

MASCO CORP /DE/
Form 10-Q
October 25, 2016

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 September 30, 2016

Commission file number: 1-5794

Masco Corporation
(Exact name of Registrant as Specified in its Charter)
Delaware 38-1794485
(State of (IRS Employer
Incorporation) 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. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

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

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

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| Class | Shares Outstanding at September 30, 2016 |
|--|--|
| Common stock, par value \$1.00 per share | 328,307,161 |

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CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)

September 30, 2016 and December 31, 2015

(In Millions, Except Share Data)

| | September 30, 2016 | December 31, 2015 |
|--|-----------------------|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash investments | \$ 1,041 | \$ 1,468 |
| Short-term bank deposits | 182 | 248 |
| Receivables | 1,054 | 853 |
| Prepaid expenses and other | 87 | 72 |
| Inventories: | | |
| Finished goods | 422 | 358 |
| Raw material | 243 | 238 |
| Work in process | 93 | 91 |
| | 758 | 687 |
| Total current assets | 3,122 | 3,328 |
| Property and equipment, net | 1,049 | 1,027 |
| Goodwill | 841 | 839 |
| Other intangible assets, net | 155 | 160 |
| Other assets | 206 | 310 |
| Total assets | \$ 5,373 | \$ 5,664 |
| LIABILITIES | | |
| Current liabilities: | | |
| Notes payable | \$ 3 | \$ 1,004 |
| Accounts payable | 866 | 749 |
| Accrued liabilities | 642 | 650 |
| Total current liabilities | 1,511 | 2,403 |
| Long-term debt | 2,993 | 2,403 |
| Other liabilities | 766 | 800 |
| Total liabilities | 5,270 | 5,606 |
| Commitments and contingencies (Note P) | | |
| EQUITY | | |
| Masco Corporation's shareholders' equity: | | |
| Common shares, par value \$1 per share | | |
| Authorized shares: 1,400,000,000; | 325 | 330 |
| Issued and outstanding: 2016 – 324,500,000; 2015 – 330,500,000 | | |
| Preferred shares authorized: 1,000,000; | | |
| Issued and outstanding: 2016 and 2015 – None | — | — |
| Paid-in capital | — | — |
| Retained deficit | (253 |) (300) |
| Accumulated other comprehensive loss | (170 |) (165) |
| Total Masco Corporation's shareholders' deficit | (98 |) (135) |

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| | | |
|------------------------------|----------|----------|
| Noncontrolling interest | 201 | 193 |
| Total equity | 103 | 58 |
| Total liabilities and equity | \$ 5,373 | \$ 5,664 |

See notes to condensed consolidated financial statements.

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MASCO CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

For the Three and Nine Months Ended September 30, 2016 and 2015

(In Millions, Except Per Common Share Data)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|--|---------|---------------------------------------|---------|
| | 2016 | 2015 | 2016 | 2015 |
| Net sales | \$1,877 | \$1,839 | \$5,598 | \$5,427 |
| Cost of sales | 1,263 | 1,250 | 3,715 | 3,706 |
| Gross profit | 614 | 589 | 1,883 | 1,721 |
| Selling, general and administrative expenses | 345 | 331 | 1,045 | 1,019 |
| Operating profit | 269 | 258 | 838 | 702 |
| Other income (expense), net: | | | | |
| Interest expense | (43) | (54) | (186) | (171) |
| Other, net | 1 | (6) | 5 | (2) |
| | (42) | (60) | (181) | (173) |
| Income from continuing operations before income taxes | 227 | 198 | 657 | 529 |
| Income tax expense | (81) | (77) | (229) | (219) |
| Income from continuing operations | 146 | 121 | 428 | 310 |
| Loss from discontinued operations, net | — | — | — | (1) |
| Net income | 146 | 121 | 428 | 309 |
| Less: Net income attributable to noncontrolling interest | 12 | 10 | 35 | 29 |
| Net income attributable to Masco Corporation | \$134 | \$111 | \$393 | \$280 |
| Income per common share attributable to Masco Corporation: | | | | |
| Basic: | | | | |
| Income from continuing operations | \$.41 | \$.33 | \$1.18 | \$.81 |
| Loss from discontinued operations, net | — | — | — | — |
| Net income | \$.41 | \$.33 | \$1.18 | \$.81 |
| Diluted: | | | | |
| Income from continuing operations | \$.40 | \$.32 | \$1.17 | \$.81 |
| Loss from discontinued operations, net | — | — | — | — |
| Net income | \$.40 | \$.32 | \$1.17 | \$.80 |
| Amounts attributable to Masco Corporation: | | | | |
| Income from continuing operations | \$134 | \$111 | \$393 | \$281 |
| Loss from discontinued operations, net | — | — | — | (1) |
| Net income | \$134 | \$111 | \$393 | \$280 |

See notes to condensed consolidated financial statements.

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MASCO CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (Unaudited)

For the Three and Nine Months Ended September 30, 2016 and 2015

(In Millions)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|--|---------|--|---------|
| | 2016 | 2015 | 2016 | 2015 |
| Net income | \$146 | \$121 | \$428 | \$309 |
| Less: Net income attributable to noncontrolling interest | 12 | 10 | 35 | 29 |
| Net income attributable to Masco Corporation | \$134 | \$111 | \$393 | \$280 |
| Other comprehensive income (loss), net of tax (Note K): | | | | |
| Cumulative translation adjustment | \$(1) | \$(17) | \$(10) | \$(70) |
| Interest rate swaps | — | — | 1 | 1 |
| Pension and other post-retirement benefits | 3 | 4 | 9 | 11 |
| Realized gain on available-for-sale securities | — | — | (1) | — |
| Other comprehensive income (loss) | 2 | (13) | (1) | (58) |
| Less: Other comprehensive income (loss) attributable to noncontrolling interest | 2 | (1) | 4 | (10) |
| Other comprehensive income (loss) attributable to Masco Corporation | \$— | \$(12) | \$(5) | \$(48) |
| Total comprehensive income | \$148 | \$108 | \$427 | \$251 |
| Less: Total comprehensive income attributable to the noncontrolling interest | 14 | 9 | 39 | 19 |
| Total comprehensive income attributable to Masco Corporation | \$134 | \$99 | \$388 | \$232 |

See notes to condensed consolidated financial statements.

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MASCO CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

For the Nine Months Ended September 30, 2016 and 2015

(In Millions)

| | Nine Months Ended September 30, 2016 2015 | |
|--|---|---------|
| CASH FLOWS FROM (FOR) OPERATING ACTIVITIES: | | |
| Cash provided by operations | \$569 | \$581 |
| Increase in receivables | (245) | (245) |
| Increase in inventories | (73) | (41) |
| Increase in accounts payable and accrued liabilities, net | 131 | 127 |
| Net cash from operating activities | 382 | 422 |
| CASH FLOWS FROM (FOR) FINANCING ACTIVITIES: | | |
| Retirement of notes | (1,300) | (500) |
| Purchase of Company common stock | (242) | (407) |
| Cash dividends paid | (95) | (94) |
| Dividend payment to noncontrolling interest | (31) | (36) |
| Cash distributed to TopBuild Corp. | — | (63) |
| Issuance of TopBuild Corp. debt | — | 200 |
| Issuance of notes, net of issuance costs | 889 | 497 |
| Issuance of Company common stock | 1 | 2 |
| Excess tax benefit from stock-based compensation | 21 | 32 |
| Decrease in debt, net | (2) | (1) |
| Credit Agreement and other financing costs | — | (3) |
| Net cash for financing activities | (759) | (373) |
| CASH FLOWS FROM (FOR) INVESTING ACTIVITIES: | | |
| Capital expenditures | (117) | (112) |
| Acquisition of companies, net of cash acquired | — | (41) |
| Proceeds from disposition of: | | |
| Short-term bank deposits | 223 | 251 |
| Other financial investments | 14 | 7 |
| Property and equipment | — | 13 |
| Purchases of: | | |
| Short-term bank deposits | (151) | (225) |
| Other, net | (9) | (37) |
| Net cash for investing activities | (40) | (144) |
| Effect of exchange rate changes on cash and cash investments | (10) | (9) |
| CASH AND CASH INVESTMENTS: | | |
| Decrease for the period | (427) | (104) |
| At January 1 | 1,468 | 1,383 |
| At September 30 | \$1,041 | \$1,279 |

See notes to condensed consolidated financial statements.

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MASCO CORPORATION

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (Unaudited)

For the Nine Months Ended September 30, 2016 and 2015

(In Millions, Except Per Common Share Data)

| | Total | Common Shares (\$1 par value) | Paid-In Capital | Retained Earnings (Deficit) | Accumulated Other Comprehensive Loss | Noncontrolling Interest |
|---|---------|-------------------------------------|--------------------|-----------------------------------|---|----------------------------|
| Balance, January 1, 2015 | \$1,128 | \$ 345 | \$ — | \$ 690 | \$ (111) | \$ 204 |
| Total comprehensive income (loss) | 251 | | | 280 | (48) | 19 |
| Shares issued | (9) | 3 | (12) | | | |
| Shares retired: | | | | | | |
| Repurchased | (407) | (15) | (29) | (363) | | |
| Surrendered (non-cash) | (18) | (1) | | (17) | | |
| Cash dividends declared | (94) | | | (94) | | |
| Dividend payment to noncontrolling interest | (36) | | | | | (36) |
| Separation of TopBuild Corp. | (828) | | | (828) | | |
| Stock-based compensation | 41 | | 41 | | | |
| Balance, September 30, 2015 | \$28 | \$ 332 | \$ — | \$ (332) | \$ (159) | \$ 187 |
| Balance, January 1, 2016 | \$58 | \$ 330 | \$ — | \$ (300) | \$ (165) | \$ 193 |
| Total comprehensive income (loss) | 427 | | | 393 | (5) | 39 |
| Shares issued | (24) | 3 | (27) | | | |
| Shares retired: | | | | | | |
| Repurchased | (252) | (8) | (8) | (236) | | |
| Surrendered (non-cash) | (14) | | | (14) | | |
| Cash dividends declared | (96) | | | (96) | | |
| Dividend payment to noncontrolling interest | (31) | | | | | (31) |
| Stock-based compensation | 35 | | 35 | | | |
| Balance, September 30, 2016 | \$103 | \$ 325 | \$ — | \$ (253) | \$ (170) | \$ 201 |

See notes to condensed consolidated financial statements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

A. ACCOUNTING POLICIES

In our opinion, the accompanying unaudited condensed consolidated financial statements contain all adjustments, of a normal recurring nature, necessary to present fairly our financial position as at September 30, 2016, and our results of operations and comprehensive income (loss) for the three-month and nine-month periods ended September 30, 2016 and 2015, and cash flows and changes in shareholders' equity for the nine-month periods ended September 30, 2016 and 2015. The condensed consolidated balance sheet at December 31, 2015 was derived from audited financial statements.

Reclassification. Certain prior year amounts have been reclassified to conform to the 2016 presentation in the condensed consolidated financial statements.

Revision of Previously Issued Financial Statements. We have revised the previously reported balances on our condensed consolidated balance sheet as of December 31, 2015 to correct the classification for warranty claims not expected to be settled within the next year. Accrued liabilities decreased and Other liabilities increased from the amounts previously reported by \$102 million. This revision had no effect on our condensed consolidated statements of operations or condensed consolidated statements of cash flows. This revision is not considered material to our prior period financial statements.

Recently Issued Accounting Pronouncements. In February 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update 2015-02 ("ASU 2015-02") "Consolidation (Topic 810) — Amendments to the Consolidations Analysis," which modifies certain aspects of both the variable interest entities and voting interest entities models. We adopted ASU 2015-02 on January 1, 2016. The adoption of the new standard did not have an impact on our financial position or our results of operations.

In April 2015, the FASB issued Accounting Standards Update 2015-03 ("ASU 2015-03") "Interest - Imputation of Interest (Subtopic 835-30) - Simplifying the Presentation of Debt Issuance Costs," that requires that all costs incurred to issue debt be presented in the balance sheet as a direct deduction from the carrying value of the debt. In August 2015, the FASB issued ASU 2015-15 to clarify that debt issuance costs related to line of credit arrangements may remain classified as an asset. We retrospectively adopted both ASU 2015-03 and ASU 2015-15 on January 1, 2016. As a result of the retrospective adoption of the standards, we reclassified \$15 million of debt issuance costs from Other assets to Long-term debt, and \$1 million of debt issuance costs from Other assets to Notes payable, as of December 31, 2015. In May 2014, the FASB issued a new standard for revenue recognition, Accounting Standards Codification 606 ("ASC 606"). The purpose of ASC 606 is to provide a single, comprehensive revenue recognition model for all contracts with customers to improve comparability across industries. ASC 606 is effective for us for annual periods beginning January 1, 2018. We are currently evaluating the impact the adoption of this new standard will have on our results of operations.

In January 2016, the FASB issued Accounting Standards Update 2016-01 ("ASU 2016-01"), "Financial Instruments-Overall: Recognition and Measurement of Financial Assets and Financial Liabilities," which primarily affects the accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. ASU 2016-01 is effective for us for annual periods beginning January 1, 2018. We are currently evaluating the impact the adoption of this new standard will have on our financial position and results of operations.

In February 2016, the FASB issued a new standard for leases, Accounting Standards Codification 842 (“ASC 842”), which changes the accounting model for identifying and accounting for leases. ASC 842 is effective for us for annual periods beginning January 1, 2019. We are currently evaluating the impact the adoption of this new standard will have on our financial position and results of operations.

In March 2016, the FASB issued Accounting Standards Update 2016-09 (“ASU 2016-09”), “Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting,” which requires the tax effects related to share-based payments to be recorded through the income statement and simplifies the accounting requirements for forfeitures and employers' tax withholding requirements. ASU 2016-09 is effective for us for annual periods beginning January 1, 2017. We anticipate the impact of the adoption of this ASU to be limited to the reclassification of certain items within our statement of cash flows, which we intend to adopt retrospectively.

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MASCO CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

A. ACCOUNTING POLICIES (Concluded)

In August 2016, the FASB issued Accounting Standards Update 2016-15 (“ASU 2016-15”), “Statement of Cash Flows (Topic 230) - Classification of Certain Cash Receipts and Cash Payments,” which is intended to reduce diversity in practice as to how certain transactions are classified in the statement of cash flows. ASC 2016-15 is effective for us for annual periods beginning January 1, 2018. We are currently evaluating the impact the adoption of this new standard will have on our statement of cash flows.

B. DISCONTINUED OPERATIONS

The presentation of discontinued operations includes a component or group of components that we have or intend to dispose of, and represents a strategic shift that has (or will have) a major effect on our operations and financial results. For spin off transactions, discontinued operations treatment is appropriate following the completion of the spin off.

On September 30, 2014, we announced a plan to spin off 100 percent of our Installation and Other Services businesses into an independent, publicly-traded company named TopBuild Corp. (“TopBuild”) through a tax-free distribution of the stock of TopBuild to our stockholders. We initiated the spin off as TopBuild was no longer considered core to our long-term growth strategy in branded building products. We completed the spin off on June 30, 2015 at which time we accounted for it as a discontinued operation. Losses from this discontinued operation were included in loss from discontinued operations, net, in the condensed consolidated statement of operations for the three-month and nine-month periods ended September 30, 2015.

The major classes of line items constituting loss from discontinued operations, net, were as follows, in millions:

| | Three Months Ended September 30, 2016 | Nine Months Ended September 30, 2015 |
|--|--|---|
| Net sales | \$ — | \$ 762 |
| Cost of sales | — | 603 |
| Gross profit | — | 159 |
| Selling, general and administrative expenses | — | 148 |
| Income from discontinued operations | \$ — | \$ 11 |
| Loss on disposal of discontinued operations, net | — (1) | — (1) |
| (Loss) income before income tax | — (1) | — 10 |
| Income tax benefit (expense) (A) | — 1 | — (11) |
| Loss from discontinued operations, net | \$ — | \$ (1) |

(A) The unusual relationship between income tax expense and income before income tax for the nine-month period ended September 30, 2015 resulted primarily from certain non-deductible transaction costs related to the spin off of TopBuild.

Other selected financial information for TopBuild during the period owned by us was as follows, in millions:

Nine
Months
Ended
September
30,
20162015

| | |
|-------------------------------|----------|
| Depreciation and amortization | \$ —\$ 6 |
| Capital expenditures | \$ —\$ 7 |

In conjunction with the spin off, we entered into a Transition Services Agreement with TopBuild under which we provide administrative services to TopBuild subsequent to the separation. The fees for services rendered under the Transition Services Agreement are not material to our results of operations.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

C. GOODWILL AND OTHER INTANGIBLE ASSETS

The changes in the carrying amount of goodwill for the nine-month period ended September 30, 2016, by segment, were as follows, in millions:

| | Gross Goodwill At September 30, 2016 | Accumulated Impairment Losses | Net Goodwill At September 30, 2016 | | |
|--------------------------------------|---|-------------------------------------|---|----------|---|
| Plumbing Products | \$ 528 | \$ (340) | \$ 188 | | |
| Decorative Architectural Products | 294 | (75) | 219 | | |
| Cabinetry Products | 240 | (59) | 181 | | |
| Windows and Other Specialty Products | 987 | (734) | 253 | | |
| Total | \$ 2,049 | \$ (1,208) | \$ 841 | | |
| | Gross Goodwill At December 31, 2015 | Accumulated Impairment Losses | Net Goodwill At December 31, 2015 | Other(A) | Net Goodwill At September 30, 2016 |
| Plumbing Products | \$ 525 | \$ (340) | \$ 185 | \$ 3 | \$ 188 |
| Decorative Architectural Products | 294 | (75) | 219 | — | 219 |
| Cabinetry Products | 240 | (59) | 181 | — | 181 |
| Windows and Other Specialty Products | 988 | (734) | 254 | (1) | 253 |
| Total | \$ 2,047 | \$ (1,208) | \$ 839 | \$ 2 | \$ 841 |

(A) Other principally includes the effect of foreign currency translation.

The carrying value of our other indefinite-lived intangible assets was \$136 million and \$137 million at September 30, 2016 and December 31, 2015, respectively, and principally included registered trademarks. The carrying value of our definite-lived intangible assets was \$19 million (net of accumulated amortization of \$17 million) and \$23 million (net of accumulated amortization of \$49 million) at September 30, 2016 and December 31, 2015, respectively, and principally included customer relationships.

D. DEPRECIATION AND AMORTIZATION

Depreciation and amortization expense, including discontinued operations, was \$100 million for both of the nine-month periods ended September 30, 2016 and 2015.

E. FAIR VALUE OF FINANCIAL INVESTMENTS

We have maintained investments in available-for-sale securities, equity method investments and a number of private equity funds, principally as part of our tax planning strategies, as any gains enhance the utilization of any current and future tax capital losses. Financial investments were as follows, in millions:

| | September 30, 2016 | December 31, 2015 |
|-----------------------------|-----------------------|----------------------|
| Prepaid expenses and other: | | |
| Auction rate securities | \$ 12 | \$ — |

Other assets:

| | | | | |
|---------------------------|----|----|----|----|
| Auction rate securities | — | | 22 | |
| Equity method investments | 14 | | 13 | |
| Private equity funds | 7 | | 10 | |
| Other investments | 3 | | 3 | |
| Total | \$ | 36 | \$ | 48 |

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MASCO CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

E. FAIR VALUE OF FINANCIAL INVESTMENTS (Concluded)

Recurring Fair Value Measurements. Our auction rate securities are measured at fair value on a recurring basis, and have been estimated using a discounted cash flow model (Level 3 input). The significant inputs in the discounted cash flow model used to value the auction rate securities include: expected maturity of auction rate securities, discount rate used to determine the present value of expected cash flows and the assumptions for credit defaults, since the auction rate securities are backed by credit default swap agreements.

In the second quarter of 2016, \$10 million of our auction rate securities were called by our counterparty and redeemed at a value that approximated our recorded basis. Our investments in auction rate securities had a recorded basis of \$12 million and \$22 million at September 30, 2016 and December 31, 2015, respectively, which included cost basis of \$10 million and \$19 million and pre-tax unrealized gains of \$2 million and \$3 million at each respective date.

Non-Recurring Fair Value Measurements. During the nine-month periods ended September 30, 2016 and 2015, we did not measure any financial investments at fair value on a non-recurring basis, as there was no other-than-temporary decline in the estimated value of these investments.

We did not have any transfers between Level 1 and Level 2 financial assets in the nine-month periods ended September 30, 2016 or 2015.

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

| | Three Months Ended September 30, 2016 | | Nine Months Ended September 30, 2015 | |
|--|--|------|---|------|
| Realized gains from auction rate securities | \$ — | \$ — | \$ 1 | \$ — |
| Realized gains from private equity funds | 1 | 1 | 2 | 5 |
| Equity investment income, net | — | — | 1 | 2 |
| Total income from financial investments, net | \$ 1 | \$ 1 | \$ 4 | \$ 7 |

Fair Value of Debt. The fair value of our short-term and long-term fixed-rate debt instruments is based principally upon modeled market prices for the same or similar issues or the current rates available to us for debt with similar terms and remaining maturities. The aggregate estimated market value of short-term and long-term debt at September 30, 2016 was approximately \$3.3 billion, compared with the aggregate carrying value of \$3.0 billion. The aggregate estimated market value of short-term and long-term debt at December 31, 2015 was approximately \$3.6 billion, compared with the aggregate carrying value of \$3.4 billion.

F. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

We are exposed to global market risk as part of our normal daily business activities. To manage these risks, we enter into various derivative contracts. These contracts include interest rate swap agreements, foreign currency contracts and metals contracts intended to hedge our exposure to copper and zinc. We review our hedging program, derivative positions and overall risk management on a regular basis.

Interest Rate Swap Agreements. In 2012, in connection with the issuance of \$400 million of debt, we terminated the interest rate swap hedge relationships that we had entered into in 2011. These interest rate swaps were designated as cash flow hedges and effectively fixed interest rates on the forecasted debt issuance to variable rates based on 3-month LIBOR. Upon termination, the ineffective portion of the cash flow hedges of an approximate \$2 million loss was recognized in our consolidated statement of operations in other, net within other income (expense), net. The remaining loss of approximately \$23 million from the termination of these swaps is being amortized as an increase to interest expense over the remaining term of the debt, through March 2022.

Foreign Currency Contracts. Our net cash inflows and outflows exposed to the risk of changes in foreign currency exchange rates arise from the sale of products in countries other than the manufacturing source, foreign currency denominated supplier payments, debt and other payables, and investments in subsidiaries. To mitigate this risk, we, including certain of our European operations, entered into foreign currency forward contracts and foreign currency exchange contracts.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

F. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES (Concluded)

Gains (losses) related to foreign currency forward and exchange contracts are recorded in our condensed consolidated statements of operations in other, net, within other income (expense), net. In the event that the counterparties fail to meet the terms of the foreign currency forward or exchange contracts, our exposure is limited to the aggregate foreign currency rate differential with such institutions.

Metals Contracts. We have entered into several contracts to manage our exposure to increases in the price of copper and zinc. Gains (losses) related to these contracts are recorded in our condensed consolidated statements of operations in cost of sales.

The pre-tax gains (losses) included in our condensed consolidated statements of operations are as follows, in millions:

| | Three Months Ended September 30, 2016 | Nine Months Ended September 30, 2015 |
|-----------------------------|--|---|
| Foreign currency contracts: | | |
| Exchange contracts | \$ — | \$ — |
| Forward contracts | — 1 | — (3) |
| Metals contracts | 1 (9) | 5 (14) |
| Interest rate swaps | — — | (1) (1) |
| Total gain (loss) | \$ 1 | \$ (8) |

We present our derivatives net by counterparty, due to the right of offset under master netting arrangements, in the condensed consolidated balance sheets. The notional amounts being hedged and the fair value of those derivative instruments are as follows, in millions:

| | At September 30, 2016 Notional Amount | Balance Sheet |
|-----------------------------|---|------------------|
| Foreign currency contracts: | | |
| Exchange contracts | \$ 7 | |
| Accrued liabilities | | \$ — |
| Forward contracts | 28 | |
| Accrued liabilities | | (1) |
| Other liabilities | | (1) |
| Metals contracts | 13 | |
| Accrued liabilities | | — |
| | At December 31, 2015 Notional Amount | Balance Sheet |

Foreign currency contracts:

| | | |
|---------------------|-------|-------|
| Exchange contracts | \$ 39 | |
| Receivables | | \$ 1 |
| Forward contracts | 30 | |
| Accrued liabilities | | (2) |
| Other liabilities | | (1) |
| Metals contracts | 50 | |
| Accrued liabilities | | (10) |

The fair value of all foreign currency and metals derivative contracts is estimated on a recurring basis, quarterly, using Level 2 inputs (significant other observable inputs).

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MASCO CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

G. WARRANTY LIABILITY

Changes in our warranty liability were as follows, in millions:

| | Nine Months Ended September 30, 2016 | Twelve Months Ended December 31, 2015 |
|--|--|--|
| Balance at January 1 | \$ 152 | \$ 135 |
| Accruals for warranties issued during the period | 48 | 56 |
| Accruals related to pre-existing warranties | 36 | 15 |
| Settlements made (in cash or kind) during the period | (43) | (50) |
| Other, net (including currency translation) | (1) | (4) |
| Balance at end of period | \$ 192 | \$ 152 |

During 2016, a business in the Windows and Other Specialty Products segment recorded a \$31 million increase as a change in estimate of expected future warranty claims resulting from recent warranty claim trends, including, among other items, the nature and type of claim and estimate of costs to service claims.

H. DEBT

On March 17, 2016, we issued \$400 million of 3.5% Notes due April 1, 2021 and \$500 million of 4.375% Notes due April 1, 2026. We received proceeds of \$896 million, net of discount, for the issuance of these Notes. The Notes are senior indebtedness and are redeemable at our option at the applicable redemption price. On April 15, 2016, proceeds from the debt issuances, together with cash on hand, were used to repay and early retire all of our \$1 billion, 6.125% Notes which were due on October 3, 2016 and all of our \$300 million, 5.85% Notes which were due on March 15, 2017. In connection with these early retirements, we incurred \$40 million of debt extinguishment costs, which we recorded as interest expense.

On March 28, 2013, we entered into a credit agreement (the "Credit Agreement") with a bank group, with an aggregate commitment of \$1.25 billion and a maturity date of March 28, 2018. On May 29, 2015 and August 28, 2015, we amended the Credit Agreement with the bank group (the "Amended Credit Agreement"). The Amended Credit Agreement reduced the aggregate commitment to \$750 million and extends the maturity date to May 29, 2020. Under the Amended Credit Agreement, at our request and subject to certain conditions, we can increase the aggregate commitment up to an additional \$375 million with the current bank group or new lenders.

The Amended Credit Agreement provides for an unsecured revolving credit facility available to us and one of our foreign subsidiaries, in U.S. dollars, European Euro and certain other currencies. Borrowings under the revolver denominated in euros are limited to \$500 million, equivalent. We can also borrow swingline loans up to \$75 million and obtain letters of credit of up to \$100 million; any outstanding letters of credit under the Amended Credit Agreement reduce our borrowing capacity. At September 30, 2016, we had no outstanding standby letters of credit under the Amended Credit Agreement.

Revolving credit loans bear interest under the Amended Credit Agreement, at our option, at (A) a rate per annum equal to the greatest of (i) the prime rate, (ii) the Federal Funds effective rate plus 0.50% and (iii) LIBOR plus 1.0% (the "Alternative Base Rate"); plus an applicable margin based upon our then-applicable corporate credit ratings; or (B) LIBOR plus an applicable margin based upon our then-applicable corporate credit ratings. The foreign currency

revolving credit loans bear interest at a rate equal to LIBOR plus an applicable margin based upon our then-applicable corporate credit ratings.

The Amended Credit Agreement contains financial covenants requiring us to maintain (A) a maximum net leverage ratio, as adjusted for certain items, of 4.0 to 1.0, and (B) a minimum interest coverage ratio, as adjusted for certain items, equal to or greater than 2.5 to 1.0.

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MASCO CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

H. DEBT (Concluded)

In order for us to borrow under the Amended Credit Agreement, there must not be any default in our covenants in the Amended Credit Agreement (i.e., in addition to the two financial covenants, principally limitations on subsidiary debt, negative pledge restrictions, legal compliance requirements and maintenance of properties and insurance) and our representations and warranties in the Amended Credit Agreement must be true in all material respects on the date of borrowing (i.e., principally no material adverse change or litigation likely to result in a material adverse change, since December 31, 2014, in each case, no material ERISA or environmental non-compliance, and no material tax deficiency). We were in compliance with all covenants and had no borrowing under the Amended Credit Agreement at September 30, 2016.

I. STOCK-BASED COMPENSATION

Our 2014 Long Term Stock Incentive Plan (the “2014 Plan”) provides for the issuance of stock-based incentives in various forms to our employees and non-employee Directors. At September 30, 2016, outstanding stock-based incentives were in the form of long-term stock awards, stock options, phantom stock awards and stock appreciation rights. Pre-tax compensation expense and the related income tax benefit for these stock-based incentives were as follows, in millions:

| | Three Months Ended September 30, 2016 | | Nine Months Ended September 30, 2015 | |
|--|--|------|---|-------|
| Long-term stock awards | \$ 5 | \$ 6 | \$ 17 | \$ 19 |
| Stock options | 1 | 1 | 2 | 5 |
| Phantom stock awards and stock appreciation rights | 4 | — | 6 | 6 |
| Total | \$ 10 | \$ 7 | \$ 25 | \$ 30 |
| Income tax benefit (37 percent tax rate) | \$ 4 | \$ 3 | \$ 9 | \$ 11 |

Long-Term Stock Awards. Long-term stock awards are granted to our key employees and non-employee Directors and do not cause net share dilution provided we continue the practice of repurchasing and retiring an equal number of shares in the open market. We granted 1,050,380 shares of long-term stock awards in the nine-month period ended September 30, 2016.

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MASCO CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

I. STOCK-BASED COMPENSATION (Continued)

Our long-term stock award activity was as follows, shares in millions:

| | Nine Months Ended September 30, 2016 2015 | |
|---|--|-------|
| Unvested stock award shares at January 1 | 5 | 6 |
| Weighted average grant date fair value | \$ 17 | \$ 18 |
| Stock award shares granted | 1 | 1 |
| Weighted average grant date fair value | \$ 26 | \$ 26 |
| Stock award shares vested | 2 | 2 |
| Weighted average grant date fair value | \$ 16 | \$ 17 |
| Stock award shares forfeited | — | — |
| Weighted average grant date fair value | \$ 20 | \$ 18 |
| Forfeitures upon spin off (A) | — | 1 |
| Weighted average grant date fair value | \$ — | \$ 20 |
| Modification upon spin off (B) | — | 1 |
| Unvested stock award shares at September 30 | 4 | 5 |
| Weighted average grant date fair value | \$ 20 | \$ 17 |

(A) In connection with the spin off of TopBuild, TopBuild employees forfeited their outstanding Masco equity awards.

(B) Subsequent to the separation of TopBuild, we modified our outstanding equity awards to employees and non-employee Directors such that all individuals received an equivalent fair value both before and after the separation. The modification to the outstanding stock awards was made pursuant to existing anti-dilution provisions in our 2014 Plan and 2005 Long Term Incentive Plan.

At September 30, 2016 and 2015, there was \$49 million and \$47 million, respectively, of total unrecognized compensation expense related to unvested stock awards; such awards had a weighted average remaining vesting period of three years at both September 30, 2016 and 2015.

The total market value (at the vesting date) of stock award shares which vested during the nine-month periods ended September 30, 2016 and 2015 was \$43 million and \$54 million, respectively.

Stock Options. Stock options are granted to our key employees. The exercise price equals the market price of our common stock at the grant date. These options generally become exercisable (vest ratably) over five years beginning

on the first anniversary from the date of grant and expire no later than 10 years after the grant date.

We granted 474,500 of stock option shares in the nine-month period ended September 30, 2016 with a grant date exercise price approximating \$26 per share. In the nine-month period ended September 30, 2016, no stock option shares were forfeited (including options that expired unexercised).

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MASCO CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

I. STOCK-BASED COMPENSATION (Continued)

Our stock option activity was as follows, shares in millions:

| | Nine Months Ended September 30, | |
|---|------------------------------------|---------------|
| | 2016 | 2015 |
| Option shares outstanding, January 1 | 12 | 18 |
| Weighted average exercise price (A) | \$17 | \$21 |
| Option shares granted | — | — |
| Weighted average exercise price | \$26 | \$26 |
| Option shares exercised | 5 | 3 |
| Aggregate intrinsic value on date of exercise (B) | \$64 million | \$32 million |
| Weighted average exercise price | \$21 | \$17 |
| Option shares forfeited | — | 3 |
| Weighted average exercise price | \$— | \$29 |
| Forfeitures upon spin off (C) | — | — |
| Weighted average exercise price | \$— | \$19 |
| Modification upon spin off (A) | — | 2 |
| Option shares outstanding, September 30 | 7 | 14 |
| Weighted average exercise price | \$15 | \$17 |
| Weighted average remaining option term (in years) | 4 | 4 |
| Option shares vested and expected to vest, September 30 | 7 | 14 |
| Weighted average exercise price | \$15 | \$17 |
| Aggregate intrinsic value (B) | \$137 million | \$111 million |
| Weighted average remaining option term (in years) | 4 | 4 |
| Option shares exercisable (vested), September 30 | 6 | 12 |
| Weighted average exercise price | \$13 | \$18 |
| Aggregate intrinsic value (B) | \$117 million | \$96 million |
| Weighted average remaining option term (in years) | 3 | 3 |

(A) Subsequent to the separation of TopBuild, we modified our outstanding equity awards to employees and non-employee Directors such that all individuals received an equivalent fair value both before and after the separation. The modification to the outstanding options was made pursuant to existing anti-dilution provisions in our 2014 Plan and 2005 Long Term Incentive Plan. The modification contributed to the lower exercise price.

(B) Aggregate intrinsic value is calculated using our stock price at each respective date, less the exercise price (grant date price), multiplied by the number of shares.

(C) In connection with the spin off of TopBuild, TopBuild employees forfeited their outstanding Masco equity awards.

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MASCO CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

I. STOCK-BASED COMPENSATION (Concluded)

At September 30, 2016 and 2015, there was \$7 million and \$6 million, respectively, of unrecognized compensation expense (using the Black-Scholes option pricing model at the grant date) related to unvested stock options; such options had a weighted average remaining vesting period of three years at September 30, 2016 and two years at September 30, 2015.

The weighted average grant date fair value of option shares granted and the assumptions used to estimate those values using a Black-Scholes option pricing model were as follows:

| | Nine Months Ended | |
|--|--------------------|--------------------|
| | September 30, 2016 | September 30, 2015 |
| Weighted average grant date fair value | \$6.43 | \$9.67 |
| Risk-free interest rate | 1.41 % | 1.75 % |
| Dividend yield | 1.49 % | 1.32 % |
| Volatility factor | 29.00 % | 42.00 % |
| Expected option life | 6 years | 6 years |

J. EMPLOYEE RETIREMENT PLANS

Net periodic pension cost for our defined-benefit pension plans was as follows, in millions:

| | Three Months Ended September 30, | | | |
|--------------------------------|----------------------------------|---------------|-----------|---------------|
| | 2016 | | 2015 | |
| | Qualified | Non-Qualified | Qualified | Non-Qualified |
| Service cost | \$1 | \$ — | \$ — | \$ — |
| Interest cost | 13 | 1 | 13 | 1 |
| Expected return on plan assets | (15) | — | (12) | — |
| Amortization of net loss | 5 | 1 | 5 | 1 |
| Net periodic pension cost | \$4 | \$ 2 | \$ 6 | \$ 2 |

| | Nine Months Ended September 30, | | | |
|--------------------------------|---------------------------------|---------------|-----------|---------------|
| | 2016 | | 2015 | |
| | Qualified | Non-Qualified | Qualified | Non-Qualified |
| Service cost | \$2 | \$ — | \$2 | \$ — |
| Interest cost | 34 | 5 | 36 | 5 |
| Expected return on plan assets | (34) | — | (35) | — |
| Amortization of net loss | 12 | 2 | 14 | 2 |
| Net periodic pension cost | \$14 | \$ 7 | \$17 | \$ 7 |

In the second quarter of 2016, we contributed \$51 million to certain qualified defined-benefit pension plans, which was not included in our previous 2016 expected contributions. At September 30, 2016, we now expect to contribute a total of approximately \$96 million to our qualified defined-benefit pension plans in 2016.

We froze all future benefit accruals under substantially all of our domestic qualified and foreign and domestic non-qualified defined benefit pension plans several years ago.

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MASCO CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

K. RECLASSIFICATIONS FROM ACCUMULATED OTHER COMPREHENSIVE LOSS

The reclassifications from accumulated other comprehensive loss to the condensed consolidated statements of operations were as follows, in millions:

| Accumulated Other Comprehensive Loss | Amounts Reclassified | | | | Statement of Operations Line Item |
|---|--|--|---|---|---|
| | Three Months Ended September 30, 2016 | Three Months Ended September 30, 2015 | Nine Months Ended September 30, 2016 | Nine Months Ended September 30, 2015 | |
| Amortization of defined benefit pension and other postretirement benefits: | | | | | |
| Actuarial losses, net | \$6 | \$6 | \$14 | \$16 | Selling, general and administrative expenses |
| Tax (benefit) | (3) | (2) | (5) | (5) | |
| Net of tax | \$3 | \$4 | \$9 | \$11 | |
| Interest rate swaps | \$— | \$— | \$1 | \$1 | Interest expense |
| Tax (benefit) | — | — | — | — | |
| Net of tax | \$— | \$— | \$1 | \$1 | |
| Available-for-sale securities | \$— | \$— | \$(1) | \$— | Other, net |
| Tax expense | — | — | — | — | |
| Net of tax | \$— | \$— | \$(1) | \$— | |

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MASCO CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

L. SEGMENT INFORMATION

Information by segment and geographic area was as follows, in millions:

| | Three Months Ended September 30, | | | | Nine Months Ended September 30, | | | |
|---|-------------------------------------|----------|----------------------------|--------|------------------------------------|----------|----------------------------|--------|
| | 2016 | 2015 | 2016 | 2015 | 2016 | 2015 | 2016 | 2015 |
| | Net Sales(A) | | Operating Profit (Loss) | | Net Sales(A) | | Operating Profit (Loss) | |
| Operations by segment (B): | | | | | | | | |
| Plumbing Products | \$ 899 | \$ 853 | \$ 174 | \$ 137 | \$ 2,635 | \$ 2,495 | \$ 491 | \$ 386 |
| Decorative Architectural Products | 536 | 527 | 111 | 102 | 1,649 | 1,600 | 355 | 318 |
| Cabinetry Products | 239 | 253 | 19 | 21 | 736 | 771 | 77 | 32 |
| Windows and Other Specialty Products | 203 | 206 | (10) | 23 | 578 | 561 | (9) | 50 |
| Total | \$ 1,877 | \$ 1,839 | \$ 294 | \$ 283 | \$ 5,598 | \$ 5,427 | \$ 914 | \$ 786 |
| Operations by geographic area: | | | | | | | | |
| North America | \$ 1,497 | \$ 1,462 | \$ 235 | \$ 234 | \$ 4,445 | \$ 4,298 | \$ 749 | \$ 645 |
| International, principally Europe | 380 | 377 | 59 | 49 | 1,153 | 1,129 | 165 | 141 |
| Total | \$ 1,877 | \$ 1,839 | 294 | 283 | \$ 5,598 | \$ 5,427 | 914 | 786 |
| General corporate expense, net | | | (25) | (25) | | | (76) | (84) |
| Operating profit | | | 269 | 258 | | | 838 | 702 |
| Other income (expense), net | | | (42) | (60) | | | (181) | (173) |
| Income from continuing operations before income taxes | | | \$ 227 | \$ 198 | | | \$ 657 | \$ 529 |

(A) Inter-segment sales were not material.

In the first quarter of 2016, we renamed our Cabinetry Products and Windows and Other Specialty Products (B) segments. The name change did not impact the review of financial information by our corporate operating executive or the composition of the segments.

M. SEVERANCE COSTS

We recorded charges related to severance of \$1 million and \$5 million for the three-month and nine-month periods ended September 30, 2016, respectively, and \$1 million and \$8 million for the three-month and nine-month periods ended September 30, 2015, respectively. Such 2016 charges are reflected in the condensed consolidated statements of operations in selling, general and administrative expenses and cost of sales while 2015 charges are principally reflected in selling, general and administrative expenses.

N. OTHER INCOME (EXPENSE), NET

Other, net, which is included in other income (expense), net, was as follows, in millions:

| Three Months Ended September 30, 2016 | Nine Months Months Ended September 30, 2015 |
|--|---|
| | |

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| | | | | |
|---|------|--------|-------|--------|
| Income from cash and cash investments | \$ 1 | \$ 1 | \$ 3 | \$ 2 |
| Income from financial investments, net (Note E) | 1 | 1 | 4 | 7 |
| Foreign currency transaction losses | (3) | (8) | (1) | (13) |
| Other items, net | 2 | — | (1) | 2 |
| Total other, net | \$ 1 | \$ (6) | \$ 5 | \$ (2) |

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MASCO CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

O. EARNINGS PER COMMON SHARE

Reconciliations of the numerators and denominators used in the computations of basic and diluted earnings per common share were as follows, in millions:

| | Three Months Ended September 30, 2016 | | Nine Months Ended September 30, 2015 | |
|---|--|--------|---|--------|
| Numerator (basic and diluted): | | | | |
| Income from continuing operations | \$ 134 | \$ 111 | \$ 393 | \$ 281 |
| Less: Allocation to unvested restricted stock awards | 2 | 2 | 5 | 4 |
| Income from continuing operations attributable to common shareholders | 132 | 109 | 388 | 277 |
| Loss from discontinued operations, net | — | — | — | (1) |
| Less: Allocation to unvested restricted stock awards | — | — | — | — |
| Loss from discontinued operations attributable to common shareholders | — | — | — | (1) |
| Net income available to common shareholders | \$ 132 | \$ 109 | \$ 388 | \$ 276 |
| Denominator: | | | | |
| Basic common shares (based upon weighted average) | 326 | 335 | 328 | 340 |
| Add: Stock option dilution | 3 | 3 | 4 | 4 |
| Diluted common shares | 329 | 338 | 332 | 344 |

For the three-month and nine-month periods ended September 30, 2016 and 2015, we allocated dividends and undistributed earnings to the unvested restricted stock awards.

Additionally, 609,000 common shares for the nine-month period ended September 30, 2016 and 4 million and 6 million common shares for the three-month and nine-month periods ended September 30, 2015, respectively, related to stock options were excluded from the computation of diluted earnings per common share due to their antidilutive effect.

On September 30, 2014, we announced that our Board of Directors authorized the repurchase of up to 50 million shares for retirement of our common stock in open-market transactions or otherwise, replacing the previous Board of Directors authorization established in 2007. In the first nine months of 2016, we repurchased and retired 8.3 million shares of our common stock (including 1.1 million shares to offset the dilutive impact of long-term stock awards granted in the first half of the year), for approximately \$252 million of which \$242 million was paid in cash during the first nine months of 2016. At September 30, 2016, we had 19.4 million shares remaining under the authorization.

On the basis of amounts paid (declared), cash dividends per common share were \$0.095 (\$0.100) and \$0.285 (\$0.290) for the three-month and nine-month periods ended September 30, 2016, respectively, and \$0.090 (\$0.095) and \$0.270 (\$0.275) for the three-month and nine-month periods ended September 30, 2015, respectively.

P. OTHER COMMITMENTS AND CONTINGENCIES

We are subject to claims, charges, litigation and other proceedings in the ordinary course of our business, including those arising from or related to contractual matters, intellectual property, personal injury, environmental matters, product liability, product recalls, construction defect, insurance coverage, personnel and employment disputes, anti-trust issues and other matters, including class actions. We believe we have adequate defenses in these matters and that the likelihood that the outcome of these matters would have a material adverse effect on us is remote. However, there is no assurance that we will prevail in these matters, and we could, in the future, incur judgments, enter into settlements of claims or revise our expectations regarding the outcome of these matters, which could materially impact our results of operations.

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MASCO CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Concluded)

Q. INCOME TAXES

Our effective tax rate was 36 percent and 35 percent for the three-month and nine-month periods ended September 30, 2016, respectively, and 39 percent and 41 percent for the three-month and nine-month periods ended September 30, 2015, respectively. The decrease in the 2016 rates results primarily from the tax benefit of the domestic production deduction which allows a deduction for certain qualified production activities within the U.S. This deduction was not available in 2015 due to the utilization of our U.S. Federal loss carryforward. Additionally, the decrease in the nine-month rate is impacted by an \$18 million valuation allowance against the deferred tax assets of TopBuild recorded as a non-cash charge to income tax expense in the second quarter of 2015. The TopBuild deferred tax assets have been impaired by our decision to spin off TopBuild into a separate company that on a stand-alone basis as of June 30, 2015, the spin off date, was unlikely to be able to realize the value of such deferred tax assets as a result of its history of losses.

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MASCO CORPORATION

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONSTHIRD QUARTER 2016 AND THE FIRST NINE MONTHS 2016
VERSUS
THIRD QUARTER 2015 AND THE FIRST NINE MONTHS 2015

SALES AND OPERATIONS

The following table sets forth our net sales and operating profit margins by business segment and geographic area, dollars in millions:

| | Three Months Ended September 30, | | Percent Change | |
|--------------------------------------|--|---------|---------------------------------------|--------|
| | 2016 | 2015 | 2016 vs. 2015 | |
| Net Sales: | | | | |
| Plumbing Products | \$899 | \$853 | 5 | % |
| Decorative Architectural Products | 536 | 527 | 2 | % |
| Cabinetry Products | 239 | 253 | (6) |)% |
| Windows and Other Specialty Products | 203 | 206 | (1) |)% |
| Total | \$1,877 | \$1,839 | 2 | % |
| North America | \$1,497 | \$1,462 | 2 | % |
| International, principally Europe | 380 | 377 | 1 | % |
| Total | \$1,877 | \$1,839 | 2 | % |
| | Nine Months Ended September 30, | | Percent Change | |
| | 2016 | 2015 | 2016 vs. 2015 | |
| Net Sales: | | | | |
| Plumbing Products | \$2,635 | \$2,495 | 6 | % |
| Decorative Architectural Products | 1,649 | 1,600 | 3 | % |
| Cabinetry Products | 736 | 771 | (5) |)% |
| Windows and Other Specialty Products | 578 | 561 | 3 | % |
| Total | \$5,598 | \$5,427 | 3 | % |
| North America | \$4,445 | \$4,298 | 3 | % |
| International, principally Europe | 1,153 | 1,129 | 2 | % |
| Total | \$5,598 | \$5,427 | 3 | % |
| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
| | 2016 | 2015 | 2016 | 2015 |
| Operating Profit (Loss) Margins: (A) | | | | |
| Plumbing Products | 19.4 % | 16.1 % | 18.6 % | 15.5 % |
| Decorative Architectural Products | 20.7 % | 19.4 % | 21.5 % | 19.9 % |
| Cabinetry Products | 7.9 % | 8.3 % | 10.5 % | 4.2 % |

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| | | | | |
|--|---------|-------|---------|-------|
| Windows and Other Specialty Products | (4.9)% | 11.2% | (1.6)% | 8.9 % |
| North America | 15.7 % | 16.0% | 16.9 % | 15.0% |
| International, principally Europe | 15.5 % | 13.0% | 14.3 % | 12.5% |
| Total | 15.7 % | 15.4% | 16.3 % | 14.5% |
| Total operating profit margin, as reported | 14.3 % | 14.0% | 15.0 % | 12.9% |

(A) Before general corporate expense, net; see Note L to the condensed consolidated financial statements.

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We report our financial results in accordance with generally accepted accounting principles (“GAAP”) in the United States. However, we believe that certain non-GAAP performance measures and ratios used in managing the business may provide users of this financial information with additional meaningful comparisons between current results and results in prior periods. Non-GAAP performance measures and ratios should be viewed in addition to, and not as an alternative for, our reported results under GAAP.

NET SALES

Net sales increased two percent and three percent for the three-month and nine-month periods ended September 30, 2016, respectively, from the comparable periods of 2015. Excluding acquisitions and the unfavorable effect of currency translation, net sales increased three percent and four percent for the three-month and nine-month periods ended September 30, 2016, respectively, from the comparable periods of 2015. The following table reconciles reported net sales to net sales, excluding acquisitions and the effect of currency translation, in millions:

| | Three Months Ended September 30, 2016 | | Nine Months Ended September 30, 2015 | |
|--|--|----------|---|----------|
| Net sales, as reported | \$ 1,877 | \$ 1,839 | \$ 5,598 | \$ 5,427 |
| Acquisitions | — | — | (6) | — |
| Net sales, excluding acquisitions | 1,877 | 1,839 | 5,592 | 5,427 |
| Currency translation | 17 | — | 42 | — |
| Net sales, excluding acquisitions and the effect of currency translation | \$ 1,894 | \$ 1,839 | \$ 5,634 | \$ 5,427 |

North American net sales increased two percent and three percent for the three-month and nine-month periods ended September 30, 2016, respectively, from the comparable periods of 2015. Net sales were positively impacted by increased sales volume of plumbing products, paints and other coating products and builders’ hardware, which, in aggregate, increased North American sales by three percent and four percent for the three-month and nine-month periods ended September 30, 2016, respectively, from the comparable periods of 2015. A favorable sales mix of cabinets and windows increased sales by one percent for both the three-month and nine-month periods ended September 30, 2016, from the comparable periods of 2015. An increase in net selling prices of windows, cabinets and plumbing products increased sales one percent for both the three-month and nine-month periods ended September 30, 2016, from the comparable periods of 2015. Such increases were partially offset by decreased sales volumes in cabinets and windows (three-month period only) and a decrease in net selling prices of paints and other coating products, which, in aggregate, decreased sales by three percent for both the three-month and nine-month periods ended September 30, 2016, from the comparable periods of 2015.

International net sales increased one percent and two percent for the three-month and nine-month periods ended September 30, 2016, respectively, from the comparable periods of 2015. In local currencies (including sales in currencies outside their respective functional currencies), net sales from International operations increased six percent for both the three-month and nine-month periods ended September 30, 2016, from the comparable periods of 2015, primarily due to increased sales volume of international plumbing products, which increased sales by five percent for both the three-month and nine-month periods ended September 30, 2016, from the comparable periods of 2015. A favorable product mix of cabinets and windows, coupled with net selling price increases of international plumbing products, increased sales by one percent and two percent for the three-month and nine-month periods ended September 30, 2016, respectively, from the comparable periods of 2015. An acquisition also increased sales by one percent for the nine-month period ended September 30, 2016, from the comparable periods of 2015. Such increases were partially offset by unfavorable currency and lower sales volume of cabinets.

Net sales in the Plumbing Products segment increased for the three-month and nine-month periods ended September 30, 2016, from the comparable periods of 2015, due to increased sales volume of both North American and International operations, which, on a combined basis, increased sales by six percent for both the three-month and nine-month periods ended September 30, 2016, from the comparable periods of 2015. Net selling price increases of

both North American and International operations also increased sales by one percent for both the three-month and nine-month periods ended September 30, 2016, from the comparable periods of 2015. Such increases were partially offset by unfavorable currency, which decreased net sales by one percent in both the three-month and nine-month periods ended September 30, 2016, from the comparable periods of 2015.

Net sales in the Decorative Architectural Products segment increased for the three-month and nine-month periods ended September 30, 2016, from the comparable periods of 2015, due to increased sales volumes of paints and other coating products and increased net selling prices of builder's hardware. An increase in sales volume of builder's hardware also increased net sales for the nine-month period. These increases were partially offset by lower net selling prices of paints and other coating products.

Net sales in the Cabinetry Products segment decreased for the three-month and nine-month periods ended September 30, 2016, from the comparable periods of 2015, due to decreased sales volume of both North American and international cabinets, which, in aggregate, decreased sales by 11 percent for both the three-month and nine-month periods ended September 30, 2016, and a stronger U.S. dollar which decreased sales by one percent for both the three-month and nine-month periods ended September 30, 2016, compared to the same periods of 2015. Such decreases were partially offset by a positive sales mix for North American and international cabinets and net selling price increases for North American cabinets, which on a combined basis increased sales six percent for both the three-month and nine-month periods ended September 30, 2016, from the comparable periods of 2015.

Net sales in the Windows and Other Specialty Products segment decreased for the three-month period ended September 30, 2016 from the comparable period of 2015, due to a stronger U.S. dollar, which decreased sales by four percent, and decreased sales volume of North American windows, which decreased sales by three percent, from the comparable period of 2015. Such decreases were partially offset by a favorable sales mix of North American and international windows and net selling prices of North American windows, which, in aggregate, increased sales five percent for the three-month period ended September 30, 2016, from the comparable period of 2015. Net sales for the nine-month period ended September 30, 2016 increased from the comparable period of 2015, due to favorable net selling prices of North American windows, increased sales mix of North American and international windows, and an international acquisition, which, in aggregate, increased sales five percent, from the comparable period of 2015. A stronger U.S. dollar decreased sales by two percent for the nine-month period ended September 30, 2016, from the comparable period of 2015.

OPERATING MARGINS

Our gross profit margins were 32.7 and 33.6 percent for the three-month and nine-month periods ended September 30, 2016, respectively, compared with 32.0 percent and 31.7 percent for the comparable periods of 2015.

Gross profit margins for the three-month and nine-month periods ended September 30, 2016 were positively affected by increased sales volume, a more favorable relationship between net selling prices and commodity costs, as well as the benefits associated with other cost savings initiatives, partially offset by an increase in warranty costs resulting from a change in expected future warranty claim costs.

Selling, general and administrative expenses, as a percentage of sales, were 18.4 percent and 18.7 percent for the three-month and nine-month periods ended September 30, 2016, respectively, compared to 18.0 percent and 18.8 percent for the comparable periods of 2015.

Operating profit for the three-month and nine-month periods ended September 30, 2016 includes \$6 million and \$16 million, respectively, of costs and charges related to our business rationalizations and other initiatives, compared with \$2 million and \$9 million for the comparable periods of 2015.

Operating margins in the Plumbing Products segment for the three-month and nine-month periods ended September 30, 2016 were positively impacted by increased sales volume and a more favorable relationship between net selling prices and commodity costs (including the favorable impact of the metal hedge contracts) and the benefits associated with business rationalization activities and other cost savings initiatives, partially offset by increases in certain variable expenses, such as selling and marketing costs and compensation expense, and an unfavorable product mix

(nine-month period only).

Operating margins in the Decorative Architectural Products segment for the three-month and nine-month periods ended September 30, 2016 were positively affected by increased sales volume of paints and other coating products, a more favorable relationship between selling prices and commodity costs of builder's hardware, as well as the benefits associated with cost savings initiatives, and, for the nine-month period, increased sales volume of builder's hardware. These increases were partially offset by an unfavorable relationship between selling prices and commodity costs of paints and other coating products.

Operating margin in the Cabinetry Products segment for the three-month period ended September 30, 2016 was negatively affected by a decrease in sales volume for North American cabinets due primarily to the strategic decision to exit certain low margin business in our direct-to-builder channel as well as an increase in certain variable expenses such as costs supporting new product launches. This decrease was partially offset by the benefits associated with business rationalization and cost savings initiatives, a positive product mix and a more favorable relationship between net selling prices and commodity costs in our North America business. Operating margin for the nine-month period ended September 30, 2016 was positively impacted by the benefits associated with business rationalization and other cost savings initiatives, a positive product mix and a more favorable relationship between net selling prices and commodity costs in our North American business. This increase was partially offset by a decrease in sales volume for both North American and international cabinets.

Operating margins in the Windows and Other Specialty Products segment for the three-month and nine-month periods ended September 30, 2016 reflect an increase in warranty costs and certain other expenses, such as higher labor costs and ERP system implementation costs at our North American windows business. Such costs were partially offset by a more favorable relationship between net selling prices and commodity costs and the benefits associated with cost savings initiatives.

OTHER INCOME (EXPENSE), NET

Interest expense for the three-month and nine-month periods ended September 30, 2016 was \$43 million and \$186 million, respectively, compared to \$54 million and \$171 million for the three-month and nine-month periods ended September 30, 2015, respectively. Interest expense decreased for the three-month period ended September 30, 2016 due to the issuance of notes at more favorable interest rates and the subsequent early retirement of debt. Interest expense increased for the nine-month period ended September 30, 2016 due primarily to the \$40 million of additional interest expense recorded in April 2016 in connection with the early retirement of debt, partially offset by the interest savings due to the discharge of indebtedness.

Other, net, for the three-month and nine-month periods ended September 30, 2016 included gains of \$1 million and \$2 million, respectively, related to distributions from private equity funds. The nine-month period ended September 30, 2016 also included \$1 million of earnings from equity investments and gains of \$1 million on the redemption of auction rate securities. Other, net for the three-month and nine-month periods ended September 30, 2015 included gains of \$1 million and \$5 million, respectively, related to distributions from private equity funds and \$2 million of earnings from equity investments for the nine-month period ended September 30, 2015.

INCOME PER COMMON SHARE FROM CONTINUING OPERATIONS — ATTRIBUTABLE TO MASCO CORPORATION

Income for the three-month and nine-month periods ended September 30, 2016 was \$134 million and \$393 million, respectively, compared with \$111 million and \$281 million, respectively, for the comparable periods of 2015. Diluted earnings per common share for the three-month and nine-month periods ended September 30, 2016 was \$.40 and \$1.17, respectively, per common share, compared with \$.32 and \$.81, respectively, per common share for the comparable periods of 2015.

Our effective tax rate was 36 percent and 35 percent for the three-month and nine-month periods ended September 30, 2016, respectively, and 39 percent and 41 percent for the three-month and nine-month periods ended September 30, 2015, respectively. The decrease in the 2016 rates results primarily from the tax benefit of the domestic production deduction which allows a deduction for certain qualified production activities within the U.S. This deduction was not available in 2015 due to the utilization of our U.S. Federal loss carryforward. Additionally, the decrease in the nine-month rate is impacted by an \$18 million valuation allowance against the deferred tax assets of TopBuild recorded as a non-cash charge to income tax expense in the second quarter of 2015. The TopBuild deferred tax assets

have been impaired by our decision to spin off TopBuild into a separate company that on a stand-alone basis as of June 30, 2015, the spin off date, was unlikely to be able to realize the value of such deferred tax assets as a result of its history of losses.

OTHER FINANCIAL INFORMATION

Our current ratio was 2.1 to 1 and 1.4 to 1 at September 30, 2016 and December 31, 2015, respectively. The increase in the current ratio was primarily due to the net debt reduction of \$400 million.

For the nine-month period ended September 30, 2016, net cash of \$382 million was generated from operating activities.

For the nine-month period ended September 30, 2016, net cash used by financing activities was \$759 million, primarily due to the early retirement of all of our \$1 billion, 6.125% Notes which were due on October 3, 2016 and all of our \$300 million, 5.85% Notes which were due on March 15, 2017, \$242 million for the repurchase and retirement of Company common stock (including 1.1 million shares repurchased to offset the dilutive impact of long-term stock awards granted in 2016), \$95 million for the payment of cash dividends and \$31 million for dividends paid to noncontrolling interests. This usage was partially offset by the issuance of \$400 million of 3.5% Notes due April 1, 2021 and \$500 million of 4.375% Notes due April 1, 2026.

In the third quarter of 2016, our Board of Directors announced an increase to our annual dividend by \$0.02 per common share, to \$0.40 per common share, beginning in the fourth quarter of 2016.

For the nine-month period ended September 30, 2016, net cash used by investing activities was \$40 million, and included \$117 million for capital expenditures, partially offset by \$72 million net proceeds from the sale of short-term bank cash deposits.

Our cash, cash investments and short-term bank deposits were \$1.2 billion and \$1.7 billion at September 30, 2016 and December 31, 2015, respectively. Our cash and cash investments consist of overnight interest bearing money market demand accounts, time deposit accounts, and money market mutual funds containing government securities and treasury obligations. Our short-term bank deposits consist of time deposits with maturities of 12 months or less.

Of the \$1.2 billion and the \$1.7 billion of cash, cash investments and short-term bank deposits held at September 30, 2016 and December 31, 2015, \$629 million and \$630 million, respectively, is held in foreign subsidiaries. If these funds were needed for our operations in the U.S., their repatriation into the U.S. would not result in significant additional U.S. income tax or foreign withholding tax, as we have recorded such taxes on substantially all undistributed foreign earnings, except for those that are legally restricted.

On March 17, 2016, we issued \$400 million of 3.5% Notes due April 1, 2021 and \$500 million of 4.375% Notes due April 1, 2026. We received proceeds of \$896 million, net of discount, for the issuance of these Notes. The Notes are senior indebtedness and are redeemable at our option at the applicable redemption price. On April 15, 2016, proceeds from the debt issuances, together with cash on hand, were used to repay and early retire all of our \$1 billion, 6.125% Notes which were due on October 3, 2016 and all of our \$300 million, 5.85% Notes which were due on March 15, 2017. In connection with these early retirements, we incurred \$40 million of debt extinguishment costs, which we recorded as interest expense.

On March 28, 2013, we entered into a credit agreement (the "Credit Agreement") with a bank group, with an aggregate commitment of \$1.25 billion and a maturity date of March 28, 2018. On May 29, 2015 and August 28, 2015, we amended the Credit Agreement with the bank group (the "Amended Credit Agreement"). The Amended Credit Agreement reduces the aggregate commitment to \$750 million and extends the maturity date to May 29, 2020. Under the Amended Credit Agreement, at our request and subject to certain conditions, we can increase the aggregate commitment up to an additional \$375 million with the current bank group or new lenders. See Note H to the condensed consolidated financial statements.

The Amended Credit Agreement contains financial covenants requiring us to maintain (A) a maximum net leverage ratio, as adjusted for certain items, of 4.0 to 1.0, and (B) a minimum interest coverage ratio, as adjusted for certain items, equal to or greater than 2.5 to 1.0. We were in compliance with all covenants and had no borrowings under our Amended Credit Agreement at September 30, 2016.

We believe that our present cash balance, cash flows from operations and, to the extent necessary, bank borrowings and future financial market activities, are sufficient to fund our working capital and other investment needs.

OUTLOOK FOR THE COMPANY

We continue to successfully execute against our long-term growth strategies by leveraging our brand portfolio, industry-leading positions, and Masco Operating System, our methodology to drive growth and productivity. We believe we will continue to see strong demand for our market-leading products, as the fundamentals for long-term demand in both repair and remodel and new home construction continue to be positive. We believe that our strong financial position, together with our current strategy of investing in our industry-leading branded building products, our continued focus on innovation and our commitment to operational excellence and disciplined capital allocation will allow us to drive long-term growth and create value for our shareholders.

FORWARD-LOOKING STATEMENTS

This report contains statements that reflect our views about our future performance constitute “forward-looking statements” under the Private Securities Litigation Reform Act of 1995. Forward-looking statements can be identified by words such as “believe,” “anticipate,” “appear,” “may,” “will,” “should,” “intend,” “plan,” “estimate,” “expect,” “assume,” and similar references to future periods. Our views about future performance involve risks and uncertainties that are difficult to predict and, accordingly, our actual results may differ materially from the results discussed in our forward-looking statements. We caution you against relying on any of these forward-looking statements. Our future performance may be affected by the levels of home improvement activity and new home construction, our ability to maintain our strong brands and to develop and introduce new and improved products, our ability to maintain our competitive position in our industries, our reliance on key customers, our ability to achieve the anticipated benefits of our strategic initiatives, our ability to sustain the performance at our cabinetry businesses, the cost and availability of raw materials, our dependence on third party suppliers, and risks associated with international operations and global strategies. These and other factors are discussed in detail in Item 1A, “Risk Factors” in our most recent Annual Report on Form 10-K, as well as in other filings we make with the Securities and Exchange Commission. The forward-looking statements in this report speak only as of the date of this report. Factors or events that could cause our actual results to differ may emerge from time to time, and it is not possible for us to predict all of them. Unless required by law, we undertake no obligation to update publicly any forward-looking statements as a result of new information, future events or otherwise.

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MASCO CORPORATION

Item 4. CONTROLS AND PROCEDURES

a. Evaluation of Disclosure Controls and Procedures.

The Company's principal executive officer and principal financial officer have concluded, based on an evaluation of the Company's disclosure controls and procedures (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) or 15d-15(e)) as required by paragraph (b) of Exchange Act Rules 13a-15 or 15d-15 that, as of September 30, 2016, the Company's disclosure controls and procedures were effective.

b. Changes in Internal Control over Financial Reporting.

During the third quarter of 2016, the Company continued a phased deployment of a new Enterprise Resource Planning ("ERP") system at Milgard. The system implementation is designed, in part, to enhance the overall system of internal control over financial reporting through further automation and improve business processes and is not in response to any identified deficiency or weakness in the Company's internal control over financial reporting. However, this system implementation is significant in scale and complexity and has resulted in modification to certain Milgard internal controls.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Information regarding legal proceedings involving us is set forth in Note P to our condensed consolidated financial statements included in Part I, Item 1 of this Report and is incorporated herein by reference.

Item 1A. Risk Factors

There have been no material changes to the risk factors of the Company set forth in Item 1A, "Risk Factors" in the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table provides information regarding the repurchase of Company common stock for the three months ended September 30, 2016:

| Period | Total Number Of Shares Purchased | Average Price Paid Per Common Share | Total Number Of Shares Purchased As Part Of Publicly Announced Plans or Programs (A) | Maximum Number Of Shares That May Yet Be Purchased Under The Plans Or Programs |
|-----------------------|----------------------------------|-------------------------------------|--|--|
| 7/1/16-7/31/16 | 226,324 | \$ 30.99 | 226,324 | 21,542,396 |
| 8/1/16-8/31/16 | 50,000 | \$ 35.37 | 50,000 | 21,492,396 |
| 9/1/16-9/30/16 | 2,050,000 | \$ 33.91 | 2,050,000 | 19,442,396 |
| Total for the quarter | 2,326,324 | \$ 33.65 | 2,326,324 | 19,442,396 |

(A) In September 2014, our Board of Directors authorized the purchase of up to 50 million shares of our common stock in open-market transactions or otherwise.

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PART II. OTHER INFORMATION, Continued

Item 6. Exhibits

12 -Computation of Ratio of Earnings to Combined Fixed Charges and Preferred Stock Dividends

31a- Certification by Chief Executive Officer Required by Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934

31b- Certification by Chief Financial Officer Required by Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934

32 - Certification Required by Rule 13a-14(b) or 15d-14(b) of the Securities Exchange Act of 1934 and Section 1350 of Chapter 63 of Title 18 of the United States Code

101-Interactive Data File

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MASCO CORPORATION

PART II. OTHER INFORMATION, Concluded

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.

MASCO
CORPORATION

By: /s/ John G. Sznewajs
Name: John G. Sznewajs
Title: Vice President and
Chief Financial Officer

October 25, 2016

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EXHIBIT INDEX

Exhibit

Exhibit 12 Computation of Ratio of Earnings to Combined Fixed Charges and Preferred Stock Dividends

Exhibit 31a Certification by Chief Executive Officer Required by Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934

Exhibit 31b Certification by Chief Financial Officer Required by Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934

Exhibit 32 Certification Required by Rule 13a-14(b) or 15d-14(b) of the Securities Exchange Act of 1934 and Section 1350 of Chapter 63 of Title 18 of the United States Code

Exhibit 101 Interactive Data File

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