid on common stock unless all unpaid accrued BGSW preferred stock dividends have been paid. For the years ended December 31, 2007, 2006 and 2005, BGSW paid total preferred dividends of $17.4 million, $14.3 million and $11.3 million, respectively, to V&S that were recorded as minority interest expense in each year.

We account for the redemption feature of the convertible redeemable preferred stock in accordance with EITF Topic D-98, Classification and Measurement of Redeemable Securities, and measure this minority interest at fair value with changes in fair value reflected in income from continuing operations. BGSW is not a publicly traded entity and therefore there is no quoted market price for its common or preferred shares. At each reporting period, we estimate fair value based on a combination of market-based earnings multiples and discounted cash flow techniques. The ultimate fair value upon redemption will be based upon numerous factors that will be subject to assessment by the BGSW board or by an independent appraiser if the board is unable to reach a consensus. In 2006, we recorded an adjustment of $47.8 million as minority interest expense in the Fortune Brands consolidated statement of income, representing an increase in the estimated fair value of the convertible redeemable preferred stock. The increase in fair value is primarily a result of the enhanced value of the Spirits business due to a greater global presence and position, opportunities to leverage growth for both the historical and newly acquired brands of the Spirits business and the synergies of the combination of BGSW and the 2005 Spirits Acquisition. No adjustments to fair value were recorded in 2007.

6. Related Party Transactions

Future Brands LLC In May 2001, the Spirits business completed transactions with V&S creating a joint venture named Future Brands LLC to distribute, over an initial ten-year period, both companies spirits brands in the United States and provide related selling and invoicing services. BGSW has accounted for this joint venture using the equity method of accounting. V&S paid $270 million to gain access to our Spirits business s U.S. distribution network and to acquire an equity interest in Future Brands. We have accounted for the $270 million gain on the sale of our equity interest in Future Brands as deferred income and the resulting tax on sale as a deferred income tax asset due to

6. Related Party Transactions (Continued)

certain continuing obligations of JBBCo., including, but not limited to, making payments to suppliers, employees and other parties with which Future Brands has contracts in the event of a default of Future Brands. In June 2001, we began amortizing these amounts to other income and income taxes on a straight-line basis over the initial term of the agreement. The 10-year amortization period is based on the 10-year term of the management agreement for Future Brands. Future Brands receives a commission from the partners for services provided. The Spirits business records revenue at the time of shipment to Future Brands customers. As part of forming this joint venture, JBBCo. has, in the event of default of Future Brands, a continuing obligation to satisfy any financial obligations of Future Brands that may arise in the event that Future Brands fails to fulfill its operating obligations and that results in a claim. These financial obligations include, but are not limited to, making payments to suppliers, employees and other parties with which Future Brands has contracts. At December 31, 2007 and 2006, JBBCo. did not have any outstanding obligations as a result of this arrangement.

The Spirits business s balances related to Future Brands included the following:

(In millions)	*2007*	*2006*
Accounts receivable (invoicing by Future Brands on behalf of JBBCo.)	$ 109.1	$ 115.1
Investment	13.1	9.8
Accounts payable (commissions) and accrued liabilities	18.2	27.8
Deferred income	92.3	119.3

Maxxium Worldwide B.V. JBBCo. is a partner in an international sales and distribution joint venture named Maxxium Worldwide B.V. (Maxxium) that distributes and sells spirits in key markets outside the United States, representing approximately one-third of our international Spirits sales. The Company owns a 25% interest in Maxxium that was carried at $96.3 million as of December 31, 2007 and is accounted for using the equity method. The other 25% partners in Maxxium are Rémy Cointreau S.A. (Rémy), The Edrington Group Ltd., and V&S Group (V&S). The Spirits business records sales at the time spirits are sold to third parties rather than at the time of shipment to Maxxium. As a result of forming this joint venture, we have guaranteed certain credit facilities and bank loans entered into by Maxxium up to an amount totaling $91 million, of which $77 million was outstanding as of December 31, 2007. At December 31, 2006, the guarantees totaled $82 million, of which $77 million was outstanding. BGSW has executed a Shareholder Loan Facility (Loan Facility) with Maxxium amounting to $22 million. There were no amounts outstanding under the Loan Facility as of either December 31, 2007 or December 31, 2006. The Loan Facility was renewed in 2005 and expires December 12, 2010.

In November 2006, Rémy gave notice to Maxxium that it will terminate its distribution agreement with Maxxium effective March 30, 2009. In connection with Rémy s termination, it is expected that Rémy will pay a substantial termination penalty to Maxxium. Based on the expected impact of Rémy s termination of the distribution agreement on Maxxium s financial position and results of operations, the Company currently estimates that its investment in Maxxium is recoverable.

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Notes to Consolidated Financial Statements Fortune Brands, Inc. and Subsidiaries

6. Related Party Transactions (Continued)

The Spirits business s balances related to Maxxium included the following:

(In millions)	*2007*	2006
Accounts receivable	$ 68.4	$79.3
Inventory	22.7	19.8
Investment	96.3	87.3
Accounts payable (expense reimbursement) and accrued liabilities	30.4	69.4

The decrease in accounts payable was primarily due to the timing of payments from BGSW to Maxxium.

7. Short-Term Borrowings and Credit Facilities

At December 31, 2007 and 2006, there were $231.0 million and $787.6 million of short-term borrowings outstanding, respectively, comprised of notes payable to banks and commercial paper that are used for general corporate purposes, including acquisitions. Included in this amount as of December 31, 2007 and 2006, there were $13.4 million and $8.1 million outstanding under committed bank credit agreements, which provide for unsecured borrowings of up to $54.5 million and $9.0 million, respectively. In addition, the Company had uncommitted bank lines of credit, which provide for unsecured borrowings for working capital, of up to $134.9 million, of which $19.0 million was outstanding at December 31, 2007 and $171.0 million, of which $17.5 million was outstanding as of December 31, 2006. The weighted-average interest rate on these borrowings was 5.4%, 5.2% and 3.9%, respectively, in 2007, 2006 and 2005, including the short-term debt of $1.0 billion and $3.8 billion classified as long-term debt on the consolidated balance sheet as of December 31, 2006 and 2005.

See Note 15 for a description of the Company s use of financial instruments.

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Notes to Consolidated Financial Statements Fortune Brands, Inc. and Subsidiaries

8. Long-Term Debt

The components of long-term debt are as follows:

(In millions)	*2007*	2006
6 1/4% Notes, Due 2008	$ 200.0	$ 200.0
3 1/2% Notes, Due 2009 (300.0)	438.0	396.0
5 1/8% Notes, Due 2011	750.0	750.0
4% Notes, Due 2013 (500.0)	729.9	660.0
4 7/8% Notes, Due 2013	300.0	300.0
5 3/8% Notes, Due 2016	950.0	950.0
8 5/8% Debentures, Due 2021	90.9	90.9
7 7/8% Debentures, Due 2023	150.0	150.0
6 5/8% Debentures, Due 2028	200.0	200.0
5 7/8% Notes, Due 2036	300.0	300.0
Short-term debt classified as long-term debt[a]		1,000.0
Miscellaneous	33.9	39.7
Total debt	4,142.7	5,036.6
Less current portion	200.0	1.7
Total long-term debt	$ 3,942.7	$ 5,034.9

[a] Based on the long-term credit facilities which support our commercial paper borrowings, we have classified $1.0 billion of these borrowings as long-term on the consolidated balance sheet as of December 31, 2006. This amount represents the commercial paper amount that the Company believes will remain outstanding for the next twelve months. No commercial paper borrowings were classified as long-term on the consolidated balance sheet as of December 31, 2007.

At December 31, 2007, we had a $2.0 billion, 5-year revolving credit agreement, which matures in 2010. On October 4, 2007, we renewed our $500 million 364-day revolving credit facility to mature in 2008. The agreement includes the option to extend payment for one year at the Company s discretion for an incremental fee of 0.125% of the outstanding amount. This facility replaces the previous 364-day facility. There were no amounts were outstanding for either facility at December 31, 2007 or 2006. The interest rates, which are variable, are based on market interest rates at the time of the borrowing and the Company s long-term credit rating. Facility fees of 0.08% per annum are subject to increases up to maximum fees of 0.15% per annum in the event our long-term debt rating falls below specified levels. These facilities support the Company s commercial paper borrowings in the commercial paper market.

In January 2006, we issued long-term debt securities totaling $2.0 billion under our shelf registration statement filed with the Securities and Exchange Commission. The $2.0 billion of notes consist of $750 million of 5 1/8% notes due January 2011, $950 million of 5 3/8% notes due January 2016 and $300 million of 5 7/8% notes due January 2036. Proceeds were used to pay down commercial paper issued in connection with the 2005 Spirits Acquisition. Net proceeds of $1,977.4 million were less price discounts of $9.3 million and underwriting fees of $13.3 million. The stated coupon rate for each debt issue approximates the effective interest rate, excluding hedging gains or losses. Refer to Note 15, Financial Instruments, on treasury rate locks associated with the U.S.-denominated long-term debt.

In addition, in January 2006, we issued long-term debt securities totaling 800 million (approximately $1 billion) in a transaction exempt from registration in accordance with Regulation S under the Securities Act of 1933 because the securities were offered and sold only outside the United States to

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Notes to Consolidated Financial Statements Fortune Brands, Inc. and Subsidiaries
8. Long-Term Debt (Continued)

persons other than U. S. persons. The notes consist of 300 million of 3 1/2% notes due January 2009 and 500 million of 4% notes due January 2013. The U.S. dollar value of these euro-denominated securities is subject to fluctuations in foreign exchange rates. Proceeds were used to pay down commercial paper issued in connection with the 2005 Spirits Acquisition and borrowings under the bridge credit agreement. Net proceeds of 794.5 million were less price discounts of 3.1 million and underwriting fees of 2.4 million. The stated coupon rate for each debt issue approximates the effective interest rate, excluding hedging gains or losses.

Estimated payments for maturing debt during the next five years as of December 31, 2007 are as follows: 2008, $200.0 million; 2009, $448.0 million; 2010, none; 2011 $750.0 million and 2012 none.

9. $2.67 Convertible Preferred Stock Redeemable at Company s Option

There were 187,347 and 204,980 shares of the $2.67 Convertible Preferred stock issued and outstanding at December 31, 2007 and 2006, respectively. Reacquired, redeemed or converted authorized shares that are not outstanding are required to be retired or restored to the status of authorized but unissued shares of preferred stock without series designation. The holders of $2.67 Convertible Preferred stock are entitled to cumulative dividends, three-tenths of a vote per share together with holders of common stock (in certain events, to the exclusion of the common shares), preference in liquidation over holders of common stock of $30.50 per share plus accrued dividends and to convert each share of Convertible Preferred stock into 6.601 shares of common stock. Authorized but unissued common shares are reserved for issuance upon the conversions, but treasury shares may be and are delivered. Holders converted 17,633 shares and 10,067 shares during 2007 and 2006, respectively. The Company may redeem the Convertible Preferred stock at a price of $30.50 per share, plus accrued dividends.

The Company paid a cash dividend of $2.67 per share in the aggregate amount of $0.5 million in the year ended December 31, 2007. The Company paid cash dividends of $0.6 million in each of the years ended December 31, 2006 and 2005.

10. Capital Stock

We have 750 million authorized shares of common stock and 60 million authorized shares of Preferred stock.

There were 153,913,500 and 151,909,241 common shares outstanding (net of treasury shares) at December 31, 2007 and 2006, respectively.

The cash dividends paid on the common stock for the years ended December 31, 2007, 2006 and 2005 aggregated $248.1 million, $223.4 million and $201.0 million, respectively.

Treasury shares delivered in connection with exercise of stock options and grants of other stock awards and conversion of preferred stock amounted to 2,015,063 in 2007 and 1,580,877 in 2006. At December 31, 2007 and 2006, there were 80,964,036 and 82,968,295 common treasury shares, respectively.

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Notes to Consolidated Financial Statements Fortune Brands, Inc. and Subsidiaries

11. Stock-Based Compensation

We use stock options and performance awards to compensate key employees and stock awards to compensate outside directors. We had stock option awards outstanding under four Long-Term Incentive Plans as of December 31, 2007. During 2007, shareholders approved the 2007 Long-Term Incentive Plan, which authorized 13 million shares of common stock for awards and may be made on or before February 27, 2017. No new stock-based awards can be made under the 1990, 1999 and 2003 Long-Term Incentive Plans, but there are existing awards under those plans that continue to be exercisable.

Stock options have exercise prices equal to the fair value of a share of our common stock on the date of grant. Options generally may not be exercised prior to one year after the date of grant. Options issued prior to December 2005 generally expire ten years after the date of grant; options issued beginning in December 2005 expire seven years after the date of grant. Options issued since November 1998 generally vest one-third each year over a three-year period beginning on the first anniversary of the date of grant.

The fair value of each option award was estimated on the date of grant using the Black-Scholes option-pricing model based on the weighted-average assumptions shown in the following table:

	2007	2006	2005
Current expected dividend yield	2.1%	2.1%	1.8%
Expected volatility	18.5%	20.5%	22.4%
Risk-free interest rate	4.2%	4.6%	3.8%
Expected term	4.0 years	3.9 years	3.9 years

The determination of expected volatility is based on historical volatility of our stock over the period commensurate with the expected term of stock options, as well as other relevant factors. The risk-free interest rate is based on U.S. government issues with a remaining term equal to the expected life of the stock options. The weighted average expected term was determined based on the historical employee exercise behavior and the contractual term of the options. The weighted-average grant date fair value of stock options granted during the twelve months ended December 31, 2007 and 2006 was $13.79 and $14.05, respectively.
FAS 123R requires that we estimate forfeitures in calculating the expense related to stock-based compensation, as opposed to recognizing forfeitures and the corresponding reduction in expense as they occur. Prior to January 1, 2006, for pro forma disclosure, we amortized stock option compensation cost on a three-year graded vesting schedule. Effective January 1, 2006, we elected to amortize stock option compensation cost on a straight-line basis over the service period.

In the twelve months ended December 31, 2007, we recognized pre-tax stock-based compensation expense for stock options in income from continuing operations of $29.1 million ($20.3 million after tax or $0.13 per basic and diluted share). In the twelve months ended December 31, 2006, we recognized pre-tax stock-based compensation expense for stock options in income from continuing operations of $33.0 million ($24.7 million after tax or $0.17 per basic share and $0.16 per diluted share). Manufacturing- and fixed asset-related compensation costs that were capitalized were not material. As a result of the adoption of FAS 123R, cash flow from operations for the years ended December 31, 2007 and 2006 decreased by $22.8 million and $10.8 million, respectively, with an offsetting increase in cash flow from financing due to reclassification of tax benefits from the exercise of stock options.

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Notes to Consolidated Financial Statements Fortune Brands, Inc. and Subsidiaries
11. Stock-Based Compensation (Continued)

If compensation cost for the stock-based compensation was determined based on the fair value of an award on the date of grant, in accordance with the provisions of Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation, and amortized to expense over the service period, on a pro forma basis, net income and earnings per share would have been as follows for 2005:

(In millions, except per share amounts)	2005
Net income as reported	$ 621.1
Add: Stock-based employee compensation (performance awards) included in reported net income, net of tax	10.5
Deduct: Total stock-based employee compensation (performance awards and options) determined under the fair-value based method for all awards, net of tax	(35.3)
Pro forma net income	$ 596.3
Earnings per common share	
Basic as reported	$ 4.26
Basic pro forma	$ 4.09
Diluted as reported	$ 4.13
Diluted pro forma	$ 3.98

The following table summarizes stock options outstanding for the three years ended December 31, 2007, 2006 and 2005, as well as activity during each of the twelve months then ended:

	Options	Weighted-Average Exercise Price
Outstanding at December 31, 2004	12,416,493	$ 50.45
Granted	57,450	83.36
Exercised	(1,648,492)	39.42
Forfeited	(806,492)	64.60
Outstanding at August 16, 2005	10,018,959	51.31
Office business spin-off adjustment[a]	495,200	
Granted	2,300,210	82.16
Exercised	(224,732)	36.94
Forfeited	(49,589)	70.58
Outstanding at December 31, 2005	12,540,048	55.12
Granted	2,747,960	74.65
Exercised[b]	(1,483,075)	42.45
Forfeited	(284,514)	73.49
Outstanding at December 31, 2006	13,520,419	60.10
Granted	2,227,774	80.95
Exercised[b]	(1,872,744)	43.39
Forfeited	(497,289)	77.56
Outstanding at December 31, 2007[c]	13,378,160	$ 65.26

[a] On August 16, 2005, in connection with the Office products business spin-off, the Company adjusted the number of shares under options and the option exercise prices to preserve, as closely as possible, the economic value of the options that existed at the time of the spin-off.

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11. Stock-Based Compensation (Continued)

(b) The intrinsic value of stock options exercised in the twelve months ended December 31, 2007 and 2006 was $74.5 million and $52.9 million, respectively. The source of shares issued was treasury stock.

(c) At December 31, 2007, the weighted-average remaining contractual life of options outstanding was 5.4 years and the aggregate intrinsic value of options outstanding was $138.8 million.

Options outstanding and exercisable at December 31, 2007 were as follows:

Range Of	Options Outstanding			Options Exercisable	
Exercise Prices	Options Outstanding	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Options Exercisable	Weighted-Average Exercise Price
$23.35 to $54.75	4,613,257	4.4	$ 43.88	4,613,257	$ 43.88
67.93 to 78.25	4,579,652	6.2	71.90	3,067,807	70.62
80.95 to 82.16	4,185,251	5.8	81.55	1,435,921	82.15
December 31, 2007	13,378,160	5.4	$ 65.26	9,116,985[a]	$ 58.91
December 31, 2006	13,520,419	6.0	60.10	8,546,355	50.90
December 31, 2005	12,540,048	6.6	55.12	7,643,129	43.78

(a) At December 31, 2007 the weighted average remaining contractual life of options exercisable was 5.1 years and the aggregate intrinsic value of options exercisable was $138.8 million.

A summary of the activity for nonvested stock options for the years ended December 31, 2006 and 2007, as well as activity during each of the twelve months then ended:

	Options	Weighted-Average Grant Date Fair Value
Nonvested at December 31, 2005	4,895,268	$15.41
Granted	2,747,960	14.05
Vested	(2,416,791)	14.88
Cancelled	(252,373)	15.66
Nonvested at December 31, 2006	4,974,064	14.91
Granted	2,227,774	13.79
Vested	(2,455,881)	15.17
Cancelled	(371,451)	14.62
Nonvested December 31, 2007	4,374,506	$14.22

The remaining unrecognized compensation cost related to unvested awards at December 31, 2007 was approximately $41.5 million, and the weighted-average period of time over which this cost will be recognized is 2.0 years. The fair value of options that vested during the twelve months ended December 31, 2007 was $37.3 million.

We use stock awards to compensate outside directors under the 2005 Non-Employee Director Stock Plan. Awards are issued annually in the second quarter as part of the compensation to outside directors. In addition, outside directors can elect to have director s fees paid in stock. Compensation cost is expensed at the time of an award based on the fair value of a share of Fortune Brands stock at the date of the award. In the twelve months ended December 31, 2007, we awarded 11,887 shares of common

stock to outside directors with a fair value on the date of the award of $80.54 (pre-tax compensation cost $1.0 million). In the twelve months ended December 2006, we issued 13,150 shares of common stock to outside directors with a fair value on the date of the award of $75.15 (pre-tax compensation cost $1.0 million).

11. Stock-Based Compensation (Continued)

Performance awards are granted to certain officers of the Company. Payout is based on achievement of targeted cumulative diluted earnings per share and average consolidated return on equity (changed to average consolidated return on invested capital, beginning with the 2006-2008 cycle). Compensation cost is amortized into expense over the three-year performance period. For awards granted prior to December 2005, performance awards could be settled in stock or cash, depending on whether an individual had satisfied the Company s stock ownership guidelines. As a result, compensation cost was based on the stock price at each balance sheet date. Because performance awards granted after December 2005 may only be paid in stock, the fair value is based on the stock price at the date of grant.

The following table summarizes performance awards outstanding for the three years ended December 31, 2007, 2006 and 2005, as well as activity during each of the twelve months then ended:

	Performance Awards
Outstanding at December 31, 2004	610,350
Granted	173,550
Paid	(204,300)
Cancelled	(11,307)
Office business spin-off adjustment[a]	32,146
Outstanding at December 31, 2005	600,439
Granted	145,875
Paid	(214,444)
Cancelled	(12,782)
Outstanding at December 31, 2006	519,088
Granted	161,475
Paid	(200,709)
Cancelled	(3,128)
Outstanding at December 31, 2007	476,726
Vested at December 31, 2007	109,092

[a] On August 16, 2005, in connection with the Office products business spin-off, the Company adjusted the number of shares under performance awards to preserve, as closely as possible, the economic value of the performance awards that existed at the time of the spin-off.

The pretax compensation cost for performance awards recorded in the twelve months ended December 31, 2007 benefited by $1.3 million ($0.8 million after tax) as a result of the decrease in the stock price and reductions related to lower expected incentive program payouts. There was no remaining unrecognized pre-tax compensation cost related to unvested awards at December 31, 2007. Cash used to settle performance awards in the twelve months ended December 31, 2007 was $15.7 million. In addition to the payment of cash, we issued 8,248 shares of common stock from treasury shares.

Shares available for issuance in connection with future awards under the Company s stock plans at December 31, 2007, 2006 and 2005 were: 11,021,672, 3,253,083, and 5,853,452, respectively. Authorized but unissued shares are reserved for issuance in connection with awards, but treasury shares may be and are delivered.

Notes to Consolidated Financial Statements Fortune Brands, Inc. and Subsidiaries

12. Pension and Other Retiree Benefits

We have a number of pension plans, principally in the United States, covering many of the Company s employees. The plans provide for payment of retirement benefits, mainly commencing between the ages of 60 and 65, and also for payment of certain disability and severance benefits. After meeting certain qualifications, an employee acquires a vested right to future benefits. The benefits payable under the plans are generally determined on the basis of an employee s length of service and earnings. Annual contributions to the plans are made, as necessary, to ensure legal funding requirements are satisfied.

The Company provides postretirement health care and life insurance benefits to certain employees and retirees in the United States and certain employee groups outside the United States. Many employees and retirees outside the United States are covered by government health care programs.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans (FAS 158), which is an amendment of FASB Statements No. 87, 88, 106, and 132(R). FAS 158 requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in the consolidated balance sheet and to recognize changes in that funded status in the year in which the changes occur through adjustments to other comprehensive income. The funded status of a benefit plan is the difference between plan assets at fair value and the benefit obligation. For pension plans, the benefit obligation is the projected benefit obligation (PBO). For other postretirement benefit plans, the benefit obligation is the accumulated postretirement benefit obligation (APBO). Previously unrecognized gains/losses, prior service costs/credits and transition assets/obligations are then recognized in accumulated other comprehensive income, and will continue to be amortized as components of net periodic benefit cost. The adoption of FAS 158 resulted in a decrease to accumulated other comprehensive income of $119.9 million.

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Notes to Consolidated Financial Statements Fortune Brands, Inc. and Subsidiaries
12. Pension and Other Retiree Benefits (Continued)

Obligations and Funded Status at December 31	Pension Benefits		Postretirement Benefits	
(In millions)	*2007*	2006	*2007*	2006
CHANGE IN PROJECTED BENEFIT OBLIGATION (PBO)				
Projected benefit obligation at beginning of year	$ 929.4	$ 857.0	$ 165.2	$ 175.0
Service cost	34.6	34.9	3.5	4.3
Interest cost	53.5	49.6	9.1	9.6
Actuarial gain	(62.3)	(8.6)	(20.2)	(17.3)
Participants contributions	0.5	0.5	2.6	2.3
Foreign exchange rate changes	7.3	9.3		
Benefits paid	(40.5)	(40.0)	(11.5)	(11.1)
Acquisitions	1.3	23.9		2.2
Plan curtailments			(1.8)	
Plan amendments	0.9	2.8	1.2	0.2
Projected benefit obligation at end of year	$ 924.7	$ 929.4	$ 148.1	$ 165.2
Accumulated benefit obligation at end of year (excludes the impact of future compensation increases)	$ 818.6	$ 817.6		
CHANGE IN PLAN ASSETS				
Fair value of plan assets at beginning of year	$ 781.1	$ 687.4	$	$
Actual return on plan assets	51.9	80.2		
Employer contributions	48.9	18.1	8.9	8.8
Participants contributions	0.5	0.5	2.6	2.3
Foreign exchange rate changes	6.7	6.9		
Benefits paid	(40.0)	(40.0)	(11.5)	(11.1)
Acquisitions		28.0		
Fair value of plan assets at end of year	849.1	781.1		
Funded Status (Fair value of plan assets less PBO)	(75.6)	(148.3)	(148.1)	(165.2)
Amounts recognized in the balance sheet consist of:				

	Pension Benefits		Postretirement Benefits	
(In millions)	*2007*	2006	2007	2006
Prepaid pension benefit	$ 28.5	$ 5.6	$	$
Current benefit payment liability	(0.9)	(0.7)	(10.4)	(10.9)
Accrued benefit liability	(103.2)	(153.2)	(137.7)	(154.3)
Net amount recognized (pre-tax)	$ (75.6)	$ (148.3)	$ (148.1)	$ (165.2)

12. Pension and Other Retiree Benefits (Continued)

The amounts in accumulated other comprehensive income on the balance sheet that have not yet been recognized as components of net periodic benefit cost at December 31, 2007 are as follows:

(In millions)	Pension Benefits	Postretirement Benefits
Accumulated other comprehensive loss:		
Net actuarial loss at December 31, 2006	$ 237.0	$ 26.2
Amortization	(14.6)	(1.0)
Current year actuarial gain	(50.9)	(20.3)
Foreign exchange rate changes	0.6	
Net actuarial loss at December 31, 2007	$ 172.1	$ 4.9
Net prior service cost/(credit) at December 31, 2006	$ 18.5	$ (10.4)
Amortization	(2.8)	1.5
Current period service cost	1.3	2.3
Net prior service cost/(credit) at December 31, 2007	$ 17.0	$ (6.6)
Total at December 31, 2007	$ 189.1	$ (1.7)

The amounts in accumulated other comprehensive income expected to be recognized as components of net periodic benefit cost over the next fiscal year are shown below.

(In millions)	Pension Benefits	Postretirement Benefits
Amortization of:		
Net actuarial loss	$ 7.9	$ 0.4
Net prior service cost/(credit)	2.5	(1.3)
Expense (income)	$ 10.4	$ (0.9)

The pension benefit obligation, accumulated benefit obligation and fair value of plans assets for pension plans with an accumulated benefit obligation in excess of plan assets (underfunded ABO) are shown below.

Information for pension plans with an accumulated benefit obligation in excess of plan assets *(In millions)*	2007	2006
Projected benefit obligation	$ 163.2	$ 414.5
Accumulated benefit obligation	139.5	361.3
Fair value of plan assets	91.5	296.5

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Notes to Consolidated Financial Statements Fortune Brands, Inc. and Subsidiaries

12. Pension and Other Retiree Benefits (Continued)

Components of net periodic benefit cost were as follows:

Components of Net Periodic Benefit Cost	Pension Benefits			Postretirement Benefits		
(In millions)	*2007*	2006	2005	*2007*	2006	2005
Service cost	$ 34.6	$ 34.9	$ 35.6	$ 3.5	$ 4.3	$ 3.5
Interest cost	53.5	49.6	57.1	9.1	9.6	9.8
Expected return on plan assets	(63.7)	(59.5)	(71.7)			
Amortization of net loss	14.6	15.7	14.6	1.0	4.5	0.8
Amortization of prior service cost (credit)	2.8	2.6	3.4	(1.5)	(1.6)	(0.1)
Curtailment gain				(2.8)		
Net periodic benefit cost	$ 41.8	$ 43.3	$ 39.0	$ 9.3	$ 16.8	$ 14.0

Assumptions	Pension Benefits			Postretirement Benefits		
	2007	2006	2005	*2007*	2006	2005
WEIGHTED-AVERAGE ASSUMPTIONS USED TO DETERMINE BENEFIT OBLIGATIONS AT DECEMBER 31:						
Discount rate	6.4%	5.9%		6.5%	6.0%	
Rate of compensation increase	4.0%	4.0%				
WEIGHTED-AVERAGE ASSUMPTIONS USED TO DETERMINE NET COST FOR YEARS ENDED DECEMBER 31:						
Discount rate	5.9%	5.7%	5.9%	6.0%	5.8%	6.0%
Expected long-term rate of return on plan assets	8.3%	8.2%	8.3%			
Rate of compensation increase	4.0%	4.1%	4.0%			

	Postretirement Benefits			
	2007		2006	
	Medical	Prescription Drug	Medical	Prescription Drug
ASSUMED HEALTH CARE COST TREND RATES USED TO DETERMINE BENEFIT OBLIGATIONS AND NET COST AT DECEMBER 31:				
Health care cost trend rate assumed for next year	7.5%	10.5%	8.25%	11.25%
Rate that the cost trend rate is assumed to decline (the ultimate trend rate)	5%	5%	5%	5%
Year that the rate reaches the ultimate trend rate	2012	2016	2012	2016

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage-point change in assumed health care cost trend rates would have the following effects:

(In millions)	1-Percentage-Point Increase	1-Percentage-Point Decrease
Effect on total of service and interest cost	$ 1.4	$ (1.2)
Effect on postretirement benefit obligation	13.6	(12.1)

Plan Assets

Our pension plan weighted-average asset allocations at December 31, 2007 and 2006 are as follows:

	Pension Plan Assets at December 31	
Asset Category	*2007*	2006
Cash	1%	1%
Equity securities	57	60
Fixed income	36	36
Other	6	3
Total	100%	100%

Our investment strategy is to optimize investment returns through a diversified portfolio of investments, taking into consideration underlying plan liabilities and asset volatility. Master trusts were established to hold the assets of our domestic defined benefit plans. The U.S. defined benefit asset allocation policy of these trusts allows for an equity allocation of 45% to 75%, a fixed income allocation of 25% to 50%, a cash allocation of up to 25% and other investments up to 20%. Non-U.S. investment trust targets may differ depending on the country, allowing up to 90% equity, 100% fixed investments and up to 20% in real estate. Asset allocations are based on the underlying liability structure and local regulations. All retirement asset allocations are reviewed periodically to ensure the allocation meets the needs of the liability structure.

Our expected 8.3% long-term rate of return on plan assets is determined based on long-term historical performance of plan assets, current asset allocation and projected long-term rates of return from pension investment consultants. The expected long-term rates of return are 10% for equities, 6% for fixed income and 8% for other investments.

Defined Contribution Plan Contributions

We sponsor a number of defined contribution plans. Contributions are determined under various formulas. Cash contributions related to these plans amounted to $34.1 million, $33.6 million and $25.0 million in 2007, 2006 and 2005, respectively.

Estimated Future Benefit Payments

The following benefit payments, which reflect expected future service, are expected to be paid:

		Postretirement Benefits	
		Before Medicare	
(In millions)	Pension Benefits	Subsidy	Medicare Subsidy
2008	$ 38.4	$ 11.1	$ 0.7
2009	45.3	11.7	0.8
2010	49.1	12.3	0.8

2011	55.7	12.9	0.8
2012	58.7	13.3	0.9
Years 2013-2017	369.5	68.0	4.2

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Notes to Consolidated Financial Statements Fortune Brands, Inc. and Subsidiaries

13. Lease Commitments

Future minimum rental payments under non-cancelable operating leases as of December 31, 2007 are as follows:

(In millions)	
2008	$ 55.3
2009	46.0
2010	32.8
2011	25.6
2012	22.2
Remainder	22.7
Total minimum rental payments	204.6
Less minimum rentals to be received under non-cancelable subleases	15.9
	$ 188.7

Total rental expense for all operating leases (reduced by minor amounts from subleases) amounted to $64.8 million, $61.0 million and $51.3 million in 2007, 2006 and 2005, respectively.

14. Income Taxes

The components of income from continuing operations before income taxes are as follows:

(In millions)	2007	2006	2005
Domestic operations	$ 687.0	$ 897.4	$ 703.4
Foreign operations	433.2	281.9	215.9
Income from continuing operations before income taxes and minority interests	$ 1,120.2	$ 1,179.3	$ 919.3

A reconciliation of income taxes at the 35% federal statutory income tax rate to income taxes from continuing operations is as follows:

(In millions)	*2007*	2006	2005
Income taxes computed at federal statutory income tax rate	$ 392.1	$ 412.8	$ 321.8
Other income taxes, net of federal tax benefit	16.3	25.3	29.2
Foreign taxes at different rate than U.S. federal statutory income tax rate	(86.2)	(39.6)	(2.4)
Tax benefit on income attributable to domestic production activities	(12.7)	(8.6)	(5.3)
Adjustments for uncertain tax positions	18.7	(28.3)	(7.7)
Net effect of change in deferred taxes	(1.0)	(58.4)	
Absence of tax benefit on currency hedge accounting expense			30.8
Adjustment for income reflected net of tax due to FIN 46R accounting[a]			(19.1)
Miscellaneous other, net	19.1	(3.9)	(25.5)
Income taxes from continuing operations as reported	$ 346.3	$ 299.3	$ 321.8

[a] Refer to Note 4, Acquisitions and Disposals, for additional information on FIN 46R accounting.

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14. Income Taxes (Continued)

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

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

During the third quarter of 2007, the Spanish tax authorities concluded their routine audit of our Spanish Spirits companies, which were included as part of the 2005 Spirits Acquisition. Pursuant to the acquisition agreement, Pernod Ricard indemnified the Company for pre-acquisition income tax contingencies and liabilities. The tax returns that were subject to examination included the 2000 through 2004 tax periods, which preceded the date of acquisition. The Spanish tax authorities issued a net tax assessment of approximately $110 million ($91.7 million for tax and $18.3 million for related interest and penalties), which we paid in October 2007. Also during the third quarter 2007, we received a $99.3 million tax indemnification payment from Pernod Ricard related to the above tax assessment ($110 million net of associated tax benefits). In order to reflect the impact of the Spanish tax assessment, we increased our liability for unrecognized tax benefits (UTB s). Additionally, we further increased our liability for UTB s to reflect tax issues similar to those raised during the course of the audit but relating to tax periods subsequent to the audit period. The majority of the Spanish UTB s pertain to pre-acquisition periods and are subject to the tax indemnification agreement with Pernod Ricard.

A reconciliation of the beginning and ending amount of UTB s is as follows:

(In millions)	
Unrecognized Tax Benefits balance at January 1, 2007	$ 207.8
Gross additions current year tax positions	121.6
Gross additions purchase accounting, prior year tax positions	218.5
Gross additions prior year tax positions	16.1
Gross reductions prior year tax positions	(7.1)
Gross reductions settlements with taxing authorities	(150.1)
Impact of change in foreign exchange rates	4.6
Unrecognized Tax Benefits balance at December 31, 2007	$ 411.4

14. Income Taxes (Continued)

The amount of UTB s that, if recognized as of January 1, 2007, would affect the Company s effective tax rate was $190.3 million compared to $315.9 million as of December 31, 2007.

It is reasonably possible that, within the next twelve months, total UTB s may decrease in the range of $205 to $230 million primarily as a result of the conclusion of U.S. federal, state and foreign income tax proceedings.

We continue to apply our accounting policy of classifying interest and penalties accruals related to UTB s as income tax expense. During the years ended December 31, 2007, 2006, and 2005, the Company recognized approximately $7.7 million, $0.0 million, and $7.6 million in interest and penalties. At December 31, 2007 and 2006, we had accruals for the payment of interest and penalties of $68.1 million and $32.0 million respectively.

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

Income taxes are as follows:

(In millions)	*2007*	2006	2005
Currently payable			
Federal	$ 249.1	$ 261.5	$ 269.0
Foreign	116.0	34.2	5.7
State and other	28.4	22.5	45.1
Deferred			
Federal, state and other	(34.0)	(28.7)	0.6
Foreign	(13.2)	9.8	1.4
	$ 346.3	$ 299.3	$ 321.8

Notes to Consolidated Financial Statements Fortune Brands, Inc. and Subsidiaries

14. Income Taxes (Continued)

The components of net deferred tax assets (liabilities) are as follows:

(In millions)	*2007*	2006
CURRENT ASSETS		
Compensation and benefits	$ 32.1	$ 23.5
Other reserves	37.4	37.0
Inventories	31.8	28.6
Accounts receivable	9.6	10.6
State income taxes	13.0	10.2
Miscellaneous	65.9	36.4
	189.8	146.3
CURRENT LIABILITIES		
Inventories	(15.5)	(12.6)
Miscellaneous	(15.8)	(14.4)
	(31.3)	(27.0)
NONCURRENT ASSETS		
Compensation and benefits	52.1	30.8
Other retiree benefits	109.1	132.4
Identifiable intangible assets	93.2	99.4
Foreign investment amortization	86.5	66.5
Other reserves	20.8	28.1
Deferred income	24.5	35.3
Miscellaneous	110.4	16.6
	496.6	409.1
NONCURRENT LIABILITIES		
Fixed assets	(178.3)	(194.9)
Pension	(13.1)	(15.6)
Identifiable intangibles assets	(1,062.8)	(1,046.6)
Foreign subsidiary loss recapture		(157.8)
Miscellaneous	(92.4)	(52.4)
	(1,346.6)	(1,467.3)
Net deferred tax liability	$ (691.5)	$ (938.9)

15. Financial Instruments

We do not enter into financial instruments for trading or speculative purposes. Financial instruments are principally used to reduce the impact of changes in foreign currency exchange rates and interest rates. The principal financial instruments used are forward foreign exchange contracts and interest rate swaps.

We enter into forward foreign exchange contracts principally to hedge currency fluctuations in transactions denominated in foreign currencies, thereby limiting our risk that would otherwise result from changes in exchange rates. The periods of the forward foreign exchange contracts correspond to the periods of the hedged transactions. We enter into net investment hedges to hedge a portion of our net investments in certain foreign subsidiaries.

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

We may, from time to time, enter into interest rate swap agreements to manage our exposure to interest rate changes. The swaps involve the exchange of fixed and variable interest rate payments without exchanging the notional principal amount. We record the payments or receipts on the agreements as adjustments to interest expense. At December 31, 2007, we had no outstanding interest rate swap agreements.

In the second quarter of 2005, we entered into call options and forward contracts to buy British pounds in order to mitigate the currency exposure related to the 2005 Spirits Acquisition, which closed in July 2005. In addition, we entered into treasury rate locks and interest rate swaps related to the anticipated issuance of debt associated with this acquisition. These hedges are described in more detail below.

We established acquisition cost hedges that consisted of call options and forward contracts to buy British pounds. We terminated the call options in early July 2005. We settled the forward contracts on July 26, 2005 when we closed on the 2005 Spirits Acquisition. In the year ended December 31, 2005, we recorded total pre-tax net acquisition hedge expense of $120.9 million ($109.0 million after tax) in Other (income) expense, net on the condensed consolidated statement of income. This included hedge program costs on the call options in the pre-tax amount of $33.0 million ($21.1 million after tax) and hedge accounting expense on the forward contracts as a result of mark-to-market accounting on the day the acquisition closed, in the amount of $87.9 million (before and after tax). The hedge accounting expense on the forward contracts, which was not tax deductible, was offset by a corresponding reduction in our book-basis investment in the acquisition on the consolidated balance sheet.

In 2005, we entered into treasury rate locks with an aggregate notional value of $1.75 billion. These locks hedged the risk to earnings associated with fluctuations in interest rates relating to anticipated issuances of dollar-denominated debt associated with the 2005 Spirits Acquisition. We accounted for these hedges as cash flow hedges since the treasury rate locks hedged against the variability of interest payments on future issuance of debt. As of December 31, 2005, we had total deferred gains of $10.4 million ($6.7 million net of deferred taxes). On January 5, 2006, we terminated the treasury rate locks when we issued the U.S. dollar-denominated long-term debt. We recorded a $2.6 million pre-tax net gain on the rate locks in accumulated other comprehensive income. We amortize the gain into earnings over the maturities of the corresponding debt as an adjustment to interest expense corresponding with the recognition of interest expense related to the new U.S. dollar-denominated debt. For more information on long-term debt, see Note 8, Long-Term Debt.

In addition, in the fourth quarter of 2005, we entered into interest rate swaps with an aggregate notional value of 800 million. We classified these interest rate swaps as cash flow hedges since the swaps hedged against fluctuations in interest rates relating to anticipated issuances of euro-denominated debt associated with the 2005 Spirits Acquisition. We terminated these swap agreements on January 27, 2006 when we issued the new euro-denominated long-term debt. We recorded a $0.6 million pre-tax gain on the swaps in accumulated other comprehensive income. We

amortize the gain into earnings over the maturities of the corresponding debt as an adjustment to interest expense corresponding with the recognition of interest expense on the new euro-denominated debt. For more information on long-term debt, see Note 8, Long-Term Debt.

In order to hedge our net investment position in the subsidiaries of the acquired Spirits assets that have euro-denominated operations, in January 2006, we issued long-term debt in the amount of 800 million (approximately $1 billion).

The estimated fair value of the Company s cash and cash equivalents, notes payable to banks and commercial paper approximates the carrying amounts due principally to their short maturities.

The estimated fair value of the Company s $4,142.7 million and $5,036.6 million total long-term debt (including current portion) at December 31, 2007 and 2006 was approximately $4,005.6 million and $4,918.9 million, respectively. The fair value is determined from quoted market prices, where available, and from investment bankers using current interest rates considering credit ratings and the remaining terms to maturity.

Concentration of credit risk with respect to accounts receivable is limited because a large number of geographically diverse customers make up the operating companies domestic and international customer base. Spirits sales are distributed through Future Brands LLC in the U.S. and Maxxium Worldwide B.V. internationally. Accounts receivable balances with these related parties are included in accounts receivable from related parties on the consolidated balance sheet. See Note 6, Related Party Transactions.

Raw materials used by the Company are subject to price volatility caused by weather, supply conditions, geopolitical and economic variables, and other unpredictable external factors. We use derivative contracts to manage our exposure to commodity price volatility. As of December 31, 2007, there were no material derivative contracts outstanding related to raw materials.

16. Guarantees and Commitments

As of December 31, 2007, we had $91.2 million of third-party guarantees of the debt of Maxxium Worldwide B.V. (Maxxium), our Spirits business s international sales and distribution joint venture. We are required to perform under these guarantees in the event that Maxxium fails to make contractual payments. The renewal extended the expiration date of the committed portion of the credit facilities to December 12, 2010. In accordance with Financial Accounting Standards Board Interpretation No. 45 (FIN 45), Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, a liability, with an offsetting increase in the investment in Maxxium, of $0.4 million existed as of December 31, 2007 to reflect the fair value of the guarantees to Maxxium.

In addition, as a part of the formation of the Future Brands LLC (Future Brands) joint venture with V&S Group in 2001, Jim Beam Brands Co. (JBBCo.) has guaranteed any financial obligations of Future Brands that may arise in the event of a Future Brands default in which it fails to fulfill its operating obligations and which results in a claim. These financial obligations include, but are not limited to, making payments to suppliers, employees and other parties with which Future Brands conducts business. We cannot estimate the possible future obligations under the Future Brands agreement. At December 31, 2007, JBBCo. did not have any outstanding obligations as a result of this arrangement.

Notes to Consolidated Financial Statements Fortune Brands, Inc. and Subsidiaries

16. Guarantees and Commitments (Continued)

We also guaranteed various leases for ACCO World Corporation, the Office products business divested in a spin-off on August 16, 2005. We will continue to guarantee payment of certain real estate leases with lease payments totaling approximately $36 million through April 2013. Accordingly, we have recorded the fair value of these guarantees on our financial statements in accordance with FIN 45. As of December 31, 2007, we recorded a liability of $1.0 million. Refer to Note 3, Discontinued Operations, for additional information on the spin-off of the Office products business.

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

Purchase obligations by the Company as of December 31, 2007 were:

	Payments Due by Period as of December 31, 2007				
(In millions)	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
Purchase obligations[(a)]	$ 785.8	$ 301.6	$ 167.8	$ 117.1	$ 199.3

(a) Purchase obligations include contracts for raw materials and finished goods purchases; advertising, selling and administrative services; and capital expenditures.

17. Product Warranties

We generally record warranty expense at the time of sale. We offer our customers various warranty terms based upon the type of product that is sold. Warranty expense is determined in accordance with the policy established at each operating company. The main consideration is historic claim experience, which is company-specific based upon the nature of the product category. Warranty expense is generally recorded at the time of sale.

The following table summarizes activity related to our product warranty liability during the years ended December 31, 2007, 2006 and 2005:

(In millions)	*2007*	2006	2005
Reserve balance at the beginning of the year	$ (15.0)	$ (13.0)	$ (16.1)
Provision for warranties issued	(36.8)	(41.3)	(33.7)
Acquisitions		(1.9)	(0.6)
Discontinued operations			2.1

Settlements made (in cash or in kind)	36.8	41.2	35.3
Reserve balance at end of year	$ (15.0)	$ (15.0)	$ (13.0)

Notes to Consolidated Financial Statements Fortune Brands, Inc. and Subsidiaries

18. Restructuring and Restructuring-related Charges

Pre-tax restructuring and restructuring-related charges for twelve months ended December 31, 2007 were:

	Twelve Months Ended December 31, 2007			
	Restructuring	Restructuring-Related		Total
(in millions)	Charges	Cost of Sales	ASG&A[a]	Charges
Spirits	$ 2.7	$	$ 1.4	$ 4.1
Home and Hardware	70.2	14.7	11.4	96.3
Golf	0.6		0.2	0.8
	$ 73.5	$ 14.7	$ 13.0	$ 101.2

[a] Advertising, selling, general and administrative expenses.

For the twelve months ended December 31, 2007, we recorded pre-tax restructuring charges of $73.5 million principally related to supply chain initiatives in the Home and Hardware business, including facility closures (including the consolidation of facilities in cabinetry, window and tool storage production and closure of a cabinetry component operation), as well as the planned exit from the entry door market in the United Kingdom and decorative column products lines in the U.S. In the Home and Hardware business, we closed or downsized several facilities in order to improve the long-term efficiency, productivity and flexibility of supply chains, and to also provide near-term benefits by aligning costs and capacity to navigate the current downturn in the U.S. home products market. The 2007 restructuring charges consisted primarily of $16.3 million for workforce reduction costs, $49.6 million for tangible and intangible asset write-downs, and $7.6 million for contract termination costs and other costs. Restructuring-related cost of sales charges were inventory write-downs associated with the exited markets and product lines. Restructuring-related advertising, selling, general and administrative charges consisted of accounts receivable reserves for doubtful accounts, warranty reserves and retention costs related to the exit from the entry door market in the U.K. and the decorative column products line in the U.S. We expect to record as incurred approximately $10-15 million of charges in the first half of 2008 to complete the Home and Hardware business restructuring activities initiated in the fourth quarter of 2007. In the twelve months ended December 31, 2006, we recorded pre-tax restructuring charges of $21.2 million, primarily related to supply-chain initiatives related to the Home and Hardware business.

Pre-tax restructuring and restructuring-related charges for twelve months ended December 31, 2006 were:

	Twelve Months Ended December 31, 2006			
	Restructuring	Restructuring-Related		Total
(in millions)	Charges	Cost of Sales	ASG&A[a]	Charges
Spirits	$ 4.3	$	$ 4.7	$ 9.0
Home and Hardware	16.9	9.0	0.4	26.3
	21.2	$ 9.0	$ 5.1	$ 35.3

[a] Advertising, selling, general and administrative expenses.

The 2006 Spirits charges related to the integration of the 2005 Spirits Acquisition. The 2006 Home and Hardware charges related to supply-chain initiatives, including consolidation of manufacturing

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Notes to Consolidated Financial Statements Fortune Brands, Inc. and Subsidiaries
18. Restructuring and Restructuring-related Charges (Continued)

facilities resulting in closure of a cabinetry plant and a tool storage plant. We did not record any restructuring charges in 2005.

In 2005, we recorded pre-tax restructuring-related integration costs of $19.6 million in advertising, selling, general and administrative expense primarily related to the 2005 Spirits Acquisition.

Reconciliation of Restructuring Liability

	Balance at	2007	Cash	Non-Cash	Balance at
(In millions)	12/31/06	Provision	Expenditures	Write-offs	12/31/07
Workforce reduction costs	$ 13.0	$ 16.3	$ (19.5)	$ (0.5)	$ 9.3
Asset write-downs		49.6		(49.6)	
Contract termination costs		5.2	(1.5)		3.7
Other	0.2	2.4	(1.0)	(0.3)	1.3
	$ 13.2	$ 73.5	$ (22.0)	$ (50.4)	$ 14.3

The restructuring liability as of December 31, 2006 and 2005 and the activity during the years ended December 31, 2006 and 2005 were not material.

19. Information on Business Segments

We report our operating segments (Spirits, Home and Hardware, and Golf) based on how we have organized our segments within the Company for making operating decisions and assessing performance based on the markets served. The Company s operating segments and types of products from which each segment derives revenues are described below:

Spirits includes products made, marketed or distributed by Beam Global Spirits & Wine, Inc. subsidiaries or affiliates.

Home and Hardware includes: kitchen and bathroom faucets and accessories manufactured, marketed or distributed by Moen; kitchen and bath cabinetry manufactured, marketed and distributed by MasterBrand Cabinets; residential entry door and patio door systems designed and manufactured by Therma-Tru; vinyl-framed windows manufactured, marketed and distributed by Simonton; locks manufactured, marketed or distributed by Master Lock and American Lock; and tool storage and organization products manufactured and distributed by Waterloo.

Golf includes golf balls, golf clubs, golf shoes and gloves manufactured, marketed or distributed by Acushnet Company.

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Notes to Consolidated Financial Statements Fortune Brands, Inc. and Subsidiaries
19. Information on Business Segments (Continued)

The Company s subsidiaries operate principally in the United States, Canada, Europe (primarily in Spain, the United Kingdom and France), Australia and Mexico.

(In millions)	*2007*	2006	2005
Net sales:			
Spirits	$ 2,606.8	$ 2,513.4	$ 1,471.8
Home and Hardware	4,550.9	4,694.2	4,153.4
Golf	1,405.4	1,313.4	1,265.8
Net sales	$ 8,563.1	$ 8,521.0	$ 6,891.0
Operating income:			
Spirits	$ 766.7	$ 660.6	$ 388.4
Home and Hardware	503.0	695.4	655.1
Golf	165.5	166.0	171.5
Less: Corporate expenses[a]	58.9	74.1	63.7
Operating income	$ 1,376.3	$ 1,447.9	$ 1,151.3
Net sales by geographic region[b]:			
United States	$ 6,208.0	$ 6,365.1	$ 5,580.8
Canada	523.8	446.7	360.8
United Kingdom	504.7	450.3	209.7
Australia	280.5	233.4	188.6
Spain	189.5	257.0	24.6
Other countries	856.6	768.5	526.5
Net sales	$ 8,563.1	$ 8,521.0	$ 6,891.0
Total assets:			
Spirits	$ 2,976.6	$ 2,619.1	$ 2,948.1
Home and Hardware	1,953.1	2,117.5	1,864.3
Golf	774.2	752.5	723.9
Segment assets[c]	5,703.9	5,489.1	5,536.3
Intangibles resulting from business acquisition, net	8,063.2	8,038.7	6,487.5
Corporate[d]	189.8	205.9	171.7
Continuing operations	13,956.9	13,733.7	12,195.5
Discontinued operations		934.6	1,006.0
Total assets	$ 13,956.9	$ 14,668.3	$ 13,201.5

[a] Corporate expenses include salaries, benefits and expenses related to Corporate office employees and functions that benefit all operating segments. Corporate expenses do not include expenses directly allocable to the reportable segments. Allocating these indirect expenses to operating segments would require an imprecise allocation methodology. There are no amounts that are the elimination or reversal of transactions between reportable segments.

[b] Based on country of destination.

[c] Represents total assets excluding intercompany receivables and intangibles resulting from business acquisitions, net.

[d] Corporate assets include cash, certain receivables related to taxes and insurance claims, and the cash surrender value on life insurance policies. Corporate assets do not include assets directly allocable to the reportable segments. Allocating these indirect assets to operating segments would require an imprecise allocation methodology.

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Notes to Consolidated Financial Statements Fortune Brands, Inc. and Subsidiaries
19. Information on Business Segments (Continued)

(In millions)	*2007*	2006	2005
Property, plant and equipment, net:			
United States	$ 1,144.6	$ 1,193.1	$ 1,091.8
Spain	198.5	180.8	2.4
Mexico	92.9	62.9	61.8
United Kingdom	72.8	77.6	22.2
Canada	71.6	57.3	59.2
Other countries	117.8	136.5	167.8
Long-lived assets	$ 1,698.2	$ 1,708.2	$ 1,405.2
Depreciation expense:			
Spirits	$ 64.3	$ 57.2	$ 47.6
Home and Hardware	115.8	105.0	84.1
Golf	35.6	34.2	33.9
Corporate	1.7	0.9	0.9
Continuing operations	217.4	197.3	166.5
Discontinued operations	14.9	13.9	20.9
Depreciation expense	$ 232.3	$ 211.2	$ 187.4
Amortization of intangibles:			
Spirits	$ 13.7	$ 13.7	$ 8.4
Home and Hardware	33.6	28.9	24.2
Golf	0.3	0.3	0.3
Continuing operations	47.6	42.9	32.9
Discontinued operations	0.5	0.6	1.8
Amortization of intangibles	$ 48.1	$ 43.5	$ 34.7
Capital expenditures:			
Spirits	$ 111.3	$ 95.6	$ 67.0
Home and Hardware	75.1	128.2	99.2
Golf	63.0	22.5	23.2
Corporate	0.1	1.6	0.8
Continuing operations	249.5	247.9	190.2
Discontinued operations	17.6	18.1	31.7
Capital expenditures, gross	267.1	266.0	221.9
Less: proceeds from disposition of assets	69.3	84.6	6.3
Capital expenditures, net	$ 197.8	$ 181.4	$ 215.6

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Notes to Consolidated Financial Statements Fortune Brands, Inc. and Subsidiaries

20. Other Income (expense), net

The components of other income (expense), net, for the years ended December 31, 2007, 2006 and 2005 are as follows:

(In millions)	*2007*	2006	2005
Amortization of deferred income (See Note 5)	$ 27.0	$ 27.0	$ 27.0
Interest income on tax receivable (See Note 14)		1.0	
Environmental reserve adjustment		6.0	
Currency hedge accounting expense (See Note 15)			(120.9)
Other miscellaneous items	10.5	6.2	15.5
Total other income (expense), net	$ 37.5	$ 40.2	$ (78.4)

21. Earnings Per Share

Basic earnings per common share are based on the weighted-average number of common shares outstanding in each year and after preferred stock dividend requirements. Diluted earnings per common share assume that any convertible preferred shares outstanding at the beginning of each year were converted at those dates, with preferred stock dividend requirements and outstanding common shares adjusted accordingly. It also assumes that outstanding common shares were increased by shares issuable upon exercise of those stock options for which market price exceeds exercise price, less shares that could have been purchased by the Company with related proceeds.

The computation of basic and diluted earnings per common share for Net income is as follows:

(In millions)	*2007*	2006	2005
Income from continuing operations	$ 749.5	$ 812.1	$ 577.5
Income from discontinued operations	13.1	18.0	43.6
Net income	762.6	830.1	621.1
Less: Preferred stock dividends	0.5	0.6	0.6
Income available to common stockholders basic	762.1	829.5	620.5
Convertible Preferred stock Dividend requirements	0.5	0.6	0.6
Income available to common stockholders diluted	$ 762.6	$ 830.1	$ 621.1
Weighted average number of common shares outstanding basic	153.1	149.1	145.6
Conversion of Convertible Preferred stock	1.2	1.4	1.5
Exercise of stock options	2.2	2.5	3.4
Weighted average number of common shares outstanding diluted	156.5	153.0	150.5
Earnings per common share			
Basic			
Continuing operations	$ 4.89	$ 5.44	$ 3.96
Discontinued operations	0.09	0.12	0.30
Net earnings per basic share	$ 4.98	$ 5.56	$ 4.26
Diluted			
Continuing operations	$ 4.79	$ 5.31	$ 3.84
Discontinued operations	0.08	0.11	0.29
Net earnings per diluted share	$ 4.87	$ 5.42	$ 4.13

Notes to Consolidated Financial Statements Fortune Brands, Inc. and Subsidiaries

21. Earnings Per Share (Continued)

For the years ended December 31, 2007 and 2006, stock options were excluded from the calculation of weighted average shares for diluted EPS if they were antidilutive (exercise price exceeded the average stock price). These excluded stock options were approximately 5.8 million and 3.1 million shares of weighted average shares outstanding, respectively. There were no shares that were antidilutive and excluded from average shares outstanding for the diluted earnings per share calculation for the twelve months ended December 31, 2005.

22. Accumulated Other Comprehensive Income

Total accumulated other comprehensive income consists of net income and other changes in stockholders equity from transactions and other events from sources other than stockholders. It includes currency translation gains and losses, unrealized gains and losses from derivative instruments designated as cash flow hedges, and pension and postretirement liability adjustments. The components of and changes in accumulated other comprehensive income are as follows:

(in millions)	Foreign Currency Adjustments	Pension and Postretirement Liability Adjustment	Derivative Hedging Gain (Loss)	Accumulated Other Comprehensive Income/(Loss)
Balance at December 31, 2005	$ 46.5	$ (76.0)	$ 7.3	$ (22.2)
Changes during year (net of taxes of $87.9)	162.4	(93.2)	(9.1)	60.1
Balance at December 31, 2006	208.9	(169.2)	(1.8)	37.9
Changes during year (net of taxes of $129.2)	256.8	53.1	1.3	311.2
Balance at December 31, 2007	$ 465.7	$ (116.1)	$ (0.5)	$ 349.1

23. Pending Litigation

Tobacco Litigation and Indemnification

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

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

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

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Notes to Consolidated Financial Statements Fortune Brands, Inc. and Subsidiaries
23. Pending Litigation (Continued)

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

Other Litigation

The Company, its Spirits business and numerous other manufacturers and importers of beer, spirits and wine were named as defendants in purported class action lawsuits in Michigan, Ohio, Wisconsin and West Virginia seeking damages and declaratory and/or injunctive relief regarding alleged deceptive and negligent marketing of beverage alcohol to people under the legal purchase age for alcohol. All of these actions were dismissed. The Michigan and Ohio cases were remanded to the trial court to be dismissed and vacated for lack of standing, each of these were later dismissed by their respective trial courts. The dismissal of the Wisconsin case was affirmed by the Wisconsin appellate court. The appeal of the West Virginia case was voluntarily dismissed. Plaintiffs in the Ohio and Michigan cases filed a motion seeking review by the United States Supreme Court, but plaintiffs later filed a stipulation dismissing the cases with prejudice.

On March 7, 2005, Bridgestone Sports Co., Ltd and Bridgestone Golf, Inc. (collectively, Bridgestone) filed a lawsuit against Acushnet Company (one of the Company s subsidiaries) in the United States District Court for the District of Delaware. The Bridgestone complaint alleged that various golf balls manufactured by Acushnet Company (Acushnet) violate ten of Bridgestone s U.S. patents. In addition, Acushnet filed a counterclaim in the action seeking damages for infringement of five of its patents. In September 2007, Acushnet entered into a final settlement agreement with Bridgestone that resolved all claims asserted by the parties in this action. The resolution of this matter did not have a material effect on the Company s results of operations or financial position.

On February 9, 2006, Callaway Golf Company filed a lawsuit seeking unspecified damages against Acushnet Company in the United States District Court for the District of Delaware. Callaway alleges that certain golf balls manufactured by Acushnet Company infringe four of Callaway s patents. Acushnet believes, and counsel has advised, that it has meritorious defenses against Callaway s allegations. Acushnet stipulated to infringement and a jury trial on invalidity was conducted in December 2007. The jury returned a mixed verdict, finding one claim invalid and eight claims valid. Acushnet filed a motion for a judgment as a matter of law to overturn the inconsistent jury verdict and in the alternative requesting a new trial. Callaway filed a motion seeking a permanent injunction. It is not possible to predict the outcome of pending litigation, and, as with any litigation, it is possible that this action could be decided unfavorably. Acushnet is vigorously contesting this action and the Company believes that the lawsuit will not have a material adverse effect on the results of the Company s operations, cash flows or financial condition.

Notes to Consolidated Financial Statements Fortune Brands, Inc. and Subsidiaries

23. Pending Litigation (Continued)

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

In addition to the lawsuits described above, the Company and its subsidiaries are defendants in lawsuits associated with their businesses and operations. It is not possible to predict the outcome of the pending actions, and, as with any litigation, it is possible that some of these actions could be decided unfavorably. We believe that there are meritorious defenses to these actions and that these actions will not have a material adverse effect upon our results of operations, cash flows or financial condition. These actions are being vigorously contested.

24. Environmental

We are subject to laws and regulations relating to the protection of the environment. It is not possible to quantify with certainty the potential impact of actions relating to environmental matters, particularly remediation and other compliance efforts that our subsidiaries may undertake in the future due to uncertainties about the status of laws, regulations, technology and information related to individual sites. We are involved in numerous remediation actions to clean up hazardous wastes as required by federal and state laws. Based on our evaluation of the cleanup cost estimates and the compliance programs, we do not believe there is a reasonable possibility that a material loss exceeding the amounts already recognized may have been incurred. Liabilities for remediation costs at each site are based on our best estimate of undiscounted future costs, excluding possible insurance recoveries or recoveries from other third parties.

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of Fortune Brands, Inc.:

In our opinion, based on our audits and the report of other auditors, the consolidated financial statements listed in the index appearing under Item 15(a)(1) present fairly, in all material respects, the financial position of Fortune Brands, Inc. and its subsidiaries at December 31, 2007 and 2006, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2007 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, based on our audits, the financial statement schedule listed in the index appearing under Item 15(a)(2) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company s management is responsible for these financial statements, the financial statement schedule, and for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management s Report on Internal Control Over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on these financial statements, the financial statement schedule, and on the Company s internal control over financial reporting based on our integrated audits. We did not audit the financial statements of Fulham Acquisition Corp., a wholly owned subsidiary, which statements reflect total revenues of $387.1 million for the period from July 26, 2005 to December 31, 2005. The financial statements of Fulham Acquisition Corp. were audited by other auditors whose report thereon has been furnished to us, and our opinion expressed herein, insofar as it relates to the amounts included for Fulham Acquisition Corp., is based solely on the report of the other auditors. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits and the report of other auditors provide a reasonable basis for our opinions.

As discussed in Notes 11, 12 and 14 to the consolidated financial statements, the Company changed the manner in which it accounts for stock-based compensation as of January 1, 2006, the manner in which it accounts for pension and other postretirement plans as of December 31, 2006 and the manner in which it accounts for uncertain tax positions as of January 1, 2007.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made

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only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PricewaterhouseCoopers LLP

Chicago, Illinois

February 27, 2008

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholder of Fulham Acquisition Corp.

We have audited the consolidated balance sheet of Fulham Acquisition Corp. and subsidiaries as of December 31, 2005, and the related consolidated statements of operations, stockholders equity and cash flows for the period from July 26, 2005 to December 31, 2005. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Fulham Acquisition Corp. and subsidiaries as of December 31, 2005, and the results of their operations and their cash flows for the period from July 26, 2005 to December 31, 2005, in conformity with U.S. generally accepted accounting principles.

KPMG Audit Plc

London, England

February 20, 2006

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To The Shareholders Of Fortune Brands, Inc.

We have prepared the consolidated balance sheet of Fortune Brands, Inc. and Subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of income, cash flows and stockholders equity for each of the three years in the period ended December 31, 2007. The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. Financial information elsewhere in this Annual Report on Form 10-K is consistent with that in the financial statements.

Internal control over financial reporting of the Company and its subsidiaries is designed to provide reasonable assurances that the financial records are adequate and can be relied upon to provide information for the preparation of financial statements and that established policies and procedures are carefully followed.

The Company s stockholders annually ratify the appointment of the Company s independent registered public accounting firm of the Company s financial statements, PricewaterhouseCoopers LLP. Their audit is performed in accordance with the standards of the Public Company Accounting Oversight Board (United States).

The Audit Committee of the Board of Directors, consisting solely of independent directors, meets periodically with the independent auditors, internal auditors and management to review accounting, auditing, and financial reporting matters. The auditors have direct access to the Audit Committee.

/s/ BRUCE A. CARBONARI
Bruce A. Carbonari
President and
Chief Executive Officer

/s/ CRAIG P. OMTVEDT
Craig P. Omtvedt
Senior Vice President and
Chief Financial Officer

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.
None.

Item 9A. Controls and Procedures.

(a) Evaluation of Disclosure Controls and Procedures.

The Company s management has evaluated, with the participation of the Company s Chief Executive Officer and Chief Financial Officer, the effectiveness of the Company s disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that the Company s disclosure controls and procedures were effective as of the end of the period covered by this Report.

(b) Management s Report on Internal Control Over Financial Reporting.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organization of the Treadway Commission (COSO). Based on our evaluation under the framework in *Internal Control Integrated Framework* issued by the COSO, our management concluded that our internal control over financial reporting was effective as of December 31, 2007.

PricewaterhouseCoopers LLP, the registered public accounting firm that audited the consolidated financial statements included in this Report, has also audited the effectiveness of the Company s internal control over financial reporting as of December 31, 2007, as stated in their report included herein.

(c) Report of the Registered Public Accounting Firm.

The report on the effectiveness of the Company s internal control over financial reporting is provided in Item 8. Financial Statements and Supplementary Data.

(d) Changes in Internal Control Over Financial Reporting.

There have not been any changes in the Company s internal control over financial reporting that occurred during the Company s fiscal quarter ended December 31, 2007 that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

Item 9B. Other Information.

None.

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PART III

Item 10. Directors, Executive Officers and Corporate Governance.

See the information under the captions Election of Directors, Board Committees Audit Committee, Report of the Audit Committee, Certain Information Regarding Security Holdings and Section 16(a) Beneficial Ownership Reporting Compliance contained in the 2008 Proxy Statement, which information is incorporated herein by reference. See also the information with respect to executive officers of the Company under the caption Supplementary Item of Part I of this Form 10-K.

The Company s Board of Directors has adopted a Code of Ethics for the CEO and Senior Financial Officers that applies to the Company s principal executive officer, principal financial officer and principal accounting officer and controller. The Code of Ethics for the CEO and Senior Financial Officers is available, free of charge, on the Company s website, www.fortunebrands.com. A copy of this Code of Ethics for the CEO and Senior Financial Officers is also available and will be sent to shareholders free of charge upon written request to the Company s Secretary. Any amendment to, or waiver from, the provisions of the Code of Ethics for the CEO and Senior Financial Officers that applies to any of those officers will be posted to the same location on the Company s website.

Item 11. Executive Compensation.

See the information under the captions Board Committees Compensation and Stock Option Committee, 2007 Compensation, Compensation Discussion and Analysis and Compensation and Stock Option Committee Report contained in the 2008 Proxy Statement, which information is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

See the information under the captions Certain Information Regarding Security Holdings and Equity Compensation Plan Information contained in the 2008 Proxy Statement, which information is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions, and Director Independence.

See the information under the captions Director Independence, Policies with Respect to Transactions with Related Persons and Certain Relationships and Related Transactions contained in the 2008 Proxy Statement, which information is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services.

See the information under the caption Fees of Independent Registered Public Accounting Firm in the 2008 Proxy Statement, which information is incorporated herein by reference.

PART IV

Item 15. Exhibits and Financial Statement Schedules.

(a) Financial Statements, Financial Statement Schedules and Exhibits.

(1) Financial Statements (all financial statements listed below are of the Company and its consolidated subsidiaries):

Consolidated Statement of Income for the years ended December 31, 2007, 2006 and 2005 contained in Item 8 hereof.

Consolidated Balance Sheet as of December 31, 2007 and 2006 contained in Item 8 hereof.

Consolidated Statement of Cash Flows for the years ended December 31, 2007, 2006 and 2005 contained in Item 8 hereof.

Consolidated Statement of Stockholders Equity for the years ended December 31, 2007, 2006 and 2005 contained in Item 8 hereof.

Notes to Consolidated Financial Statements contained in Item 8 hereof.

Report of Independent Registered Public Accounting Firm contained in Item 8 hereof.

(2) Financial Statement Schedules

See Financial Statement Schedule of the Company and subsidiaries at page 111.

(3) Exhibits

3(i). Restated Certificate of Incorporation of the Company as in effect on the date hereof is incorporated herein by reference to Exhibit 3(i) to our Annual Report on Form 10-K for the fiscal year ended December 31, 1998, Commission file number 1-9076.

3(ii). By-laws of Fortune Brands, Inc. (as amended), as of August 20, 2007, is incorporated herein by reference to Exhibit 3.1 to the Company s Current Report on Form 8-K dated August 22, 2007, Commission file number 1-9076.

4.1. Indenture dated as of July 15, 1988 between the Company and Chemical Bank (as successor by merger to Manufacturers Hanover Trust Company) as Trustee (Chemical) is incorporated herein by reference to Exhibit 4a to our Current Report on Form 8-K dated June 27, 1989, Commission file number 1-9076.

4.2. First Supplemental Indenture dated as of November 14, 1990 between the Company and Chemical is incorporated herein by reference to Exhibit 4b to our Current Report on Form 8-K dated November 19, 1990, Commission file number 1-9076.

4.3. Second Supplemental Indenture dated as of September 1, 1991 between the Company and Chemical is incorporated herein by reference to Exhibit 4c to our Current Report on Form 8-K dated October 10, 1991, Commission file number 1-9076.

4.4. Indenture dated as of April 15, 1999 between the Company and JPMorgan Chase Bank (formerly The Chase Manhattan Bank) as Trustee is incorporated herein by reference to Exhibit 4 to our Current Report on Form 8-K dated December 10, 1999, Commission file number 1-9076.

4.5. Conformed copy of the Fiscal Agency Agreement, dated February 1, 2006, between Fortune Brands, Inc. and JPMorgan Chase Bank, N.A., including exhibits thereto, is incorporated herein by reference to Exhibit 4.1 to the Company s Current Report on Form 8-K dated February 1, 2006, Commission file number 1-9076.

10.1. Fortune Brands, Inc. Annual Executive Incentive Compensation Plan is incorporated herein by reference to Exhibit A to our Definitive Proxy Statement filed on March 9, 2007, Commission file number 1-9076.*

10.2. Fortune Brands, Inc. 1990 Long-Term Incentive Plan (As Amended and Restated as of January 1, 1994) is incorporated herein by reference to Exhibit 10a to our Quarterly Report on Form 10-Q dated August 11, 1994, Commission file number 1-9076.*

10.3. Amendment to Fortune Brands, Inc. 1990 Long-Term Incentive Plan hereto is incorporated herein by reference to Exhibit 10a1 to our Quarterly Report on Form 10-Q dated November 12, 1997, Commission file number 1-9076.*

10.4. Amendment to Fortune Brands, Inc. 1990 Long-Term Incentive Plan and Amendment thereto is incorporated herein by reference to Exhibit 10a1 to our Quarterly Report on Form 10-Q dated November 13, 2001, Commission file number 1-9076.*

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10.5. Amendment to Fortune Brands, Inc. 1990 Long-Term Incentive Plan is incorporated herein by reference to Exhibit 10.7 to our Quarterly Report on Form 10-Q dated November 8, 2007, Commission file number 1-9076.*

10.6. Fortune Brands, Inc. 1999 Long-Term Incentive Plan, as amended, is incorporated herein by reference to Exhibit 10a1 to our Quarterly Report on Form 10-Q dated August 14, 2003, Commission file number 1-9076.*

10.7. Amendment to Fortune Brands, Inc. 1999 Long-Term Incentive Plan is incorporated herein by reference to Exhibit 10.8 to our Quarterly Report on Form 10-Q dated November 8, 2007, Commission file number 1-9076.*

10.8. Fortune Brands, Inc. 2003 Long-Term Incentive Plan incorporated herein by reference to Exhibit B to our Proxy Statement filed on March 12, 2003, Commission file number 1-9076.*

10.9. Amendment to the 2003 Long-Term Incentive Plan is incorporated herein by reference to Exhibit 10a1 to our Quarterly Report on Form 10-Q dated May 5, 2004, Commission file number 1-9076.*

10.10. Amendment to the 2003 Long-Term Incentive Plan Amendment is incorporated herein by reference to Exhibit 10.1 to our Current Report on Form 8-K dated September 30, 2005, Commission file number 1-9076.*

10.11. Amendment to Fortune Brands, Inc. 2003 Long-Term Incentive Plan is incorporated herein by reference to Exhibit 10.9 to our Quarterly Report on Form 10-Q dated November 8, 2007, Commission file number 1-9076.*

10.12. Fortune Brands, Inc. 2007 Long-Term Incentive Plan is incorporated herein by reference to Exhibit B to our Proxy Statement filed on March 9, 2007, Commission file number 1-9076.*

10.13. Form of Nonqualified Stock Option Award Notice and Terms and Conditions for awards under the Fortune Brands, Inc. 2003 Long-Term Incentive Plan is incorporated herein by reference to Exhibit 10a1 to our Quarterly Report on Form 10-Q dated November 9, 2004, Commission file number 1-9076.*

10.14. September 2005 Nonqualified Stock Option Terms and Conditions for awards under the Fortune Brands, Inc. 2003 Long-Term Incentive Plan is incorporated herein by reference to Exhibit 10.3 to our Current Report on Form 8-K dated September 30, 2005, Commission file number 1-9076.*

10.15. September 2006 Nonqualified Stock Option Terms and Conditions for awards under the Fortune Brands, Inc. 2003 Long-Term Incentive Plan is incorporated herein by reference to Exhibit 10.58 to our Annual Report on Form 10-K for the fiscal year ended December 31, 2007, Commission file number 1-9076.*

10.16. Form of Nonqualified Stock Option Terms and Conditions for awards under the Fortune Brands, Inc. 2007 Long-Term Incentive Plan.*

10.17. February 2008 Nonqualified Stock Option Terms and Conditions for an award made to Bruce A. Carbonari under the Fortune Brands, Inc. 2007 Long-Term Incentive Plan.*

10.18. Form of Incentive Stock Option Award Notice and Terms and Conditions for awards under the Fortune Brands, Inc. 2003 Long-Term Incentive Plan is incorporated herein by reference to Exhibit 10b1 to our Quarterly Report on Form 10-Q dated November 9, 2004, Commission file number 1-9076.*

10.19. September 2005 Incentive Stock Option Terms and Conditions for awards under the Fortune Brands, Inc. 2003 Long-Term Incentive Plan is incorporated herein by reference to Exhibit 10.2 to our Current Report on Form 8-K dated September 30, 2005, Commission file number 1-9076.*

10.20.	September 2006 Incentive Stock Option Terms and Conditions for awards under the Fortune Brands, Inc. 2003 Long-Term Incentive Plan is incorporated herein by reference to Exhibit 10.61 to our Annual Report on Form 10-K for the fiscal year ended December 31, 2007, Commission file number 1-9076.*
10.21.	Form of Incentive Stock Option Terms and Conditions for awards under the Fortune Brands, Inc. 2007 Long-Term Incentive Plan.*
10.22.	Form of Performance Award Notice and Terms and Conditions for awards under the Fortune Brands, Inc. 2003 Long-Term Incentive Plan is incorporated herein by reference to Exhibit 10c1 to our Quarterly Report on Form 10-Q dated November 9, 2004, Commission file number 1-9076.*
10.23.	Form of Performance Award Notice and Terms and Conditions for 2006-2008 awards under the Fortune Brands, Inc. 2003 Long-Term Incentive Plan is incorporated herein by reference to Exhibit 10.2 to our Current Report on Form 8-K dated March 2, 2006, Commission file number 1-9076.*
10.24.	Form of Performance Award Notice and Terms and Conditions for 2007-2009 awards under the Fortune Brands, Inc. 2003 Long-Term Incentive Plan is incorporated herein by reference to Exhibit 10.64 to our Annual Report on Form 10-K for the fiscal year ended December 31, 2007, Commission file number 1-9076.*
10.25.	Form of Performance Stock Award Terms and Conditions for awards under the Fortune Brands, Inc. 2007 Long-Term Incentive Plan.*
10.26.	Long-Term Incentive Plan Payment Matrix for the 2005-2007 performance period for Performance Awards under the Fortune Brands, Inc. 2003 Long-Term Incentive Plan is incorporated herein by reference to Exhibit 10.1 to our Current Report on Form 8-K dated February 23, 2005, Commission file number 1-9076.*
10.27.	Long Term Incentive Plan Payment Matrix for the 2006-2008 performance period for Performance Awards under the 2003 Long-Term Incentive Plan is incorporated herein by reference to Exhibit 10.1 of the Company s Current Report on Form 8-K dated March 2, 2006, Commission file number 1-9076.*
10.28.	Description of salary and incentive pay awards for certain executive officers of Fortune Brands, Inc. for 2008.*
10.29.	Form of Restricted Stock Unit Agreements between the Company and certain executives is incorporated herein by reference to Exhibit 10.1 of the Company s Current Report on Form 8-K dated February 28, 2008, Commission file number 1-9076.*
10.30.	Restricted Stock Unit Agreement between the Company and Norman H. Wesley is incorporated herein by reference to Exhibit 10.2 of the Company s Current Report on Form 8-K dated February 28, 2008, Commission file number 1-9076.*
10.31.	Fortune Brands, Inc. Supplemental Plan, as Amended and Restated, is incorporated herein by reference to Exhibit 10.1 to our Current Report on Form 8-K dated August 6, 2007, Commission file number 1-9076.*
10.32.	Form of Trust Agreement among the Company, The Northern Trust Company (Northern), et al. establishing an aggregate rabbi trust in favor of certain executive officers for purposes of paying amounts under the Supplemental Plan is incorporated herein by reference to Exhibit 10h1 to our Annual Report on Form 10-K for the fiscal year ended December 31, 2002, Commission file number 1-9076.*

10.33. Form of Amended and Restated Trust Agreement among the Company, Northern, et al. establishing an employee grantor trust in favor of certain executive officers for purposes of paying amounts under the Supplemental Plan is incorporated herein by reference to Exhibit 10i1 to our Annual Report on Form 10-K for the fiscal year ended December 31, 2002, Commission file number 1-9076.*

10.34. Schedule identifying employee grantor Trust Agreements in favor of certain executives is incorporated herein by reference to Exhibit 10i2 to our Annual Report on Form 10-K for the year ended December 31, 2003, Commission file number 1-9076.*

10.35. Resolution of the Board of Directors of the Company adopted on July 26, 1988 with respect to retirement and health benefits provided to Mark A. Roche is incorporated herein by reference to Exhibit 10f2 to our Annual Report on Form 10-K for the fiscal year ended December 31, 1998, Commission file number 1-9076.*

10.36. Trust Agreement among Moen Incorporated, Northern Trust Company and Bruce A. Carbonari establishing an employee grantor trust for purposes of paying amounts under the Moen Incorporated Supplemental Plan.*

10.37. Form of Change in Control Agreement between the Company and each of Messrs. Wesley, Carbonari, Omtvedt, Roche, Klein and Hausberg, is incorporated herein by reference to Exhibit 10.1 to the Company s Current Report on Form 8-K filed on September 21, 2007, Commission file number 1-9076.*

10.38. Form of Trust Agreement among the Company, Northern, et al. establishing an aggregate rabbi trust in favor of certain executive officers for purposes of paying amounts under change in control agreements is incorporated herein by reference to Exhibit 10n1 to our Annual Report on Form 10-K for the fiscal year ended December 31, 2002, Commission file number 1-9076.*

10.39. Severance and Retirement Agreement dated September 19, 2007 between the Company and Norman H. Wesley is incorporated herein by reference to Exhibit 10.4 to our Current Report on Form 8-K filed on September 21, 2007, Commission file number 1-9076.*

10.40. Severance Agreement dated September 19, 2007 between the Company and Bruce A. Carbonari is incorporated herein by reference to Exhibit 10.3 to our Current Report on Form 8-K filed on September 21, 2007, Commission file number 1-9076.*

10.41. Letter Agreement dated January 2, 2002 between the Company and Bruce A. Carbonari to provide benefits upon retirement is incorporated herein by reference to Exhibit 10.81 to our Annual Report on Form 10-K for the fiscal year ended December 31, 2007, Commission file number 1-9076.*

10.42. Form of Severance Agreement between the Company and each of Messrs. Omtvedt, Roche, Klein and Hausberg, is incorporated herein by reference to Exhibit 10.2 to the Company s Current Report on Form 8-K filed on September 21, 2007, Commission file number 1-9076.*

10.43. Fortune Brands, Inc. Severance Plan for Vice Presidents, adopted as of January 1, 2000, is incorporated herein by reference to Exhibit 10a1 to our Quarterly Report on Form 10-Q dated August 11, 2000, Commission file number 1-9076.*

10.44. Form of Aircraft Time-Sharing Agreement between the Company and each of Messrs. Wesley, Carbonari and Omtvedt is incorporated herein by reference to Exhibit 10.1 to our Current Report on Form 8-K dated January 24, 2008, Commission file number 1-9076.*

10.45. Fortune Brands, Inc. Non-Employee Director Stock Option Plan is incorporated herein by reference to Exhibit 10b1 to our Quarterly Report on Form 10-Q dated August 13, 1997, Commission file number 1-9076.*

10.46. Amendment to Fortune Brands, Inc. Non-Employee Director Stock Option Plan is incorporated herein by reference to Exhibit 10a1 to our Quarterly Report on Form 10-Q dated August 13, 1998, Commission file number 1-9076.*

10.47. Amendment to Fortune Brands, Inc. Non-Employee Director Stock Option Plan and Amendment thereto is incorporated herein by reference to Exhibit 10b9 to our Annual Report on Form 10-K for the fiscal year ended December 31, 1999, Commission file number 1-9076.*

10.48. Amendment to Fortune Brands, Inc. Non-Employee Director Stock Option Plan and Amendments thereto is incorporated herein by reference to Exhibit 10a1 to our Quarterly Report on Form 10-Q dated May 15, 2001, Commission file number 1-9076.*

10.49. Amendment to Fortune Brands, Inc. Non-Employee Director Stock Option Plan is incorporated herein by reference to Exhibit 10.10 to our Quarterly Report on Form 10-Q dated November 8, 2007, Commission file number 1-9076.*

10.50. Fortune Brands, Inc. 2002 Non-Employee Director Stock Option Plan, as amended, is incorporated herein by reference to Exhibit 10a1 to our Quarterly Report on Form 10-Q dated November 12, 2003, Commission file number 1-9076.*

10.51. Amendment to Fortune Brands, Inc. 2002 Non-Employee Director Stock Option Plan is incorporated herein by reference to Exhibit 10.11 to our Quarterly Report on Form 10-Q dated November 8, 2007, Commission file number 1-9076.*

10.52. Form of Stock Option Agreement for awards under the Fortune Brands, Inc. 2002 Non-Employee Director Stock Option Plan is incorporated herein by reference to Exhibit 10d1 to our Quarterly Report on Form 10-Q dated November 9, 2004, Commission file number 1-9076.*

10.53. Fortune Brands, Inc. Stock Plan for Non-Employee Directors is incorporated herein by reference to Exhibit A to our Definitive Proxy Statement filed on March 14, 2000, Commission file number 1-9076.*

10.54. Fortune Brands, Inc. 2005 Non-Employee Director Stock Plan is incorporated herein by reference to Exhibit A to our Definitive Proxy Statement filed on March 14, 2005, Commission file number 1-9076.*

10.55. Fortune Brands, Inc. Directors Deferred Compensation Plan is incorporated herein by reference to Exhibit 10.6 to our Quarterly Report on Form 10-Q dated November 8, 2007, Commission file number 1-9076.*

10.56. Resolutions of the Board of Directors of the Company adopted on October 28, 1986 and July 26, 1988 adopting and amending a retirement plan for directors of the Company who are not officers or employees of the Company or a subsidiary thereof are incorporated herein by reference to Exhibit 10e1 to our Annual Report on Form 10-K for the fiscal year ended December 31, 1991, Commission file number 1-9076.*

10.57. Resolution of the Board of Directors of the Company adopted on July 26, 1994 amending the resolutions regarding a non-employee director retirement plan is incorporated herein by reference to Exhibit 10e2 to our Annual Report on Form 10-K for the fiscal year ended December 31, 1994, Commission file number 1-9076.*

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10.58. Resolutions of the Board of Directors of the Company adopted on January 28, 1997 providing for the accrual of benefits under the non-employee director retirement plan to cease and terminating the non-employee director retirement plan for directors elected after 1997 is incorporated herein by reference to Exhibit 10.21 to our Annual Report on Form 10-K for the fiscal year ended December 31, 2007, Commission file number 1-9076.*

10.59. Five Year Revolving Credit Agreement dated as of October 6, 2005 by and among Fortune Brands, Inc., Fortune Brands Finance UK P.L.C., the lenders that are party thereto, JPMorgan Chase Bank, N.A., as Administrative Agent, and Barclays Bank PLC and Citibank North America, Inc., as Syndication Agents, is incorporated herein by reference to Exhibit 99.2 to our Current Report on Form 8-K dated October 11, 2005, Commission file number 1-9076.

10.60. Credit Agreement dated as of April 20, 2005, among Fortune Brands, Inc., the Lenders party hereto, and Credit Suisse First Boston, as Administrative Agent, is incorporated herein by reference to Exhibit 10.1 to our Quarterly Report on Form 10-Q dated August 8, 2005, Commission file number 1-9076.

10.61. Amendment No. 1 dated as of July 24, 2005, to the Credit Agreement dated as of April 20, 2005 (the Credit Agreement), among Fortune Brands, Inc., the Lenders (as defined in Article I of the Credit Agreement), and Credit Suisse (formerly Credit Suisse First Boston), as administrative agent for the Lenders, is incorporated herein by reference to Exhibit 10.5 to our Quarterly Report on Form 10-Q dated August 8, 2005, Commission file number 1-9076.

10.62. Amended and Restated Credit Agreement dated as of July 26, 2005 among Fortune Brands, Inc., the lenders party thereto and Credit Suisse, as Administrative Agent, is incorporated herein by reference to Exhibit 99 to our Current Report on Form 8-K dated July 27, 2005, Commission file number 1-9076.

10.63. 364-Day Revolving Credit Agreement dated as of October 4, 2007 among Fortune Brands, Inc., Fortune Brands Finance UK p.l.c., the lenders party thereto, Barclays Bank PLC and Citibank, N.A., as Syndication Agents, JPMorgan Chase Bank, N.A., as Administrative Agent, is incorporated herein by reference to Exhibit 99.1 to the Company s Current Report on Form 8-K dated October 4, 2007, Commission file number 1-9076.

10.64. Indemnification Agreement dated as of December 22, 1994 among the Company, The American Tobacco Company and Brown & Williamson Tobacco Corporation.

10.65. Supplemental Agreement, dated as of July 30, 2004, among Fortune Brands, Inc., Brown & Williamson Tobacco Corporation (B&W) and R.J. Reynolds Tobacco Company (formerly known as Brown & Williamson U.S.A., Inc.) incorporated herein by reference to Exhibit 10a2 to our Quarterly Report on Form 10-Q dated August 9, 2004, Commission file number 1-9076.

10.66. Termination, Replacement and Restatement Agreement dated July 10, 2003 among the Company as Borrower, JPMorgan Chase Bank as Administrative Agent, Citibank N.A. as Administrative Agent and 14 financial institutions as lenders is incorporated herein by reference to Exhibit 10b1 to our Quarterly Report on Form 10-Q dated August 14, 2003, Commission file number 1-9076.

10.67. Master Transaction Agreement dated March 20, 2001 by and among V&S Vin & Sprit AB, The Absolut Spirits Company, Incorporated, Jim Beam Brands Worldwide, Inc., Jim Beam Brands Co. and the Company is incorporated herein by reference to Exhibit 10b1 to our Quarterly Report on Form 10-Q dated May 15, 2001, Commission file number 1-9076.

10.68. Agreement and Plan of Merger dated March 15, 2005 among the Company, ACCO World Corporation, Gemini Acquisition Sub, Inc. and General Binding Corporation is incorporated herein by reference to Exhibit 2.1 to our Current Report on Form 8-K dated March 21, 2005, Commission file number 1-9076.

10.69. Amendment to Agreement and Plan of Merger dated as of August 4, 2005 among Fortune Brands, Inc., ACCO World Corporation, Gemini Acquisition Sub, Inc. and General Binding Corporation is incorporated herein by reference to Exhibit 2.1 to our Current Report on Form 8-K dated August 8, 2005, Commission file number 1-9076.

10.70. Distribution Agreement dated March 15, 2005 between Fortune Brands, Inc. and ACCO World Corporation is incorporated herein by reference to Exhibit 2.2 to our Current Report on Form 8-K dated March 21, 2005, Commission file number 1-9076.

10.71. Amendment to Distribution Agreement dated as of August 4, 2005 between Fortune Brands, Inc. and ACCO World Corporation is incorporated herein by reference to Exhibit 2.2 to our Current Report on Form 8-K dated August 8, 2005, Commission file number 1-9076.

10.72. Tax Allocation Agreement dated as of August 16, 2005 by and between Fortune Brands, Inc. and ACCO World Corporation is incorporated herein by reference to Exhibit 10 to our Current Report on Form 8-K dated August 22, 2005, Commission file number 1-9076.

10.73. Asset Purchase Agreement dated as of April 21, 2005 among Larios Pernod Ricard, S.A., Fortune Brands, Inc., and Pernod Ricard S.A. is incorporated herein by reference to Exhibit 10.4 to our Quarterly Report on Form 10-Q dated August 8, 2005, Commission file number 1-9076.

10.74. Amended and Restated Framework Agreement dated 21 April, 2005 between Pernod Ricard S.A. and Fortune Brands, Inc. (as amended by a Deed of Variations dated 24 July 2005) is incorporated herein by reference to Exhibit 10.4 to our Quarterly Report on Form 10-Q dated August 8, 2005, Commission file number 1-9076.

10.75. Amended and Restated Transaction Co-Operation Agreement dated 21 April, 2005 among Pernod Ricard S.A., Fortune Brands, Inc. and Goal Acquisitions Limited (as amended by a Deed of Variations dated 24 July 2005) is incorporated herein by reference to Exhibit 10.2 to our Quarterly Report on Form 10-Q dated August 8, 2005, Commission file number 1-9076.

10.76. Agreement dated as of January 27, 2006 between Fortune Brands, Inc. and Pernod Ricard S.A. is incorporated herein by reference to Exhibit 99.1 to our Current Report on Form 8-K dated February 2, 2006, Commission file number 1-9076.

10.77. Agreement and Plan of Merger dated as of February 9, 2006 by and among Fortune Brands, Inc., Brightstar Acquisition, LLC and SBR, Inc. is incorporated herein by reference to Exhibit 2.1 to our Current Report on Form 8-K dated February 10, 2006, Commission file number 1-9076.

10.78. Agreement and Plan of Merger dated as of February 21, 2006 by and among Fortune Brands, Inc., Tres Acquisition Co. and Tres Investment Company is incorporated herein by reference to Exhibit 2.2 to our Current Report on Form 8-K/A dated February 22, 2006, Commission file number 1-9076.

10.79. Agreement and Plan of Merger dated as of February 21, 2006 by and among Fortune Brands, Inc., SB Ross Acquisition Co. and S. Byrl Ross Enterprises, Inc. is incorporated herein by reference to Exhibit 2.3 to our Current Report on Form 8-K/A dated February 22, 2006, Commission file number 1-9076.

10.80. Escrow and Exchange Agent Agreement dated as of June 7, 2006 by and among Fortune Brands, Inc., Brightstar Acquisition LLC, SBR, Inc., The Bank of New York, as escrow agent, and Samuel B. Ross, II, as Holders Representative is incorporated herein by reference to Exhibit 10.1 to the Company s Quarterly Report on Form 10-Q for the period ended June 30, 2006, Commission file number 1-9076.

12. Statement re computation of ratio of earnings to combined fixed charges and preferred dividends.

21. Subsidiaries of the Company.

23.1. Consent of Independent Registered Public Accounting Firm, PricewaterhouseCoopers LLP.

23.2. Consent of Independent Registered Public Accounting Firm, KPMG Audit Plc.

24. Powers of Attorney relating to execution of this Annual Report on Form 10-K.

31.1. Certificate of Chief Executive Officer Required Under Section 302 of the Sarbanes-Oxley Act of 2002.

31.2. Certificate of Chief Financial Officer Required Under Section 302 of the Sarbanes-Oxley Act of 2002.

32. Joint CEO/CFO Certification Required Under Section 906 of the Sarbanes-Oxley Act of 2002.

99. List of Pending/Terminated Cases.

* Indicates the exhibit is a management contract or compensatory plan or arrangement.
In lieu of filing certain instruments with respect to long-term debt of the kind described in Item 601(b)(4) of Regulation S-K, the Company agrees to furnish a copy of such instruments to the Securities and Exchange Commission upon request.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

FORTUNE BRANDS, INC.

(The Company)

Date: March 3, 2008

By: /s/ MARK A. ROCHE
Mark A. Roche

Senior Vice President, General Counsel and Secretary

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Schedule II Valuation and Qualifying Accounts

For the years ended December 31, 2007, 2006 and 2005

Fortune Brands, Inc. and Subsidiaries

		Additions			
(In millions)	Balance @ Beginning of Period	Charged to Expense	Charged to Other Accounts[(a)]	Write-offs and Deductions[(b)]	Balance @ End of Period
2007:					
Allowance for cash discounts	$ 7.7	$ 80.9	$	$ 81.5	$ 7.1
Allowance for returns	21.9	146.2		149.6	18.5
Allowance for doubtful accounts	19.5	14.2	3.7	9.2	28.2
	$ 49.1	$ 241.3	$ 3.7	$ 240.3	$ 53.8
2006:					
Allowance for cash discounts	$ 6.7	$ 81.3	$	$ 80.3	$ 7.7
Allowance for returns	20.0	165.8	1.6	165.5	21.9
Allowance for doubtful accounts	25.7	5.2	0.5	11.9	19.5
	$ 52.4	$ 252.3	$ 2.1	$ 257.7	$ 49.1
2005:					
Allowance for cash discounts	$ 6.5	$ 74.9	$	$ 74.7	$ 6.7
Allowance for returns	12.9	147.7		140.6	20.0
Allowance for doubtful accounts	23.1	4.1	3.9	5.4	25.7
	$ 42.5	$ 226.7	$ 3.9	$ 220.7	$ 52.4

(a) Balance at acquisition date of subsidiaries, net of dispositions.
(b) Net of recoveries of amounts written off in prior years and immaterial foreign currency impact.