

Edgar Filing: FORTUNE BRANDS INC - Form 10-Q

FORTUNE BRANDS INC  
Form 10-Q  
May 15, 2003

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 March 31, 2003

Commission file number 1-9076

FORTUNE BRANDS, INC.

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

DELAWARE

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

13-3295276

-----  
(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 ( )

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes (X) No ( )

The number of shares outstanding of the Registrant's common stock, par value \$3.125 per share, at April 30, 2003 was 145,319,288 shares.

PART I. FINANCIAL INFORMATION

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## Item 1. FINANCIAL STATEMENTS.

### FORTUNE BRANDS, INC. AND SUBSIDIARIES CONDENSED CONSOLIDATED BALANCE SHEET

(In millions)  
(Unaudited)

|                                                                       | March 31,<br>2003 | December 31,<br>2002 |
|-----------------------------------------------------------------------|-------------------|----------------------|
|                                                                       | -----             | -----                |
| Assets                                                                |                   |                      |
| Current assets                                                        |                   |                      |
| Cash and cash equivalents                                             | \$ 103.7          | \$ 15.4              |
| Accounts receivable, net                                              | 899.0             | 845.1                |
| Inventories                                                           |                   |                      |
| Bulk whiskey                                                          | 208.5             | 200.5                |
| Other raw materials, supplies and<br>work in process                  | 247.6             | 247.0                |
| Finished products                                                     | 404.8             | 388.3                |
|                                                                       | -----             | -----                |
|                                                                       | 860.9             | 835.8                |
| Other current assets                                                  | 228.9             | 206.8                |
|                                                                       | -----             | -----                |
| Total current assets                                                  | 2,092.5           | 1,903.1              |
| Property, plant and equipment, net                                    | 1,173.1           | 1,189.6              |
| Goodwill resulting from business<br>acquisitions, net                 | 1,448.8           | 1,443.6              |
| Other intangibles assets resulting<br>from business acquisitions, net | 885.2             | 889.1                |
| Other assets                                                          | 393.9             | 396.8                |
|                                                                       | -----             | -----                |
| Total assets                                                          | \$5,993.5         | \$5,822.2            |
|                                                                       | =====             | =====                |

See Notes to Condensed Consolidated Financial Statements.

### FORTUNE BRANDS, INC. AND SUBSIDIARIES CONDENSED CONSOLIDATED BALANCE SHEET

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

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|                                                                           | March 31,<br>2003<br>----- | December 31,<br>2002<br>----- |
|---------------------------------------------------------------------------|----------------------------|-------------------------------|
| Liabilities and stockholders' equity                                      |                            |                               |
| Current liabilities                                                       |                            |                               |
| Notes payable to banks                                                    | \$ 51.0                    | \$ 37.8                       |
| Commercial paper                                                          | 326.4                      | 123.5                         |
| Current portion of long-term debt                                         | 132.6                      | 132.9                         |
| Accounts payable                                                          | 275.2                      | 268.2                         |
| Accrued taxes                                                             | 381.8                      | 316.7                         |
| Accrued customer programs                                                 | 120.9                      | 152.8                         |
| Accrued salaries, wages and other compensation                            | 87.2                       | 141.3                         |
| Accrued expenses and other liabilities                                    | 311.0                      | 341.5                         |
|                                                                           | -----                      | -----                         |
| Total current liabilities                                                 | 1,686.1                    | 1,514.7                       |
| Long-term debt                                                            | 841.7                      | 841.7                         |
| Deferred income                                                           | 193.5                      | 200.2                         |
| Postretirement and other liabilities                                      | 560.1                      | 553.5                         |
|                                                                           | -----                      | -----                         |
| Total liabilities                                                         | 3,281.4                    | 3,110.1                       |
|                                                                           | -----                      | -----                         |
| Minority interest in consolidated subsidiaries                            | 398.9                      | 398.9                         |
| Stockholders' equity                                                      |                            |                               |
| \$2.67 Convertible Preferred stock -<br>redeemable at Company's option    | 7.8                        | 7.9                           |
| Common stock, par value \$3.125 per<br>share, 229.6 million shares issued | 717.4                      | 717.4                         |
| Paid-in capital                                                           | 115.2                      | 116.0                         |
| Accumulated other<br>comprehensive loss                                   | (158.0)                    | (177.6)                       |
| Retained earnings                                                         | 4,589.7                    | 4,529.9                       |
| Treasury stock, at cost                                                   | (2,958.9)                  | (2,880.4)                     |
|                                                                           | -----                      | -----                         |
| Total stockholders' equity                                                | 2,313.2                    | 2,313.2                       |
|                                                                           | -----                      | -----                         |
| Total liabilities and<br>stockholders' equity                             | \$5,993.5                  | \$5,822.2                     |
|                                                                           | =====                      | =====                         |

See Notes to Condensed Consolidated Financial Statements.

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|                                                           | 2003       | 2002       |
|-----------------------------------------------------------|------------|------------|
|                                                           | -----      | -----      |
| Net sales                                                 | \$ 1,392.1 | \$ 1,270.4 |
| Cost of products sold                                     | 770.7      | 698.2      |
| Excise taxes on spirits and wine                          | 70.5       | 74.7       |
| Advertising, selling, general and administrative expenses | 371.4      | 343.4      |
| Amortization of intangibles                               | 4.8        | 3.3        |
| Restructuring charges                                     | 2.1        | 1.8        |
|                                                           | -----      | -----      |
| Operating income                                          | 172.6      | 149.0      |
| Interest and related expenses                             | 18.2       | 16.8       |
| Other income, net                                         | (8.9)      | (6.4)      |
|                                                           | -----      | -----      |
| Income before income taxes and minority interests         | 163.3      | 138.6      |
| Income taxes                                              | 59.5       | 50.7       |
| Minority interests                                        | 4.3        | 3.9        |
|                                                           | -----      | -----      |
| Net income                                                | \$ 99.5    | \$ 84.0    |
|                                                           | =====      | =====      |
| Earnings per common share                                 |            |            |
| Basic                                                     | \$ 0.68    | \$ 0.57    |
|                                                           | =====      | =====      |
| Diluted                                                   | \$ 0.66    | \$ 0.55    |
|                                                           | =====      | =====      |
| Dividends paid per common share                           | \$ 0.27    | \$ 0.25    |
|                                                           | =====      | =====      |
| Average number of common shares outstanding               |            |            |
| Basic                                                     | 146.2      | 148.8      |
|                                                           | =====      | =====      |
| Diluted                                                   | 149.9      | 153.5      |
|                                                           | =====      | =====      |

See Notes to Condensed Consolidated Financial Statements.

FORTUNE BRANDS, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS  
for the Three Months Ended March 31, 2003 and 2002

-----  
(In millions)  
(Unaudited)

2003 2002

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|                                                                      |          |         |
|----------------------------------------------------------------------|----------|---------|
|                                                                      | -----    | -----   |
| Operating activities                                                 |          |         |
| Net income                                                           | \$ 99.5  | \$ 84.0 |
| Restructuring charges                                                | 1.7      | 0.4     |
| Depreciation and amortization                                        | 46.0     | 41.6    |
| Deferred income taxes                                                | 36.4     | 13.3    |
| Increase in accounts receivable                                      | (46.1)   | (32.6)  |
| (Increase) decrease in inventories                                   | (17.4)   | 59.3    |
| Decrease in accounts payable, accrued expenses and other liabilities | (83.1)   | (130.3) |
| Increase in accrued taxes                                            | 27.5     | 24.0    |
| Tax benefit on exercise of stock options                             | 0.6      | --      |
| Other operating activities, net                                      | (16.3)   | 2.6     |
|                                                                      | -----    | -----   |
| Net cash provided from operating activities                          | 48.8     | 62.3    |
|                                                                      | -----    | -----   |
| Investing activities                                                 |          |         |
| Additions to property, plant and equipment                           | (31.3)   | (31.4)  |
| Proceeds from the disposition of property, plant and equipment       | 2.9      | 1.1     |
|                                                                      | -----    | -----   |
| Net cash used by investing activities                                | (28.4)   | (30.3)  |
|                                                                      | -----    | -----   |
| Financing activities                                                 |          |         |
| Increase in short-term debt, net                                     | 215.2    | 20.1    |
| Dividends paid to stockholders                                       | (39.7)   | (37.4)  |
| Cash purchases of common stock for treasury                          | (90.3)   | (52.1)  |
| Proceeds received from exercise of stock options                     | 5.7      | 80.6    |
| Other financing activities, net                                      | (24.9)   | (0.5)   |
|                                                                      | -----    | -----   |
| Net cash provided by financing activities                            | 66.0     | 10.7    |
|                                                                      | -----    | -----   |
| Effect of foreign exchange rate changes on cash                      | 1.9      | 0.4     |
|                                                                      | -----    | -----   |
| Net increase in cash and cash equivalents                            | 88.3     | 43.1    |
|                                                                      |          |         |
| Cash and cash equivalents at beginning of period                     | \$ 15.4  | \$ 48.7 |
|                                                                      | -----    | -----   |
| Cash and cash equivalents at end of period                           | \$ 103.7 | \$ 91.8 |
|                                                                      | =====    | =====   |

See Notes to Condensed Consolidated Financial Statements.

FORTUNE BRANDS, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY  
for the Three Months Ended March 31, 2003 and 2002

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(In millions)  
(Unaudited)

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|                                                                                                    | \$2.67<br>Convertible<br>Preferred<br>Stock | Common<br>stock | Paid-in<br>capital | Accumulated<br>other<br>comprehensive<br>loss | Retain<br>earnings |
|----------------------------------------------------------------------------------------------------|---------------------------------------------|-----------------|--------------------|-----------------------------------------------|--------------------|
| Balance at December 31, 2001                                                                       | \$ 8.6                                      | \$ 717.4        | \$ 113.2           | \$ (131.7)                                    | \$4,157            |
| Comprehensive income                                                                               |                                             |                 |                    |                                               |                    |
| Net income                                                                                         | --                                          | --              | --                 | --                                            | 84                 |
| Changes during the period                                                                          | --                                          | --              | --                 | (2.1)                                         | --                 |
| Total Comprehensive (loss) income                                                                  | --                                          | --              | --                 | (2.1)                                         | 84                 |
| Dividends                                                                                          | --                                          | --              | --                 | --                                            | (37)               |
| Purchases                                                                                          | --                                          | --              | --                 | --                                            | --                 |
| Tax benefit on exercise of stock<br>options                                                        | --                                          | --              | --                 | --                                            | --                 |
| Conversion of preferred stock,<br>delivery of stock plan shares and<br>sale of stock in subsidiary | (0.3)                                       | --              | (16.1)             | --                                            | --                 |
| Balance at March 31, 2002                                                                          | \$ 8.3                                      | \$ 717.4        | \$ 97.1            | \$ (133.8)                                    | \$4,204            |
| Balance at December 31, 2002                                                                       | \$ 7.9                                      | \$ 717.4        | \$ 116.0           | \$ (177.6)                                    | \$4,529            |
| Comprehensive income                                                                               |                                             |                 |                    |                                               |                    |
| Net income                                                                                         | --                                          | --              | --                 | --                                            | 99                 |
| Changes during the period                                                                          | --                                          | --              | --                 | 19.6                                          | --                 |
| Total Comprehensive income                                                                         | --                                          | --              | --                 | 19.6                                          | 99                 |
| Dividends                                                                                          | --                                          | --              | --                 | --                                            | (39)               |
| Purchases                                                                                          | --                                          | --              | --                 | --                                            | --                 |
| Tax benefit on exercise of stock<br>options                                                        | --                                          | --              | 0.6                | --                                            | --                 |
| Conversion of preferred stock and<br>delivery of stock plan shares                                 | (0.1)                                       | --              | (1.4)              | --                                            | --                 |
| Balance at March 31, 2003                                                                          | \$ 7.8                                      | \$ 717.4        | \$ 115.2           | \$ (158.0)                                    | \$4,589            |

See Notes to Condensed Consolidated Financial Statements.

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

1. Principles of Consolidation

The condensed consolidated balance sheet as of March 31, 2003, the

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related condensed consolidated statements of income for the three month periods ended March 31, 2003 and 2002, and the related condensed consolidated statements of cash flows and stockholders' equity for the three month periods ended March 31, 2003 and 2002 are unaudited. In the opinion of management, all adjustments necessary for a fair presentation of such financial statements have been included. Such adjustments included restructuring and restructuring-related charges in 2003 and 2002. 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 2002 Annual Report on Form 10-K.

### 2. Accounting Changes

#### Costs Associated with Exit or Disposal Activities

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In July 2002, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard No. 146 (SFAS 146), "Accounting for Costs Associated with Exit or Disposal Activities." SFAS 146 requires companies to initially recognize and measure costs associated with exit or disposal activities at fair value only when the liability is incurred rather than at the date of a commitment to an exit or disposal plan. Examples of costs covered by SFAS 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. SFAS 146 also supercedes, in its entirety, previous accounting guidance that was provided by Emerging Issues Task Force Issue No. 94-3 (EITF 94-3), "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." SFAS 146 is effective for exit or disposal activities initiated after December 31, 2002. The adoption of SFAS 146 did not have a material impact for the three months ended March 31, 2003 on the Company's operating results or financial position.

## FORTUNE BRANDS, INC. AND SUBSIDIARIES

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

### 2. Accounting Changes (Concluded)

#### Costs Associated with Exit or Disposal Activities (Concluded)

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See Note 10 to the Condensed Consolidated Financial Statements for further discussion.

#### Consolidation of Variable Interest Entities

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In January 2003, the FASB issued Interpretation No. 46 (FIN 46), "Consolidation of Variable Interest Entities." The objective of FIN 46 is to improve financial reporting by companies with transactions involving variable interest entities. Prior to FIN 46, companies generally included another entity in its consolidated financial statements only if it controlled the entity through voting interests. FIN 46 changes that by requiring a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk or loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. Consolidation by a primary beneficiary of the assets, liabilities and results of activities of variable interest entities will provide more complete information about the resources, obligations, risks and opportunities of the consolidated company. FIN 46 is effective for newly created variable interest entities as of January 31, 2003 and will be effective for existing variable interest entities as of July 1, 2003. The adoption of FIN 46 will not have an impact on the Company's results or financial position.

### 3. Guarantees and Commitments

Financial Accounting Standards Board Interpretation No. 45 (FIN 45), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantee's of Indebtedness of Others," was issued in November 2002. FIN 45 requires that upon issuance of a guarantee, the guarantor must disclose and recognize a liability for the fair value of the obligation it assumes under that guarantee. The initial recognition and measurement requirement of FIN 45 is effective for guarantees issued or modified after December 31, 2002. The Company has not issued or modified any guarantees since December 31, 2002.

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

### 3. Guarantees and Commitments (Concluded)

Guarantees and Commitments: As of March 31, 2003, the Company had third-party guarantees totaling approximately \$70 million. These represent guarantees of Maxxium Worldwide B.V. debt. The Company is required to perform under these guarantees in the event that the guaranteed party fails to make contractual payments.

The Company has provided certain indemnities pursuant to which it may be required to make payments to an indemnified party in connection with certain divestitures. These indemnities relate to various representations typically included in divestitures 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 atypical for such transactions. Accordingly, pursuant to FIN 45, payments under these divestiture-related indemnity obligations cannot be reasonably estimated. The duration of the indemnities varies, and in some cases is indefinite. We have not recorded any liability for these indemnities in the consolidated financial statements.

The Company has not made any payments related to indemnity obligations that were material to the company's financial position or results of operations for any quarter. Furthermore, the Company does not expect that

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any sums it may have to pay in connection with any of these indemnity obligations would have a material adverse effect on our consolidated financial position for fiscal 2003 or in subsequent periods.

The Company has not recorded a liability for these guarantees and indemnities as they have been excluded from the initial recognition and measurement provisions pursuant to FIN 45.

### 4. Acquisitions

In April 2002, the home and hardware business acquired Omega Holdings, Inc. (Omega), a U.S.-based manufacturer of custom and semi-custom cabinetry. This acquisition broadens our cabinet product line and is providing additional selling opportunities across customers, while producing purchasing and manufacturing efficiencies.

If Omega had been included in our results of operations during the three months ended March 31, 2002, the Company's unaudited pro forma net sales for the quarter would have been 7% higher and net income and diluted earnings per share would each have been 10% higher.

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

### 5. Goodwill and Other Identifiable Intangibles

The Company carries finite-lived identifiable intangibles, principally tradenames, that are subject to amortization over their estimated useful life, either 15 or 30 years. The gross carrying value and accumulated amortization of the Company's amortizable intangible assets were \$586.9 million and \$183.8 million, respectively, as of March 31, 2003.

The Company's intangible amortization was \$4.8 million and \$3.3 million, respectively, for the three months ended March 31, 2003 and 2002. The Company expects to record intangible amortization of approximately \$19.0 million for each of the next five fiscal years ending December 31, 2003 through December 31, 2007.

In addition to these amortizable intangibles, the Company also had goodwill of approximately \$1.5 billion as of March 31, 2003 and indefinite-lived intangibles, principally tradenames, of \$482.1 million as of March 31, 2003. The change in goodwill during the three months ended March 31, 2003 of \$5.2 million was attributable to Omega purchase accounting adjustments and foreign currency fluctuations.

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

### 6. Information on Business Segments

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Net sales and operating income for the three months ended March 31, 2003 and 2002 by segment are as follows:

|                   | Net Sales     |           |
|-------------------|---------------|-----------|
|                   | 2003          | 2002      |
|                   | -----         | -----     |
|                   | (In millions) |           |
| Home and hardware | \$ 620.6      | \$ 520.3  |
| Spirits and wine  | 239.2         | 234.7     |
| Golf              | 282.4         | 266.0     |
| Office            | 249.9         | 249.4     |
|                   | -----         | -----     |
|                   | \$1,392.1     | \$1,270.4 |
|                   | =====         | =====     |

|                    | Operating Income |         |
|--------------------|------------------|---------|
|                    | 2003             | 2002    |
|                    | -----            | -----   |
|                    | (In millions)    |         |
| Home and hardware  | \$ 88.3          | \$ 70.0 |
| Spirits and wine   | 57.9             | 56.3    |
| Golf               | 32.7             | 30.9    |
| Office             | 8.0              | 3.9     |
|                    | -----            | -----   |
| Less:              |                  |         |
| Corporate expenses | 14.3             | 12.1    |
|                    | -----            | -----   |
| Operating income   | \$ 172.6         | \$149.0 |
|                    | =====            | =====   |

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

#### 7. Earnings Per Share

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

Three Months Ended

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|                                                                   | March 31,                                     |         |
|-------------------------------------------------------------------|-----------------------------------------------|---------|
|                                                                   | 2003                                          | 2002    |
|                                                                   | (In millions,<br>except per<br>share amounts) |         |
| Net income                                                        | \$ 99.5                                       | \$ 84.0 |
| Less: Preferred stock dividends                                   | 0.2                                           | 0.2     |
| Income available to common<br>stockholders - basic                | 99.3                                          | 83.8    |
| Convertible Preferred stock<br>dividend requirements              | 0.2                                           | 0.2     |
| Income available to common<br>stockholders - diluted              | \$ 99.5                                       | \$ 84.0 |
| Weighted average number of common<br>shares outstanding - basic   | 146.2                                         | 148.8   |
| Conversion of Convertible<br>Preferred stock                      | 1.6                                           | 1.8     |
| Exercise of stock options                                         | 2.1                                           | 2.9     |
| Weighted average number of common<br>shares outstanding - diluted | 149.9                                         | 153.5   |
| Earnings per common share                                         |                                               |         |
| Basic                                                             | \$ 0.68                                       | \$ 0.57 |
| Diluted                                                           | \$ 0.66                                       | \$ 0.55 |

## 8. Stock Plans

The 1999 Long-Term Incentive Plan authorizes the granting to key employees of the Company and its subsidiaries of incentive and nonqualified stock options, stock appreciation rights, restricted stock, performance awards and other stock-based awards, any of which may be granted alone or in combination with other types of awards or dividend equivalents. Such grants may be made on or before December 31, 2004 for up to 12 million shares of common stock, but no more than two million shares may be granted to any one individual. Stock options, stock appreciation rights, restricted stock, performance awards and other stock-based awards may no longer be granted under the Company's 1990 Long-Term Incentive Plan, as amended.

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

## 8. Stock Plans (Continued)

Outstanding awards under the 1990 Long-Term Incentive Plan may continue to be exercised or paid pursuant to their terms.

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Stock options under the Plans have exercise prices equal to fair market values at dates of grant. Options generally may not be exercised prior to one year or more than ten years from the date of grant. Options granted since November 1998 generally vest one-third each year over a three-year period after the date of grant. Stock appreciation rights, which may be granted in conjunction with option grants, permit the optionees to receive shares of common stock, cash or a combination of shares and cash measured by the difference between the option exercise price and the fair market value of the common stock at the time of exercise of such right.

The Company applies APB Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations in accounting for its stock plans as allowed under Statement of Financial Accounting Standards No. 148 (SFAS 148), "Accounting for Stock-Based Compensation - Transition and Disclosure." Had compensation cost for the fixed stock options been determined in accordance with SFAS 148, pro forma net income and earnings per common share for the three months ended March 31, 2003 and 2002 would have been as follows:

| (In millions, except per share amounts)                                                                                       | 2003    | 2002    |
|-------------------------------------------------------------------------------------------------------------------------------|---------|---------|
| Net income - as reported                                                                                                      | \$ 99.5 | \$ 84.0 |
| Deduct: Total stock-based employee compensation<br>determined under the fair-value based method for all awards,<br>net of tax | 5.4     | 3.0     |
| Pro forma net income                                                                                                          | \$ 94.1 | \$ 81.0 |
| Earnings per Common share                                                                                                     |         |         |
| Basic - as reported                                                                                                           | \$ 0.68 | \$ 0.57 |
| Basic - pro forma                                                                                                             | \$ 0.64 | \$ 0.54 |
| Diluted - as reported                                                                                                         | \$ 0.66 | \$ 0.55 |
| Diluted - pro forma                                                                                                           | \$ 0.63 | \$ 0.53 |

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

#### 8. Stock Plans (Concluded)

The weighted-average fair values of options granted during 2003 and 2002 were \$10.08 and \$11.63, respectively. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants in 2003 and 2002:

|                         | 2003 | 2002 |
|-------------------------|------|------|
| Expected dividend yield | 2.5% | 2.3% |

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|                         |           |           |
|-------------------------|-----------|-----------|
| Expected volatility     | 31.2%     | 30.6%     |
| Risk-free interest rate | 2.7%      | 2.7%      |
| Expected term           | 4.5 Years | 4.5 Years |

### 9. Product Warranties

The Company records warranty expense at the time of sale. The Company offers its customers various warranty terms based upon the type of product that is sold. In addition, the Company does not offer extended warranty terms on any of the products it sells.

The following table summarizes the activity related to the Company's product warranty liability during the three month period ended March 31, 2003:

(In millions)

|                                                   |        |
|---------------------------------------------------|--------|
| Balance as of January 1, 2003                     | \$ 9.2 |
| Accruals for warranties issued during 2003        | 7.8    |
| Settlements made (in cash or in kind) during 2003 | (5.6)  |
| Balance as of March 31, 2003                      | \$11.4 |

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

### 10. Restructuring and Restructuring-Related Charges

#### RESTRUCTURING AND RESTRUCTURING-RELATED 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.

In conjunction with this restructuring program, the Company's office products business recorded charges associated with consolidation of manufacturing facilities and employee termination during the three months ended March 31, 2003 and 2002, as follows:

| Restructuring Charges |                                      |                                      |
|-----------------------|--------------------------------------|--------------------------------------|
|                       | -----                                | -----                                |
|                       | Three Months Ended<br>March 31, 2003 | Three Months Ended<br>March 31, 2002 |
|                       | -----                                | -----                                |
|                       | (In millions)                        |                                      |
| Office                | \$2.1                                | \$ 1.8                               |

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The charges principally related to asset write-offs and employee termination costs.

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

### 10. Restructuring and Restructuring-Related Charges (Continued)

Pursuant to the provisions of SFAS 146, the following tables represent the reconciliation of the restructuring charges and supplemental information for actions initiated after December 31, 2002.

|                               | 2003<br>Provision<br>----- | Cash<br>Expenditures<br>----- | Non-Cash<br>Write-offs<br>----- | Adjustments<br>----- |
|-------------------------------|----------------------------|-------------------------------|---------------------------------|----------------------|
| Rationalization of operations |                            |                               |                                 |                      |
| Employment termination costs  | \$0.1                      | \$ (0.1)                      | \$ --                           | --                   |
| Other                         | 0.3                        | (0.1)                         | (0.1)                           | --                   |
| Loss on disposal of assets    | 1.7                        | (0.1)                         | (1.6)                           | --                   |
|                               | ----                       | -----                         | -----                           | -----                |
|                               | \$2.1                      | \$ (0.3)                      | \$ (1.7)                        | \$ --                |
|                               | =====                      | =====                         | =====                           | =====                |

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

The Company expects to record additional after-tax charges of \$20 to \$25 million (\$30 to \$40 million pre tax) to complete our remaining restructuring program.

During the three-month period ended March 31, 2003, the Company recorded pre-tax restructuring-related charges as follows:

| Restructuring-related Charges        |                 |       |                                      |                 |       |
|--------------------------------------|-----------------|-------|--------------------------------------|-----------------|-------|
| Three Months Ended<br>March 31, 2003 |                 |       | Three Months Ended<br>March 31, 2002 |                 |       |
| (In millions)                        |                 |       |                                      |                 |       |
| Cost of<br>Sales<br>Charges          | SG&A<br>Charges | Total | Cost of<br>Sales<br>Charges          | SG&A<br>Charges | Total |
| -----                                | -----           | ----- | -----                                | -----           | ----- |

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|        |        |        |        |        |        |       |
|--------|--------|--------|--------|--------|--------|-------|
| Office | \$ 4.3 | \$ 0.1 | \$ 4.4 | \$ 0.7 | \$ 0.7 | \$ 1. |
|--------|--------|--------|--------|--------|--------|-------|

These restructuring-related charges include the relocation of manufacturing and distribution facilities and inventory write-offs associated with the discontinuance of certain unprofitable product lines.

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

### 10. Restructuring and Restructuring-Related Charges (Concluded)

The following table represents the reconciliation of the restructuring liability, as of March 31, 2003, for restructuring charges recognized pursuant to EITF 94-3:

|                                       | Balance at<br>12/31/02 | Cash<br>Expenditures | Non-Cash<br>Write-offs | Balance<br>3/31/03 |
|---------------------------------------|------------------------|----------------------|------------------------|--------------------|
|                                       | -----                  | -----                | -----                  | -----              |
| (In millions)                         |                        |                      |                        |                    |
| Rationalization of operations         |                        |                      |                        |                    |
| Employment termination costs (1), (2) | \$11.3                 | \$ (2.9)             | \$ (1.0) (2)           | \$                 |
| International distribution            |                        |                      |                        |                    |
| and lease agreements                  | 4.2                    | (0.3)                | --                     |                    |
| Loss on disposal of assets            | 0.8                    | (0.4)                | (0.2)                  |                    |
|                                       | -----                  | -----                | -----                  | -----              |
|                                       | \$16.3                 | \$ (3.6)             | \$ (1.2)               | \$1                |
|                                       | =====                  | =====                | =====                  | =====              |

(1) Of the planned downsizing of 2,072 positions, 1,851 reductions had been implemented as of March 31, 2003. The employee groups affected by these restructuring actions were in the office products business and include plant and administrative hourly and salaried employees.

(2) The \$1.0 million included in non-cash write-offs represents a reclassification of employment termination costs to accrued pension.

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

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

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## 11. Comprehensive Loss

The components of accumulated other comprehensive loss are as follows:

|                              | Foreign<br>currency<br>adjustments | Minimum<br>pension liability<br>adjustment | Accumulated<br>other comprehensi<br>loss |
|------------------------------|------------------------------------|--------------------------------------------|------------------------------------------|
|                              | -----                              | -----                                      | -----                                    |
|                              | (In millions)                      |                                            |                                          |
| Balance at December 31, 2001 | \$ (113.6)                         | \$ (18.1)                                  | \$ (131.7)                               |
| Changes in three months      | (2.0)                              | (0.1)                                      | (2.1)                                    |
|                              | -----                              | -----                                      | -----                                    |
| Balance at March 31, 2002    | \$ (115.6)                         | \$ (18.2)                                  | \$ (133.8)                               |
|                              | =====                              | =====                                      | =====                                    |
| Balance at December 31, 2002 | \$ (92.5)                          | \$ (85.1)                                  | \$ (177.6)                               |
| Changes in three months      | 19.6                               | -                                          | 19.6                                     |
|                              | -----                              | -----                                      | -----                                    |
| Balance at March 31, 2003    | \$ (72.9)                          | \$ (85.1)                                  | \$ (158.0)                               |
|                              | =====                              | =====                                      | =====                                    |

Included in the foreign currency adjustments balance at March 31, 2003 is total deferred derivative loss of \$0.7 million.

## 12. Subsequent Event

On April 16, 2003, the home and hardware business acquired American Lock Company, a U.S.-based manufacturer of security and safety hardware for \$31.5 million.

This operation will be included in consolidated results from the date of acquisition.

## 13. Pending Litigation

### Tobacco Litigation and Indemnification

On December 22, 1994, the Company sold The American Tobacco Company (ATCO) subsidiary to Brown & Williamson Tobacco Corporation (B&W), a wholly-owned subsidiary of B.A.T Industries p.l.c. In connection with the sale, B&W and ATCO, which has since merged into B&W

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(the "Indemnitor"), 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 ATCO. The Indemnitor has complied with the terms of the indemnification agreement since 1994 and the Company is not aware of any inability on the part of the Indemnitor to satisfy its indemnity obligations.

The Company is a defendant in numerous 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. Management is unable to make a meaningful estimate of the amount or range of loss that could result from an unfavorable outcome of the pending litigation. However, management believes that there are a number of meritorious defenses to the pending actions, including the fact that the Company never made or sold tobacco, and these actions are being vigorously contested by the Indemnitor. Management believes that the pending actions will not have a material adverse effect upon the results of operations, cash flows or financial condition of the Company because it believes it has meritorious defenses and the Company is indemnified under the previously mentioned indemnification agreement.

### Other Litigation

There is an increasing volume of asbestos-related personal injury litigation in the United States generally. A subsidiary of the Company, Moen Incorporated, has been named as a defendant in approximately 165 cases claiming personal injury from asbestos. All of these suits name multiple defendants and, in most cases, in excess of 75 defendants are named in addition to Moen. 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. Management believes it has 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.

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

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

#### 13. Pending Litigation (Concluded)

pending actions, and, as with any litigation, it is possible that some of these actions could be decided unfavorably. 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.

#### 14. Environmental

The Company is subject to laws and regulations relating to the protection of the environment. While it is not possible to quantify with

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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.

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### REPORT OF INDEPENDENT ACCOUNTANTS

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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 March 31, 2003, and the related condensed consolidated statements of income and the condensed consolidated statements of cash flows and stockholders' equity for the three-month periods ended March 31, 2003 and March 31, 2002. These interim 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, 2002, 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 21, 2003, 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, 2002, 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  
April 15, 2003

Item 2.

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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 March 31, 2003  
as Compared to the Three Months Ended March 31, 2002

-----

|                   | Net Sales     |           |
|-------------------|---------------|-----------|
|                   | 2003          | 2002      |
|                   | -----         | -----     |
|                   | (In millions) |           |
| Home and hardware | \$ 620.6      | \$ 520.3  |
| Spirits and wine  | 239.2         | 234.7     |
| Golf              | 282.4         | 266.0     |
| Office            | 249.9         | 249.4     |
|                   | -----         | -----     |
|                   | \$ 1,392.1    | \$1,270.4 |
|                   | =====         | =====     |

|                    | Operating Income |         |
|--------------------|------------------|---------|
|                    | 2003             | 2002    |
|                    | -----            | -----   |
|                    | (In millions)    |         |
| Home and hardware  | \$ 88.3          | \$ 70.0 |
| Spirits and wine   | 57.9             | 56.3    |
| Golf               | 32.7             | 30.9    |
| Office             | 8.0              | 3.9     |
| Less:              |                  |         |
| Corporate expenses | 14.3             | 12.1    |
|                    | -----            | -----   |
| Operating Income   | \$172.6          | \$149.0 |
|                    | =====            | =====   |

-----

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Fortune Brands, Inc. is a holding company with subsidiaries that manufacture or produce and sell leading consumer branded products in the following industries: home and hardware, spirits and wine, golf equipment and office products. It earns cash and profits by building its consumer brands to grow sales, including the development of innovative new products and effective marketing campaigns, and improving its productivity and cost structure. It strives to enhance shareholder value by strategically positioning its businesses to achieve higher growth and higher returns, including through acquisitions, dispositions and joint ventures, and through other shareholder value initiatives such as using its financial resources to repurchase shares and pay attractive dividends.

The Company's net income increased 18% during the three months ended March 31, 2003 as compared to the same period in 2002. The increase was due primarily to the benefit of the acquisition and growth of the Omega Group cabinet company, cost savings and strong operating performance, particularly in our office, home and hardware and golf businesses. In 2003, the Company faces overall economic uncertainty and the impact of increased industry-wide expenses for pension, post-retirement benefit plans and insurance. The Company's operating units will also face challenges and opportunities unique to each of their industries, as discussed in this report.

### FIRST QUARTER 2003 COMPARED TO 2002

#### Net sales

-----

Net sales increased \$121.7 million, or 10%, to \$1.4 billion. Sales benefited principally from the acquisition of Omega Holdings, Inc., a U.S.-based manufacturer of custom and semi-custom cabinetry, increased volumes associated with line extensions and the introduction of new products, principally in the golf and home and hardware businesses, as well as favorable foreign exchange. These benefits were offset, in part, by lower volumes in certain existing product lines, principally in the golf, home and hardware and office businesses, and the sale by the home and hardware business in November 2002 of its plumbing parts business.

#### Cost of products sold

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Cost of products sold increased \$72.5 million, or 10%, on the higher sales.

#### Excise taxes on spirits and wine

-----

Excise taxes on spirits and wine decreased \$4.2 million, or 6%, due to a product mix shift during the period.

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

-----

#### CONSOLIDATED (Continued)

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#### Advertising, selling, general and administrative expenses

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Advertising, selling, general and administrative expenses increased \$28.0

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million, or 8%, on higher advertising and marketing expenditures, pension expense and general insurance costs, partially offset by cost savings achieved as a result of our restructuring actions and other cost containment initiatives across all of our operations, particularly in our office products business.

### Amortization of intangibles

Amortization of intangibles increased \$1.5 million to \$4.8 million due to the amortization of certain finite-lived intangibles acquired as part of the Omega cabinets acquisition.

### Restructuring charges

For the three months ended March 31, 2003, we recorded pre-tax restructuring charges of \$2.1 million (\$1.4 million after tax). The charges principally related to asset write-offs and employee termination costs in the office products business.

For the three months ended March 31, 2002, we recorded pre-tax restructuring charges of \$1.8 million (\$1.2 million after tax). The charges principally related to employee termination costs, asset write-offs and costs associated with a consolidation of manufacturing facilities.

### Interest and related expenses

Interest and related expenses increased \$1.4 million, or 8%. This increase reflected higher average borrowings to finance working capital requirements, share repurchases and the Omega cabinets acquisition.

### Other income, net

Other income, net increased \$2.5 million to \$8.9 million as a result of the favorable impact of exchange rates on our overseas transactions.

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

### CONSOLIDATED (Continued)

#### Income taxes

Income taxes increased \$8.8 million, or 17%. The reported effective income tax rates for the three-months ended March 31, 2003 and 2002 were 36.4% and 36.6%, respectively.

#### Minority interests

Minority interests increased \$0.4 million to \$4.3 million, due to the higher operating income in our office products business.

#### Net income

Net income of \$99.5 million, or 68 cents basic and 66 cents diluted per share,

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for the three months ended March 31, 2003 compared with net income of \$84.0 million, or 57 cents basic and 55 cents diluted per share, for the three months ended March 31, 2002. The increase in net income of \$15.5 million was principally due to higher net sales (resulting in part from the Omega acquisition) and cost savings resulting from our restructuring actions and other cost containment initiatives across all of our operations. These increases were partly offset by higher advertising and marketing expenditures, pension expense, general insurance costs and income taxes.

In January 2003, the FASB issued Interpretation No. 46 (FIN 46), "Consolidation of Variable Interest Entities." The objective of FIN 46 is to improve financial reporting by companies with transactions involving variable interest entities. Prior to FIN 46, companies generally included another entity in its consolidated financial statements only if it controlled the entity through voting interests. FIN 46 changes that by requiring a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk or loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. Consolidation by a primary beneficiary of the assets, liabilities and results of activities of variable interest entities will provide more complete information about the resources, obligations, risks and opportunities of the consolidated company. FIN 46 is effective for newly created variable interest entities as of January 31, 2003 and will be effective for existing variable interest entities as of July 1, 2003. The adoption of FIN 46 will not have an impact on the Company's results or financial position.

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

CONSOLIDATED (Concluded)  
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On an annual basis, we evaluate the assumptions used in determining our pension liabilities and assets as well as pension expense based upon historical returns on plan assets and current economic conditions at the time the assumptions are set.

The December 2001 review led to a reduction in both our weighted-average discount rate from 7.2% to 7.0% and weighted-average expected rate of return from 9.6% to 8.3%. These revisions led to an increase in pension expense of approximately \$15 million to \$21.9 million in 2002. Our December 2002 review led to a reduction of our weighted-average discount rate from 7.0% to 6.6% for 2003. Our weighted-average expected return on plan assets remained unchanged at 8.3%. Management believes that these assumptions are appropriate. The 2002 revisions will result in an increase to our pension expense of approximately \$10 to \$15 million in 2003.

In addition, we expect to provide cash contributions in 2003 of approximately \$40 million to fund existing pension liabilities for our qualified defined-benefit plans. A significant portion of these contributions will be made in the third quarter of 2003. Additional cash contributions in 2003 will be required as benefits are paid under our various supplemental defined-benefit plans. In 2002, our total defined-benefit plan cash contribution was \$16.4 million.

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

Net sales increased \$100.3 million, or 19%, to \$620.6 million. The increase was attributable to the acquisition and growth of Omega Holdings, Inc. and successful line extensions and new product introductions, principally faucets and cabinets. The sales growth was partially offset by the absence of the plumbing parts business and soft retail volume in our tool storage business. Operating income increased \$18.3 million, or 26%, to \$88.3 million on the higher sales and productivity gains partially offset by higher operating expenses.

Management expects that our home and hardware business will benefit from strong demographic trends supporting the home repair and remodeling and new home construction markets, particularly for kitchen and bath products.

The continued consolidation of the customer base in the home and hardware industry and increased price competition will continue to present challenges to us and our competitors. Customer consolidation will also present opportunities for the most innovative and efficient manufacturers.

Our home and hardware business may be impacted by the continued uncertain U.S. economic outlook and its potential impact on the U.S. housing and remodeling markets.

Spirits and Wine  
-----

Net sales increased \$4.5 million, or 2%, to \$239.2 million principally on favorable foreign exchange, growth in ready-to-drink Jim Beam and Cola in Australia, a price increase for Jim Beam bourbon and higher sales of DeKuyper cordials and super-premium products in the U.S. These benefits were partly offset by lower excise taxes associated with a mix shift in the U.S. during the period and lower volumes for the Jim Beam brand in the U.S.

Operating income increased \$1.6 million, or 3%, to \$57.9 million on the higher sales partly offset by increased operating expenses. The higher operating expenses reflect increased brand investment expenses and general and administrative costs.

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

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Management expects that our spirits and wine business will benefit from growth in the premium and super-premium spirits market, and has focused its product development and marketing activities on those segments. Factors that could adversely affect results include: the possibility of excise tax increases; increased regulation; and continued softness in the restaurant and bar channel. In addition, the spirits and wine industry could be impacted by the continued trend towards consolidation of the supplier, distributor and retailer tiers.

### Golf

----

Net sales increased \$16.4 million, or 6%, to \$282.4 million. The increase was led by significant share gains in golf clubs, line extensions and the introduction of new products in golf balls and golf clubs and favorable foreign exchange. These benefits were partly offset by the discontinuance of certain golf ball models and a change in product mix to lower-priced golf shoes as well as the effect of lower rounds of play resulting from weak economic and adverse weather conditions. Operating income increased \$1.8 million, or 6%, to \$32.7 million on the higher sales partly offset by higher operating expenses.

Management believes our golf products business will benefit over the long term by the increasing attraction of golf to maturing baby boomers and potential growth in international markets.

As competitors with significant brand awareness have entered the category, the golf ball industry has experienced increased price competition. Largely as a result of the introduction of the new Titleist Pro V1, Pro V1x, NXT and DT SoLo golf ball models, as well as the Pinnacle Power Core golf ball model, our golf ball business has gained U.S. market share in the past year. These market share gains have tempered the effects of price competition and lower rounds of play.

The ability of the Company's golf business to maintain and increase revenues will depend upon continued strong innovation and marketing across

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

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### Golf (Concluded)

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product categories, 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. Each of the USGA and the R&A has proposed 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

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have a material effect on our golf products business and/or the golf products industry.

Office

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Net sales of \$249.9 million were flat versus the same three-month period last year. The benefits of favorable foreign exchange and successful line extensions were offset by lower volumes in certain existing product lines due to weak economic growth, particularly in white-collar employment, and the continued growth of private-label products. While inventories at North American retailers are roughly half the level they were two years ago, industry-wide inventory reductions are abating.

Operating income increased \$4.1 million, or 105%, to \$8.0 million as a result of the business's ongoing repositioning, including successful cost and asset reduction initiatives as well as favorable foreign exchange. The profit recovery in the business was broad-based, with particularly strong gains in our key international markets, Europe and Australia.

The office products industry is increasingly concentrated in a small number of major customers, principally office products superstores, large retailers, wholesalers and contract stationers. Customer consolidation and growth of private label products continue to increase pricing pressures, presenting challenges to our office products group and its competitors.

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

Office (Concluded)

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Since 2001, we have been repositioning and restructuring the office products 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, during the three-months ended March 31, 2003, we recorded total after-tax restructuring and restructuring-related charges of \$4.2 million (\$6.5 million pre tax) as part of the final phase of our office products repositioning. Once completed, this restructuring action will have reduced the business' manufacturing and distribution square footage by approximately one-third, providing significant cost savings. These actions have already generated significant working capital improvements. We expect to record additional after-tax charges of \$20 to \$25 million (\$30 to \$40 million pre tax) to complete this final phase. The overall office products repositioning program will continue to be self-funding within the office products business.

### LIQUIDITY AND CAPITAL RESOURCES

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Net cash provided from operating activities of \$48.8 million for the three

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months ended March 31, 2003 compared with \$62.3 million for the same three-month period last year. The higher cash flow in 2002 reflects the benefit of inventory reduction efforts in the office products business.

Net cash used by investing activities for the three months ended March 31, 2003 was \$28.4 million, compared with \$30.3 million in the same three-month period last year.

Net cash provided by financing activities for the three months ended March 31, 2003 was \$66.0 million, compared with \$10.7 million in the same three-month period last year. During the three months ended March 31, 2003, purchases of our common stock amounted to \$90.3 million (2,000,000 shares repurchased) and proceeds received from the exercise of stock options (\$5.7 million) decreased as options exercises were lower than in the same three-month period last year.

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

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#### LIQUIDITY AND CAPITAL RESOURCES (Concluded)

-----

Total debt increased \$215.8 million during the three-month period ended March 31, 2003. This increase reflected higher average borrowings to finance working capital requirements and share repurchases. The ratio of total debt to total capital increased to 33.3% at March 31, 2003 from 29.5% at December 31, 2002.

We believe that our internally generated funds, together with access to global credit markets, are adequate to meet our capital needs.

#### Guarantees and Commitments:

Third-party guarantees executed in connection with the formation of two spirits and wine distribution joint ventures total approximately \$70 million as of March 31, 2003. We are required to perform under these guarantees in the event that the guaranteed party fails to make contractual payments. We do not carry a liability for these guarantees as they have been excluded from the initial recognition and measurement provisions of FASB Financial Interpretation No. 45 (FIN 45), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others."

#### Indemnification Contracts:

We have provided certain indemnities pursuant to which we may be required to make payments to an indemnified party in connection with certain divestitures. These indemnities relate to various representations typically included in divestitures such as environmental, tax, product liability, employee liability and other contingencies depending on the transaction. In several of these divestitures, a maximum obligation for certain contingencies is not specified, which is not atypical for such transactions. Accordingly, pursuant to FIN 45, payments under these divestiture-related indemnity obligations cannot be reasonably estimated. The duration of the indemnities varies, and in some cases is indefinite. We have not recorded any liability for these indemnities in the consolidated financial statements.

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We have not made any payments related to indemnity obligations that were material to the company's financial position or results of operations for any quarter. Furthermore, we do not expect that any sums we may have to pay in connection with any of these indemnity obligations would have a material adverse effect on our consolidated financial position for fiscal 2003 or in subsequent periods.

In addition, we are contingently liable for surety bonds of \$20.2 million.

In total, the guarantees identified above do not have and are not expected to have a significant impact on our liquidity.

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### CAUTIONARY STATEMENT

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This Quarterly Report on Form 10-Q 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 and hardware and golf products businesses, expenses and disruptions related to shifts in manufacturing to different locations and sources, the impact of weak conditions in the leisure travel industry on our golf and spirits and wine businesses as well as other risks and uncertainties detailed from time to time in the Company's Securities and Exchange Commission filings.

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

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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, 2002.

### Item 4. CONTROLS AND PROCEDURES.

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#### (a) Evaluation of Disclosure Controls and Procedures

The Company's Chief Executive Officer and Chief Financial Officer have reviewed and evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in the Exchange Act) within the past ninety days. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that the Company's current disclosure controls and procedures are effective in providing them on a timely basis with material information relating to the Company required to be disclosed in the reports the Company files or submits under the Exchange Act.

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### (b) Changes in Internal Controls.

There have not been any significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation. There were no significant deficiencies or material weaknesses and therefore no corrective actions were taken.

## PART II. OTHER INFORMATION

### Item 1. LEGAL PROCEEDINGS.

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#### (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, which has since merged into B&W (the "Indemnitor"), 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 May 1, 2003, there were approximately 34 smoking and health cases pending on behalf of individual plaintiffs in which Registrant has been named as one of the defendants, compared with approximately 34 such cases as of February 24, 2003 as reported by Registrant in its Annual Report on Form 10-K for the fiscal year ended December 31, 2002.

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##### Class Actions

As of May 1, 2003, there were approximately nine purported smoking and health class actions pending in which Registrant has been named as one of the defendants, compared with approximately nine such cases on February 24, 2003, as reported by Registrant in its Annual Report on Form 10-K for the fiscal year ended December 31, 2002.

##### Health Care Cost Recovery Actions

As of May 1, 2003, there were approximately four health care cost recovery actions pending in which Registrant had been named as one of the defendants, compared with approximately four such cases as of February 24, 2003, as reported by Registrant in its Annual Report on Form 10-K for the fiscal year ended December 31, 2002.

##### List of Pending Cases

See Exhibit 99.1 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.

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### List of Terminated Cases

See Exhibit 99.1 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

It is not possible to predict the outcome of the pending litigation, and it is possible that some of these actions could be decided unfavorably. Management is unable to make a meaningful estimate of the amount or range of loss that could result from an unfavorable outcome of the pending litigation. However, management believes that there are a number of meritorious defenses to the pending actions, including the fact that the Company never made or sold tobacco, and these actions are being vigorously contested by the Indemnitor. Management believes that the pending actions will not have a material adverse effect upon the results of operations, cash flows or financial condition of the Registrant because it believes it has meritorious defenses and the Registrant is indemnified under the previously mentioned indemnification agreement.

Reference is made to Note 13, "Pending Litigation" in the Notes to Condensed Consolidated Financial Statements set forth in Part I, Item 1 of this Quarterly Report on Form 10-Q.

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

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#### (a) Exhibits

10a1. Amendment effective as of February 3, 2003 to the Agreement between Norman M. Wesley and the Company constituting Exhibit 10m1 of our Form 10-K for the fiscal year ended December 31, 2001.\*

10a2. Amendment dated February 3, 2003 to the Severance and Retirement Agreement between Norman H. Wesley and the Company constituting Exhibit 10c1 to our Quarterly Report on Form 10-Q dated May 12, 2000.\*

12. Statement re computation of ratio of earnings to fixed charges.

15. Letter from PricewaterhouseCoopers LLP dated May 14, 2003 re unaudited financial information.

99.1 List of Pending/Terminated Cases.

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

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

#### (b) Reports on Form 8-K

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Registrant filed a Current Report on Form 8-K, dated January 23, 2003, in respect of Registrant's press release dated January 22, 2003 announcing Registrant's financial results for the fiscal year ended December 31, 2002 (Items 5 and 7(c)).

Registrant furnished a Current Report on Form 8-K, dated February 18, 2003, in respect of distribution of Registration's revised investor brochure that was first distributed on February 18, 2002 and Registrant's press release dated February 18, 2003 regarding the Company's first quarter 2003 performance (Item 7(c) and 9).

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SIGNATURE

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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: May 15, 2003

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By /s/ C. P. Omtvedt

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

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CERTIFICATION

I, Norman H. Wesley, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Fortune Brands, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for

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establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

- a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
- b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
- c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

- a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
- b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 15, 2003

/s/ Norman H. Wesley

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Norman H. Wesley  
Chairman and  
Chief Executive Officer

### CERTIFICATION

I, C.P. Omtvedt, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Fortune Brands, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly

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report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 15, 2003

/s/ C.P. Omtvedt

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

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| Exhibit<br>-----                                                                       | Sequentially<br>Numbered Page<br>-----                                                                                                                                                                  |
|----------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10a1.                                                                                  | Amendment effective as of February 3, 2003 to the Agreement between Norman M. Wesley and the Company constituting Exhibit 10m1 of our Form 10-K for the fiscal year ended December 31, 2001.*           |
| 10a2.                                                                                  | Amendment dated February 3, 2003 to the Severance and Retirement Agreement between Norman H. Wesley and the Company constituting Exhibit 10c1 to our Quarterly Report on Form 10-Q dated May 12, 2000.* |
| 12.                                                                                    | Statement re computation of ratio of earnings to fixed charges.                                                                                                                                         |
| 15.                                                                                    | Letter from PricewaterhouseCoopers LLP dated May 14, 2003 re unaudited financial information.                                                                                                           |
| 99.1                                                                                   | List of Pending/Terminated Cases.                                                                                                                                                                       |
| 99.2                                                                                   | Joint CEO/CFO Certificate Required Under Section 906 of the Sarbanes-Oxley Act of 2002.                                                                                                                 |
| * Indicates that exhibit is a management contract or compensatory plan or arrangement. |                                                                                                                                                                                                         |