FORTUNE BRANDS INC
Form 10-Q
August 08, 2008

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2008

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ______ to ______

Commission file number 1-9076

FORTUNE BRANDS, INC.

(Exact name of Registrant as specified in its charter)

DELAWARE	**13-3295276**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
520 Lake Cook Road, Deerfield, Illinois	**60015-5611**
(Address of principal executive offices)	**(Zip Code)**

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

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

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

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

Smaller reporting company ¨

The number of shares outstanding of the registrant s common stock, par value $3.125 per share, at July 31, 2008 was 149,919,432.

PART I. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEET

(in millions)

	June 30, 2008 (Unaudited)	December 31, 2007
Assets		
Current assets		
Cash and cash equivalents	$ 160.7	$ 203.7
Accounts receivable, net	1,212.3	1,101.9
Inventories		
Maturing spirits	1,250.6	1,152.8
Other raw materials, supplies and work in process	414.6	424.4
Finished products	497.0	470.4
	2,162.2	2,047.6
Other current assets	432.9	427.7
Total current assets	3,968.1	3,780.9
Property, plant and equipment, net	1,676.7	1,698.2
Goodwill resulting from business acquisitions	3,933.0	4,196.5
Other intangible assets resulting from business acquisitions, net	3,902.7	3,866.7
Investments in unconsolidated subsidiaries	85.1	110.0
Other assets	292.4	304.6
Total assets	$ 13,858.0	$ 13,956.9

See notes to condensed consolidated financial statements.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEET

(in millions, except per share amounts)

	June 30, 2008 (Unaudited)	December 31, 2007
Liabilities and stockholders equity		
Current liabilities		
Notes payable to banks	$ 36.3	$ 32.5
Commercial paper	612.2	198.5
Current portion of long-term debt	472.9	200.0
Accounts payable	429.7	468.9
Accrued taxes	103.9	376.7
Accrued customer programs	98.6	141.4
Accrued salaries, wages and other compensation	132.3	167.5
Accrued expenses and other liabilities	444.9	508.4
Total current liabilities	2,330.8	2,093.9
Long-term debt	3,563.1	3,942.7
Deferred income	51.8	65.2
Deferred income taxes	913.1	951.3
Other liabilities	659.0	659.8
Total liabilities	7,517.8	7,712.9
Minority interest in consolidated subsidiaries	468.7	558.5
Stockholders equity		
$2.67 Convertible Preferred stock redeemable at Company s option	5.6	5.7
Common stock, par value $3.125 per share, 234.9 shares issued	734.0	734.0
Paid-in capital	709.9	684.3
Accumulated other comprehensive income	510.3	349.1
Retained earnings	7,125.8	6,999.3
Treasury stock, at cost	(3,214.1)	(3,086.9)
Total stockholders equity	5,871.5	5,685.5
Total liabilities and stockholders equity	$ 13,858.0	$ 13,956.9

See notes to condensed consolidated financial statements.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF INCOME

For the Six Months Ended June 30, 2008 and 2007

(in millions, except per share amounts)

(Unaudited)

	2008	2007
Net sales	$ 3,901.5	$ 4,202.4
Cost of products sold	2,077.4	2,277.5
Excise taxes on spirits	223.8	216.0
Advertising, selling, general and administrative expenses	1,029.8	999.7
Amortization of intangibles	24.9	24.0
Restructuring charges	10.1	13.1
Intangible asset impairment charges	324.3	
Operating income	211.2	672.1
Interest expense	118.8	151.9
Other expense (income), net	14.1	(16.9)
Income from continuing operations before income taxes and minority interests	78.3	537.1
Income tax expense	14.0	174.3
Minority interest (income) expense	(69.9)	12.0
Income from continuing operations	134.2	350.8
Income from discontinued operations	122.3	1.4
Net income	$ 256.5	$ 352.2
Earnings per common share		
Basic		
Continuing operations	$ 0.87	$ 2.30
Discontinued operations	0.80	0.01
Net earnings	$ 1.67	$ 2.31
Diluted		
Continuing operations	$ 0.86	$ 2.24
Discontinued operations	0.79	0.01
Net earnings	$ 1.65	$ 2.25
Dividends paid per common share	$ 0.84	$ 0.78
Average number of common shares outstanding		
Basic	153.5	152.6
Diluted	155.8	156.3

See notes to condensed consolidated financial statements.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF INCOME

For the Three Months Ended June 30, 2008 and 2007

(in millions, except per share amounts)

(Unaudited)

	2008	2007
Net sales	$ 2,095.4	$ 2,293.3
Cost of products sold	1,099.7	1,215.8
Excise taxes on spirits	128.7	118.9
Advertising, selling, general and administrative expenses	538.4	523.8
Amortization of intangibles	12.5	12.0
Restructuring charges	7.8	7.0
Intangible asset impairment charges	324.3	
Operating (loss) income	(16.0)	415.8
Interest expense	58.2	76.4
Other expense (income), net	13.7	(7.5)
(Loss) income from continuing operations before income taxes and minority interests	(87.9)	346.9
Income tax (income) expense	(38.4)	111.5
Minority interest (income) expense	(76.1)	5.9
Income from continuing operations	26.6	229.5
Income from discontinued operations	109.4	2.5
Net income	$ 136.0	$ 232.0
Earnings per common share		
Basic		
Continuing operations	$ 0.17	$ 1.50
Discontinued operations	0.72	0.02
Net earnings	$ 0.89	$ 1.52
Diluted		
Continuing operations	$ 0.17	$ 1.47
Discontinued operations	0.71	0.01
Net earnings	$ 0.88	$ 1.48
Dividends paid per common share	$ 0.42	$ 0.39
Average number of common shares outstanding		
Basic	153.0	152.8
Diluted	155.3	156.4

See notes to condensed consolidated financial statements.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

For the Six Months Ended June 30, 2008 and 2007

(in millions)

(Unaudited)

	2008	2007
Operating activities		
Net income	$ 256.5	$ 352.2
Restructuring charges	2.8	0.9
Depreciation and amortization	131.4	136.4
Intangible asset impairment charges	324.3	
Stock-based compensation	19.7	18.3
Deferred income taxes	(1.2)	(20.6)
Increase in accounts receivable	(91.5)	(136.7)
(Increase) decrease in inventories	(62.0)	0.9
Decrease in accounts payable	(46.4)	(31.9)
Decrease in accrued expenses and other liabilities	(230.4)	(181.0)
(Decrease) increase in accrued taxes	(266.1)	40.0
Other operating activities, net	(3.2)	(46.5)
Net cash provided by operating activities	33.9	132.0
Investing activities		
Additions to property, plant and equipment	(71.9)	(98.9)
Proceeds from the disposition of property, plant and equipment	6.8	4.6
Acquisitions, net of cash acquired, and divestitures	(1.9)	(6.2)
Net cash used by investing activities	(67.0)	(100.5)
Financing activities		
Increase (decrease) in short-term debt and commercial paper, net	415.7	(8.7)
Repayment of long-term debt	(200.0)	
Dividends paid to stockholders	(129.0)	(119.3)
Cash purchases of common stock for treasury	(141.4)	
Proceeds received from exercise of stock options	10.9	42.9
Tax benefit on exercise of stock options	2.1	11.7
Other financing activities, net	20.2	4.6
Net cash used by financing activities	(21.5)	(68.8)
Effect of foreign exchange rate changes on cash	11.6	5.4
Net decrease in cash and cash equivalents	$ (43.0)	$ (31.9)
Cash and cash equivalents at beginning of period	$ 203.7	$ 182.7
Cash and cash equivalents at end of period	$ 160.7	$ 150.8

See notes to condensed consolidated financial statements.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY

For the Six Months Ended June 30, 2008 and 2007

(in millions, except per share amounts)

(Unaudited)

	$2.67 Convertible Preferred Stock	Common Stock	Paid-in Capital	Accumulated Other Comprehensive Income	Retained Earnings	Treasury Stock, At Cost	Total
Balance at December 31, 2006	$ 6.3	$ 734.0	$ 615.7	$ 37.9	$ 6,496.3	($ 3,162.2)	$ 4,728.0
Comprehensive income							
Net income					352.2		352.2
Changes during the period				87.6			87.6
Total comprehensive income				87.6	352.2		439.8
Adjustment to initially apply FASB Interpretation No. 48					(3.6)		(3.6)
Dividends ($0.78 per Common share and $1.335 per Preferred share)					(119.3)		(119.3)
Stock-based compensation			27.4		(5.9)	39.9	61.4
Excess tax benefit on exercise of stock options			15.4				15.4
Conversion of preferred stock (<0.1 shares)	(0.3)		(1.4)			1.7	
Balance at June 30, 2007	$ 6.0	$ 734.0	$ 657.1	$ 125.5	$ 6,719.7	($ 3,120.6)	$ 5,121.7
Balance at December 31, 2007	$ 5.7	$ 734.0	$ 684.3	$ 349.1	$ 6,999.3	($ 3,086.9)	$ 5,685.5
Comprehensive income							
Net income					256.5		256.5
Changes during the period				161.2			161.2
Total comprehensive income				161.2	256.5		417.7
Dividends ($0.84 per Common share and $1.335 per Preferred share)					(129.0)		(129.0)
Treasury stock purchases (2.0 shares)						(141.4)	(141.4)
Stock-based compensation			24.0		(1.0)	13.2	36.2
Excess tax benefit on exercise of stock options			2.5				2.5
Conversion of preferred stock (<0.1 shares)	(0.1)		(0.9)			1.0	
Balance at June 30, 2008	$ 5.6	$ 734.0	$ 709.9	$ 510.3	$ 7,125.8	($ 3,214.1)	$ 5,871.5

See notes to condensed consolidated financial statements.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation and Principles of Consolidation

References to we, our and the Company refer to Fortune Brands, Inc. and its consolidated subsidiaries as a whole, unless the context otherwise requires.

The condensed consolidated balance sheet as of June 30, 2008, the related condensed consolidated statements of income for the three-month and six-month periods ended June 30, 2008 and 2007 and the related condensed consolidated statements of cash flows and stockholders equity for the six-month periods ended June 30, 2008 and 2007 are unaudited. In the opinion of management, all adjustments necessary for a fair presentation of the financial statements have been included. 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 our annual consolidated financial statements and notes. The year-end condensed consolidated balance sheet was derived from the 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 consolidated financial statements and notes included in our Annual Report on Form 10-K for the year ended December 31, 2007.

2. Recently Issued Accounting Standards

<u>Business Combinations</u>

In December 2007, the FASB issued FAS No. 141 (revised 2007) (FAS 141R), Business Combinations. FAS 141R replaces FAS No. 141, Business Combinations. FAS 141R establishes principles and requirements for how an acquirer, a) recognizes and measures the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree, b) recognizes and measures the goodwill acquired and c) determines what information to disclose. FAS 141R also requires that all acquisition-related costs, including restructuring, be recognized separately from the acquisition. FAS 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008 (calendar 2009 for Fortune Brands). This Statement eliminates adjustments to goodwill for changes in deferred tax assets and uncertain tax positions after the acquisition accounting measurement period (limited to one year from acquisition), including for acquisitions prior to adoption of FAS 141R. We do not expect FAS 141R to materially impact our results of operations, cash flows or financial position.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. Recently Issued Accounting Standards (Continued)

Noncontrolling Interests in Consolidated Financial Statements

In December 2007, the FASB issued FAS No. 160 (FAS 160), Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51. FAS 160 amends Accounting Research Bulletin No. 51, establishing accounting and reporting standards for the noncontrolling interest (currently referred to as minority interest) in a subsidiary and for the deconsolidation of a subsidiary. This Statement changes the consolidated balance sheet presentation of noncontrolling interests from the mezzanine level (between liabilities and stockholders equity) to a component of stockholders equity, however because the minority interest in the Spirits business held by V&S Group is in the form of redeemable preferred stock, it would continue to be classified in the mezzanine level (between liabilities and stockholders equity). As of June 30, 2008, the carrying value of the minority interest held by V&S Group was $455.0 million and the carrying value of other minority interests/noncontrolling interests (which would be reclassified to equity upon adoption of FAS 160) was $13.7 million. FAS 160 requires expanded disclosures in the consolidated financial statements that clearly identify and distinguish between the interests of the parent s owners and the interests of the noncontrolling owners of a subsidiary. FAS 160 is effective for financial statements issued for fiscal years beginning after December 15, 2008 (calendar 2009 for Fortune Brands). This statement applies prospectively except presentation and disclosure requirements are applied retrospectively for all periods presented. FAS 160 will have an impact on the presentation of noncontrolling interests on the Fortune Brands statements of income, financial position and stockholders equity.

Fair Value Measurements

In February 2008, the FASB issued FASB Staff Position FAS 157-2 (FSP FAS 157-2), Effective Date of FASB Statement No. 157, which delays the effective date of FAS No. 157 for all nonrecurring fair value measurements of nonfinancial assets and liabilities until fiscal years beginning after November 15, 2008 (calendar 2009 for Fortune Brands). We have elected to defer the adoption of nonrecurring fair value measurement disclosures of nonfinancial assets and liabilities. The adoption of FSP FAS 157-2 is not expected to have a material impact on our results of operations, cash flows or financial position.

Disclosures about Derivative Instruments and Hedging Activities

In March 2008, the FASB issued FAS No. 161 (FAS 161), Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133. FAS 161 establishes disclosure requirements for derivative instruments and for hedging activities in order to provide users of financial statements with an enhanced understanding of a) how and why derivatives are used, b) how derivative instruments and related hedged items are accounted for, and c) how they affect financial position, financial performance and cash flows. FAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008 (calendar 2009 for Fortune Brands). We are currently evaluating the impact of FAS 161 on our disclosures.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Discontinued Operations

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

Interest expense associated with the outstanding debt of Fortune Brands was allocated to each of the discontinued operations assuming the discontinued operations had a debt to equity ratio consistent with the debt to equity ratio of Fortune Brands in accordance with the provisions of EITF 87-24, Allocation of Interest to Discontinued Operations.

The following table summarizes the results of the discontinued operations for the six and three months ended June 30, 2008 and 2007.

	Six Months Ended June 30,		Three Months Ended June 30,	
(in millions)	**2008**	**2007**	**2008**	**2007**
Net sales	$	$ 101.2	$	$ 61.5
Income from discontinued operations before income taxes	$ 4.0	$ 4.9	$ 4.0	$ 6.5
Income tax (benefit) expense	(118.3)	3.5	(105.4)	4.0
Income from discontinued operations, net of income taxes	$ 122.3	$ 1.4	$ 109.4	$ 2.5

In the second quarter of 2008, we recorded pre-tax income of $4.0 million from the settlement of outstanding working capital claims related to the sale of the U.S. Wine business in December 2007 (after tax $2.5 million). In addition, in the second quarter, the Congressional Joint Committee on Taxation completed its review of a tax refund associated with a capital loss carry forward item that was favorably resolved in an IRS administrative proceeding relating to our 2001-2002 federal tax returns. As a result, the final settlement of the audit of our 2001-2002 federal tax returns removed uncertainty relating to the utilization of a capital loss carry forward, and we recorded a $98.0 million tax benefit ($98.7 million of unrecognized tax benefits less interest of $0.7 million) related to a capital loss carry forward position associated with the sale of the U.S. Wine business. In addition, in the second quarter of 2008, income taxes were favorably impacted by tax credits associated with the conclusion of our 2004-2005 federal tax audit that pertained to other discontinued operations.

In the first quarter of 2008, we revised the calculation of the after tax gain on the sale of the U.S. Wine business by recording a tax benefit of $12.9 million. The tax benefit resulted from lower estimated state tax liabilities from the sale of the U.S. Wine business.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. Goodwill and Other Intangible Assets

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

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

FAS 142 requires that purchased intangible assets other than goodwill be amortized over their useful lives unless these lives are determined to be indefinite. Certain of our tradenames have been assigned an indefinite life as we currently anticipate that these tradenames will contribute cash flows to the Company indefinitely. Indefinite-lived intangible assets are not amortized, but are evaluated at each reporting period to determine whether the indefinite useful life is appropriate. We review indefinite-lived intangible assets for impairment annually, and whenever market or business events indicate there may be a potential impact on that intangible. Impairment losses are recorded to the extent that the carrying value of the indefinite-lived intangible asset exceeds its fair value. Our predominant method of approximating fair value in determining whether an impairment exists is to use cash flow projections. We measure impairment based on discounted expected future cash flows attributable to the tradename compared to the carrying value of that tradename. When separate cash flow information is not available, we use the relief-from-royalty approach. Fair value is represented by the present value of hypothetical royalty income over the remaining useful life. The Company cannot predict the occurrence of certain events that might adversely affect the carrying value of goodwill and indefinite-lived intangible assets. Such events may include, but are not limited to, the impact of the economic environment, particularly related to our Home and Hardware companies; a material negative change in relationships with significant customers; or strategic decisions made in response to economic and competitive conditions.

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

FORTUNE BRANDS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. Goodwill and Other Intangible Assets (Continued)

In the second quarter of 2008, the Company revised its full year operating income and cash flow expectations and revised its long-term forecast of the U.S. home products market. The Company forecasts the U.S. home products market in two portions: the new home construction portion and the repair/remodel portion. Primarily due to the impact of a worse than anticipated decline in the U.S. home products market on financial results, the Company concluded it was necessary to conduct an interim goodwill impairment test of reporting units most significantly impacted by new home construction and most recently acquired (newer historical carrying values), principally the Therma-Tru door and Simonton window brands. Based on the results of the testing, the Company recorded pre-tax goodwill impairment charges of $288.9 million (both before and after tax), predominantly related to its Therma-Tru door reporting unit. For each reporting unit, the impairment charge was measured as the excess of the implied fair value of the goodwill over its carrying value. The implied fair value of goodwill was estimated based on a hypothetical allocation of each reporting unit s fair value to all of its underlying assets and liabilities in accordance with the requirements of FAS 142. Consistent with historical practice, the Company estimates the fair value of a reporting unit based on an estimate of future cash flows discounted at a market participant derived weighted average cost of capital. Our estimate of discounted future cash flows decreased significantly from year-end 2007 primarily due to a reduction of current year forecasted revenues and cash flows compared to our original plan (which results in projecting future revenue and cash flow growth off of a significantly lower base) and the shifting of cash flow growth beyond 2008 into later years.

In addition, pre-tax impairment charges were recorded on indefinite lived tradenames, primarily related to Therma-Tru and Simonton brands, in the amount of $31.2 million ($19.3 million after tax) in aggregate, as well as other identifiable intangibles of $4.2 million ($2.5 million after tax) in the Home and Hardware business. The impairment of tradenames was due primarily to a reduction in our estimate of potential royalty income resulting from a reduction of our estimated revenue and royalty rate in future periods. We continue to believe that the indefinite lives assigned to these tradenames are appropriate.

We had goodwill of $3,933.0 million as of June 30, 2008. The decrease in goodwill of $263.5 million during the six months ended June 30, 2008 was primarily due to impairment charges of $288.9 million discussed above and acquisition-related adjustments, primarily related to income taxes, partly offset by foreign currency translation adjustments.

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

(in millions)	Balance at December 31, 2007	Acquisition-Related Adjustments	Impairment Charges	Translation Adjustments	Balance at June 30, 2008
Spirits	$ 2,264.6	$ (25.1)	$	$ 48.2	$ 2,287.7
Home and Hardware	1,920.1	(5.4)	(288.9)	7.7	1,633.5
Golf	11.8				11.8
Total goodwill, net	$ 4,196.5	$ (30.5)	$ (288.9)	$ 55.9	$ 3,933.0

FORTUNE BRANDS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. Goodwill and Other Intangible Assets (Continued)

We also had indefinite-lived intangibles, principally trade names, of $3,191.3 million and $3,136.1 million as of June 30, 2008 and December 31, 2007, respectively. The increase of $55.2 million was due to changes in foreign currency rates ($86.4 million), partly offset by impairment charges ($31.2 million).

Amortizable identifiable intangible assets, principally trade names, are subject to amortization over their estimated useful life, 5 to 30 years, based on the assessment of a number of factors that may impact useful life. These factors include historical performance with respect to consumer name recognition, geographic market presence, market share, plans for ongoing trade name support and promotion, financial results and other relevant factors.

The gross carrying value and accumulated amortization by class of intangible assets as of June 30, 2008 and December 31, 2007 were as follows:

	As of June 30, 2008			As of December 31, 2007		
(in millions)	Gross Carrying Amounts	Accumulated Amortization	Net Book Value	Gross Carrying Amounts	Accumulated Amortization	Net Book Value
Indefinite-lived intangible assets	$ 3,263.4	$ (72.1) [1]	$ 3,191.3	$ 3,208.1	$ (72.0)[1]	$ 3,136.1
Amortizable intangible assets						
Trade names	497.1	(157.0)	340.1	485.6	(148.4)	337.2
Customer and contractual relationships	395.7	(116.2)	279.5	399.1	(103.6)	295.5
Patents/proprietary technology	81.5	(25.9)	55.6	81.6	(22.8)	58.8
Licenses and other	45.3	(9.1)	36.2	45.3	(6.2)	39.1
Total	1,019.6	(308.2)	711.4	1,011.6	(281.0)	730.6
Total identifiable intangibles	$ 4,283.0	$ (380.3)	$ 3,902.7	$ 4,219.7	$ (353.0)	$ 3,866.7

[1] Accumulated amortization prior to the adoption of Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. Minority Interest Held by V&S Group

V&S Group (V&S) owned a 10% minority interest in our Spirits business (BGSW). The carrying value of the minority interest at June 30, 2008 and December 31, 2007 was $455.0 million and $542.9 million, respectively. As a result of the announcement of the pending sale of V&S to Pernod Ricard, on April 3, 2008, we exercised our call option to repurchase the minority interest. On July 24, 2008, we repurchased the minority interest in BGSW for the carrying value of $455.0 million.

For each of the six-month periods ended June 30, 2008 and 2007, BGSW declared preferred dividends of $8.6 million to V&S ($4.3 million each quarter) that were recorded as minority interest expense.

We accounted for the redemption feature of the convertible redeemable preferred stock in accordance with EITF Topic D-98, Classification and Measurement of Redeemable Securities, and measured this minority interest at fair value with changes in fair value reflected in income from continuing operations. BGSW is not a publicly traded entity and therefore there is no quoted market price for its common or preferred shares. At each reporting period prior to June 30, 2008, we estimated fair value based on a combination of market-based earnings multiples and discounted cash flow techniques. The fair value at June 30, 2008 of $455.0 million was based on valuation by an independent third party performed in connection with the repurchase of the minority interest. The valuation reflected the features of the preferred stock, which could not be sold to a third party and had unique shareholder rights as a preferred security. As a result, in the six and three months ended June 30, 2008, we recorded an $87.9 million decrease in the fair value of the minority interest as minority interest income. On July 24, 2008, we repurchased the 10% minority interest in BGSW from V&S for the carrying value of $455.0 million. No adjustments to fair value were recorded in the six and three months ended June 30, 2007.

6. Maxxium Worldwide B.V.

The Spirits business is a partner in an international sales and distribution joint venture named Maxxium Worldwide B.V. (Maxxium). The Company owns a 25% interest in Maxxium that is accounted for using the equity method. The other 25% partners in Maxxium are Rémy Cointreau S.A. (Rémy), The Edrington Group Ltd., and V&S.

In November 2006, Rémy gave notice to Maxxium that it will terminate its distribution agreement with Maxxium effective March 30, 2009. In connection with Rémy s termination, it is expected that Rémy will pay a substantial termination penalty to Maxxium.

On July 24, 2008, the government of Sweden sold V&S, another of our Maxxium joint venture partners, to Pernod Ricard. Pernod Ricard has indicated that it will withdraw V&S from Maxxium within two years from closing.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

6. Maxxium Worldwide B.V. (Continued)

In the second quarter of 2008, we recorded a $25.1 million write-down of our investment in the Maxxium joint venture in the statement of income in other expense (income), net, primarily to reflect our share of a goodwill write-down recorded in the financial statements of Maxxium that resulted from the eventual departures of Rémy and V&S. The carrying value of the investment in Maxxium at June 30, 2008 was $72.1 million.

7. Income Taxes

The effective income tax rate for the six months ended June 30, 2008 and 2007 was 17.9% and 32.5%, respectively. The 2008 effective income tax rate was favorably impacted by a $98.4 million tax benefit related to final settlement of the federal income tax audit related to our 2001-2002 federal tax returns. Additionally, the effective income tax rate was favorably impacted by tax credits associated with the conclusion of our 2004-2005 federal tax audit and higher foreign income taxed at lower statutory rates. The effective income tax rate was unfavorably impacted by the absence of a tax benefit on goodwill impairment charges of $288.9 million.

The effective income tax rate for the three months ended June 30, 2008 and 2007 was 43.7% and 32.1%, respectively. The 2008 effective income tax rate was favorably impacted by a $98.4 million tax benefit related to final settlement of the federal income tax audit related to our 2001-2002 federal tax returns. Additionally, the effective income tax rate was favorably impacted by tax credits associated with the conclusion of our 2004-2005 federal tax audit and higher foreign income taxed at lower statutory rates. The effective income tax rate was unfavorably impacted by the absence of a tax benefit on goodwill impairment charges of $288.9 million.

It is reasonably possible that, in the next twelve months, total unrecognized tax benefits may decrease in the range of $1.0 to $10.0 million, primarily due to the expiration of the statute of limitations in various tax jurisdictions and tax audit settlements. During the second quarter, the Congressional Joint Committee on Taxation completed its review of a tax refund associated with a capital loss carry forward item that was favorably resolved in an IRS administrative proceeding relating to our 2001-2002 federal tax returns. Unrecognized Tax Benefits (UTBs) of approximately $76.8 million were reversed into income, relating to the approval of the refund associated with our 2001-2002 federal tax returns. Additionally, the final settlement of the audit of our 2001-2002 federal tax returns removed uncertainty relating to the utilization of a capital loss carry forward, and we reversed $14.4 million of UTBs relating to the utilization of a portion of the capital loss carry forward against the 2007 capital gain on the sale of the U.S. distribution rights to Dalmore Scotch. We recorded, in income from discontinued operations, a reversal of $98.7 million of UTBs associated with utilization of a portion of the capital loss carry forward against the capital gain on the sale of the U.S. Wine business in December 2007. Other adjustments in the six months ended June 30, 2008 for UTBs amounted to an increase of $19.7 million primarily to reflect additional purchase accounting adjustments related to a 2005 Spirits business acquisition.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

8. Information on Business Segments

Net sales and operating income for the six months ended June 30, 2008 and 2007 by segment were as follows:

	Six Months Ended June 30,		
(in millions)	**2008**	**2007**	**% Change vs. Prior Year**
Net Sales			
Spirits	$ 1,123.2	$ 1,136.0	(1.1)%
Home and Hardware	1,929.5	2,224.7	(13.3)
Golf	848.8	841.7	0.8
Net Sales	$ 3,901.5	$ 4,202.4	(7.2)%
Operating Income			
Spirits	$ 267.2	$ 305.2	(12.5)%
Home and Hardware	(141.8)	256.3	
Golf	119.6	142.2	(15.9)
Less: Corporate expenses	33.8	31.6	7.0
Operating Income	$ 211.2	$ 672.1	(68.6)%

Net sales and operating income for the three months ended June 30, 2008 and 2007 by segment were as follows:

	Three Months Ended June 30,		
(in millions)	**2008**	**2007**	**% Change vs. Prior Year**
Net Sales			
Spirits	$ 607.9	$ 616.6	(1.4)%
Home and Hardware	1,035.1	1,202.1	(13.9)
Golf	452.4	474.6	(4.7)
Net Sales	$ 2,095.4	$ 2,293.3	(8.6)%
Operating Income			
Spirits	$ 138.6	$ 174.3	(20.5)%
Home and Hardware	(202.7)	169.9	
Golf	68.1	88.6	(23.1)
Less: Corporate expenses	20.0	17.0	17.6
Operating (Loss) Income	$ (16.0)	$ 415.8	%

FORTUNE BRANDS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

9. Earnings Per Share

The computation of basic and diluted earnings per common share (EPS) is as follows:

(in millions, except for per share amounts)	Six Months Ended June 30,		Three Months Ended June 30,	
	2008	2007	2008	2007
Income from continuing operations	$ 134.2	$ 350.8	$ 26.6	$ 229.5
Income from discontinued operations	122.3	1.4	109.4	2.5
Net income	256.5	352.2	136.0	232.0
Less: Preferred stock dividends	0.2	0.3	0.1	0.2
Income available to common stockholders basic	256.3	351.9	135.9	231.8
Convertible Preferred stock dividends	0.2	0.3	0.1	0.2
Income available to common stockholders diluted	$ 256.5	$ 352.2	$ 136.0	$ 232.0
Weighted average number of common shares outstanding basic	153.5	152.6	153.0	152.8
Conversion of Convertible Preferred stock	1.2	1.3	1.2	1.3
Exercise of stock options	1.1	2.4	1.1	2.3
Weighted average number of common shares outstanding diluted	155.8	156.3	155.3	156.4
Earnings per common share				
Basic				
Continuing operations	$ 0.87	$ 2.30	$ 0.17	$ 1.50
Discontinued operations	0.80	0.01	0.72	0.02
Net earnings	$ 1.67	$ 2.31	$ 0.89	$ 1.52
Diluted				
Continuing operations	$ 0.86	$ 2.24	$ 0.17	$ 1.47
Discontinued operations	0.79	0.01	0.71	0.01
Net earnings	$ 1.65	$ 2.25	$ 0.88	$ 1.48

For the three and six months ended June 30, 2008 and 2007, certain stock options were excluded from the calculation of weighted average shares for diluted EPS if they were antidilutive (the exercise price exceeded the average stock price). These excluded stock options were approximately 8.7 million and 4.1 million shares for the six months ended June 30, 2008 and 2007, respectively. These excluded stock options were approximately 8.7 million and 4.0 million shares for the three months ended June 30, 2008 and 2007, respectively.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

10. Pension and Other Retiree Benefits

The components of net periodic benefit cost for pension and postretirement benefits for the six months ended June 30, 2008 and 2007 were as follows:

	Six Months Ended June 30,			
	Pension Benefits		Postretirement Benefits	
(in millions)	2008	2007	2008	2007
Service cost	$ 15.7	$ 17.4	$ 1.6	$ 2.1
Interest cost	28.8	26.8	4.5	4.9
Expected return on plan assets	(34.7)	(31.0)		
Amortization of prior service cost	1.2	1.3	(0.6)	(0.8)
Amortization of net actuarial loss	3.7	6.9	0.1	1.2
Net periodic benefit cost	$ 14.7	$ 21.4	$ 5.6	$ 7.4

The components of net periodic benefit cost for pension and postretirement benefits for the three months ended June 30, 2008 and 2007 were as follows:

	Three Months Ended June 30,			
	Pension Benefits		Postretirement Benefits	
(in millions)	2008	2007	2008	2007
Service cost	$ 7.7	$ 8.7	$ 0.8	$ 1.0
Interest cost	14.3	13.5	2.2	2.5
Expected return on plan assets	(17.3)	(15.5)		
Amortization of prior service cost	0.6	0.6	(0.3)	(0.4)
Amortization of net actuarial loss	1.7	3.5		0.6
Net periodic benefit cost	$ 7.0	$ 10.8	$ 2.7	$ 3.7

The decrease in pension and postretirement expense for the six and three months ended June 30, 2008 compared to 2007 was primarily a result of an increase in the discount rate. In addition, pension expense decreased due to a higher expected return on plan assets as a result of the impact of pension contributions in 2007, as well as certain pension plan changes.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

11. Fair Value Measurements

On January 1, 2008, we adopted Statement of Financial Accounting Standards No. 157 (FAS 157), Fair Value Measurement. FAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about assets and liabilities measured at fair value. FAS 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three levels. Level 1 inputs, the highest priority, are quoted prices in active markets for identical assets or liabilities. Level 2 inputs reflect other than quoted prices included in Level 1 that are either observable directly or through corroboration with observable market data. Level 3 inputs are unobservable inputs, due to little or no market activity for the asset or liability, such as internally-developed valuation models. As permitted under FAS 157, we elected to defer the adoption of the nonrecurring fair value measurement disclosures of nonfinancial assets and liabilities, such as goodwill and indefinite-lived intangible assets, until January 1, 2009.

Assets and liabilities measured at fair value on a recurring basis as of June 30, 2008 were as follows:

		Fair Value at Reporting Date Using	
(in millions)	**June 30, 2008**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Assets			
Derivatives	$ 10.9	$ 10.9	$
Deferred compensation program assets	66.3	66.3	
Total assets	$ 77.2	$ 77.2	$
Liabilities			
Derivatives	$ 11.5	$ 11.5	$
Deferred compensation program liabilities	66.3	66.3	
Minority interest in Spirits business	455.0		455.0
Total liabilities	$ 532.8	$ 77.8	$ 455.0

FORTUNE BRANDS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

11. Fair Value Measurements (Continued)

Derivatives are either foreign exchange contracts recorded at fair value to hedge currency fluctuations for transactions denominated in foreign currencies, commodity swaps of forecasted commodity purchases or interest rate swaps. Deferred compensation programs assets and liabilities are for programs where select employees can defer compensation until death, disability or other termination of employment.

Assets and liabilities measured at fair value using unobservable inputs require a significant degree of judgment and estimates regarding assumptions, including, but not limited to, projected future levels of income based on management s plans, as well as business trends, prospects, and market and economic conditions. As a result, changes to the fair values could have a material impact on results of operations and liquidity when realized.

Below is a reconciliation of assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during the six and three months ended June 30, 2008.

(in millions)	Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Minority Interest in Spirits Business Six and Three Months Ended June 30, 2008	
Beginning balance	$	542.9
Unrealized gains included in earnings		(87.9)
Ending balance	$	455.0

At each reporting period prior to June 30, 2008, we estimated the fair value of the minority interest in the Spirits business based on a combination of market-based earnings multiples and discounted cash flow techniques. In the six and three months ended June 30, 2008, based on the fair value determination by an independent third party performed in connection with the repurchase of the minority interest, we recorded an $87.9 million decrease in the fair value of the minority interest in the Spirits business as minority interest income. On July 24, 2008, we repurchased the minority interest in BGSW from V&S for the carrying value of $455.0 million. For additional information on the accounting for the minority interest in the Spirits business, refer to Note 5, Minority Interest Held by V&S Group.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

12. Financial Instruments

We do not enter into financial instruments for trading or speculative purposes. Financial instruments are principally used to reduce the impact of changes in foreign currency exchange rates, interest rates and commodities used as raw materials in our products. The principal financial instruments used are forward foreign exchange contracts, interest rate swaps and commodity swaps. In the second quarter of 2008, we entered into interest rate swaps with an aggregate notional principal amount of $400 million. The swap agreements hedge changes in fair value on a portion of our fixed rate 5.375% notes due 2016 that result from changes in a benchmark interest rate (U.S. LIBOR). The swaps have been designated and are classified as fair value hedges in accordance with FAS 133. There were no interest rate swaps outstanding as of December 31, 2007.

We enter into forward foreign exchange contracts principally to hedge currency fluctuations in transactions denominated in foreign currencies, thereby limiting our risk that would otherwise result from changes in exchange rates. The periods of the forward foreign exchange contracts correspond to the periods of the hedged transactions. We also enter into forward foreign exchange contracts to hedge a portion of our net investments in certain foreign subsidiaries. We enter into commodity swaps that correspond to periods of forecasted commodity purchases. We account for these commodity derivatives as economic hedges. The effective portions of cash flow hedges are reported in other comprehensive income and are recognized in the statement of income when the hedged item affects earnings. The ineffective portion of all hedges is recognized in current period earnings. Changes in the fair value of economic hedges are recorded directly into current period earnings.

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

FORTUNE BRANDS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

13. Guarantees and Commitments

As of June 30, 2008, we had third-party guarantees totaling approximately $98 million. These represent guarantees of the debt of Maxxium, our Spirits business international sales and distribution joint venture. We are required to perform under these guarantees in the event that Maxxium fails to make contractual payments. The current guarantees of Maxxium s credit facilities expire December 12, 2010. In accordance with Financial Accounting Standards Board Interpretation No. 45 (FIN 45), Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, a liability, with an offsetting increase in the investment in Maxxium, of $0.4 million existed as of June 30, 2008 to reflect the fair value of the guarantees to Maxxium.

In addition, as a part of the formation of the Future Brands LLC (Future Brands) joint venture with V&S, Jim Beam Brands Co. (JBBCo.) guaranteed any financial obligations of Future Brands that may arise in the event of a Future Brands default in which it fails to fulfill its operating obligations and which results in a claim. These financial obligations include, but are not limited to, making payments to suppliers, employees and other parties with which Future Brands conducts business. We cannot estimate the possible future obligations under the Future Brands agreement. At June 30, 2008, JBBCo. did not have any outstanding obligations as a result of this arrangement.

We also guaranteed various leases for ACCO World Corporation, the Office business divested in a spin-off in 2005. We will continue to guarantee payment of certain real estate leases, with lease payments totaling approximately $32.8 million, through April 2013. Accordingly, we have recorded the fair value of these guarantees on our financial statements in accordance with FIN 45. The liability related to this guarantee was $0.9 million as of June 30, 2008.

We have provided typical indemnities in connection with divestitures. These indemnities relate to various representations generally included in divestiture agreements, such as environmental, tax, product liability, employee liability and other contingencies, depending on the transactions. In several of these divestitures, a maximum obligation for certain contingencies is not specified, which is not unusual for these transactions. Pursuant to FIN 45, we cannot reasonably estimate potential payments under these divestiture-related indemnity obligations. The indemnities vary in duration, and in some cases the durations are indefinite. Because FIN 45 was effective after December 31, 2002, we have not recorded any liability in the consolidated financial statements for indemnities entered into prior to that date. We have not made any indemnity payments that were material to our financial position or results of operations for any quarter. Furthermore, we do not expect that any potential payments in connection with any of these indemnity obligations would have a material adverse effect on our consolidated financial position, results of operations or liquidity for 2008 or in future periods.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

14. Restructuring and Restructuring-Related Charges

Pre-tax restructuring and restructuring-related charges for six months ended June 30, 2008 and 2007 were as follows.

(in millions)	Six Months Ended June 30, 2008			
	Restructuring	Restructuring-Related		Total
	Charges	Cost of Sales	G&A [(1)]	Charges
Spirits	$ 3.9	$	$ 8.1	$ 12.0
Home and Hardware	6.2	2.6	3.7	12.5
	$ 10.1	$ 2.6	$ 11.8	$ 24.5

(in millions)	Six Months Ended June 30, 2007			
	Restructuring	Restructuring-Related		Total
	Charges	Cost of Sales	G&A [(1)]	Charges
Spirits	$ 2.7	$	$	$ 2.7
Home and Hardware	10.4	6.3	0.4	17.1
	$ 13.1	$ 6.3	$ 0.4	$ 19.8

(1) General and administrative expenses.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

14. Restructuring and Restructuring-Related Charges (Continued)

Pre-tax restructuring and restructuring-related charges for three months ended June 30, 2008 and 2007 were as follows.

(in millions)	Three Months Ended June 30, 2008			
	Restructuring	Restructuring-Related		Total
	Charges	Cost of Sales	G&A [1]	Charges
Spirits	$ 3.9	$	$ 7.1	$ 11.0
Home & Hardware	3.9		1.5	5.4
	$ 7.8	$	$ 8.6	$ 16.4

(in millions)	Three Months Ended June 30, 2007			
	Restructuring	Restructuring-Related		Total
	Charges	Cost of Sales	G&A [1]	Charges
Spirits	$ 0.4	$	$	$ 0.4
Home & Hardware	6.6	3.5	0.3	10.4
	$ 7.0	$ 3.5	$ 0.3	$ 10.8

(1) General and administrative expenses.

Spirits charges in 2008 related to one-time charges for supply-chain activities and organizational repositioning. Spirits charges in 2007 primarily related to a distribution model change in Australia. Home and Hardware charges in 2008 and 2007 principally related to supply chain realignment and cost reduction initiatives.

Reconciliation of Restructuring Liability

(in millions)	Balance at December 31, 2007	2008 Provision	Cash Expenditures	Non-Cash Write-offs	Balance at June 30, 2008
Workforce reductions	$ 9.3	$ 8.9	$ (8.9)	$	$ 9.3
Asset write-downs		2.5	0.4	(2.9)	
Contract termination costs	3.7	(0.3)	(2.1)		1.3
Other	1.3	(1.0)	(0.3)		
	$ 14.3	$ 10.1	$ (10.9)	$ (2.9)	$ 10.6

FORTUNE BRANDS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

15. Accumulated Other Comprehensive Income

Total accumulated other comprehensive income consists of net income and other changes in stockholders equity from transactions and other events from sources other than stockholders. It includes currency translation gains and losses, unrealized gains and losses from derivative instruments designated as cash flow hedges, deferred net gains on treasury rate locks, and amortization of unrecognized net periodic pension and postretirement cost. Included in the foreign currency adjustments balance at June 30, 2008 were deferred losses of $2.6 million related to the hedging of anticipated transactions denominated in foreign currencies.

Total comprehensive income for the three months ended June 30, 2008 and 2007 was $170.7 million and $328.9 million, respectively. The primary reason for the decrease was lower net income. The difference between total comprehensive income and net income was primarily attributable to currency translation gains and losses in the six and three months ended June 30, 2008 of $158.4 million and $36.2 million, respectively.

16. Pending Litigation

Tobacco Litigation and Indemnification

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

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

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

FORTUNE BRANDS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

16. Pending Litigation (Continued)

Tobacco Litigation and Indemnification (Continued)

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

Other Litigation

On February 9, 2006, Callaway Golf Company filed a lawsuit seeking unspecified damages against Acushnet Company in the United States District Court for the District of Delaware. Callaway alleges that certain golf balls manufactured by Acushnet Company infringe four of Callaway s patents. Acushnet believes, and counsel has advised, that it has meritorious defenses against Callaway s allegations. Acushnet stipulated to infringement and a jury trial on invalidity was conducted in December 2007. The jury returned a mixed verdict, finding one claim invalid and eight claims valid. Acushnet filed a motion for a judgment as a matter of law to overturn the inconsistent jury verdict and in the alternative requesting a new trial. Callaway filed a motion seeking a permanent injunction. Subsequent to the trial, the U.S. Patent and Trademark Office (PTO) issued second office actions again determining all four Callaway patents to be invalid. The PTO then closed the reexamination on two of the patents, issuing a final determination that the patents are invalid. The PTO has since issued a Right of Appeal Notice on one of those two patents, providing Callaway the opportunity to appeal the determination to the Patent Board of Appeals. It is not possible to predict the outcome of pending litigation, and, as with any litigation, it is possible that this action could be decided unfavorably. Acushnet is vigorously contesting this action and the Company believes that the lawsuit will not have a material adverse effect on the results of the Company s operations, cash flows or financial condition.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

16. Pending Litigation (Continued)

Other Litigation (Continued)

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

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

17. Environmental

We are subject to laws and regulations relating to the protection of the environment. It is not possible to quantify with certainty the potential impact of actions relating to environmental matters, particularly remediation and other compliance efforts that our subsidiaries may undertake in the future. In our opinion, however, compliance with current environmental protection laws (before taking into account estimated recoveries from third parties) will not have a material adverse effect upon our results of operations, cash flows or financial condition.

Item 2. **FORTUNE BRANDS, INC. AND SUBSIDIARIES**

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

OVERVIEW

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

For a description of certain factors that may have had, or may in the future have, a significant impact on our business, financial condition or results of operations, see Forward-Looking Statements.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

RESULTS OF OPERATIONS

Six Months Ended June 30, 2008 Compared To Six Months Ended June 30, 2007

(in millions)	Net Sales 2008	2007	% Change vs. Prior Year
Spirits	$ 1,123.2	$ 1,136.0	(1.1)%
Home and Hardware	1,929.5	2,224.7	(13.3)
Golf	848.8	841.7	0.8
Net Sales	$ 3,901.5	$ 4,202.4	(7.2)%

	Operating Income 2008	2007	% Change vs. Prior Year
Spirits	$ 267.2	$ 305.2	(12.5)%
Home and Hardware	(141.8)	256.3	
Golf	119.6	142.2	(15.9)
Less:			
Corporate expenses	33.8	31.6	7.0
Operating Income	$ 211.2	$ 672.1	(68.6)%

The 7% sales decrease was primarily due to the downturn in the U.S. home products market that impacted our Home and Hardware business, as well as decreased international sales in the Spirits business. These decreases were partially offset by growth in international markets in the Golf and Home & Hardware businesses, and favorable foreign currency.

Operating income decreased due to non-cash intangible asset impairment charges in the Home and Hardware business, lower sales, adverse operating leverage in the Home and Hardware business, and higher commodity costs, including fuel-related costs, as well as double-digit increases in brand investment in the Spirits and Golf businesses. Operating income benefited from select price increases, as well as productivity improvements and cost reductions in the Home and Hardware business.

Income from continuing operations decreased due to lower operating income discussed above and a non-cash write-down of the Spirits business s investment in the Maxxium Worldwide B.V. (Maxxium) international sales and distribution joint venture. Income from continuing operations benefited from a gain due to a reduction in the fair value of the minority interest in the Spirits business, lower interest expense and tax-related credits.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

RESULTS OF OPERATIONS (Continued)

Net Sales

Net sales decreased $300.9 million, or 7%, to $3.9 billion due to:

- the downturn in the U.S. home products market and its impact on our Home and Hardware business,
- weak consumer sentiment reducing demand for discretionary purchases, and
- lower international sales in the Spirits business.

Sales benefited from:

- newly introduced products and line extensions across all businesses (approximately $109 million in total, net of discontinued products),
- growth in international markets for the Golf and Home & Hardware businesses,
- favorable foreign currency ($88 million), and
- price increases implemented to offset higher costs for materials in the Home and Hardware business, as well as targeted price increases in the Spirits business.

Cost of products sold

Cost of products sold decreased $200.1 million, or 9%, primarily on lower sales, as well as cost reduction programs, global sourcing initiatives and productivity improvements, partly offset by unfavorable coverage of manufacturing costs and higher commodity costs (including fuel-related costs).

Excise taxes on spirits

Excise taxes on spirits were up 60 basis points as a percentage of sales compared to the prior year due to higher Spirits segment sales as a percent of total Company sales and increased sales in certain countries with higher excise taxes. Excise taxes are generally levied based on the alcohol content of spirits products. Consistent with industry practice, excise taxes collected from customers are reflected in net sales and the corresponding payments to governments are reflected in expenses.

Advertising, selling, general and administrative expenses

Advertising, selling, general and administrative expenses increased $30.1 million, or 3%, primarily as a result of double-digit percentage increases in brand investment in the Spirits and Golf businesses, as well as business repositioning costs in the Spirits business, partly offset by decreases in the Home and Hardware business.

Amortization of intangibles

Amortization of intangibles increased $0.9 million to $24.9 million due to changes in foreign currency rates.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

RESULTS OF OPERATIONS (Continued)

Intangible asset impairment charges

In the second quarter of 2008, we recorded pre-tax intangible impairment charges in the Home and Hardware business of $324.3 million, primarily due to the impact of a steeper than anticipated decline in the U.S. home products market in the current year, and the expectation of a slower than previously anticipated recovery in new home construction. For additional information, refer to the Results of Operations for the Three Months ended June 30, 2008 Compared to the Three Months Ended June 30, 2007 in this Quarterly Report on Form 10-Q.

Restructuring charges

For the six months ended June 30, 2008, we recorded restructuring charges of $10.1 million related to supply chain realignment and cost reduction initiatives in the Home and Hardware business ($6.2 million), as well as costs for supply chain activities in the Spirits business ($3.9 million). In the six months ended June 30, 2007, we recorded restructuring charges of $13.1 million principally related to cost reduction initiatives in the Home and Hardware business ($10.4 million), as well as a change in the distribution model in Australia for the Spirits business ($2.7 million).

Interest expense

Interest expense decreased $33.1 million, or 22%, to $118.8 million, primarily as a result of lower average debt, as well as slightly lower average interest rates.

Other expense (income), net

Other expense (income), net, decreased $31.0 million to an expense of $14.1 million, predominantly as a result of a $25.1 million write-down of our investment in Maxxium, our international sales and distribution joint venture, primarily to reflect our share of a goodwill write-down recorded in the financial statements of Maxxium that resulted from the eventual departures of Rémy Cointreau S.A. (Rémy) and V&S. In addition, we recorded $8.2 million of expenses related to participation in the auction process for the acquisition of V&S. Other expense (income), net, also includes non-operating income and expense, such as amortization of deferred income related to Future Brands LLC (our U.S. spirits distribution joint venture), interest income and transaction gains/losses related to foreign currency-denominated transactions.

Income tax expense

The effective income tax rate for the six months ended June 30, 2008 and 2007 was 17.9% and 32.5%, respectively. The 2008 effective income tax rate was favorably impacted by a $98.4 million tax benefit related to final settlement of the federal income tax audit related to our 2001-2002 federal tax returns. Additionally, the effective income tax rate was favorably impacted by tax credits associated with the conclusion of our 2004-2005 federal tax audit and higher foreign income taxed at lower statutory rates. The effective income tax rate was unfavorably impacted by the absence of a tax benefit on goodwill impairment charges of $288.9 million.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

RESULTS OF OPERATIONS (Continued)

Minority interest (income) expense

Minority interest income was $69.9 million this year compared to expense of $12.0 million last year. The favorable change of $81.9 million was primarily due to an $87.9 million gain from a reduction in the fair value of the 10% minority interest in the Spirits business as a result of a valuation by an independent third party performed in connection with the repurchase of the minority interest.

Net income

Net income was $256.5 million, or $1.67 per basic share and $1.65 per diluted share, for the six months ended June 30, 2008. This compared to net income of $352.2 million, or $2.31 per basic share and $2.25 per diluted share, for the six months ended June 30, 2007. Income from continuing operations (excluding the U.S. Wine business that was sold last year) was $134.2 million, or $0.87 per basic share and $0.86 per diluted share, for the six months ended June 30, 2008. These results compared to $350.8 million, or $2.30 per basic share and $2.24 per diluted share, for the six months ended June 30, 2007, respectively. The $216.6 million decrease in income from continuing operations was primarily due to intangible asset impairment charges ($310.7 million after tax) in the Home and Hardware business, lower operating income from business operations, and a write-down of the Spirits business s investment in Maxxium. Income from continuing operations benefited from a gain due to a reduction in the fair value of the minority interest in the Spirits business, lower interest expense and tax-related credits.

Income from discontinued operations was $122.3 million for the six months ended June 30, 2008, or $0.80 per basic share and $0.79 per diluted share, primarily due to one-time tax benefits of a capital loss carry forward position associated with the sale of the U.S. Wine business, as well as revision to the calculation of the state tax benefit on the gain on the sale of the U.S. Wine business. This compared to income from discontinued operations for the six months ended June 30, 2007 of $1.4 million, or $0.01 per basic and diluted share.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Results of Operations By Segment

Spirits

Net sales decreased $12.8 million, or 1%, to $1,123.2 million, due to lower sales in certain international markets, particularly Spain and Mexico, and the impact of the wind-down of transitional manufacturing agreements with Pernod Ricard S.A. (Pernod Ricard) to produce certain products at cost subsequent to a 2005 acquisition, as well as the impact on volume of an unexpected Australia excise tax on ready-to-drink spirit products instituted in April. These effects were partially offset by favorable foreign exchange ($37 million), the impact of targeted price increases, and higher sales at the premium end of our portfolio.

Operating income decreased $38.0 million, or 12%, to $267.2 million, primarily on lower sales, including the unfavorable margin impact of lower volume of high-margin ready-to-drink products in Australia as a result of the new excise tax, as well as a double-digit increase in brand spending for our spirits brands, and costs for supply chain activities and organizational repositioning. These factors were partially offset by the impact of price increases and a favorable mix shift toward our premium brands.

The Spirits business is a partner in Maxxium, our international sales and distribution joint venture. The Company retains a 25% ownership interest in Maxxium and accounts for its investment using the equity method. The Company s other equal partners in Maxxium are Rémy, The Edrington Group Ltd. and V&S. In November 2006, Rémy gave notice to Maxxium that it will terminate its distribution agreement with Maxxium effective March 30, 2009. In connection with Rémy s termination, it is expected that Rémy will pay a substantial termination penalty to Maxxium. On July 24, 2008, the government of Sweden sold V&S, the owner of Absolut vodka, to Pernod Ricard. Pernod Ricard indicated that it will withdraw V&S from Maxxium within two years from closing. In the second quarter of 2008, we recorded a $25.1 million write-down of our Maxxium investment (in other expense (income), net), primarily to reflect our share of a goodwill write-down recorded in the financial statements of Maxxium that resulted from the eventual departures of Rémy and V&S. The carrying value of the investment in Maxxium at June 30, 2008 was $72.1 million. Maxxium s direct sales force sells in many markets outside the United States representing approximately 15% of the net sales of the Spirits business. The Company has sufficient global distribution capabilities and does not expect the withdrawal of Rémy and V&S from Maxxium to have a material adverse impact on our Spirits business.

V&S, through its U.S. subsidiary, is our U.S. sales and distribution joint venture partner in Future Brands LLC. The initial operating term of Future Brands LLC ends February 2012.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Results of Operations By Segment (Continued)

Spirits (Continued)

V&S owned a 10% interest in the convertible preferred stock of our Spirits business. As a result of the sale of V&S, we exercised our call option to repurchase V&S s 10% equity stake in the Spirits business. On July 24, 2008, we repurchased the minority interest for the carrying value of $455.0 million.

In April 2008, the Australian government increased excise taxes on ready-to-drink products by 70%, equating to a 25% price increase to consumers, which adversely impacted Beam s pre-mixed Jim Beam and Cola product offering. Operating income will continue to be negatively impacted by the excise tax increase until its impact is annualized in the second quarter of 2009.

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

Home and Hardware

Net sales decreased $295.2 million, or 13%, to $1,929.5 million. The decrease was primarily attributable to the downturn in the U.S. home products market, as well as the slowing of the U.S. economy as home values have fallen and fuel prices have increased. Sales benefited from new products and line extensions (approximately $145 million in total, particularly in faucets and exterior doors), higher sales of security products, expansion in international markets, continued extension of brands into adjacent product categories, and the impact of select price increases.

Operating income decreased $398.1 million resulting in a loss of $141.8 million, primarily due to intangible asset impairment charges of $324.3 million. In addition, operating income continued to be negatively impacted by lower sales, the resulting unfavorable coverage of manufacturing and overhead costs, and higher commodity and fuel-related costs (approximately $20 million excluding the benefit of price increases). Operating income benefited from select price increases, productivity improvements, global sourcing initiatives to reduce materials costs, as well as a reduction in manufacturing, overhead and administrative cost structures.

In the second quarter of 2008, we recorded pre-tax intangible impairment charges in the Home and Hardware segment, principally for the door and window brands, of $324.3 million, primarily due to the impact of a worse than anticipated decline in the U.S. home products market in the current year, and the expectation of a slower than previously anticipated recovery in new home construction.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Results of Operations By Segment (Continued)

Home and Hardware (Continued)

The downturn in the overall U.S. home products market, which we now project to decline at a mid-teens rate throughout 2008, will continue to negatively impact the results of operations for our Home and Hardware business. Our business may also continue to be affected by competitive pricing, as well as further increases in the costs of certain commodities and sourced components. We will strive to mitigate the impact of the downturn on our net sales through market share gain initiatives, successful extension of brands into new markets, expanding existing customer relationships, and building on our substantial presence in the more stable replace-and-remodel segment of the U.S. home products market. Through previously announced restructuring activities and ongoing cost control initiatives, we are aligning supply-chain and administrative costs with marketplace demand in order to mitigate the impact of the downturn on our operating income and operating margins. We anticipate that 2008 operating income will benefit from lower restructuring and restructuring-related charges.

Golf

Net sales increased $7.1 million, or 1%, to $848.8 million. The sales increase was primarily due to higher sales in key international markets and for golf shoes and accessories, the impact of new product introductions and favorable foreign exchange ($25 million). These increases were partly offset by the impact of lower consumer demand in the U.S. for discretionary purchases such as golf clubs, as well as the effect of adverse weather in the U.S. and the timing of new product introductions on both golf clubs and golf balls.

Operating income decreased $22.6 million, or 16%, to $119.6 million, primarily due to a double-digit increase in brand investment (which will annualize in the second half of 2008), close-out pricing in advance of the launch of next-generation products, higher distribution costs and patent license expenses.

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

FORTUNE BRANDS, INC. AND SUBSIDIARIES

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Results of Operations By Segment (Continued)

Golf (Continued)

The United States Golf Association (USGA) and the Royal and Ancient Golf Club (R&A) establish standards for golf equipment used in the United States and outside the United States, respectively. In recent years, each of the USGA and the R&A has enacted new rules further restricting the dimensions or performance of golf clubs and golf balls. In March of 2005, the USGA and R&A requested that manufacturers participate in a golf ball research project by manufacturing and submitting balls that would conform to an overall distance standard that is 15 to 25 yards shorter than the current standard of 317 yards. As a result of their recent research regarding spin, the USGA has adopted a rules change, effective for products manufactured after January 1, 2010, reducing the groove volume and limiting the groove edge angle allowable on all irons and wedges. The USGA and R&A have adopted a rule change to allow greater adjustability in golf clubs, which went into effect on January 1, 2008. Existing rules and any new rules could change the golf products industry s ability to innovate and deploy new technologies and the competitive dynamic among industry participants, potentially impacting our Golf business.

Corporate

Corporate expenses of $33.8 million, which include salaries, benefits and expenses related to corporate office employees, increased $2.2 million, primarily due to the timing of benefit expenses.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

RESULTS OF OPERATIONS

Three Months Ended June 30, 2008 Compared To Three Months Ended June 30, 2007

	Net Sales		
(in millions)	2008	2007	% Change vs. Prior Year
Spirits	$ 607.9	$ 616.6	(1.4)%
Home and Hardware	1,035.1	1,202.1	(13.9)
Golf	452.4	474.6	(4.7)
Net Sales	$ 2,095.4	$ 2,293.3	(8.6)%

	Operating Income		
	2008	2007	% Change vs. Prior Year
Spirits	$ 138.6	$ 174.3	(20.5)%
Home and Hardware	(202.7)	169.9	
Golf	68.1	88.6	(23.1)
Less:			
Corporate expenses	20.0	17.0	17.6
Operating (Loss) Income	$ (16.0)	$ 415.8	%

The 9% sales decrease was primarily due to the downturn in the U.S. home products market that impacted our Home and Hardware business, a slowing in consumer demand impacting discretionary purchases, and lower international sales in the Spirits business, including the impact of an unexpected Australian excise tax on ready-to-drink spirits products. These decreases were partially offset by growth in international markets in the Golf and Home & Hardware businesses and favorable foreign currency.

Operating income decreased to a loss due to non-cash intangible asset impairment charges in the Home and Hardware business, lower sales, adverse operating leverage in the Home and Hardware business, double-digit increases in brand investment in the Golf and Spirits businesses, and higher commodity costs, including fuel-related costs. Operating income benefited from select price increases, as well as productivity improvements and reduced cost structures in the Home and Hardware business.

Income from continuing operations decreased due to the operating loss discussed above and a write-down of the Spirits business s investment in the Maxxium international sales and distribution joint venture. Income from continuing operations benefited from a gain due to a reduction in the fair value of the minority interest in the Spirits business, lower interest expense and tax-related credits.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

RESULTS OF OPERATIONS (Continued)

Net Sales

Net sales decreased $197.9 million, or 9%, to $2.1 billion due to:

- the downturn in the U.S. home products markets and its impact on our Home and Hardware business,
- weak consumer sentiment reducing demand for discretionary purchases, and
- lower international sales in the Spirits business, including the impact of an unexpected Australian excise tax on ready-to-drink spirits products.

Sales benefited from:

- newly introduced products and line extensions across all businesses (approximately $53 million in total, net of discontinued products)
- growth in international markets for the Golf and Home & Hardware businesses,
- favorable foreign currency ($40 million), and
- price increases implemented to offset higher costs for materials in the Home and Hardware business, as well as targeted price increases in the Spirits business.

Cost of products sold

Cost of products sold decreased $116.1 million, or 10%, primarily on lower sales, as well as cost reduction programs, global sourcing initiatives and productivity improvements, partly offset by unfavorable coverage of manufacturing costs and the impact of higher commodity costs.

Excise taxes on spirits

Excise taxes on spirits were up 100 basis points as a percentage of sales compared to the prior year due to higher Spirits segment sales as a percent of total Company sales, as well as increased sales in countries with higher excise taxes. Excise taxes are generally levied based on the alcohol content of spirits products. Consistent with industry practice, excise taxes collected from customers are reflected in net sales and the corresponding payments to governments in expenses.

Advertising, selling, general and administrative expenses

Advertising, selling, general and administrative expenses increased $14.6 million, or 3%, primarily as a result of double-digit increases in brand investment in the Spirits and Golf businesses, as well as business repositioning costs in the Spirits business, partly offset by decreases in the Home and Hardware business.

Amortization of intangibles

Amortization of intangibles increased $0.5 million to $12.5 million due to changes in foreign currency rates.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

RESULTS OF OPERATIONS (Continued)

Intangible asset impairment charges

In the second quarter of 2008, we recorded pre-tax intangible impairment charges in the Home and Hardware business of $324.3 million. We forecast the U.S. home products market in two portions: the new home construction portion and the repair/remodel portion. Primarily due to the impact of a worse than anticipated decline in the U.S. home products market on financial results, the Company concluded it was necessary to conduct an interim goodwill impairment test of reporting units most significantly impacted by new construction and most recently acquired (newer historical carrying values), primarily the Therma-Tru door and Simonton window brands. Based on the results of the testing, the Company recorded pre-tax goodwill impairment charges, predominantly related to its Therma-Tru door reporting unit. For each reporting unit, the impairment charge was measured as the excess of the implied fair value of the goodwill over its carrying value. The implied fair value of goodwill was estimated based on a hypothetical allocation of each reporting unit s fair value to all of its underlying assets and liabilities in accordance with the requirements of with Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets. Consistent with historical practice, the Company estimates the fair value of a reporting unit based on an estimate of future cash flows discounted at a market participant derived weighted average cost of capital. Our estimate of discounted future cash flows decreased significantly from year-end 2007 primarily due to a reduction of current year forecasted revenues and cash flows compared to our original plan (which results in projecting future revenue and cash flow growth off of a significantly lower base) and the shifting of cash flow growth beyond 2008 into later years.

Restructuring charges

For the three months ended June 30, 2008, we recorded restructuring charges of $7.8 million related to supply chain realignment and cost reduction initiatives in the Home and Hardware business ($3.9 million) and supply chain activities in the Spirits business ($3.9 million). In the three months ended June 30, 2007, we recorded restructuring charges of $7.0 million principally related to cost reduction initiatives in the Home and Hardware business.

Interest expense

Interest expense decreased $18.2 million, or 24%, to $58.2 million primarily as a result of lower average debt, as well as slightly lower average interest rates.

Other expense (income), net

Other expense (income), net, decreased $21.2 million to expense of $13.7 million, predominantly as a result of a $25.1 million write-down of our investment in Maxxium joint venture, primarily to reflect our share of a goodwill write-down recorded in the financial statements of Maxxium that resulted from the eventual departures of Rémy and V&S. Other expense (income), net, also includes non-operating income and expense, such as amortization of deferred income related to Future Brands LLC (our U.S. spirits distribution joint venture), interest income and transaction gains/losses related to foreign currency-denominated transactions.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

RESULTS OF OPERATIONS (Continued)

Income tax (benefit) expense

The effective income tax rate for the three months ended June 30, 2008 and 2007 was 43.7% and 32.1%, respectively. The 2008 effective income tax rate was favorably impacted by a $98.4 million tax benefit related to final settlement of the federal income tax audit related to our 2001-2002 federal tax returns. Additionally, the effective income tax rate was favorably impacted by tax credits associated with the conclusion of our 2004-2005 federal tax audit and higher foreign income taxed at lower statutory rates. The effective income tax rate was unfavorably impacted by the absence of a tax benefit on goodwill impairment charges of $288.9 million.

Minority interest (income) expense

Minority interest income was $76.1 million this year compared to expense of $5.9 million last year. The benefit of $82.0 million was primarily due to an $87.9 million gain from a reduction in the fair value of the 10% minority interest in the Spirits business, as a result of a valuation by an independent third party performed in connection with the repurchase of the minority interest.

Net income

Net income was $136.0 million, or $0.89 per basic share and $0.88 per diluted share, for the three months ended June 30, 2008. This compared to net income of $232.0 million, or $1.52 per basic share and $1.48 per diluted share, for the three months ended June 30, 2007. Income from continuing operations (excluding the U.S. Wine business that was sold last year) was $26.6 million, or $0.17 per basic and diluted share, for the three months ended June 30, 2008. These results compared to $229.5 million, or $1.50 per basic share and $1.47 per diluted share, for the three months ended June 30, 2007, respectively. The $202.9 million decrease in income from continuing operations was primarily due to intangible asset impairment charges of $310.7 million in the Home and Hardware business, lower operating income from business operations, and a write-down of the Spirits business s investment in Maxxium. Income from continuing operations benefited from a gain due to a reduction in the fair value of the minority interest in the Spirits business, lower interest expense and tax-related credits.

Income from discontinued operations was $109.4 million for the three months ended June 30, 2008, or $0.72 per basic share and $0.71 per diluted share, primarily due to one-time tax benefits from a capital loss carry forward position associated with the sale of the U.S. Wine business. This compared to income from discontinued operations for the three months ended June 30, 2007 of $2.5 million, or $0.02 per basic share and $0.01 per diluted share.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Results of Operations By Segment

Spirits

Net sales decreased $8.7 million, or 1%, to $607.9 million, due to lower sales in certain international markets, particularly Spain and Mexico, the impact of the wind-down of transitional manufacturing agreements with Pernod Ricard to produce certain products at cost subsequent to a 2005 acquisition, and the adverse impact on volume of an unexpected Australian excise tax on ready-to-drink spirits products instituted in April. These effects were partially offset by favorable foreign exchange ($16 million), the impact of targeted price increases, and rebuilding of U.S. distributor inventories after a first quarter reduction.

Operating income decreased $35.7 million, or 20%, to $138.6 million, due to lower sales, including the impact of lower sales of high-margin ready-to-drink spirits products as a result of the new Australia excise tax, as well as a double-digit increase in brand spending for our spirits brands, and costs for organizational repositioning and supply-chain activities. These factors were partially offset by the impact of price increases.

Home and Hardware

Net sales decreased $167.0 million, or 14%, to $1,035.1 million. The decrease was primarily attributable to the downturn in the U.S. home products market. The slowing of the U.S. economy also contributed to the decline. Sales benefited from new products and line extensions (approximately $92 million in total, particularly in faucets and exterior doors), higher sales of security products, expansion in international markets, continued extension of brands into adjacent product categories, and the impact of select price increases.

Operating income decreased $372.6 million to a loss of $202.7 million, primarily due to intangible asset impairment charges of $324.3 million, primarily in the window and door brands. Operating income continued to be negatively impacted by lower sales and the resulting unfavorable coverage of manufacturing and overhead costs. In addition, operating income was unfavorably impacted by increased commodity and fuel-related costs (approximately $20 million excluding the benefit of price increases and including the absence of last year s $6 million commodity hedge gains). Operating income benefited from select price increases, productivity improvements, and global sourcing initiatives to reduce materials costs, as well as a reduction in manufacturing, overhead and administrative cost structures.

Results of Operations By Segment (Continued)

Golf

Net sales decreased $22.2 million, or 5%, to $452.4 million. The sales decrease was primarily due to weak consumer demand in the U.S. for discretionary purchases such as golf clubs, the timing of new product introductions, and adverse weather in the U.S. Sales benefited from growth in key international markets and favorable foreign exchange ($12 million).

Operating income decreased $20.5 million, or 23%, to $68.1 million, primarily due to a double-digit increase in brand investment, close-out pricing in advance of the launch of next-generation products and patent license expenses.

Corporate

Corporate expenses of $20.0 million, which include salaries, benefits and expenses related to corporate office employees, increased $3.0 million, primarily due to the timing of benefit expenses.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

LIQUIDITY AND CAPITAL RESOURCES

Our primary liquidity needs are to support working capital requirements, fund capital expenditures, service indebtedness and pay dividends, as well as finance acquisitions and share repurchases when deemed appropriate. Our principal sources of liquidity are cash flows from operating activities, commercial paper, borrowings under our credit agreements and long-term notes. Our operating income is generated by our subsidiaries. There are no significant restrictions on the ability of our subsidiaries to pay dividends or make other distributions to Fortune Brands. We periodically review our portfolio of brands and evaluate strategic options to increase shareholder value. We cannot predict whether or when we may enter into an acquisition, disposition, joint venture or other strategic options, or what impact any such transaction could have on our results of operations, cash flows or financial condition, whether as a result of the issuance of debt or equity securities, or otherwise.

Cash Flows

Net cash provided by operating activities was $33.9 million for the six months ended June 30, 2008 compared $132.0 million for the same six-month period last year. The decrease in cash provided of $98.1 million was principally due to $48.0 million of taxes paid in the first quarter of 2008 related to the sale of the U.S. Wine business last year, as well as an increase in inventories of maturing spirits in the Spirits business in 2008 compared to 2007.

Net cash used by investing activities for the six months ended June 30, 2008 decreased to $67.0 million, compared with $100.5 million in the same six-month period last year, primarily as a result of a reduction in capital spending, primarily in the Home and Hardware business.

Net cash used by financing activities for the six months ended June 30, 2008 was $21.5 million, compared with $68.8 million in the same six-month period last year. The decrease of $47.3 million was primarily due to $141.4 million in share repurchases, as well as less cash from the exercise of stock options ($32.0 million), partially offset by a net increase in debt ($215.7 million).

Capitalization

Total debt increased $310.9 million during the six-month period ended June 30, 2008 to $4.7 billion. The ratio of total debt to total capital increased to 42.5% at June 30, 2008 from 41.2% at December 31, 2007 primarily due to higher debt resulting from repurchases of common stock and lower cash provided by operating activities.

We have two revolving credit agreements with various banks. These agreements include a $2.0 billion, 5-year revolving credit agreement, which matures in 2010, and a $500 million, 364-day revolving credit agreement which matures in October 2008. There were no amounts outstanding under either credit agreement as of June 30, 2008. The 364-day credit agreement includes an option to extend payment for one year at the Company s discretion for an incremental fee of 0.125% of the outstanding amount. The facilities support the Company s commercial paper borrowings in the commercial paper market.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

LIQUIDITY AND CAPITAL RESOURCES (Continued)

Common Stock Repurchase Program

On March 25, 2008, our Board of Directors approved a share repurchase program pursuant to which we could purchase up to 15 million shares of our common stock in open market or privately negotiated transactions from March 25, 2008 to December 31, 2008. In the six and three months ended June 30, 2008, we repurchased 2.0 million shares of common stock.

Repurchase of 10% Minority Interest in Spirits Business

On July 24, 2008, we repurchased the 10% minority interest in the Spirits business from V&S for $455.0 million, financed by commercial paper borrowings and cash flow from operations.

Dividends

A summary of 2008 dividend activity for the Company s common stock is shown below:

Dividend Amount	Declaration Date	Record Date	Payment Date
$0.42 per share	January 22, 2008	February 6, 2008	March 3, 2008
$0.42 per share	April 29, 2008	May 14, 2008	June 2, 2008
$0.44 per share	July 25, 2008	August 13, 2008	September 2, 2008

A summary of 2008 dividend activity for the Company s $2.67 Convertible Preferred stock is shown below:

Dividend Amount	Declaration Date	Record Date	Payment Date
$0.6675 per share	January 22, 2008	February 6, 2008	March 10, 2008
$0.6675 per share	April 29, 2008	May 14, 2008	June 10, 2008
$0.6675 per share	July 25, 2008	August 13, 2008	September 10, 2008

We currently expect to pay quarterly cash dividends in the future, but such payments are dependent upon our financial condition, results of operations, capital requirements and other factors, including those set forth in the section titled Forward-Looking Statements.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

LIQUIDITY AND CAPITAL RESOURCES (Continued)

Adequacy of Liquidity Sources

We believe that our internally generated funds, together with access to global credit markets, are adequate to meet our long-term and short-term capital needs, repayment of the current portion of long-term debt and our share repurchase activities. Our cash flows from operations, borrowing availability and overall liquidity are subject to certain risks and uncertainties, including those set forth under Forward-Looking Statements.

Guarantees and Commitments

Third-party guarantees executed in connection with the formation of Maxxium, our Spirits international sales and distribution joint venture, totaled approximately $98 million as of June 30, 2008. We are required to perform under these guarantees in the event that Maxxium fails to make contractual payments. The current guarantees of Maxxium s credit facilities expire December 12, 2010. In accordance with Financial Accounting Standards Board Interpretation No. 45 (FIN 45), Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, we recorded a liability of $0.4 million as of June 30, 2008 to reflect the fair value of the guarantees to Maxxium, with an offsetting increase in the investment in Maxxium.

In addition, as a part of the formation of the Future Brands LLC (Future Brands) joint venture with V&S, Jim Beam Brands Co. (JBBCo.) has guaranteed any financial obligations of Future Brands that may arise in the event of a Future Brands default in which it fails to fulfill its operating obligations and which results in a claim. These financial obligations include, but are not limited to, making payments to suppliers, employees and other parties with which Future Brands conducts business. We cannot estimate the possible future obligations under the Future Brands agreement. At June 30, 2008, JBBCo. did not have any outstanding obligations as a result of this arrangement.

We also guarantee various leases for ACCO World Corporation, the Office business divested in a spin-off on August 16, 2005. We will continue to guarantee payment of certain real estate leases with lease payments totaling approximately $32.8 million through April 2013. Accordingly, we have recorded the fair value of these guarantees on our financial statements in accordance with FIN 45. The liability related to this guarantee was $0.9 million as of June 30, 2008. Refer to Note 3, Discontinued Operations, in the Notes to the Consolidated Financial Statements of our Annual Report on Form 10-K for the year ended December 31, 2007 for additional information on the spin-off of the Office business.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

LIQUIDITY AND CAPITAL RESOURCES (Continued)

Guarantees and Commitments (Continued)

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 divestiture agreements 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, potential payments under these divestiture-related indemnity obligations cannot be reasonably estimated. The indemnities vary in duration, and in some cases the durations are indefinite. Because FIN 45 was effective after December 31, 2002, we have not recorded any liability in the consolidated financial statements for indemnities entered into prior to that date.

We have not made any payments related to indemnity obligations that were material to our financial position or results of operations for any quarter. Furthermore, we do not expect that potential payments 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 2008 or in subsequent periods.

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

RECENTLY ISSUED ACCOUNTING STANDARDS

Business Combinations

In December 2007, the FASB issued FAS No. 141 (revised 2007) (FAS 141R), Business Combinations. FAS 141R replaces FAS No. 141, Business Combinations. FAS 141R establishes principles and requirements for how an acquirer, a) recognizes and measures the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree, b) recognizes and measures the goodwill acquired and c) determines what information to disclose. FAS 141R also requires that all acquisition-related costs, including restructuring, be recognized separately from the acquisition. FAS 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008 (calendar 2009 for Fortune Brands). This Statement eliminates adjustments to goodwill for changes in deferred tax assets and uncertain tax positions after the acquisition accounting measurement period (limited to one year from acquisition), including for acquisitions prior to adoption of FAS 141R. We do not expect FAS 141R to materially impact our results of operations, cash flows or financial position.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Concluded)

RECENTLY ISSUED ACCOUNTING STANDARDS (Continued)

Noncontrolling Interests in Consolidated Financial Statements

In December 2007, the FASB issued FAS No. 160 (FAS 160), Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51. FAS 160 amends Accounting Research Bulletin No. 51, establishing accounting and reporting standards for the noncontrolling interest (currently referred to as minority interest) in a subsidiary and for the deconsolidation of a subsidiary. This Statement changes the consolidated balance sheet presentation of noncontrolling interests from the mezzanine level (between liabilities and stockholders equity) to a component of stockholders equity, however because the minority interest in the Spirits business held by V&S is in the form of redeemable preferred stock, it would continue to be classified in the mezzanine level (between liabilities and stockholders equity). As of June 30, 2008, the carrying value of the minority interest held by V&S was $455.0 million and the carrying value of other minority interests/noncontrolling interests (which would be reclassified to equity upon adoption of FAS 160) was $13.7 million. FAS 160 requires expanded disclosures in the consolidated financial statements that clearly identify and distinguish between the interests of the parent s owners and the interests of the noncontrolling owners of a subsidiary. FAS 160 is effective for financial statements issued for fiscal years beginning after December 15, 2008 (calendar 2009 for Fortune Brands). This statement applies prospectively except presentation and disclosure requirements are applied retrospectively for all periods presented. FAS 160 will have an impact on the presentation of noncontrolling interests on the Fortune Brands statements of income, financial position and stockholders equity.

Fair Value Measurements

In February 2008, the FASB issued FASB Staff Position FAS 157-2 (FSP FAS 157-2), Effective Date of FASB Statement No. 157, which delays the effective date of FAS No. 157 for all nonrecurring fair value measurements of nonfinancial assets and liabilities until fiscal years beginning after November 15, 2008 (calendar 2009 for Fortune Brands). We have elected to defer the adoption of nonrecurring fair value measurement disclosures of nonfinancial assets and liabilities. The adoption of FSP FAS 157-2 is not expected to have a material impact on our results of operations, cash flows or financial position.

Disclosures about Derivative Instruments and Hedging Activities

In March 2008, the FASB issued FAS No. 161 (FAS 161), Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133. FAS 161 establishes the disclosure requirements for derivatives instruments and for hedging activities in order to provide users of financial statements with an enhanced understanding of a) how and why derivatives are used, b) how derivative instruments and related hedged items are accounted for, and c) how they affect financial position, financial performance and cash flows. FAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008 (calendar 2009 for Fortune Brands). We are currently evaluating the impact of FAS 161 on our disclosures.

FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains statements relating to future results**.** Readers are cautioned that these are forward-looking statements, as defined in the Private Securities Litigation Reform Act of 1995, that involve a number of risks and uncertainties. Readers are cautioned that these forward-looking statements speak only as of the date hereof, and the Company does not assume any obligation to update, amend or clarify them to reflect events, new information or circumstances occurring after the date of this Report. Actual results may differ materially from those projected as a result of certain risks and uncertainties, including, but not limited to:

- competitive market pressures (including pricing pressures),
- consolidation of trade customers,
- successful development of new products and processes,
- ability to secure and maintain rights to intellectual property,
- risks pertaining to strategic acquisitions and joint ventures, including the potential financial effects and performance of such acquisitions or joint ventures, integration of acquisitions and the related confirmation or remediation of internal controls over financial reporting,
- changes related to the privatization of V&S Group,
- ability to attract and retain qualified personnel,
- general economic conditions, including the U.S. housing market,
- weather,
- risks associated with doing business outside the United States, including currency exchange rate risks,
- interest rate fluctuations,
- commodity and energy price volatility,
- costs of certain employee and retiree benefits and returns on pension assets,
- dependence on performance of distributors and other marketing arrangements,

the impact of excise tax increases on distilled spirits,

changes in golf equipment regulatory standards and other regulatory developments,

potential liabilities, costs and uncertainties of litigation,

impairment in the carrying value of goodwill or other acquired intangibles,

historical consolidated financial statements that may not be indicative of future conditions and results due to the recent portfolio realignment,

any possible downgrades of the Company s credit ratings,

as well as other risks and uncertainties detailed from time to time in the Company s Securities and Exchange Commission filings.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

In the second quarter of 2008, we entered into interest rate swaps with an aggregate notional principal amount of $400 million. The swap agreements hedge changes in fair value on a portion of our fixed rate 5.375% notes due 2016 that result from changes in a benchmark interest rate (U.S. LIBOR). The swaps have been designated and are classified as fair value hedges in accordance with FAS 133. A 100 basis point increase in swap interest rates would decrease the fair value of the swap agreements by $25 million. There were no interest rate swaps outstanding as of December 31, 2007.

There are no other material changes in the information provided in Item 7A-Quantitative and Qualitative Disclosures about Market Risk of the Company s Annual Report on Form 10-K for the year ended December 31, 2007.

Item 4. CONTROLS AND PROCEDURES.

(a) Evaluation of Disclosure Controls and Procedures.

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

(b) Changes in Internal Control Over Financial Reporting.

There have not been any changes in the Company s internal control over financial reporting that occurred during the Company s fiscal quarter ended June 30, 2008 that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS.

(a) Smoking and Health Proceedings.

Tobacco Overview

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

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

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

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

As of August 1, 2008, there were approximately 10 smoking and health cases pending against the Company all of which were filed by individual plaintiffs. This number has not changed from the number reported in our Annual Report on Form 10-K for the year ended December 31, 2007. See Pending Cases below.

Certain Developments Affecting the Indemnitor

On July 14, 2000, in Engle v. R.J. Reynolds Tobacco Company, et al., a Florida state case brought against B&W (individually and as successor to ATCO) and other U.S. tobacco manufacturers on behalf of a class of Florida residents allegedly injured as a result of their alleged addiction to cigarettes containing nicotine, a jury awarded a total of $144.87 billion in punitive damages against the defendants, including $17.59 billion against B&W. On November 6, 2000, Florida Circuit Judge Robert Kaye upheld this jury award, and held that the class of plaintiffs eligible to recover damages should be extended to smokers with illnesses diagnosed more than four years before the lawsuit was filed in 1994. On May 21, 2003, a Florida appellate court reversed the jury s verdict and damages award and decertified the class. On October 22, 2003, plaintiffs counsel sought review of this decision in the Florida Supreme Court. On July 6, 2006 the Florida Supreme Court vacated the jury s $145 billion punitive damage award and also decertified the class and reinstated compensatory damages to the two named plaintiffs, and permitted individual members of the former class to file separate lawsuits within one year of issuance of the mandate (which was ultimately issued January 11, 2007). On August 7, 2006, both parties filed motions for rehearing with the Florida Supreme Court. On December 21, 2006, the Florida Supreme Court denied plaintiffs rehearing motion, and granted in part and denied in part defendants rehearing motion. The December 21, 2006 ruling did not amend the July 6, 2006 decision s major holdings, but instead addressed the claims to which the Engle jury s phase one verdict will be applicable in the individual lawsuits that the Florida Supreme Court s decision has permitted. On October 1, 2007, the United States Supreme Court denied defendants motion seeking review by that courtThe Company is not a party to the Engle litigation.

In September 1999, the United States government filed a recoupment lawsuit in Federal Court in Washington, D.C. against the leading tobacco manufacturers (including B&W individually and as a successor to ATCO) seeking recovery of costs paid by the Federal government for claimed smoking-related illness. In this action, the U.S. District Court for the District of Columbia dismissed certain counts of the lawsuit, but also ruled that the government may proceed with two counts under the federal RICO statute. On February 4, 2005, the U.S. Circuit Court of Appeals for the District of Columbia held that the government may not, however, seek a disgorgement of defendants profits from the sale of tobacco as a part of its RICO claim. The U.S. Supreme Court denied the government s petition to review the case on October 17, 2005. The trial was concluded in June, 2005. On August 17, 2006, the Court issued its final judgment and remedial order, which found that the defendants violated federal civil RICO law by defrauding the public with regard to smoking and health issues. The court did not award monetary damages to the government, but did order the defendants to, among other things, remove descriptors such as low tar, light or ultra light from cigarette packages and to publish certain corrective statements regarding smoking and health issues. Both the defendants and the government are pursuing appeals of this matter. The Company is not a party to this action.

On March 21, 2003, a judgment for $7.1 billion in compensatory and $3 billion in punitive damages was entered by an Illinois state court against Philip Morris, Inc. in Price, et al. v. Philip Morris, Inc., a class action alleging that certain advertising for light or low tar cigarettes was deceptive under the Illinois Consumer Fraud Act. On December 15, 2005, the Illinois Supreme Court reversed the judgment and remanded the case to the lower court with instruction to dismiss the case. On November 27, 2006, the U.S. Supreme Court refused to hear plaintiff s appeal and ordered the lower court to dismiss plaintiff s pending motion to vacate. On December 18, 2006, the defendants filed a motion to dismiss and for entry of final judgment with the lower court, which was granted. On January 17, 2007, the plaintiffs subsequently filed a motion in the lower court seeking to vacate or withhold judgment. On August 30, 2007, the lower court dismissed plaintiff s pending motion, effectively concluding the case. Class actions involving similar

allegations (Howard, et al. v. Brown & Williamson Tobacco Corp. and Turner v. R.J. Reynolds Tobacco Co.) are pending against B&W and R.J. Reynolds Tobacco Company, respectively, in the same court. Proceedings in the Howard and Turner cases have been stayed pending resolution of the Price litigation. The Company is not a party to the Price, Howard or Turner litigation.

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

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

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

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

Pending Cases

There were no pending smoking and health proceedings in which the Company has been named as a defendant other than as previously reporting in Exhibit 99 of our Annual Report on Form 10-K for the year ended December 31, 2007.

Terminated Cases

No tobacco-related cases were terminated in the three months ended June 30, 2008.

Conclusion

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

(b) Other Litigation.

On February 9, 2006, Callaway Golf Company filed a lawsuit seeking unspecified damages against Acushnet Company in the United States District Court for the District of Delaware. Callaway alleges that certain golf balls manufactured by Acushnet Company infringe four of Callaway s patents. Acushnet believes, and counsel has advised, that it has meritorious defenses against Callaway s allegations. Acushnet stipulated to infringement and a jury trial on invalidity was conducted in December 2007. The jury returned a mixed verdict, finding one claim invalid and eight claims valid. Acushnet filed a motion for a judgment as a matter of law to overturn the inconsistent jury verdict and in the alternative requesting a new trial. Callaway filed a motion seeking a permanent injunction. Subsequent to the trial, the U.S. Patent and Trademark Office (PTO) issued second office actions again determining all four Callaway patents to be invalid. The PTO then closed the reexamination on two of the patents, issuing a final determination that the patents are invalid. The PTO has since issued a Right of Appeal Notice on one of those two patents, providing Callaway the opportunity to appeal the determination to the Patent Board of Appeals. It is not possible to predict the outcome of pending litigation, and, as with any litigation, it is possible that this action could be decided unfavorably. Acushnet is vigorously contesting this action and the Company believes that the lawsuit will not have a material adverse effect on the results of the Company s operations, cash flows or financial condition.

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

(c) Environmental Matters.

We are subject to laws and regulations relating to protection of the environment. It is not possible to quantify with certainty the potential impact of actions relating to environmental matters, particularly remediation and other compliance efforts that our subsidiaries may undertake in the future. In our opinion, however, compliance with current environmental protection laws (before taking into account estimated recoveries from third parties) will not have a material adverse effect upon our results of operations, cash flows or financial condition.

Item 1A. RISK FACTORS.

There were no material changes from risk factors previously disclosed in our Annual Report on Form 10-K as of December 31, 2007.

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

Below are the repurchases of common stock by the Company or any affiliated purchaser (as defined in Rule 10b-18(a) (3) under the Exchange Act) for the three months ended June 30, 2008:

Three Months Ended June 30, 2008	Total number of shares purchased [1]	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs [1]	Maximum number of shares that may yet be purchased under the plans or programs [1]
April 1 April 30	510,866	$ 68.90	510,866	14,489,134
May 1 May 31	1,499,100	69.18	1,499,100	12,990,034
June 1 June 30	36,000	68.57	36,000	12,954,034
Total	2,045,966	$ 69.10	2,045,966	

(1) The Company repurchased 2,045,966 shares between April 1, 2008 and June 30, 2008 pursuant to the Company s share repurchase program approved by the Company s Board of Directors on March 25, 2008. The share repurchase program authorizes the Company to purchase up to 15,000,000 shares from March 25, 2008 to December 31, 2008.

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

(a) The Annual Meeting of Stockholders was held on April 29, 2008.

(b) The Company s Certificate of Incorporation provides for the classification of the Board of Directors into three classes, as nearly equal in number as possible, with staggered terms of office and provides that upon the expiration of the term of office for a class of directors, nominees for such class shall be elected for a term of three years or until their successors are duly elected and qualified. The three nominees for Class I directors, Mr. Richard A. Goldstein, Mr. Pierre E. Leroy and Mr. A. D. David Mackay were duly elected at the 2008 Annual Meeting for a term of office expiring at the 2011 Annual Meeting. The terms of office of the Class II directors, Mr. Bruce A. Carbonari, Mrs. Ann F. Hackett and Mr. David M. Thomas, and the terms of office of the Class III directors, Mrs. Anne M. Tatlock, Mr. Norman H. Wesley and Mr. Peter M. Wilson, continued after the 2008 Annual Meeting.

(c) (i) The three nominees for Class I directors were elected by a majority of the combined votes cast by the holders of the Company s Common Stock and $2.67 Convertible Preferred Stock voting thereon: (A) Mr. Goldstein: 89,366,392 votes for and 44,280,427 votes withheld; (B) Mr. Leroy: 83,669,705 votes for and 49,977,114 votes withheld; and (C) Mr. Mackay: 89,344,846 votes for and 44,301,973 votes withheld.

(ii) A proposal (designated Item 2 and set forth in Company s Proxy Statement), approved by the Board of Directors, to elect PricewaterhouseCoopers LLP as the independent registered public accounting firm for the Company for 2008, was approved by a majority of the combined votes cast by the holders of Company s Common Stock and $2.67 Convertible Preferred Stock voting thereon: 131,390,762 shares voted for the proposal, 1,037,685 shares voted against the proposal and 1,218,368 shares abstained.

(iii) A stockholder proposal (designated Item 3 and set forth in Company s Proxy Statement), to adopt and implement the annual election of each director was approved by a majority of the combined votes cast by the holders of Company s Common Stock and $2.67 Convertible Preferred Stock voting thereon: 82,527,175 shares voted for the proposal; 28,532,986 shares voted against the proposal; 1,855,597 shares abstained; and 20,731,060 were broker non-votes.

Item 6. **EXHIBITS**

Exhibit

3(i).	Restated Certificate of Incorporation of the Company as in effect on the date hereof is incorporated herein by reference to Exhibit 3(i) to our Annual Report on Form 10-K for the fiscal year ended December 31, 1998, Commission file number 1-9076.
3(ii).	By-laws of Fortune Brands, Inc. (as amended), as of July 29, 2008, is incorporated herein by reference to Exhibit 3.1 to the Company s Current Report on Form 8-K dated July 31, 2008, Commission file number 1-9076.
10.1	Amendment to the Fortune Brands, Inc. Supplemental Plan, is incorporated herein by reference to Exhibit 10.1 to the Company s Current Report on Form 8-K dated July 31, 2008, Commission file number 1-9076.
10.2*	Fortune Brands, Inc. Severance Plan for Vice Presidents (as amended and restated effective January 1, 2008) as of July 29, 2008.
12.*	Statement re Computation of Ratio of Earnings to Fixed Charges.
31.1.*	Certificate of Chief Executive Officer Required Under Section 302 of the Sarbanes-Oxley Act of 2002.
31.2.*	Certificate of Chief Financial Officer Required Under Section 302 of the Sarbanes-Oxley Act of 2002.
32.*	Joint CEO/CFO Certificate Required Under Section 906 of the Sarbanes-Oxley Act of 2002.

* Filed herewith.

SIGNATURE

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

FORTUNE BRANDS, INC.
(Registrant)

Date: August 8, 2008

/s/ Craig P. Omtvedt
Craig P. Omtvedt
Senior Vice President
and Chief Financial Officer
(Duly authorized officer and principal financial officer of the Registrant)

EXHIBIT INDEX

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3(i).	Restated Certificate of Incorporation of the Company as in effect on the date hereof is incorporated herein by reference to Exhibit 3(i) to our Annual Report on Form 10-K for the fiscal year ended December 31, 1998, Commission file number 1-9076.
3(ii).	By-laws of Fortune Brands, Inc. (as amended), as of July 29, 2008, is incorporated herein by reference to Exhibit 3.1 to the Company s Current Report on Form 8-K dated July 31, 2008, Commission file number 1-9076.
10.1	Amendment to the Fortune Brands, Inc. Supplemental Plan, is incorporated herein by reference to Exhibit 10.1 to the Company s Current Report on Form 8-K dated July 31, 2008, Commission file number 1-9076.
10.2*	Fortune Brands, Inc. Severance Plan for Vice Presidents (as amended and restated effective January 1, 2008) as of July 29, 2008.
12.*	Statement re Computation of Ratio of Earnings to Fixed Charges.
31.1.*	Certificate of Chief Executive Officer Required Under Section 302 of the Sarbanes-Oxley Act of 2002.
31.2.*	Certificate of Chief Financial Officer Required Under Section 302 of the Sarbanes-Oxley Act of 2002.
32.*	Joint CEO/CFO Certificate Required Under Section 906 of the Sarbanes-Oxley Act of 2002.

* Filed herewith.