MASCO CORP /DE/
Form 10-Q
May 03, 2007

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**
**WASHINGTON, D.C. 20549**

**FORM 10-Q**
**QUARTERLY REPORT**
**PURSUANT TO SECTION 13 OR 15(d) OF**
**THE SECURITIES EXCHANGE ACT OF 1934**
**For the quarterly period ended March 31, 2007**
**Commission file number: 1-5794**
**Masco Corporation**
(Exact name of Registrant as Specified in Charter)

| | |
|---|---|
| **Delaware** | **38-1794485** |
| (State or Other Jurisdiction of Incorporation) | (IRS Employer Identification No.) |
| **21001 Van Born Road, Taylor, Michigan** | **48180** |
| (Address of Principal Executive Offices) | (Zip Code) |

**(313) 274-7400**
(Registrant s telephone number, including area code)

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.

þ Yes o No

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

Large accelerated þ Accelerated o Non-accelerated o

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

o Yes þ No

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

| Class | Shares Outstanding at May 1, 2007 |
|---|---|
| Common stock, par value $1.00 per share | 377,700,000 |

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**MASCO CORPORATION**
**CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)**
**March 31, 2007 and December 31, 2006**
**(In Millions, Except Share Data)**

| | March 31, 2007 | December 31, 2006 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash investments | $ 1,165 | $ 1,958 |
| Receivables | 1,779 | 1,613 |
| Prepaid expenses and other | 313 | 281 |
| Inventories: | | |
| Finished goods | 660 | 610 |
| Raw material | 460 | 480 |
| Work in process | 159 | 173 |
| | 1,279 | 1,263 |
| Total current assets | 4,536 | 5,115 |
| Property and equipment, net | 2,351 | 2,363 |
| Goodwill | 3,965 | 3,957 |
| Other intangible assets, net | 304 | 306 |
| Other assets | 529 | 584 |
| Total assets | $ 11,685 | $ 12,325 |
| **LIABILITIES** | | |
| Current liabilities: | | |
| Notes payable | $ 323 | $ 1,446 |
| Accounts payable | 890 | 815 |
| Accrued liabilities | 1,126 | 1,128 |
| Total current liabilities | 2,339 | 3,389 |
| Long-term debt | 4,044 | 3,533 |
| Deferred income taxes and other | 1,041 | 932 |
| Total liabilities | 7,424 | 7,854 |
| Commitments and contingencies | | |
| **SHAREHOLDERS EQUITY** | | |
| Common shares, par value $1 per share | 376 | 384 |

| | | |
|---|---|---|
| Authorized shares: 1,400,000,000; issued and outstanding: 2007 375,840,000; 2006 383,890,000 | | |
| Retained earnings | 3,364 | 3,575 |
| Accumulated other comprehensive income | 521 | 512 |
| Total shareholders equity | 4,261 | 4,471 |
| Total liabilities and shareholders equity | $ 11,685 | $ 12,325 |

See notes to condensed consolidated financial statements.

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**MASCO CORPORATION**
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME (Unaudited)**
**For the Three Months Ended March 31, 2007 and 2006**
**(In Millions, Except Per Common Share Data)**

| | Three Months Ended March 31, 2007 | Three Months Ended March 31, 2006 |
|---|---|---|
| Net sales | $ 2,881 | $ 3,167 |
| Cost of sales | 2,125 | 2,293 |
| Gross profit | 756 | 874 |
| Selling, general and administrative expenses | 499 | 519 |
| Operating profit | 257 | 355 |
| Other income (expense), net: | | |
| Interest expense | (63) | (64) |
| Other, net | 42 | 34 |
| | (21) | (30) |
| Income from continuing operations before income taxes, minority interest and cumulative effect of accounting change, net | 236 | 325 |
| Income taxes | 85 | 112 |
| Income from continuing operations before minority interest and cumulative effect of accounting change, net | 151 | 213 |
| Minority interest | 9 | 6 |
| Income from continuing operations before cumulative effect of accounting change, net | 142 | 207 |
| Income from discontinued operations, net | 1 | |
| Cumulative effect of accounting change, net | | (3) |
| Net income | $ 143 | $ 204 |
| Earnings per common share: | | |
| Basic: | | |
| Income from continuing operations before cumulative effect of accounting change, net | $ .37 | $ .51 |
| Income from discontinued operations, net | | |
| Cumulative effect of accounting change, net | | (.01) |

| | | | | |
|---|---|---|---|---|
| Net income | $ | .37 | $ | .50 |
| Diluted: | | | | |
| Income from continuing operations before cumulative effect of accounting change, net | $ | .37 | $ | .50 |
| Income from discontinued operations, net | | | | |
| Cumulative effect of accounting change, net | | | | (.01) |
| Net income | $ | .37 | $ | .50 |
| Cash dividends per common share: | | | | |
| Declared | $ | .23 | $ | .22 |
| Paid | $ | .22 | $ | .20 |

See notes to condensed consolidated financial statements.

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**MASCO CORPORATION**
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)**
**For the Three Months Ended March 31, 2007 and 2006**
**(In Millions)**

| | Three Months Ended March 31, 2007 | 2006 |
|---|---|---|
| **CASH FLOWS FROM (FOR) OPERATING ACTIVITIES:** | | |
| Cash provided by operations | $ 202 | $ 314 |
| (Increase) in receivables | (177) | (256) |
| (Increase) in inventories | (19) | (125) |
| Increase in accounts payable and accrued liabilities, net | 82 | 98 |
| Net cash from operating activities | 88 | 31 |
| **CASH FLOWS FROM (FOR) FINANCING ACTIVITIES:** | | |
| Increase in debt | 1 | 39 |
| Payment of debt | (10) | (12) |
| Retirement of notes | (1,125) | (827) |
| Issuance of notes, net of issuance costs | 596 | |
| Purchase of Company common stock | (274) | (324) |
| Issuance of Company common stock | 12 | 7 |
| Cash dividends paid | (87) | (84) |
| Net cash (for) financing activities | (887) | (1,201) |
| **CASH FLOWS FROM (FOR) INVESTING ACTIVITIES:** | | |
| Capital expenditures | (55) | (110) |
| Purchases of marketable securities | | (79) |
| Purchases of other financial investments, net | | (1) |
| Proceeds from disposition of: | | |
| Marketable securities | 31 | 90 |
| Other financial investments, net | 17 | |
| Property and equipment | 9 | (1) |
| Acquisition of businesses, net of cash acquired | (3) | |
| Other, net | 5 | (12) |
| Net cash from (for) investing activities | 4 | (113) |
| Effect of exchange rate changes on cash and cash investments | 2 | 1 |

| | | |
|---|---|---|
| **CASH AND CASH INVESTMENTS:** | | |
| Decrease for the period | (793) | (1,282) |
| At January 1 | 1,958 | 1,964 |
| At March 31 | $ 1,165 | $ 682 |

See notes to condensed consolidated financial statements.

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**MASCO CORPORATION**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

A. In the opinion of the Company, the accompanying unaudited condensed consolidated financial statements contain all adjustments, of a normal recurring nature, necessary to present fairly its financial position as at March 31, 2007 and the results of operations and changes in cash flows for the three months ended March 31, 2007 and 2006. The condensed consolidated balance sheet at December 31, 2006 was derived from audited financial statements.

Certain prior-year amounts have been reclassified to conform to the 2007 presentation in the condensed consolidated financial statements. The results of operations related to 2006 discontinued operations have been separately stated in the accompanying condensed consolidated statement of income for the three months ended March 31, 2006. In the Company s condensed consolidated statement of cash flows for the three months ended March 31, 2006, cash flows of discontinued operations are not separately classified.

*Recently Issued Accounting Pronouncements.* In February 2007, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards ( SFAS ) No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of SFAS No. 115, ( SFAS No. 159 ). SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The adoption of SFAS No. 159 is effective January 1, 2008. The Company is currently evaluating the impact that the provisions of SFAS No. 159 will have on its consolidated financial statements.

B. The Company s 2005 Long Term Stock Incentive Plan (the 2005 Plan ) replaced the 1991 Long Term Stock Incentive Plan (the 1991 Plan ) in May 2005 and provides for the issuance of stock-based incentives in various forms. At March 31, 2007, outstanding stock-based incentives were in the form of restricted long-term stock awards, stock options, phantom stock awards and stock appreciation rights. Additionally, the Company s 1997 Non-Employee Directors Stock Plan (the 1997 Plan ) provides for the payment of part of the compensation to non-employee Directors in Company common stock. Pre-tax compensation expense (income) and the related income tax benefit, related to these stock-based incentives, were as follows, in millions:

| | Three months ended March 31, 2007 | Three months ended March 31, 2006 |
|---|---|---|
| Restricted long-term stock awards | $ 16 | $ 18 |
| Stock options | 9 | 9 |
| Phantom stock awards and stock appreciation rights | (5) | 2 |
| Total | $ 20 | $ 29 |
| Income tax benefit | $ 7 | $ 11 |

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**MASCO CORPORATION**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (continued)**

Note B concluded:

**Restricted Long-Term Stock Awards**

Long-term stock awards are granted to key employees and non-employee Directors of the Company and do not cause net share dilution inasmuch as the Company continues the practice of repurchasing and retiring an equal number of shares on the open market.

The Company s long-term stock award activity was as follows, shares in millions:

| | Three Months Ended March 31, | |
|---|---|---|
| | **2007** | **2006** |
| Unvested stock award shares at January 1 | 9 | 9 |
| Weighted average grant date fair value | $27 | $25 |
| | | |
| Stock award shares granted | 1 | 1 |
| Weighted average grant date fair value | $33 | $30 |
| | | |
| Stock award shares vested | (1) | (1) |
| Weighted average grant date fair value | $26 | $24 |
| | | |
| Stock award shares forfeited | | |
| Weighted average grant date fair value | $28 | $25 |
| | | |
| Unvested stock award shares at March 31 | 9 | 9 |
| Weighted average grant date fair value | $27 | $26 |

At March 31, 2007, there was $200 million of total unrecognized compensation expense related to unvested stock awards; such awards had a weighted average remaining vesting period of seven years.

The total market value (at the vesting date) of stock award shares which vested during the three months ended March 31, 2007 was $32 million.

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**MASCO CORPORATION**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (continued)**

C. The changes in the carrying amount of goodwill for the three months ended March 31, 2007, by segment, were as follows, in millions:

| | At Dec. 31, 2006 | Additions (A) | Other(B) | At Mar. 31, 2007 |
|---|---|---|---|---|
| Cabinets and Related Products | $ 288 | $ | $ 1 | $ 289 |
| Plumbing Products | 504 | | 2 | 506 |
| Installation and Other Services | 1,740 | 4 | (1) | 1,743 |
| Decorative Architectural Products | 300 | | | 300 |
| Other Specialty Products | 1,125 | 1 | 1 | 1,127 |
| Total | $ 3,957 | $ 5 | $ 3 | $ 3,965 |

**(A)** Additions include acquisitions.

**(B)** Other principally includes the effect of foreign currency translation and purchase price adjustments related to prior-year acquisitions.

Other indefinite-lived intangible assets were $246 million at both March 31, 2007 and December 31, 2006, and principally included registered trademarks. The carrying value of the Company s definite-lived intangible assets was $58 million (net of accumulated amortization of $54 million) at March 31, 2007 and $60 million (net of accumulated amortization of $51 million) at December 31, 2006, and principally included customer relationships and non-compete agreements.

D. Depreciation and amortization expense was $59 million and $63 million for the three months ended March 31, 2007 and 2006, respectively.

E. The Company has maintained investments in marketable securities and a number of private equity funds, principally as part of its tax planning strategies, as any gains enhance the utilization of any current and future tax capital losses. Financial investments included in other assets were as follows, in millions:

| | March 31, 2007 | December 31, 2006 |
|---|---|---|
| Marketable securities | $ 41 | $ 72 |

| | | | | | |
|---|---|---|---|---|---|
| Asahi Tec Corporation | common and preferred stock | | 53 | | |
| Private equity funds | | | 204 | | 211 |
| Metaldyne Corporation | | | | | 57 |
| TriMas Corporation | | | 34 | | 30 |
| Other investments | | | 18 | | 9 |
| Total | | $ | 350 | $ | 379 |

The Company s investments in available-for-sale securities at March 31, 2007 (including the Asahi Tec Corporation common and preferred stock) and December 31, 2006 were as follows, in millions:

| | Cost Basis | Pre-tax Unrealized Gains | Pre-tax Unrealized Losses | Recorded Basis |
|---|---|---|---|---|
| March 31, 2007 | $ 96 | $4 | $ (6) | $94 |
| December 31, 2006 | $ 67 | $9 | $ (4) | $72 |

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**MASCO CORPORATION**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (continued)**

Note E concluded:

Income from financial investments, net, included in other, net, within other income (expense), net, was as follows, in millions:

| | Three Months Ended March 31, 2007 | 2006 |
|---|---|---|
| Realized gains from marketable securities | $ 7 | $ 8 |
| Realized losses from marketable securities | | (3) |
| Dividend income from marketable securities | 1 | 1 |
| Income from other investments, net | 15 | 1 |
| Dividend income from other investments | 4 | 5 |
| Income from financial investments, net | $ 27 | $ 12 |

On January 11, 2007, the acquisition of Metaldyne by Asahi Tec Corporation ( Asahi Tec ), a Japanese automotive supplier, was finalized. The combined fair value of the Asahi Tec common and preferred stock, as well as the derivative related to the conversion feature on the preferred stock received in exchange for the Company s investment in Metaldyne, was $72 million. The Asahi Tec common and preferred stock are restricted from sale for up to 24 months from the transaction date. The preferred stock accrues dividends at an annual rate of 3.75% pay-in-kind or 1.75% cash at the discretion of Asahi Tec; the Company has elected to record such dividends when cash proceeds are received. As a result of the transaction, the Company recognized a gain of $14 million, net of transaction fees, included in the Company s consolidated statement of income, in income from other investments, net. Any unrealized gains or losses related to the change in fair value of the Asahi Tec common and preferred stock at March 31, 2007 have been recognized, net of tax, through shareholders equity, as a component of other comprehensive income in the Company s consolidated balance sheet. The unrealized loss of $10 million, related to the fair value of the derivative related to the conversion feature on the preferred stock, has been included in the Company s consolidated statement of income, in income from other investments, net. At March 31, 2007, the Company had a net investment in Asahi Tec of $62 million, including $53 million of common and preferred stock and $9 million, included in other investments, related to the conversion derivative.

In addition, immediately prior to its sale, Metaldyne Corporation distributed shares of TriMas Corporation common stock as a dividend to the holders of Metaldyne common stock; the Company recognized $4 million included in the Company s consolidated statement of income in dividend income from other investments.

The private equity investments at March 31, 2007 and December 31, 2006, with an aggregate carrying value of $204 million and $211 million, respectively, were not evaluated for impairment, as there were no indicators of impairment or identified events or changes in circumstances that would have a significant adverse effect on the fair value of the investments.

F. On January 20, 2007, holders of $1.8 billion (94 percent) principal amount at maturity of the Zero Coupon Convertible Senior Notes ( Notes ) required the Company to repurchase their Notes at a cash value of $825 million. As a result of this repurchase, a $93 million deferred income tax liability will be payable in 2007. Subsequent to the repurchase, there were outstanding $108 million principal amount at maturity of such Notes, with an accreted value of $51 million, which has been included in long-term debt at March 31, 2007, as the next put option date is July 20, 2011. The Company may at any time redeem all or part of the Notes at their then accreted value.

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**MASCO CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (continued)**

Note F concluded:

In the first quarter of 2007, the Company also retired $300 million of floating-rate notes due March 9, 2007. On March 14, 2007, the Company issued $300 million of floating-rate notes due 2010; the interest rate is calculated based upon the three-month LIBOR plus .30 percent per year. On March 14, 2007, the Company also issued $300 million of fixed-rate 5.85% notes due 2017. These debt issuances provided net proceeds of $596 million and were in consideration of the March 2007 and upcoming August 2007 debt maturities.

G. At March 31, 2007 and December 31, 2006, the Company did not have a balance in paid-in capital due to the repurchases of Company common stock. The Company s activity in retained earnings and paid-in capital was as follows, in millions:

| | Three Months Ended March 31, 2007 | Twelve Months Ended December 31, 2006 |
|---|---|---|
| Balance at January 1 | $ 3,575 | $ 4,286 |
| Net income | 143 | 488 |
| Shares issued | 11 | 56 |
| Shares retired: | | |
| Repurchased | (265) | (825) |
| Surrendered (non-cash) | (9) | (19) |
| Cash dividends declared | (86) | (352) |
| Stock-based compensation | 21 | 117 |
| Cumulative effect of accounting change regarding income tax uncertainties (Note O) | (26) | |
| Reclassification of stock award activity | | (176) |
| Balance at end of period | $ 3,364 | $ 3,575 |

The Company s total comprehensive income was as follows, in millions:

| | Three Months Ended March 31, 2007 | Three Months Ended March 31, 2006 |
|---|---|---|
| Net income | $ 143 | $ 204 |
| Other comprehensive income (loss): | | |
| Cumulative translation adjustments, net | 12 | 20 |
| Unrealized (loss) gain on marketable securities, net | (4) | 2 |
| Prior service cost and net loss, net | 1 | |
| Total comprehensive income | $ 152 | $ 226 |

The unrealized (loss) gain on marketable securities, net, is net of income tax (benefit) of $(4) million and $1 million for the three months ended March 31, 2007 and 2006, respectively.

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**MASCO CORPORATION**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (continued)**

Note G concluded:

The components of accumulated other comprehensive income were as follows, in millions:

| | March 31, 2007 | December 31, 2006 |
|---|---|---|
| Cumulative translation adjustments | $ 639 | $ 627 |
| Unrealized (loss) gain on marketable securities, net | (1) | 3 |
| Unrecognized prior service cost and net loss, net | (117) | (118) |
| Accumulated other comprehensive income | $ 521 | $ 512 |

The unrealized (loss) gain on marketable securities, net, is reported net of income tax (benefit) of $(2) million and $2 million at March 31, 2007 and December 31, 2006, respectively. The unrecognized prior service cost and net loss, net, is reported net of income tax benefit of $66 million at both March 31, 2007 and December 31, 2006.

H. The Company owns 64 percent of Hansgrohe AG. The aggregate minority interest, net of dividends, of $117 million and $108 million at March 31, 2007 and December 31, 2006, respectively, was recorded in the caption deferred income taxes and other liabilities on the Company s condensed consolidated balance sheets.

I. Net periodic pension cost for the Company s defined-benefit pension plans was as follows, in millions: