

Edgar Filing: FORTUNE BRANDS INC - Form 10-Q

FORTUNE BRANDS INC  
Form 10-Q  
August 12, 2002

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period  
ended June 30, 2002

Commission file number 1-9076

FORTUNE BRANDS, INC.

-----  
(Exact name of registrant as specified in its charter)

DELAWARE

13-3295276

-----  
(State or other jurisdiction of  
incorporation or organization)

-----  
(I.R.S. Employer  
Identification No.)

300 Tower Parkway, Lincolnshire, Illinois 60069-3640

-----  
(Address of principal executive offices) (Zip Code)

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

-----  
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes (X) No ( )

The number of shares outstanding of the Registrant's common stock, par value \$3.125 per share, at July 31, 2002 was 150,083,064 shares.

PART I. FINANCIAL INFORMATION

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Item 1. FINANCIAL STATEMENTS.

FORTUNE BRANDS, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEET

(In millions)

	June 30, 2002	December 31, 2001
	-----	-----
	(Unaudited)	
Assets		
Current assets		
Cash and cash equivalents	\$ 55.7	\$ 48.7
Accounts receivable, net	970.0	860.6
Inventories		
Bulk whiskey	193.9	180.8
Other raw materials, supplies and work in process	250.4	249.6
Finished products	390.2	426.2
	-----	-----
	834.5	856.6
Other current assets	234.7	203.7
	-----	-----
Total current assets	2,094.9	1,969.6
Property, plant and equipment, net	1,194.8	1,158.4
Intangibles resulting from business acquisitions, net	2,267.9	1,789.6
Other assets	417.8	383.3
	-----	-----
Total assets	\$5,975.4 =====	\$5,300.9 =====

See Notes to Condensed Consolidated Financial Statements.

FORTUNE BRANDS, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEET

(In millions, except per share amounts)

	June 30, 2002	December 31, 2001
	-----	-----
	(Unaudited)	

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Liabilities and stockholders' equity

Current liabilities		
Notes payable to banks	\$ 56.4	\$ 37.8
Commercial paper	341.9	--
Current portion of long-term debt	1.1	1.4
Accounts payable	266.2	308.9
Accrued taxes	411.8	353.3
Accrued customer programs	126.9	132.5
Accrued salaries, wages and other compensation	111.9	100.2
Accrued expenses and other liabilities	316.2	324.3
	-----	-----
Total current liabilities	1,632.4	1,258.4
Long-term debt	974.8	950.3
Deferred income	213.8	227.2
Postretirement and other liabilities	375.3	371.5
	-----	-----
Total liabilities	3,196.3	2,807.4
	-----	-----
Minority interest in consolidated subsidiaries	398.2	390.8
Stockholders' equity		
\$2.67 Convertible Preferred stock - redeemable at Company's option	8.1	8.6
Common stock, par value \$3.125 per share, 229.6 shares issued	717.4	717.4
Paid-in capital	113.0	113.2
Accumulated other comprehensive loss	(114.0)	(131.7)
Retained earnings	4,363.3	4,157.7
Treasury stock, at cost	(2,706.9)	(2,762.5)
	-----	-----
Total stockholders' equity	2,380.9	\$2,102.7
	-----	-----
Total liabilities and stockholders' equity	\$5,975.4	\$5,300.9
	=====	=====

See Notes to Condensed Consolidated Financial Statements.

FORTUNE BRANDS, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENT OF INCOME  
for the Six Months Ended June 30, 2002 and 2001

(In millions, except per share amounts)  
(Unaudited)

	2002	2001
	-----	-----
Net sales	\$ 2,783.8	\$ 2,677.4

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Cost of products sold	1,522.8	1,474.7
Excise taxes on spirits and wine	149.3	171.4
Advertising, selling, general and administrative expenses	719.3	702.5
Amortization of intangibles	6.7	31.5
Restructuring charges	19.3	12.0
Interest and related expenses	37.7	58.9
Other income	(29.5)	(2.7)
	-----	-----
Income before income taxes	358.2	229.1
Income taxes	69.6	61.3
Minority interests	7.7	3.4
	-----	-----
Net income	\$ 280.9	\$ 164.4
	=====	=====
Earnings per share		
Basic	\$ 1.88	\$ 1.07
	=====	=====
Diluted	\$ 1.82	\$ 1.05
	=====	=====
Dividends paid per share	\$ 0.50	\$ 0.48
	=====	=====
Average number of shares outstanding		
Basic	149.5	153.2
	=====	=====
Diluted	154.3	156.4
	=====	=====

See Notes to Condensed Consolidated Financial Statements.

FORTUNE BRANDS, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENT OF INCOME  
for the Three Months Ended June 30, 2002 and 2001

(In millions, except per share amounts)  
(Unaudited)

	2002	2001
	-----	-----
Net sales	\$ 1,513.1	\$ 1,405.8
Cost of products sold	824.6	786.2
Excise taxes on spirits and wine	74.6	88.2
Advertising, selling, general and administrative expenses	375.9	353.4
Amortization of intangibles	3.4	15.8
Restructuring charges	17.5	12.0
Interest and related expenses	20.9	27.1
Other income	(23.4)	(2.5)

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Income before income taxes	219.6	125.6
Income taxes	18.9	20.8
Minority interests	3.8	1.9
Net income	\$ 196.9	\$ 102.9
Earnings per share		
Basic	\$ 1.31	\$ 0.67
Diluted	\$ 1.27	\$ 0.66
Dividends paid per share	\$ 0.25	\$ 0.24
Average number of shares outstanding		
Basic	150.3	152.7
Diluted	155.1	156.1

See Notes to Condensed Consolidated Financial Statements.

FORTUNE BRANDS, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS  
 for the Six Months Ended June 30, 2002 and 2001

(In millions)  
 (Unaudited)

	2002	2001
Operating activities		
Net income	\$ 280.9	\$ 164.4
Depreciation and amortization	86.0	110.1
Restructuring charges	19.3	12.0
Deferred taxes	15.9	(94.0)
Increase in accounts receivable	(66.1)	(16.0)
Decrease in inventories	49.7	30.0
Decrease in accounts payable, accrued expenses and other liabilities	(113.7)	(17.8)
Increase in accrued taxes	95.0	90.0
Tax benefit on exercise of stock options	(22.8)	--
Other operating activities, net	(73.8)	(111.0)
Net cash provided from operating activities	270.4	167.7
Investing activities		
Additions to property, plant and equipment	(75.1)	(84.6)
Acquisitions, net of cash acquired	(433.0)	(6.5)
Proceeds from contribution of assets to joint venture	--	270.0

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Other investing activities, net	2.1	2.8
	-----	-----
Net cash (used) provided by investing activities	(506.0)	181.7
	-----	-----
Financing activities		
Proceeds from sale of minority interest in wholly-owned subsidiary	--	375.0
Increase (decrease) in short-term debt, net	358.4	(537.8)
Issuance of long-term debt	25.0	0.2
Repayment of long-term debt	(100.7)	(6.7)
Dividends to stockholders	(75.3)	(74.0)
Cash purchases of common stock for treasury	(85.0)	(69.7)
Proceeds received from exercise of stock options	120.8	19.0
	-----	-----
Net cash provided (used) by financing activities	243.2	(294.0)
	-----	-----
Effect of foreign exchange rate changes on cash	(0.6)	(5.3)
	-----	-----
Net increase in cash and cash equivalents	7.0	50.1
	-----	-----
Cash and cash equivalents at beginning of period	48.7	20.9
	-----	-----
Cash and cash equivalents at end of period	\$ 55.7	\$ 71.0
	=====	=====

See Notes to Condensed Consolidated Financial Statements.

FORTUNE BRANDS, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY  
 for the Six Months Ended June 30, 2002 and 2001

(In millions)  
 (Unaudited)

	\$2.67 Convertible Preferred stock	Common stock	Paid-in capital	Accumulated other comprehensive loss	R e
Balance at December 31, 2000	\$ 9.2	\$ 717.4	\$ 125.9	\$ (79.6)	\$
Comprehensive income					
Net income	--	--	--	--	
Changes during the period	--	--	--	(26.8)	
	-----	-----	-----	-----	
Total comprehensive (loss) income	--	--	--	(26.8)	
	-----	-----	-----	-----	
Dividends	--	--	--	--	
Purchases	--	--	--	--	
Conversion of preferred stock and delivery of stock plan shares	(0.3)	--	(6.8)	--	
	-----	-----	-----	-----	

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Balance at June 30, 2001	\$ 8.9	\$ 717.4	\$ 119.1	\$ (106.4)	\$
	=====	=====	=====	=====	=====
Balance at December 31, 2001	\$ 8.6	\$ 717.4	\$ 113.2	\$ (131.7)	\$
Comprehensive income					
Net income	--	--	--	--	
Changes during the period	--	--	--	17.7	
	-----	-----	-----	-----	
Total comprehensive income	--	--	--	17.7	
	-----	-----	-----	-----	
Dividends	--	--	--	--	
Purchases	--	--	--	--	
Tax benefit on exercise of stock options	--	--	22.8	--	
Conversion of preferred stock, delivery of stock plan shares and sale of stock in a subsidiary	(0.5)	--	(23.0)	--	
	-----	-----	-----	-----	
Balance at June 30, 2002	\$ 8.1	\$ 717.4	\$113.0	\$ (114.0)	\$
	=====	=====	=====	=====	=====

See Notes to Condensed Consolidated Financial Statements.

FORTUNE BRANDS, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. Principles of Consolidation

The condensed consolidated balance sheet as of June 30, 2002, the related condensed consolidated statements of income for the three month and six month periods ended June 30, 2002 and 2001, and the related condensed consolidated statements of cash flows and stockholders' equity for the six month periods ended June 30, 2002 and 2001 are unaudited. In the opinion of management, all adjustments necessary for a fair presentation of such financial statements have been included. Such adjustments include restructuring and other nonrecurring charges and normal recurring items. Interim results may not be indicative of results for a full year.

The condensed consolidated financial statements and notes are presented as permitted by Form 10-Q and do not contain certain information included in the Company's annual consolidated financial statements and notes. The year-end condensed consolidated balance sheet was derived from the Company's audited financial statements, but does not include all disclosures required by generally accepted accounting principles. This Form 10-Q should be read in conjunction with the Company's consolidated financial statements and notes incorporated by reference in its 2001 Annual Report on Form 10-K.

2. Accounting Changes

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### Goodwill and Purchased Intangible Assets

In July 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("FAS Statement No. 142"). FAS Statement No. 142 requires goodwill to be tested for impairment on an annual basis and under certain circumstances, and written down when impaired, rather than amortized as previous standards required. In addition, FAS Statement No. 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 it was deemed that these tradenames are currently anticipated to contribute cash flows to the Company indefinitely. Indefinite-lived intangible assets will not be amortized, but are required to be evaluated at each reporting period to determine whether the indefinite useful life is appropriate.

FAS Statement No. 142 is effective for all fiscal years beginning after December 15, 2001. In accordance with FAS Statement No. 142, of the total intangibles of \$1.8 billion, the Company ceased amortizing

#### FORTUNE BRANDS, INC. AND SUBSIDIARIES NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

### 2. Accounting Changes (Continued)

#### Goodwill and Purchased Intangible Assets (Continued)

intangibles totaling \$1.4 billion, including \$1.1 billion of goodwill and \$0.3 billion of indefinite-lived tradenames, as of January 1, 2002.

In addition, other purchased intangible assets, primarily definite-lived tradenames, are carried at cost less accumulated amortization. The remaining tradenames are amortized over their estimated useful lives, either 15 or 30 years. The gross carrying value and accumulated amortization of the Company's amortizable intangible assets were \$518.2 million and \$171.4 million, respectively, as of June 30, 2002. These amounts do not include values related to the acquisition of Omega Holdings, Inc. These will be assigned as final valuations are completed, which is expected to occur during the third quarter of 2002. The Company's anticipated annual amortization is expected to be approximately \$16 million as compared to \$62.7 million in 2001.

The following tables present the impact of FAS Statement No. 142 on net income and net income per share had the standard been in effect for the six and three months ended June 30, 2001:

	Six Months Ended	
	June 30, 2002	June 30, 2001
	-----	-----
Net income - as reported	\$ 280.9	\$ 164.4
Adjustments:		
Amortization of goodwill	--	18.8
Amortization of tradenames	--	4.2
Income tax effect	--	(1.8)



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Net adjustments	-----	-----
	--	21.2
Net income - adjusted	-----	-----
	\$ 280.9	185.6
	=====	=====
Basic net income per share - as reported	\$ 1.88	\$ 1.07
Basic net income per share - as adjusted	\$ 1.88	\$ 1.21
Diluted net income per share - as reported	\$ 1.82	\$ 1.05
Diluted net income per share - as adjusted	\$ 1.82	\$ 1.19

FORTUNE BRANDS, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

2. Accounting Changes (Continued)

Goodwill and Purchased Intangible Assets (Concluded)

	Three Months Ended	
	June 30, 2002	June 30, 2001
	-----	-----
Net income - as reported	\$ 196.9	\$ 102.9
Adjustments:		
Amortization of goodwill	--	9.4
Amortization of tradenames	--	2.1
Income tax effect	--	(0.9)
	-----	-----
Net adjustments	--	10.6
Net income - adjusted	\$ 196.9	113.5
	=====	=====
Basic net income per share - as reported	\$ 1.31	\$ 0.67
Basic net income per share - as adjusted	\$ 1.31	\$ 0.74
Diluted net income per share - as reported	\$ 1.27	\$ 0.66
Diluted net income per share - as adjusted	\$ 1.27	\$ 0.73

As of June 30, 2002, we have performed our transitional tests and no impairment of goodwill or other intangible assets has been recognized under FAS Statement No. 142.

Net Sales

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As required by the Emerging Issues Task Force Issues No. 00-14 and No. 00-25, net sales reflect the effect of a reclassification of certain expenses - previously included in selling and general and administrative expenses - as a reduction of net sales. These reclassifications, which reduced reported net sales by \$57.0 and \$27.6 million for the six and three months ending June 30, 2001. These reclassifications did not result in a change in the Company's operating company contribution, earnings or earnings per share in any of the periods affected.

### FORTUNE BRANDS, INC. AND SUBSIDIARIES NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

#### 2. Accounting Changes (Concluded)

##### Recently Issued Accounting Standards

On July 30, 2002, the Financial Accounting Standards Board issued Financial Accounting Standard No. 146 (FAS Statement No. 146), "Accounting for Costs Associated with Exit or Disposal Activities". FAS Statement No. 146 requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. Examples of costs covered by FAS Statement No. 146 include lease termination costs and certain employee severance costs that are associated with a restructuring, discontinued operation, plant closing or other exit or disposal activity. FAS Statement No. 146 also supercedes, in its entirety, previous accounting guidance that was provided by Emerging Issues Task Force Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)."

FAS Statement No. 146 is effective for exit or disposal activities that are initiated after December 31, 2002 and the Company will apply FAS Statement No. 146 prospectively to exit or disposal activities initiated after December 31, 2002.

#### 3. Sale of Stock of Subsidiary

In January 2002, the Company completed the second of two transactions to sell shares in its wholly-owned office products subsidiary, ACCO World Corporation ("ACCO"). These two transactions resulted in an aggregate reduction of less than 2% of the Company's interest in ACCO. The Company treated the sale as an equity transaction in accordance with Company policy, recording the difference between the purchase price and the book value of the subsidiary's stock to "Paid-in-capital." As a result of the first of the two transactions, the Company recognized a net tax benefit of \$72.9 million in 2001. The two transactions resulted in a substantial tax loss carryforward that will be realized in the event the Company has qualified taxable capital gains.

#### 4. Acquisition/Joint Venture

In April 2002, the home products business acquired Omega Holdings, Inc. ("Omega"), a U.S.-based manufacturer of custom and semi-custom cabinetry. This acquisition broadens the product line, providing additional

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### FORTUNE BRANDS, INC. AND SUBSIDIARIES NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

#### 4. Acquisition/Joint Venture (Concluded)

selling opportunities across customers, and is expected to produce purchasing and manufacturing efficiencies. The cost of this acquisition was \$538 million. The cost exceeded the estimated fair value of net assets acquired by approximately \$480 million.

If Omega had been included in consolidated results from January 1, 2001, the Company's net sales, net income and diluted earnings per share would have each been 3% higher for the six months ended June 30, 2002. Similarly, net sales, net income and diluted earnings per share would have been 6%, 7% and 7% higher respectively for the six months ended June 30, 2001.

On May 31, 2001, the Company's spirits and wine business completed transactions with Vin & Sprit AB of Sweden (V&S) creating a joint venture, named Future Brands LLC (the "LLC"), to distribute over an initial ten-year period both companies' spirits and wine brands in the United States. The Company's spirits and wine business has accounted for this joint venture using the equity method of accounting. V&S paid \$270 million to gain access to the U.S. distribution network of our spirits and wine business and to acquire a 49% interest in the LLC, and paid \$375 million to purchase a 10% equity interest in Jim Beam Brands Worldwide ("JBBW") in the form of convertible preferred stock. The shares of JBBW convertible preferred stock issued to V&S are convertible into 10% of the JBBW common stock and have voting power equivalent to a 10% interest in JBBW common stock. The preferred stock is entitled to a dividend equal to the greater of 10% of the dividend paid upon JBBW common stock or 3% of the preferred stock's face value (\$375 million) plus unpaid accrued dividends; no dividends may be paid on common stock unless all unpaid accrued JBBW preferred stock dividends have been paid. V&S also received a 3-year option to increase its equity stake in JBBW by up to an additional 9.9%. V&S may require the Company to purchase the JBBW preferred stock in whole or in part at any time after May 31, 2004, or upon a change in control of JBBW, Jim Beam Brands Co. ("JBB Co."), or certain other events. The Company has accounted for the \$270 million gain on the sale of 49% of the LLC as deferred income and the resulting tax on sale as a deferred income tax asset due to certain continuing obligations of JBB Co., including, but not limited to, making payments to suppliers, employees and other parties with which the LLC has contracts in the event of a default of the LLC. In June 2001, the Company began amortizing these amounts to other income on a straight-line basis over the initial term of the agreement.

### FORTUNE BRANDS, INC. AND SUBSIDIARIES NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

#### 5. Income Taxes

In June 2002, the Company recorded a tax benefit of \$61.7 million plus after-tax interest of \$9.6 million. This resulted from new IRS regulations, issued in March 2002, that reinterpret the capital loss disallowance rules

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and enabled the Company to utilize a previously disallowed capital tax loss to offset capital gains taxed in 1996 and 1997. The Company will receive cash representing the tax refund and related interest upon the conclusion of the IRS's regular audit of our 1997 tax returns.

### 6. Information on Business Segments

Net sales and operating company contribution are as follows:

	Six Months Ended June 30,			
	Net Sales		Operating Company Contribution	
	2002	2001	2002	2001
	(In millions)			
Home products	\$1,191.8	\$ 988.0	\$ 178.6	\$ 138.3
Spirits and wine	480.8	580.2	129.0	133.9
Golf products	600.7	554.6	95.4	91.8
Office products	510.5	554.6	16.3	14.6
	\$2,783.8	\$2,677.4	\$ 419.3	\$ 378.6

FORTUNE BRANDS, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

### 6. Information on Business Segments (Continued)

	Three Months Ended June 30,			
	Net Sales		Operating Company Contribution	
	2002	2001	2002	2001
	(In millions)			
Home products	\$ 671.2	\$ 526.4	\$ 108.3	\$ 76.8
Spirits and wine	246.1	302.7	70.6	75.1
Golf products	334.7	300.4	63.9	58.3
Office products	261.1	276.3	8.6	7.3
	\$1,513.1	\$1,405.8	\$ 251.4	\$ 217.5

Operating company contribution is net sales less all costs and expenses other than restructuring and other nonrecurring charges, amortization of intangibles, corporate administrative expense, interest and related expenses, other (income) expenses, net, income taxes and minority interests.

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A reconciliation of operating company contribution to consolidated income before income taxes is as follows:

	Six Months Ended June 30,	
	2002	2001
	(In millions)	
Operating company contribution	\$419.3	\$378.6
Amortization of intangibles	6.7	31.5
Restructuring charges	19.3	12.0
Other nonrecurring charges	3.4	30.3
Interest and related expenses	37.7	58.9
Non-operating expenses	(6.0)	16.8
	\$358.2	\$229.1
	=====	=====

FORTUNE BRANDS, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

6. Information on Business Segments (Concluded)

	Three Months Ended June 30,	
	2002	2001
	(In millions)	
Operating company contribution	\$251.4	\$217.5
Amortization of intangibles	3.4	15.8
Restructuring charges	17.5	12.0
Other nonrecurring charges	2.0	30.3
Interest and related expenses	20.9	27.1
Non-operating expenses	(12.0)	6.7
	\$219.6	\$125.6
	=====	=====

7. Earnings Per Share

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

	Six Months Ended June 30,		Three Months Ended June 30,	
	2002	2001	2002	2001
	(In millions, except per share amounts)			
Net income	\$ 280.9	\$ 164.4	\$ 196.9	\$ 102.9
Less: Preferred stock dividends	0.4	0.4	0.2	0.2
	Income available to common			

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stockholders - basic	280.5	164.0	196.7	102.7
Convertible Preferred stock				
dividend requirements	0.4	0.4	0.2	0.2
	-----	-----	-----	-----
Income available to common				
stockholders - diluted	\$ 280.9	\$164.4	\$ 196.9	\$ 102.9
	=====	=====	=====	=====
Weighted average number of common				
shares outstanding - basic	149.5	\$153.2	150.3	152.7
Conversion of Convertible				
Preferred stock	1.7	1.8	1.7	1.9
Exercise of stock options	3.1	1.4	3.1	1.5
	-----	-----	-----	-----
Weighted average number of common				
shares outstanding - diluted	154.3	\$156.4	155.1	156.1
	=====	=====	=====	=====
Earnings per common share				
Basic	\$ 1.88	\$ 1.07	\$ 1.31	\$ 0.67
	=====	=====	=====	=====
Diluted	\$ 1.82	\$ 1.05	\$ 1.27	\$ 0.66
	=====	=====	=====	=====

FORTUNE BRANDS, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

8. Restructuring and Other Nonrecurring Charges

RESTRUCTURING AND OTHER NONRECURRING CHARGES PROGRAM - 2001

In April 2001, the Company announced that as a result of its evaluation of strategic options for its office products business, it would immediately begin implementing a plan designed to improve both financial results and the long-term value of the business. The Company determined that it would not divest its office products business due to weakness in the overall economy and current conditions in the office products industry. In addition, in the fourth quarter of 2001, the home products business recorded restructuring and other nonrecurring charges for workforce reductions and rationalization of operations while the golf business recorded charges for capacity reductions in select technology platforms.

As a result of these actions, the Company recorded pre-tax restructuring charges for the three-month and six-month periods ended June 30, 2002 as follows:

	Restructuring Charges	
	-----	-----
	Six Months Ended	Three Months Ended
	June 30, 2002	June 30, 2002
	-----	-----
	(In millions)	
Office products	\$19.3	\$ 17.5

The charges principally related to employee termination costs, asset write-offs and costs associated with a consolidation of manufacturing facilities.

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Reconciliation of the restructuring liability, as of June 30, 2002 is as follows:

	Balance at 12/31/01	2002 Provision	Cash Expenditures
			(In millions)
Rationalization of operations			
Employment termination costs (1)	\$ 17.1	\$ 12.2	\$ (14.7)
Other	4.7	--	(1.2)
International distribution and lease agreements	5.2	1.1	(0.5)
Loss on disposal of assets	2.4	6.0	(0.6)
	\$ 29.4	\$ 19.3	\$ (17.0)
	=====	=====	=====

(1) Of the 1,678 positions planned for elimination, 1,203 had been eliminated as of June 30, 2002.

FORTUNE BRANDS, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

### 8. Restructuring and Other Nonrecurring Charges (Concluded)

The Company expects that substantially all remaining payments will be made within the next twelve months.

During the three-month and six-month periods ended June 30, 2002, the Company recorded pre-tax other nonrecurring charges as follows:

	Other Nonrecurring Charges					
	Six Months Ended June 30, 2002			Three Months Ended June 30, 2002		
	(In millions)					
	Cost of Sales Charges	SG&A Charges	Total	Cost of Sales Charges	SG&A Charges	Total
	-----	-----	-----	-----	-----	-----
Office products	\$ 2.5	\$ 0.9	\$ 3.4	\$ 1.8	\$ 0.2	\$ 2.0

The nonrecurring charges relate to the relocation of manufacturing facilities and inventory write-offs.

RESTRUCTURING AND OTHER NONRECURRING CHARGES PROGRAM - 1999

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The following table represents our reconciliation of the restructuring liability for the 1999 program, as of June 30, 2002, as follows:

	Balance at 12/31/01 -----	Cash Expenditures -----	Adjustments to Income/ Non-Cash Write-offs -----
(In millions)			
Rationalization of operations			
Employment termination costs (1), (2)	\$2.8	\$(0.5)	\$(2.3)
International distribution and lease agreements (3)	0.5	(0.1)	(0.4)
	----	-----	----
	\$3.3	\$(0.6)	\$(2.7)
	=====	=====	=====

- (1) 2,299 positions had been eliminated as of June 30, 2002 with no additional eliminations planned.
- (2) \$0.7 of the \$2.3 classified as non-cash write-offs represents the reversal of certain employment termination costs that were reflected as a reduction of restructuring charges recorded in 2001. The remaining \$1.6 represents a reclass to reduce employment termination costs.
- (3) The amount classified as non-cash write-offs represents a reclass to reduce certain lease termination costs.

FORTUNE BRANDS, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

### 9. Comprehensive Loss

The components of accumulated other comprehensive loss are as follows:

	Foreign currency adjustments -----	Minimum pension liability adjustment -----	Accumulate other comprehe loss -----
(In millions)			
Balance at December 31, 2000	\$ (75.4)	\$ (4.2)	\$ (79.6)
Changes in six months	(26.8)	--	(26.8)
	-----	-----	-----
Balance at June 30, 2001	\$(102.2)	\$ (4.2)	\$(106.4)
	=====	=====	=====
Balance at December 31, 2001	\$(113.6)	\$ (18.1)	\$(131.7)
Changes in six months	17.8	(0.1)	17.7
	-----	-----	-----



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Balance at June 30, 2002	\$ (95.8)	\$ (18.2)	\$ (114.0)
	=====	=====	=====

Included in the foreign currency adjustments balance at June 30, 2002 are total deferred derivative losses of \$0.9 million.

For the three month periods ended June 30, 2002 and 2001, total comprehensive income resulted in income of \$216.7 million and \$99.8 million, respectively.

### 10. Pending Litigation

#### Tobacco Litigation and Indemnification

On December 22, 1994, the Company sold The American Tobacco Company subsidiary to Brown & Williamson Tobacco Corporation, a wholly-owned subsidiary of B.A.T Industries p.l.c. In connection with the sale, Brown & Williamson Tobacco Corporation and The American Tobacco Company ("the Indemnitors") agreed to indemnify the Company against claims including legal expenses arising from smoking and health and fire safe cigarette matters relating to the tobacco business of The American Tobacco Company.

The Company is a defendant in numerous actions based upon allegations that human ailments have resulted from tobacco use. Management believes that there are meritorious defenses to the pending actions, including the fact that the Company never made or sold tobacco, and these actions are being vigorously contested. However, it is not possible to predict the outcome of the pending litigation,

#### FORTUNE BRANDS, INC. AND SUBSIDIARIES NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Concluded)

### 10. Pending Litigation (Concluded)

and it is possible that some of these actions could be decided unfavorably. Management is unable to make a meaningful estimate of the amount or range of loss that could result from an unfavorable outcome of the pending litigation. Management believes that the pending actions will not have a material adverse effect upon the results of operations, cash flows or financial condition of the Company as long as the Indemnitors continue to fulfill their obligations to indemnify the Company under the aforementioned indemnification agreement.

#### Other Litigation

In addition to the lawsuits described above, the Company and its subsidiaries are defendants in lawsuits associated with their business and operations. It is not possible to predict the outcome of the pending actions, but management believes that there are meritorious defenses to these actions and that these actions will not have a material adverse effect upon the results of operations, cash flows or financial condition of the Company. These actions are being vigorously contested.

### 11. Environmental

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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. Such accruals are adjusted as new information develops or circumstances change and are not discounted. While it is not possible to quantify with certainty the potential impact of actions regarding environmental matters, particularly remediation and other compliance efforts that the Company's subsidiaries may undertake in the future, in the opinion of management, compliance with the present environmental protection laws, before taking into account estimated recoveries from third parties, will not have a material adverse effect upon the results of operations, cash flows or financial condition of the Company.

### REPORT OF INDEPENDENT ACCOUNTANTS

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

We have reviewed the accompanying condensed consolidated balance sheet of Fortune Brands, Inc. and Subsidiaries as of June 30, 2002, and the related condensed consolidated statements of income for each of the three-month and six-month periods ended June 30, 2002 and June 30, 2001, and the condensed consolidated statements of cash flows and stockholders' equity for the six-month periods ended June 30, 2002 and June 30, 2001. These financial statements are the responsibility of the Company's management.

We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying condensed consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We previously audited in accordance with auditing standards generally accepted in the United States of America, the consolidated balance sheet as of December 31, 2001, and the related consolidated statements of income, cash flows and stockholders' equity for the year then ended (not presented herein), and in our report dated January 22, 2002 we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2001, is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

PricewaterhouseCoopers LLP

Chicago, Illinois 60606  
July 17, 2002

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Item 2.

### MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

#### FORTUNE BRANDS, INC. AND SUBSIDIARIES

Results of Operations for the Six Months Ended June 30, 2002 as Compared to  
the Six Months Ended June 30, 2001

	Net Sales		Operating Company Contribution(1)	
	2002	2001	2002	2001
	-----			
	(In millions)			
Home products	\$1,191.8	\$ 988.0	\$ 178.6	\$ 138.3
Spirits and wine	480.8	580.2	129.0	133.9
Golf products	600.7	554.6	95.4	91.8
Office products	510.5	554.6	16.3	14.6
	-----	-----	-----	-----
	\$2,783.8	\$2,677.4	\$ 419.3	\$ 378.6
	=====	=====	=====	=====

(1) Operating company contribution is net sales less all costs and expenses other than restructuring and other nonrecurring charges, amortization of intangibles, corporate administrative expense, interest and related expenses, other (income) expenses, net, income taxes and minority interests.

#### CONSOLIDATED

Net sales increased \$106.4 million, or 4%. Sales benefited from the acquisition of Omega Holdings, Inc., a U.S.-based manufacturer of custom and semi-custom cabinetry, higher volumes in certain existing product lines in the home products business, and increased volumes associated with the introduction of new products and line extensions, primarily in the golf products business. These factors were offset, in part, by lower volumes in certain existing product lines, principally in the golf and office products businesses, and the sale of the U.K.-based Scotch whisky business in October 2001, as well as unfavorable foreign exchange (\$6 million). On a comparable basis, net sales increased \$115.9 million, or 5%, over the prior year period. Comparable results exclude the impact of revenues for the U.K.-based Scotch whisky business for the first six months of 2001, sales of Absolut Vodka recorded on an interim basis in the second quarter of 2001, the Omega cabinets acquisition for the second quarter of 2002, and the impact of excise taxes and foreign exchange.

#### FORTUNE BRANDS, INC. AND SUBSIDIARIES MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

CONSOLIDATED (Continued)

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Operating company contribution increased \$40.7 million, or 11%. This increase was due to sales from the Omega cabinets business, strong demand and positive operating leverage in our home products business, cost savings achieved as a result of the establishment of the Future Brands LLC spirits and wine joint venture in June 2001 and other cost containment initiatives across all of our operations, particularly in our office products business. On a comparable basis, operating company contribution increased \$34.1 million, or 9%. Comparable results exclude the impact of the U.K.-based Scotch whisky business for the first six months of 2001, sales of Absolut Vodka recorded on an interim basis in the second quarter of 2001, the Omega cabinets acquisition for the second quarter of 2002, and the impact of foreign exchange.

For the six months ended June 30, 2002, we recorded pre-tax restructuring and other nonrecurring charges in our office products business of \$22.7 million, \$15.1 million after tax, or ten cents per share. The charges principally related to employee termination costs, asset write-offs and costs associated with a consolidation and relocation of manufacturing facilities.

For the six months ended June 30, 2001, we recorded pre-tax restructuring and other nonrecurring charges of \$42.3 million (\$27.8 million after tax, or 18 cents per share). These charges principally related to product line discontinuances, rationalization of operations, expenses associated with the exploration of strategic options and workforce reduction initiatives across its operations.

Interest and related expenses decreased \$21.2 million, or 36%. This decline primarily reflected lower average borrowings as we repaid debt using proceeds received from Vin & Sprit and from the sale of the U.K.-based Scotch whiskey business as well as lower interest rates, partially offset by commercial paper borrowings used to initially finance the Omega cabinets acquisition.

The effective income tax rate comparison was impacted by the recognition, during the second quarter of 2002, of a \$61.7 million tax credit resulting from new IRS regulations that reinterpret the capital loss disallowance rules. The new regulations now enable us to utilize a previously disallowed capital tax loss to offset capital gains taxed in 1996 and 1997. The other factors impacting the effective income tax rate comparison include: the reversal of a \$31.0 million tax reserve for the years 1990 through 1992 in the second quarter of 2001; and the restructuring and other nonrecurring charges recorded in the first six months of 2002 and the second quarter of 2001. Excluding these items, the effective income tax rates for the six months ended June 30, 2002 and 2001 were 36.5% and 39.4%, respectively. This lower effective tax rate principally reflected lower goodwill amortization related to the adoption of FAS Statement No. 142.

Net income increased \$116.5 million, or 71%, to \$280.9 million, or \$1.88 basic and \$1.82 diluted per share, for the six months ended June 30, 2002

### FORTUNE BRANDS, INC. AND SUBSIDIARIES MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

CONSOLIDATED (Continued)

compared with net income of \$164.4 million, or \$1.07 basic and \$1.05 diluted per share, for the same six month period last year. This increase was attributable to the \$61.7 million tax credit recognized in the second quarter of 2002, higher operating company contribution, lower intangible amortization resulting from the

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adoption of FAS Statement No. 142, and lower interest expense.

Income from operations before net gains increased \$63.5 million to \$224.7 million, or \$1.50 basic and \$1.46 diluted per share, for the six months ended June 30, 2002 compared with \$161.2 million, or \$1.05 basic and \$1.03 diluted per share, for the six months ended June 30, 2001. For the six months ended June 30, 2002, income from operations before net gains represents net income before the \$22.7 million (\$15.1 million after tax) restructuring and other nonrecurring charges, and the recognition of a \$61.7 million tax credit and related interest of \$14.9 million (\$9.6 million after tax). For the six months ended June 30, 2001, income from operations before net gains represents net income before the \$42.3 million (\$27.8 million after tax) restructuring and other nonrecurring charges and a \$31.0 tax reserve that was no longer required for the years 1990 through 1992.

On July 30, 2002, the Financial Accounting Standards Board issued Financial Accounting Standard No. 146, "Accounting for Costs Associated with Exit or Disposal Activities". FAS Statement No. 146 requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. Examples of costs covered by the Statement include lease termination costs and certain employee severance costs that are associated with a restructuring, discontinued operation, plant closing or other exit or disposal activity. FAS Statement No. 146 supercedes in its entirety previous accounting guidance that was provided by Emerging Issues Task Force Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." FAS Statement No. 146 is effective for exit or disposal activities that are initiated after December 31, 2002, and we will apply the Statement prospectively to exit or disposal activities initiated after December 31, 2002.

As a result of an uncertain U.S. and global economic outlook, it is difficult to predict consumer spending trends and the effect they may have on our businesses in the second half of 2002.

### FORTUNE BRANDS, INC. AND SUBSIDIARIES MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

CONSOLIDATED (Concluded)

On a periodic basis, the Company evaluates the assumptions used in determining its pension liabilities and assets as well as pension expense or income based upon current economic conditions at the time the assumptions are set and historical asset returns on plan assets.

Accordingly, in late 2001, for purposes of preparing our December 31, 2001 pension disclosures and determining our consolidated 2002 pension expense, certain pension assumptions were revised. These included the weighted-average expected return on plan assets, which was lowered from 9.6% to 8.3%, and the weighted-average discount rate, which was reduced from 7.2% to 7%. These changes will result in an increase to the Company's consolidated pension expense in 2002 of approximately \$15 million. In 2001, our consolidated pension expense was \$7.3 million. Management of the Company continues to believe that these assumptions are appropriate.

FORTUNE BRANDS, INC. AND SUBSIDIARIES  
MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Home Products

Net sales increased \$203.8 million, or 21%, as a result of the acquisition of Omega Holdings, Inc., overall volume increases and higher average prices partially offset by higher rebates as well as unfavorable foreign exchange (\$1 million). The overall volume increases were attributable to the introduction of new products coupled with line extensions and higher volumes in certain existing product lines, primarily cabinets and Moen faucets. Strong demand and share gains were aided by a robust building and remodeling environment, which supported the underlying sales growth for our cabinet brands and solid growth for Moen faucets.

Operating company contribution increased \$40.3 million, or 29%. The higher operating company contribution resulted from the acquisition of Omega Holdings, Inc., higher underlying sales across all of our home businesses and positive operating leverage.

The continued consolidation of the customer base in the home products industry, for example among home centers and large homebuilders, and increased price competition will continue to present us and our competitors with pricing challenges. Customer consolidation will also present opportunities for the most innovative and efficient manufacturers and skilled marketers.

Spirits and Wine

Net sales decreased \$99.4 million, or 17%, principally due to the divestiture of the U.K.-based Scotch whisky business in October 2001 and the absence of sales of Absolut Vodka recorded on an interim basis in the second quarter of 2001, partially offset by higher average selling prices in the Jim Beam bourbon and DeKuyper product lines, increased sales of Beam ready-to-drink products in Australia and premium and super-premium products in the U.S., as well as favorable foreign exchange (\$1 million). On a comparable basis, net sales increased \$7.1 million, or 2%, over the prior year period. Comparable results exclude the impact of revenues for the U.K.-based Scotch whisky business for the first six months of 2001, sales of Absolut Vodka recorded on an interim basis in the second quarter of 2001 as well as the impact of excise taxes and foreign exchange.

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### FORTUNE BRANDS, INC. AND SUBSIDIARIES MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

#### Spirits and Wine (Concluded)

Operating company contribution decreased \$4.9 million, or 4%. On a comparable basis, operating company contribution increased \$8.7 million, or 7%. Comparable results exclude the impact of the U.K.-based Scotch whisky business for the first six months of 2001 as well as the impact of foreign exchange. The major factors impacting this comparable increase were lower distribution costs in the United States, as a result of the establishment of the Future Brands LLC joint venture in June 2001 and the higher comparable sales as well as favorable foreign exchange (\$1 million). With the establishment of Vin & Sprit's new U.S. subsidiary as the exclusive importer of Vin & Sprit's products, revenues and expenses under this interim agreement were no longer recorded by our spirits and wine business as of February 1, 2002.

The Maxxium joint venture, the merger of Grand Metropolitan and Guinness to create Diageo in late 1997, the 2001 sale of the Seagram brands to Diageo and Pernod-Ricard, the Jim Beam-Absolut U.S. distribution joint venture and the Brown-Forman and Bacardi U.S. partnership reflect the continued trend towards consolidation in the highly competitive spirits and wine business. Continued consolidation of the supplier, distributor and retailer tiers, may present pricing and service challenges for our subsidiaries and their competitors. It may also present opportunities, particularly for the most efficient and innovative competitors.

#### Golf Products

Net sales increased \$46.1 million, or 8%, on the introduction of new products coupled with line extensions (principally golf clubs and golf balls) and improved product mix, partly offset by lower volumes in certain existing product lines, as well as unfavorable foreign exchange (\$3 million). Higher overall volumes were led by increased sales of golf clubs, golf balls, golf gloves and outerwear. Operating company contribution increased \$3.6 million, or 4%, on the higher sales partly offset by higher marketing spending to support the business's new product initiatives.

Competitors whose products have significant brand awareness have introduced golf balls into their product offerings in the past three years and the golf ball industry has experienced increased price competition, partially as a result of such introductions. Largely as a result of the improved availability

### FORTUNE BRANDS, INC. AND SUBSIDIARIES MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

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### Golf Products (Concluded)

of the Titleist Pro V1 as well as the recent introduction of the Titleist NXT and Pinnacle golf balls, our golf ball business has not only recovered U.S. market share initially lost to new competitors, but has gained share year to date. The ability of the Company's golf business to maintain and increase revenues will depend upon its innovation and marketing, including the promotion of its products by professional golfers.

The United States Golf Association (USGA) and the Royal and Ancient Golf Club (R&A) establish standards for golf equipment used in the United States and outside the United States, respectively. On August 6, 2002, the USGA and R&A announced a joint decision to unify the rule relating to golf club head performance. The USGA will retain its current Coefficient of Restitution (COR) limit of .830. Beginning in 2003, the R&A will adopt the .830 limit for its Open Championship and in 2008 for all play in R&A jurisdictions. All Acushnet Company products currently conform and will continue to conform to the USGA and R&A regulations. It is difficult to determine at this time what the impact of this joint decision and the unification of the golf club head performance rule will be on the golf club industry.

Each of the USGA and the R&A has announced its intention to propose new rules addressing the overall distance standard for golf balls, golf club head size and golf club shaft length. Until more details regarding such potential rule changes become available, we cannot determine whether they would have a material effect on our group's golf equipment business and/or the golf equipment industry.

### Office Products

Net sales decreased \$44.1 million, or 8%. The lower sales resulted primarily from lower volumes in the United States and Europe as well as unfavorable foreign exchange (\$3 million). Approximately half of the sales decline was due to the full year effect of discontinued product lines resulting from initiatives to refocus the business around its core product categories; the initiatives will continue to impact sales comparisons for the remainder of 2002. The balance of the sales decrease was caused by weakness in the U.S. and European economies and, in particular, lower white-collar employment. In response to these economic conditions, our customers continued to reduce inventories although the pace of reductions slowed as the year has

FORTUNE BRANDS, INC. AND SUBSIDIARIES  
MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

### Office Products (Concluded)

progressed. The decrease in net sales was partly offset by the introduction of new products, improved product mix and lower customer rebates.

Operating company contribution improved \$1.7 million, or 12%, reflecting the cost savings achieved as a result of the business's restructuring actions and its focus on its most profitable product categories.

The office products business is increasingly concentrated in a small number of



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major customers, principally office products superstores, large retailers, wholesalers and contract stationers. The continuing consolidation of customers is causing increased pricing pressures that negatively affect results. These conditions continue to present challenges to our office products group and its competitors.

We decided, in April 2001, not to divest our office products business due to weakness in the overall economy particularly impacting the office products industry. We are currently repositioning and restructuring the business to improve both financial results and the long-term value of the business. Under this plan, our office products group is realigning and streamlining its worldwide operations, intensifying its focus on growing profitable core product categories, divesting or discontinuing non-strategic and low-return product categories and reducing overhead expenses and excess capacity. As a result of this plan, we recorded total pre-tax restructuring and other nonrecurring charges of \$22.7 million during the six months ended June 30, 2002 to complete the first phase of our repositioning program and initiate the final phase of our office products repositioning. The final phase will reduce the size of the business's manufacturing and distribution facilities by approximately one-third and we expect it will provide significant further cost savings and working capital improvements. Over the next twelve to fifteen months, we expect to take additional after-tax charges of \$30-40 million to complete this final phase. We expect the overall office products repositioning program will generate annualized pre-tax savings of approximately \$50 million.

### LIQUIDITY AND CAPITAL RESOURCES

Net cash provided from operating activities was \$270.4 million for the six months ended June 30, 2002 compared with \$167.7 million for the same six-month period last year. The principal reason for the increase was the higher net income during the six months ended June 30, 2002.

### FORTUNE BRANDS, INC. AND SUBSIDIARIES MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

### LIQUIDITY AND CAPITAL RESOURCES (Concluded)

Net cash used by investing activities for the six months ended June 30, 2002 was \$506 million, as compared with net cash provided by investing activities of \$181.7 million in the same six-month period last year. The decrease principally reflects the cash payment of \$433 million used to acquire Omega Holdings, Inc. in the second quarter of 2002 and the proceeds of \$270 million received from the sale of 49% of the LLC to V&S in connection with the formation of the Future Brands joint venture in the same six-month period last year.

Net cash provided by financing activities for the six months ended June 30, 2002 was \$243.2 million, as compared with net cash used by financing activities of \$294 million in the same six-month period last year. During the six months ended June 30, 2002, we redeemed Omega debt securities with a principal amount of \$100 million, repurchased \$85 million (1,759,000 shares repurchased) of our common stock and received proceeds from the exercise of stock options (\$120.8 million) which increased because option exercises were higher than in the same six-month period last year.

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Total debt increased \$384.7 million during the six months ended June 30, 2002 to \$1.4 billion. This increase was principally debt incurred to provide cash paid to acquire Omega Holdings, Inc. in April 2002. The ratio of total debt to total capital was 33.1% as of June 30, 2002 versus 28.4% as of December 31, 2001. We believe that our internally generated funds, together with access to global credit markets, are adequate to meet our capital needs.

Item 2.

### MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

#### FORTUNE BRANDS, INC. AND SUBSIDIARIES

Results of Operations for the Three Months Ended June 30, 2002 as Compared  
to the Three Months Ended June 30, 2001

	Net Sales		Operating Company Contribution(1)	
	2002	2001	2002	2001
	-----	-----	-----	-----
	2002	2001	2002	2001
	-----	-----	-----	-----
	(In millions)			
Home products	\$ 671.2	\$ 526.4	\$ 108.3	\$ 76.8
Spirits and wine	246.1	302.7	70.6	75.1
Golf products	334.7	300.4	63.9	58.3
Office products	261.1	276.3	8.6	7.3
	-----	-----	-----	-----
	\$1,513.1	\$1,405.8	\$251.4	\$217.5
	=====	=====	=====	=====

(1) Operating company contribution is net sales less all costs and expenses other than restructuring and other nonrecurring charges, amortization of intangibles, corporate administrative expenses, interest and related expenses, other (income) expenses, net, income taxes and minority interests.

#### CONSOLIDATED

Net sales increased \$107.3 million, or 8%, benefiting from the acquisition of Omega Holdings, Inc. In addition, increased volumes associated with the introduction of new products and line extensions, primarily in the golf products business, as well as favorable foreign exchange (\$3 million) were offset by lower volumes in certain existing product lines, principally in both the golf and office products businesses, and the sale of the U.K.-based Scotch whisky business in October 2001. On a comparable basis, net sales increased \$65.2 million, or 5%, over the prior year period. Comparable results exclude the impact of revenues for the U.K.-based Scotch whisky business in the second quarter of 2001, sales of Absolut Vodka recorded on an interim basis in the second quarter of 2001 and the Omega cabinets acquisition for the second quarter of 2002 as well as the impact of excise taxes and foreign exchange.

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CONSOLIDATED (Continued)

Operating company contribution increased \$33.9 million, or 16%, due to the acquisition of the Omega cabinets business, strong demand and positive operating leverage in our home products business, cost savings achieved as a result of the establishment of the Future Brands LLC joint venture by the Company's spirits and wine business in June 2001 and other cost containment initiatives across all of our operations, particularly in our office products business. On a comparable basis, operating company contribution increased \$21.9 million, or 11%. Comparable results exclude the impact of the U.K.-based Scotch whisky business in the second quarter of 2002, the Omega cabinets acquisition for the second quarter of 2002 and the impact of foreign exchange.

For the three months ended June 30, 2002, we recorded pre-tax restructuring and other nonrecurring charges of \$19.5 million, \$12.9 million after tax, or eight cents per share. The charges principally related to employee termination costs, asset write-offs and costs associated with a consolidation and relocation of manufacturing facilities.

For the three months ended June 30, 2001, we recorded pre-tax restructuring and other nonrecurring charges of \$42.3 million, \$27.8 million after tax, or 18 cents per share. (See the section on "Consolidated" describing the six months results for additional information on these charges.)

Interest and related expenses decreased \$6.2 million, or 23%, reflecting lower interest rates and the repayment of debt using proceeds received from V&S, partially offset by commercial paper borrowings used to initially finance the Omega cabinets acquisition.

The effective income tax rate comparison was impacted by the recognition, during the second quarter of 2002, of a \$61.7 million tax credit resulting from new IRS regulations that reinterpret the capital loss disallowance rules. The new regulations now enable us to utilize a previously disallowed capital tax loss to offset capital gains taxed in 1996 and 1997. The other factors affecting the effective income tax rate comparison include: the reversal of a \$31.0 million tax reserve for the years 1990 through 1992 in the second quarter of 2001; and the restructuring and other nonrecurring charges recorded in the second quarter of 2002 and 2001. Excluding these items, the effective income tax rates for the three months ended June 30, 2002 and 2001 were 36.5% and 39.5%, respectively. This lower effective tax rate principally reflected lower goodwill amortization related to the adoption of FAS Statement No. 142.

Net income increased \$94.0 million, or 91%, to \$196.9 million, or \$1.31 basic and \$1.27 diluted per share, compared with net income of \$102.9 million, or 67 cents basic and 66 cents diluted per share, for the same three month period last year. This increase resulted from the \$61.7 million tax credit recognized in the second quarter of 2002, higher operating company contribution, lower intangible amortization as a result of the adoption of FAS Statement No. 142, and lower interest expense.

FORTUNE BRANDS, INC. AND SUBSIDIARIES  
MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

CONSOLIDATED (Concluded)

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Income from operations before net gains increased \$38.8 million to \$138.5 million, or 92 cents basic and 89 cents diluted per share, for the three months ended June 30, 2002, compared with \$99.7 million, or 65 cents basic and 64 cents diluted per share, for the three months ended June 30, 2001. For the three months ended June 30, 2002, income from operations before net gains represents net income before the \$19.5 million (\$12.9 million after tax) restructuring and other nonrecurring charges, the recognition of a \$61.7 million tax credit and related interest of \$14.9 million (\$9.6 million after tax). For the three months ended June 30, 2001, income from operations before net gains represents net income before the \$42.3 million (\$27.8 million after tax) restructuring and other nonrecurring charges and a \$31.0 tax reserve that was no longer required for the years 1990 through 1992.

### FORTUNE BRANDS, INC. AND SUBSIDIARIES MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

#### Home Products

Net sales increased \$144.8 million, or 28%. The increase was attributable to the acquisition of Omega Holdings, Inc., overall volume increases and higher average prices, partially offset by higher rebates. The overall volume increases were attributable to line extensions and higher volumes in certain existing product lines, primarily cabinets and Moen faucets.

Operating company contribution increased \$31.5 million, or 41%, due to the acquisition of Omega, higher underlying sales across all of our home businesses and positive operating leverage.

#### Spirits and Wine

Net sales decreased \$56.6 million, or 19%, principally on the divestiture of the U.K.-based Scotch whisky business in October 2001 and the absence of sales of Absolut Vodka recorded on an interim basis in June 2001, partially offset by: higher average selling prices in the Jim Beam bourbon and DeKuyper product lines; higher sales of Beam ready-to-drink products in Australia, After Shock liqueur in the U.K. and premium and super-premium products in the U.S.; and favorable foreign exchange (\$2 million). On a comparable basis, net sales increased \$7.2 million, or 4%, over the prior year period. Comparable results exclude the impact of revenues for the U.K.-based Scotch whisky business in the second quarter of 2001, sales of Absolut Vodka recorded on an interim basis in the second quarter of 2001 as well as the impact of excise taxes and foreign exchange.

Operating company contribution decreased \$4.5 million, or 6%. On a comparable basis, operating company contribution increased \$4.4 million, or 7%. Comparable results exclude the impact of the U.K.-based Scotch whisky business in the second quarter of 2001, as well as the impact of foreign exchange. This comparable increase was attributable to lower distribution costs in the United States resulting from the Future Brands LLC joint venture established in June 2001, and the higher comparable sales as well as favorable foreign exchange (\$1 million).

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### FORTUNE BRANDS, INC. AND SUBSIDIARIES MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

#### Golf Products

Net sales increased \$34.3 million, or 11%, due to the introduction of new products coupled with line extensions (principally golf clubs and golf balls) and an improved golf ball product mix partly offset by lower volumes in certain existing product lines. Higher overall volumes were led by increased sales of new golf balls and golf clubs, golf gloves and outerwear despite a decrease in rounds of play. Given the high levels of competitors' inventories, industry conditions could be more challenging in the second half of 2002, particularly if rounds of play remain lower.

Operating company contribution increased \$5.6 million, or 10%, on the higher sales partly offset by higher marketing spending to support the business's new product initiatives.

#### Office Products

Net sales decreased \$15.2 million, or 6%. The lower sales resulted primarily from lower volumes due to industry weakness in North America and Europe and the business's exit from unprofitable product lines. Approximately half of the sales decline was due to the full year effect of discontinued product lines resulting from initiatives to refocus the business around its core product categories; the initiatives will continue to impact sales comparisons for the remainder of 2002. The balance of the sales decrease was caused by weakness in the U.S. and European economies and, in particular, lower white-collar employment. These factors were partly offset by the introduction of new products, an improved product mix shift and lower customer rebates. Inventory reductions at major customers slowed in the three months ended June 30, 2002 as compared to the three-month period ended March 31, 2002.

Operating company contribution improved \$1.3 million, or 18%, reflecting the cost savings achieved as a result of the restructuring actions of the office products business and its focus on the most profitable product categories.

### FORTUNE BRANDS, INC. AND SUBSIDIARIES MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

#### CAUTIONARY STATEMENT

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This annual report contains statements relating to future results. They are forward-looking statements as that term is defined in the Private Securities Litigation Reform Act of 1995. Readers are cautioned that these forward-looking statements speak only as of the date hereof. Actual results may differ materially from those projected as a result of certain risks and uncertainties, including but not limited to changes in general economic conditions, foreign exchange rate fluctuations, changes in interest rates, returns on pension assets, competitive product and pricing pressures, trade consolidations, the impact of excise tax increases with respect to distilled spirits, regulatory developments, the uncertainties of litigation, changes in golf equipment regulatory standards, the impact of weather, particularly on the home products and golf brand groups, expenses and disruptions related to shifts in manufacturing to different locations and sources, challenges in the integration of acquisitions and joint ventures, as well as other risks and uncertainties detailed from time to time in the Company's Securities and Exchange Commission filings.

### Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There are no material changes in the information provided in Item 7A of the Company's Form 10-K for the fiscal year ended December 31, 2001.

## PART II. OTHER INFORMATION

### Item 1. LEGAL PROCEEDINGS.

#### (a) Smoking and Health Proceedings

#### Indemnification Agreement

On December 22, 1994, Registrant sold The American Tobacco Company ("ATCO") to Brown & Williamson Tobacco Corporation ("B&W"), at the time a wholly-owned subsidiary of B.A.T. Industries p.l.c. In connection with the sale, B&W and ATCO (collectively, the "Indemnitors") agreed to indemnify Registrant against claims including legal expenses arising from smoking and health and fire safe cigarette matters relating to the tobacco business of ATCO.

#### Individual Cases

On August 1, 2002, there were approximately 77 smoking and health cases pending on behalf of individual plaintiffs in which Registrant has been named as one of the defendants, compared with approximately 76 such cases as of March 1, 2002 as reported by Registrant in its Annual Report on Form 10-K for the fiscal

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year ended December 31, 2001.

### Class Actions

As of August 1, 2002, there were approximately 13 purported smoking and health class actions pending in which Registrant has been named as one of the defendants, compared with approximately 13 such cases on March 1, 2002, as reported by Registrant in its Annual Report on Form 10-K for the fiscal year ended December 31, 2001.

### Health Care Cost Recovery Actions

As of August 1, 2002, there were approximately 2 health care cost recovery actions pending in which Registrant had been name as one of the defendants, compared with approximately 2 such cases as of March 1, 2002, as reported by Registrant in its Annual Report on Form 10-K for the fiscal year ended December 31, 2001.

### List of Pending Cases

See Exhibit 99 to this Form 10-Q for a list of additional proceedings involving the smoking and health controversy in which Registrant has been named as a defendant and not previously reported.

### List of Terminated Cases

See Exhibit 99 to this Form 10-Q for a list of smoking and health proceedings, in which Registrant has been named as a defendant, which have been terminated and have not previously been reported as such.

### Conclusion

Management believes that there are meritorious defenses to the above-mentioned pending actions, including the fact that the Company never made or sold tobacco, and these actions are being vigorously contested. However, it is not possible to predict the outcome of the pending litigation, and it is possible that some of these actions could be decided unfavorably. Management is unable to make a meaningful estimate of the amount or range of loss that could result from an unfavorable outcome of the pending litigation. Management believes that the pending actions will not have a material adverse effect upon the results of operations, cash flows or financial condition of Registrant as long as the Indemnitors continue to fulfill their obligations to indemnify Registrant under the aforementioned indemnification agreement.

(b) Reference is made to Note 10, "Pending Litigation", in the Notes to Condensed Consolidation Financial Statements set forth in Part I, Item 1 of this Quarterly Report on Form 10-Q.

### Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

(a) The Annual Meeting of Stockholders was held on April 30, 2002.

(b) Registrant's Certificate of Incorporation provides for the classification of the Board of Directors into three classes, as nearly equal in number as possible, with staggered terms of office and provides that upon the expiration of the term of office for a class of directors, nominees for such class shall be elected for a term of three years or until their successors are duly elected and qualified. The two nominees for Class I directors, Mr. Thomas C.

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Hays and Mr. Gordon R. Lohman, were duly elected at the 2002 Annual Meeting for a term of office expiring at the 2005 Annual Meeting. The term of office of the Class II directors, Ms. Patricia O. Ewers, Mr. John W. Johnstone, Jr., Mr. Eugene A. Renna and Mr. David M. Thomas, and the Class III directors, Ms. Anne M. Tatlock, Mr. Norman H. Wesley and Mr. Peter M. Wilson, also continued after the 2002 Annual Meeting.

- (c) (i) The two nominees for Class I directors were elected by a plurality of the combined votes cast by the holders of Registrant's Common Stock and \$2.67 Convertible Preferred

Stock voting thereon: (A) Mr. Hays: 134,243,150 votes for and 1,393,399 votes withheld; (B) Mr. Lohman: 134,196,696 votes for and 1,439,853 votes withheld;

(ii) A proposal (designated Item 2 and set forth in Registrant's Proxy Statement), approved by the Board of Directors, to elect PricewaterhouseCoopers LLP independent accountants of Registrant for the year 2002, was approved by a majority of the combined votes cast by the holders of Registrant's Common Stock and \$2.67 Convertible Preferred Stock voting thereon: 132,160,320 affirmative votes; 2,668,675 negative votes; and 807,554 votes abstained.

(iii) A proposal (designated Item 3 and set forth in Registrant's Proxy Statement), approved by the Board of Directors, to approve the Registrant's Annual Executive Incentive Compensation Plan, was approved by a majority of the combined votes cast by the holders of Registrant's Common Stock and \$2.67 Convertible Preferred Stock voting thereon: 127,939,636 affirmative votes; 5,916,609 negative votes; and 1,697,544 votes abstained.

(iv) A proposal (designated Item 4 and set forth in Registrant's Proxy Statement), from a stockholder, Nick Rossi, relating to the Registrant's rights plan, was approved by a majority of the combined votes cast by the holders of Registrant's Common Stock and \$2.67 Convertible Preferred Stock voting thereon: 75,074,560 affirmative votes; 39,519,276 negative votes; and 18,336,226 votes abstained.

### Item 6. EXHIBITS AND REPORTS ON FORM 8-K.

#### (a) Exhibits

- 10a1. Termination, Replacement and Restatement Agreement, dated as of July 12, 2002, by and among Registrant as Borrower, JPMorgan Chase Bank as Administrative Agent, Citibank, N.A. as Syndication Agent and 14 financial institutions as Lenders.
12. Statement re computation of ratio of earnings to fixed charges.
15. Letter from PricewaterhouseCoopers LLP dated August 12, 2002 re unaudited financial information.
- 99.1 List of Pending/Terminated Cases.



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99.2 Joint CEO/CFO Certificate Required Under Section 906 of The Sarbanes-Oxley Act of 2002

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, Registrant agrees to furnish a copy of such instruments to the Securities and Exchange Commission upon request.

(b) Reports on Form 8-K

Registrant furnished a Current Report on Form 8-K, dated April 5, 2002, in respect of Registrant's press release dated April 5, 2002 announcing Registrant's acquisition of The Omega Group, a manufacturer of kitchen and bath cabinetry (Items 7(c) and 9).

Registrant filed a Current Report on Form 8-K, dated April 18, 2002, in respect of Registrant's press release dated April 18, 2002 announcing Registrant's financial results for the three month period ended March 31, 2002 (Items 5 and 7(c)).

Registrant filed a Current Report on Form 8-K, dated April 29, 2002, in respect of the completion of Registrant's acquisition of The Omega Group (Items 2 and 7(c)).

Registrant furnished a Current Report on Form 8-K, dated May 2, 2002, in respect of distribution of Registrant's revised investor brochure dated May 1, 2002 (Item 7(c) and 9).

Registrant filed a Current Report on Form 8-K, dated June 13, 2002, in respect of Registrant's press release dated June 13, 2002 announcing Registrant's revised target for its second quarter earnings results. (Items 5 and 7(c)).

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Quarterly Report to be signed on its behalf by the undersigned, thereunto duly authorized.

FORTUNE BRANDS, INC.

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(Registrant)

Date: August 12, 2002

By /s/ C. P. Omtvedt

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C. P. Omtvedt  
Senior Vice President  
and Chief Financial Officer

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EXHIBIT INDEX

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