

MASCO CORP /DE/
Form 10-Q
October 24, 2017

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, 2017

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.)
17450 College Parkway, Livonia, Michigan 48152
(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 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, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth 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) Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

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Yes 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 September 30, 2017
Common stock, par value \$1.00 per share	314,565,292

MASCO CORPORATION

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MASCO CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)

September 30, 2017 and December 31, 2016
(In Millions, Except Share Data)

	September 30, 2017	December 31, 2016
ASSETS		
Current assets:		
Cash and cash investments	\$ 1,141	\$ 990
Short-term bank deposits	77	201
Receivables	1,128	917
Prepaid expenses and other	96	114
Inventories:		
Finished goods	478	366
Raw material	280	254
Work in process	108	92
	866	712
Total current assets	3,308	2,934
Property and equipment, net	1,097	1,060
Goodwill	801	832
Other intangible assets, net	156	154
Other assets	121	157
Total assets	\$ 5,483	\$ 5,137
LIABILITIES		
Current liabilities:		
Accounts payable	\$ 916	\$ 800
Notes payable	117	2
Accrued liabilities	675	658
Total current liabilities	1,708	1,460
Long-term debt	2,969	2,995
Other liabilities	746	785
Total liabilities	5,423	5,240
Commitments and contingencies (Note N)		
EQUITY		
Masco Corporation's shareholders' equity:		
Common shares, par value \$1 per share		
Authorized shares: 1,400,000,000;	311	318
Issued and outstanding: 2017 – 311,500,000; 2016 – 318,000,000		
Preferred shares authorized: 1,000,000;		
Issued and outstanding: 2017 and 2016 – None	—	—
Paid-in capital	—	—
Retained deficit	(343) (381)
Accumulated other comprehensive loss	(127) (235)
Total Masco Corporation's shareholders' deficit	(159) (298)

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Noncontrolling interest	219	195
Total equity	60	(103)
Total liabilities and equity	\$ 5,483	\$ 5,137

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, 2017 and 2016
 (In Millions, Except Per Common Share Data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Net sales	\$1,936	\$1,877	\$5,770	\$5,598
Cost of sales	1,286	1,263	3,775	3,715
Gross profit	650	614	1,995	1,883
Selling, general and administrative expenses	355	345	1,090	1,045
Operating profit	295	269	905	838
Other income (expense), net:				
Interest expense	(43)	(43)	(239)	(186)
Other, net	4	1	58	5
	(39)	(42)	(181)	(181)
Income before income taxes	256	227	724	657
Income tax expense	96	81	243	229
Net income	160	146	481	428
Less: Net income attributable to noncontrolling interest	12	12	35	35
Net income attributable to Masco Corporation	\$148	\$134	\$446	\$393
Income per common share attributable to Masco Corporation:				
Basic:				
Net income	\$.47	\$.41	\$1.40	\$1.18
Diluted:				
Net income	\$.46	\$.40	\$1.38	\$1.17

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, 2017 and 2016
 (In Millions)

	Three Months Ended September 30, 2017		Nine Months Ended September 30, 2016	
Net income	\$160	\$146	\$481	\$428
Less: Net income attributable to noncontrolling interest	12	12	35	35
Net income attributable to Masco Corporation	\$148	\$134	\$446	\$393
Other comprehensive income (loss), net of tax (Note J):				
Cumulative translation adjustment	\$33	\$(1)	\$119	\$(10)
Interest rate swaps	—	—	2	1
Pension and other post-retirement benefits	4	3	11	9
Realized gain on available-for-sale securities	—	—	—	(1)
Other comprehensive income (loss)	37	2	132	(1)
Less: Other comprehensive income attributable to noncontrolling interest	6	2	24	4
Other comprehensive income (loss) attributable to Masco Corporation	\$31	\$—	\$108	\$(5)
Total comprehensive income	\$197	\$148	\$613	\$427
Less: Total comprehensive income attributable to the noncontrolling interest	18	14	59	39
Total comprehensive income attributable to Masco Corporation	\$179	\$134	\$554	\$388

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, 2017 and 2016
(In Millions)

	Nine Months Ended September 30, 2017 2016	
CASH FLOWS FROM (FOR) OPERATING ACTIVITIES:		
Cash provided by operations	\$745	\$670
Increase in receivables	(227)	(245)
Increase in inventories	(143)	(73)
Increase in accounts payable and accrued liabilities, net	92	131
Net cash from operating activities	467	483
CASH FLOWS FROM (FOR) FINANCING ACTIVITIES:		
Retirement of notes	(535)	(1,300)
Purchase of Company common stock	(312)	(242)
Cash dividends paid	(96)	(95)
Dividends paid to noncontrolling interest	(35)	(31)
Issuance of notes, net of issuance costs	593	889
Debt extinguishment costs	(104)	(40)
Issuance of Company common stock	—	1
Employee withholding taxes paid on stock-based compensation	(29)	(40)
Decrease in debt, net	—	(2)
Net cash for financing activities	(518)	(860)
CASH FLOWS FROM (FOR) INVESTING ACTIVITIES:		
Capital expenditures	(113)	(117)
Proceeds from disposition of:		
Business, net of cash disposed	128	—
Short-term bank deposits	206	223
Other financial investments	6	14
Property and equipment	6	—
Purchases of:		
Short-term bank deposits	(65)	(151)
Other, net	(11)	(9)
Net cash from (for) investing activities	157	(40)
Effect of exchange rate changes on cash and cash investments	45	(10)
CASH AND CASH INVESTMENTS:		
Increase (decrease) for the period	151	(427)
At January 1	990	1,468
At September 30	\$1,141	\$1,041

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, 2017 and 2016
(In Millions, Except Per Share Data)

	Total	Common Shares (\$1 par value)	Paid-In Capital	Retained Deficit	Accumulated Other Comprehensive Loss	Noncontrolling Interest
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)		
Dividends paid to noncontrolling interest	(31)					(31)
Stock-based compensation	35		35			
Balance, September 30, 2016	\$103	\$ 325	\$ —	\$ (253)	\$ (170)	\$ 201
Balance, January 1, 2017	\$(103)	\$ 318	\$ —	\$(381)	\$(235)	\$ 195
Total comprehensive income	613			446	108	59
Shares issued	(14)	2	(16)			
Shares retired:						
Repurchased	(312)	(8)	(6)	(298)		
Surrendered (non-cash)	(15)	(1)		(14)		
Cash dividends declared	(96)			(96)		
Dividends paid to noncontrolling interest	(35)					(35)
Stock-based compensation	22		22			
Balance, September 30, 2017	\$60	\$ 311	\$ —	\$(343)	\$(127)	\$ 219

See notes to condensed consolidated financial statements.

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MASCO CORPORATION
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 fairly state our financial position at September 30, 2017, our results of operations and comprehensive income (loss) for the three-month and nine-month periods ended September 30, 2017 and 2016, and cash flows and changes in shareholders' equity for the nine-month periods ended September 30, 2017 and 2016. The condensed consolidated balance sheet at December 31, 2016 was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

Reclassification. Certain prior year amounts have been reclassified to conform to the 2017 presentation in the condensed consolidated financial statements.

Recently Adopted Accounting Pronouncements. In July 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2015-11, "Inventory (Topic 330): Simplifying the Measurement of Inventory," which requires that inventory within the scope of the guidance be measured at the lower of cost and net realizable value, as opposed to the lower of cost or market. We adopted ASU 2015-11 on January 1, 2017. The adoption of the new standard did not have an impact on our financial position or results of operations.

In March 2016, the FASB issued 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, simplifies the accounting requirements for forfeitures and employers' tax withholding requirements, and modifies the presentation of certain items on the statement of cash flows. We adopted ASU 2016-09 on January 1, 2017, using the retrospective options for reclassifying excess tax benefit from stock-based compensation and employee withholding taxes paid on stock-based compensation within our statements of cash flows. The adoption of the remaining requirements did not have an impact on our financial position or results of operation. As a result of this adoption, we increased cash flows from (for) operating activities and decreased cash flows from (for) financing activities by \$61 million for the nine-month period ended September 30, 2016. For full year 2016 and 2015, we currently estimate increasing cash flows from (for) operating activities and decreasing cash flows from (for) financing activities by \$62 million and \$111 million, respectively. Subsequent to adoption, tax effects related to employee share-based payments will be recorded to income tax expense, thus increasing the volatility in our effective tax rate.

In January 2017, the FASB issued ASU 2017-04, "Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment," which removes Step 2 of the goodwill impairment test. A goodwill impairment will now be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. We early adopted ASU 2017-04 effective January 1, 2017. The adoption of the new standard did not have an impact on our financial position or results of operations.

Recently Issued Accounting Pronouncements. In May 2014, the FASB issued a new standard for revenue recognition, Accounting Standards Codification ("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. The standard allows for either a full retrospective or modified retrospective method of adoption. We will adopt this standard on its effective date, January 1, 2018, under the full retrospective method of adoption. We do not expect the adoption will have a material impact on our financial position or results of operations. We have finalized our accounting policy, trained our business units on the new standard and are currently evaluating our internal controls under the new

standard. We have not experienced significant issues in our implementation process.

In January 2016, the FASB issued 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. The adoption of this standard is not expected to have a material impact on our financial position or results of operations.

In February 2016, the FASB issued a new standard for leases, 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 and requires retrospective application. We expect this standard to increase our total assets and total liabilities; however, we are currently evaluating the magnitude of the impact the adoption of this new standard will have on our financial position and results of operations.

MASCO CORPORATION

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

A. ACCOUNTING POLICIES (Concluded)

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments," which modifies the methodology for recognizing loss impairments on certain types of financial instruments. The new methodology requires an entity to estimate the credit losses expected over the life of an exposure. Additionally, ASU 2016-13 amends the current available-for-sale security other-than-temporary impairment model for debt securities. ASU 2016-13 is effective for us for annual periods beginning January 1, 2020. We are currently evaluating the impact the adoption of this new standard will have on our financial position and results of operations.

In October 2016, the FASB issued ASU 2016-16, "Income Taxes (Topic 740): Intra-Entity Asset Transfers of Assets Other than Inventory," which no longer allows the tax effects of intra-entity asset transfers (intercompany sales) of assets other than inventory to be deferred until the transferred asset is sold to a third party or otherwise recovered through use. The new standard requires the tax expense from the sale of the asset in the seller's tax jurisdiction and the corresponding basis differences in the buyer's jurisdiction to be recognized when the transfer occurs even though the pre-tax effects of the transaction are eliminated in consolidation. ASU 2016-16 is effective for us for annual periods beginning January 1, 2018. The adoption of this standard is not expected to have a material impact on our financial position or results of operations.

In March 2017, the FASB issued ASU 2017-07, "Compensation-Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost," which modifies the presentation of net periodic pension and post-retirement benefit cost ("net benefit cost") in the income statement and the components eligible for capitalization as assets. ASU 2017-07 is effective for us for annual periods beginning January 1, 2018. We do not expect the adoption of the new standard will have a material impact on our financial position or results of operations. For full year 2016, we expect \$31 million of expense to be retrospectively reclassified from operating profit to other income (expense), net, within our results of operations. For the nine-month period ended September 30, 2017, we expect \$22 million of expense to be retrospectively reclassified from operating profit to other income (expense), net, within our results of operations.

In May 2017, the FASB issued ASU 2017-09, "Compensation-Stock Compensation (Topic 718): Scope of Modification Accounting," which clarifies when to account for a change to the terms or conditions of a share-based payment award as a modification. ASU 2017-09 is effective for us for annual periods beginning January 1, 2018, and is applied prospectively. Upon adoption, modification accounting is required only if the fair value, the vesting conditions, or the classification of the award (as equity or liability) changes as a result of the change in terms or conditions.

In August 2017, the FASB issued ASU 2017-12, "Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities," which improves and simplifies accounting rules around hedge accounting and better portrays the economic results of an entity's risk management activities in its financial statements. ASU 2017-12 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.

B. DIVESTITURES

In the second quarter of 2017 we divested of Arrow Fastener Co., LLC ("Arrow"), a manufacturer and distributor of fastening tools, for proceeds of \$128 million. In connection with the divestiture we recognized a gain of \$2 million

and \$51 million for the three-month and nine-month periods ended September 30, 2017, respectively, included in other, net, within other income (expense), net in our condensed consolidated statement of operations. The results of this business are included within income before income taxes in the condensed consolidated statement of operations and reported as part of our Windows and Other Specialty Products segment prior to the date of the divestiture.

MASCO CORPORATION

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, 2017, by segment, were as follows, in millions:

	Gross Goodwill At September 30, 2017	Accumulated Impairment Losses	Net Goodwill At September 30, 2017			
Plumbing Products	\$ 534	\$ (340)	\$ 194			
Decorative Architectural Products	294	(75)	219			
Cabinetry Products	240	(59)	181			
Windows and Other Specialty Products	718	(511)	207			
Total	\$ 1,786	\$ (985)	\$ 801			
	Gross Goodwill At December 31, 2016	Accumulated Impairment Losses	Net Goodwill At December 31, 2016	Other(A)	Divestitures (B)	Net Goodwill At September 30, 2017
Plumbing Products	\$ 519	\$ (340)	\$ 179	\$ 15	\$ —	\$ 194
Decorative Architectural Products	294	(75)	219	—	—	219
Cabinetry Products	240	(59)	181	—	—	181
Windows and Other Specialty Products	987	(734)	253	1	(47)	207
Total	\$ 2,040	\$ (1,208)	\$ 832	\$ 16	\$ (47)	\$ 801

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

(B) Divestitures includes the disposition of Arrow in the second quarter of 2017 and is comprised of \$270 million of gross goodwill and \$223 million of accumulated impairment losses.

The carrying value of our other indefinite-lived intangible assets was \$136 million at both September 30, 2017 and December 31, 2016, and principally included registered trademarks. The carrying value of our definite-lived intangible assets was \$20 million (net of accumulated amortization of \$10 million) and \$18 million (net of accumulated amortization of \$16 million) at September 30, 2017 and December 31, 2016, respectively, and principally included customer relationships.

D. DEPRECIATION AND AMORTIZATION

Depreciation and amortization expense was \$95 million and \$100 million for the nine-month periods ended September 30, 2017 and 2016, respectively.

E. 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 may include interest rate swap agreements, foreign currency contracts and metals contracts. 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 approximately \$2 million loss was recognized in our consolidated statement of operations in other, 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. At September 30, 2017, the balance remaining in accumulated other comprehensive loss was \$9 million (pre-tax).

MASCO CORPORATION

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

E. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES (Concluded)

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, enter into foreign currency forward contracts and foreign currency exchange contracts.

Gains (losses) related to foreign currency forward and exchange contracts are recorded in our condensed consolidated statements of operations in 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. From time to time, we have entered into contracts to manage our exposure to increases in the prices 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, 2017		Nine Months Ended September 30, 2016	
Foreign currency contracts:				
Exchange contracts	\$ (1)	\$ —	\$ (1)	\$ —
Forward contracts	1	—	1	—
Metals contracts	—	1	—	5
Interest rate swaps	—	—	(3)	(1)
Total gain (loss)	\$ —	\$ 1	\$ (3)	\$ 4

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, 2017	
	Notional Amount	Balance Sheet
Foreign currency contracts:		
Exchange contracts	\$ 2	
Accrued liabilities		\$ —
Forward contracts	4	
Receivables		—
	At December 31,	

	2016	
	Notional	Balance
	Amount	Sheet
Foreign currency contracts:		
Forward contracts	\$ 21	
Accrued liabilities		\$ (2)
Metals contracts	1	
Accrued liabilities		—

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

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

F. WARRANTY LIABILITY

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

	Nine Months Ended September 30, 2017	Twelve Months Ended December 31, 2016
Balance at January 1	\$ 192	\$ 152
Accruals for warranties issued during the period	43	66
Accruals related to pre-existing warranties	6	33
Settlements made (in cash or kind) during the period	(43)	(56)
Other, net (including currency translation)	1	(3)
Balance at end of period	\$ 199	\$ 192

In the second and third quarters of 2016, a business unit in the Windows and Other Specialty Products segment recorded \$10 million and \$21 million, respectively, for increases in its estimate of expected future warranty claims relating to previously sold windows and doors. The change in estimate resulted from the adoption of an improved warranty valuation model and the availability of additional information used to support the estimate of costs to service claims and recent warranty claims trends, including a shift to increased costs to repair.

G. DEBT

On June 21, 2017, we issued \$300 million of 3.5% Notes due November 15, 2027 and \$300 million of 4.5% Notes due May 15, 2047. We received proceeds of \$599 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 June 27, 2017, proceeds from the debt issuances, together with cash on hand, were used to repay and early retire \$299 million of our 7.125% Notes due March 15, 2020, \$74 million of our 5.95% Notes due March 15, 2022, \$62 million of our 7.75% Notes due August 1, 2029, and \$100 million of our 6.5% Notes due August 15, 2032. In connection with these early retirements, we incurred a loss on debt extinguishment of \$107 million, which was 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 extended 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, 2017, 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.

MASCO CORPORATION

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

G. 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 no borrowings have been made at September 30, 2017.

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, which are Level 1 inputs. The aggregate estimated market value of short-term and long-term debt was approximately \$3.4 billion, compared with the aggregate carrying value of \$3.1 billion, at September 30, 2017. The aggregate estimated market value of short-term and long-term debt was approximately \$3.3 billion, compared with the aggregate carrying value of \$3.0 billion, at December 31, 2016.

H. STOCK-BASED COMPENSATION

Our 2014 Long Term Stock Incentive Plan provides for the issuance of stock-based incentives in various forms to our employees and non-employee Directors. At September 30, 2017, outstanding stock-based incentives were in the form of long-term stock awards, stock options, restricted stock units, phantom stock awards and stock appreciation rights.

Pre-tax compensation expense for these stock-based incentives were as follows, in millions:

	Three Months Ended September 30, 2017		Nine Months Ended September 30, 2016	
Long-term stock awards	\$ 6	\$ 5	\$ 19	\$ 17
Stock options	—	1	2	2
Restricted stock units	—	—	1	—
Phantom stock awards and stock appreciation rights	2	4	7	6
Total	\$ 8	\$ 10	\$ 29	\$ 25

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 inasmuch as we continue the practice of repurchasing and retiring an equal number of shares in the open market. We granted 819,000 shares of long-term stock awards in the nine-month period ended September 30, 2017.

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

H. STOCK-BASED COMPENSATION (Continued)

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

	Nine Months Ended September 30,	
	2017	2016
Unvested stock award shares at January 1	4	5
Weighted average grant date fair value	\$ 20	\$ 17
Stock award shares granted	1	1
Weighted average grant date fair value	\$ 34	\$ 26
Stock award shares vested	2	2
Weighted average grant date fair value	\$ 18	\$ 16
Stock award shares forfeited	—	—
Weighted average grant date fair value	\$ 24	\$ 20
Unvested stock award shares at September 30	3	4
Weighted average grant date fair value	\$ 24	\$ 20

At September 30, 2017 and 2016, there was \$50 million and \$49 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, 2017 and 2016.

The total market value (at the vesting date) of stock award shares which vested during the nine-month periods ended September 30, 2017 and 2016 was \$45 million and \$43 million, respectively.

Stock Options. Stock options are granted to certain 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 397,350 shares of stock options in the nine-month period ended September 30, 2017 with a grant date weighted-average exercise price of approximately \$34 per share. In the nine-month period ended September 30, 2017, no stock option shares were forfeited (including options that expired unexercised).

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

H. STOCK-BASED COMPENSATION (Continued)

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

	Nine Months Ended	
	September 30,	
	2017	2016
Option shares outstanding, January 1	7	12
Weighted average exercise price	\$15	\$17
Option shares granted	—	—
Weighted average exercise price	\$34	\$26
Option shares exercised	1	5
Aggregate intrinsic value on date of exercise (A)	\$36 million	\$64 million
Weighted average exercise price	\$15	\$21
Option shares forfeited	—	—
Weighted average exercise price	\$—	\$—
Option shares outstanding, September 30	6	7
Weighted average exercise price	\$16	\$15
Weighted average remaining option term (in years)	4	4
Option shares vested and expected to vest, September 30	6	7
Weighted average exercise price	\$16	\$15
Aggregate intrinsic value (A)	\$132 million	\$137 million
Weighted average remaining option term (in years)	4	4
Option shares exercisable (vested), September 30	4	6
Weighted average exercise price	\$13	\$13
Aggregate intrinsic value (A)	\$115 million	\$117 million
Weighted average remaining option term (in years)	3	3

(A) 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.

At September 30, 2017 and 2016, there was \$8 million and \$7 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 both September 30, 2017 and 2016.

MASCO CORPORATION

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

H. STOCK-BASED COMPENSATION (Concluded)

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,	
	2017	2016
Weighted average grant date fair value	\$9.68	\$6.43
Risk-free interest rate	2.16 %	1.41 %
Dividend yield	1.19 %	1.49 %
Volatility factor	30.00 %	29.00 %
Expected option life	6 years	6 years

Restricted Stock Units. In March 2017, our Organization and Compensation Committee ("Compensation Committee") of the Board of Directors approved a Long Term Incentive Program ("LTIP Program"), replacing our previous Long Term Cash Incentive Plan. Under the LTIP Program, we granted restricted stock units to certain senior executives. These restricted stock units will vest and share awards will be issued at no cost to the employees, subject to our achievement of specified return on invested capital performance goals over a three-year period that have been established by the Compensation Committee for the performance period and the employee's continued employment through the share award date. Restricted stock units are granted at a target number; based on our performance, the number of restricted stock units that vest can be adjusted downward to zero and upward to a maximum of 200%. We granted 124,780 restricted stock units in the nine-month period ended September 30, 2017, with a grant date fair value of approximately \$34 per share. No restricted stock units were forfeited in the nine-month period ended September 30, 2017.

I. EMPLOYEE RETIREMENT PLANS

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

	Three Months Ended September 30,			
	2017		2016	
	Quali- fied	Non- Qualified	Quali- fied	Non- Qualified
Service cost	\$1	\$ —	\$1	\$ —
Interest cost	11	2	13	1
Expected return on plan assets	(12)	—	(15)	—
Amortization of net loss	5	1	5	1
Net periodic pension cost	\$5	\$ 3	\$4	\$ 2