

A Homespun Fortune

October 18, 2011



Pershing Square Capital Management, L.P.

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Fortune Brands Home & Security



Ticker: "FBHS"

Recent stock price: \$13 ⁽¹⁾

- ▶ **FBHS (or the "Company") is a leading North American residential building products company**

- ▶ **Manufacturer of:**
 - Faucets
 - Kitchen and bath cabinets
 - Security and storage products
 - Windows and doors

- ▶ **Equity market capitalization of ~\$2.0bn**

- ▶ **Enterprise valuation of ~\$2.5bn**

- ▶ **Spun-off from Fortune Brands on October 4, 2011**

(1) Based on stock price as of Friday, October 14 2011.

Snapshot of FBHS



Plumbing



- **#1 Faucet brand in North America**
- Stable business driven by replacement demand and “low ticket” remodeling projects

Kitchen & Bath Cabinetry



- **#1 N. American kitchen and bath cabinet maker**
- Leveraged to housing recovery

Security and Storage



- **#1 Padlock brand in North America**
- Stable, recurring cash flows
- Good growth potential

Windows and Doors



- Leveraged to housing recovery

Investment Highlights

Secular Winner...

- ▶ **Industry leader with significant scale and strong market positions**
- ▶ **Winning new business and growing as financially leveraged competitors remain defensive**
- ▶ **Strong management team -- highly experienced operators**

...And Cyclical Winner

- ▶ **Well-positioned when the housing market normalizes**
- ▶ **Cyclical growth will not require capital investment above normal levels**
- ▶ **Immense operating leverage: EBITDA can be 3x in a normalized housing market**

Platform Business

- ▶ **Highly fragmented industry is ripe for consolidation**
- ▶ **Opportunities to leverage scale and distribution through acquisitions in adjacent categories (i.e. electronic security, bath accessories)**

Investment Highlights

Attractive Valuation

- ▶ **Current valuation assumes minimal housing recovery over the next five years**
- ▶ **Immense upside potential**
 - If housing starts improve by 2016, stock is worth ~\$18 to \$27 today, depending on the strength of recovery
 - Midpoint of valuation analysis is ~\$22 per share today, up about 70%⁽¹⁾
- ▶ **Minimal downside**
 - If housing starts don't improve, FBHS can still shrink capacity to get to an attractive level of profitability

Classic spin-off dynamics

- ▶ **Orphaned stock: October 4th spin-off**
 - Most Fortune Brands shareholders owned it for Beam, a non-cyclical business

Strong balance sheet

- ▶ **Flexibility to make opportunistic acquisitions**
- ▶ **Limits downside risk as we wait for the housing markets to recover**

(1) See page 31 for valuation analysis.

FBHS: Business Overview

The Plumbing segment, which contributed 54% of FBHS pre-corporate 2010 EBIT, has performed exceptionally well in the downturn due to both marketplace gains and the “small ticket” aspect of the category

Commentary

- ✓ Manufactures faucets, accessories, and kitchen sinks under the #1 Moen brand
- ✓ Large installed base helps win replacement sales
- ✓ Faucets are a “small ticket” remodeling expenditure – an affordable way to improve the look of the bathroom/kitchen
- ✓ Generally a stable category where branding and innovation can drive marketplace gains
- ✓ Variable-cost business model

Financials

\$ in millions

Plumbing	FY 2008	FY 2009	FY 2010
Revenue	\$967	\$835	\$924
<i>Growth</i>		(14)%	11 %
EBIT	\$171	\$117	\$133
<i>Margin</i>	17.6 %	14.0 %	14.3 %
% of FBHS Revenues	26%	28%	29%
% of FBHS pre-corp EBIT	48%	81%	54%

The Cabinets segment is barely profitable today as demand for new homes and “big ticket” remodeling projects has diminished drastically

\$ in millions

Kitchen & Bath Cabinets	FY 2008	FY 2009	FY 2010
Revenue	\$1,552	\$1,126	\$1,189
Growth		(27)%	6%
EBIT	\$141	\$4	\$31
Margin	9.1%	0.4%	2.6%
% of FBHS Revenues	41%	37%	37%
% of FBHS pre-corp EBIT	40%	3%	13%

The segment has significant excess capacity, which is pressuring margins today, but will allow for explosive growth when the housing markets recover

- ▶ **#1 North American manufacturer of kitchen and bath cabinets**
 - Key brands include: Aristokraft, Omega, and Diamond
- ▶ **Well-balanced distribution channels and flexible supply chain allow for differentiated price points and multiple levels of cabinet customization**
 - Distributes through dealers, wholesalers, home centers, and large builders
- ▶ **Highly geared to “big ticket” remodeling projects and new home construction**
- ▶ **Currently winning new business against competitors like Masco**
- ▶ **High fixed-cost business model**

Masterlock is a great business with a strong marketplace position, stable cash flows, minimal capex requirements and good growth potential in adjacent categories

Commentary

- ✓ **Manufactures Masterlock padlocks and Waterloo storage products**
- ✓ **Historically stable demand in core padlock market**
- ✓ **FBHS exploring opportunities to expand Masterlock brand through acquisitions**
- ✓ **Good potential to grow in adjacent categories (electronic security and monitoring)**

Financials

\$ in millions

Security & Storage	FY 2008	FY 2009	FY 2010
Revenue	\$571	\$495	\$520
<i>Growth</i>		(13)%	5%
EBIT	\$59	\$42	\$61
<i>Margin</i>	10.3%	8.4%	11.7%
% of FBHS Revenues	15%	16%	16%
% of FBHS pre-corp EBIT	17%	29%	25%

Security and Storage contributed 25% of FBHS's 2010 EBIT

FBHS's Windows and Doors segment contributed only 8% of total pre-corporate EBIT in 2010.

Commentary

- ✓ **Manufactures fiberglass and steel residential and patio door systems and vinyl-framed windows**
- ✓ **Key brands include Therma-Tru Doors and Simonton Windows**
- ✓ **Currently lapping difficult comparisons driven by 2010 federal tax credits for energy efficiency**

Financials

\$ in millions

Windows & Doors	FY 2008	FY 2009	FY 2010
Revenue	\$668	\$551	\$601
<i>Growth</i>		(18)%	9 %
EBIT	(\$17)	(\$19)	\$21
<i>Margin</i>	(2.6)%	(3.4)%	3.4 %
% of FBHS Revenues	18%	18%	19%
% of FBHS pre-corp EBIT	(5)%	(13)%	8 %

EBIT Margins remain depressed as the segment is significantly leveraged to new home construction

FBHS: Margins Significantly Depressed

Consolidated EBIT margins are currently at ~5%, well below peak levels of 14% reached in 2006.

	2006	2007	2008	2009	2010	LTM
<i>(\$ in millions)</i>						
Revenue	\$4,694	\$4,551	\$3,759	\$3,007	\$3,234	\$3,261
<i>Growth</i>		(3)%	(17)%	(20)%	8%	1%
<i>% of Peak</i>	100%	97%	80%	64%	69%	69%
EBITDA	\$816	\$703	\$435	\$195	\$288	\$264
<i>Margin</i>	17.4%	15.4%	11.6%	6.5%	8.9%	8.1%
<i>Growth</i>		(11)%	(25)%	(44)%	37%	(9)%
<i>% of Peak</i>	100%	86%	53%	24%	35%	32%
EBIT	\$668	\$553	\$301	\$81	\$180	\$160
<i>Margin</i>	14.2%	12.2%	8.0%	2.7%	5.6%	4.9%
<i>Growth</i>		(15)%	(34)%	(66)%	107%	(12)%
<i>% of Peak</i>	100%	83%	45%	12%	27%	24%
Memo:						
Housing Starts	1,812	1,342	900	555	586	569
<i>Growth</i>		(26)%	(33)%	(38)%	6%	(3)%

Segments: A Tale of Two Cities

The company's operating profit margin decline is primarily the result of comparatively weaker performance in the highly cyclical Cabinets and Windows/Doors segments...

FBHS Segments Doing Well Today:

	% of FBHS 2010 Revenue	% of FBHS 2010 EBIT ⁽¹⁾
Plumbing	29%	54%
Security and Storage	16%	25%
Total	45%	79%

- ✓ Strong and stable replacement demand
- ✓ Leveraged to “low-ticket” remodeling
- ✓ More variable-cost model
- ✓ Represents ~45% of FBHS sales and ~80% of FBHS EBIT today ⁽¹⁾
- ✓ Margins have held up nicely

(1) Excludes corporate costs

FBHS Segments Under Pressure:

	% of FBHS 2010 Revenue	% of FBHS 2010 EBIT ⁽¹⁾
Cabinets	37%	13%
Windows / Doors	19%	8%
Total	55%	21%

- ✓ Leveraged to new home construction and big ticket remodeling
- ✓ More fixed-cost model
- ✓ Represents 55% of FBHS sales and ~20% of FBHS EBIT today ⁽¹⁾
- ✓ Currently at low capacity utilization rates, in anticipation of a recovery
- ✓ Explosive growth potential when housing markets recover

Restructured the Business in the Downturn...

The Company substantially improved its cost structure by reducing its footprint between 2006 and 2009. Manufacturing facilities and employee count have been reduced by roughly 40%.

	2004	2005	2006	2007	2008	2009
Employees	21,171	21,480	27,729	22,771	18,409	15,834
<i>Y-o-Y Change</i>		1 %	29 %	(18)%	(19)%	(14)%
<i>Change Since Peak</i>				(18)%	(34)%	(43)%
Manufacturing Plants	48	53	64	56	47	41
<i>Y-o-Y Change</i>		10 %	21 %	(13)%	(16)%	(13)%
<i>Change Since Peak</i>				(13)%	(27)%	(36)%

...But Kept Enough Capacity for a Recovery

FBHS is well-positioned to accelerate profit growth as volumes grow in a recovery scenario

- ▶ **Currently operating at ~60% capacity overall, in anticipation of a recovery**
 - Lower levels of capacity at highly cyclical segments (Cabinet and Window/Doors)
 - Higher levels of capacity in more stable segments (Plumbing and Security)
- ▶ **Footprint is currently right-sized to support \$5bn in sales (at 1.5mm new housing starts)**
 - Current sales base is ~\$3.3bn

What If Capacity Were Reduced Further?

If management becomes more bearish about a recovery, it can reduce capacity further and shrink the cost base. We believe that if the business were right-sized to the current sales base of ~\$3.3bn, EBIT margins could be approximately 10%

	<u>% of 2010 Revenue</u>	<u>2010 Margins</u>		<u>Normalized Margins</u>
Cabinets	37 %	2.6 %	Capacity reduction	10 %
Plumbing	29 %	14.3 %		15 %
Windows Doors	19 %	3.4 %		8 %
Security & Storage	16 %	11.7 %		12 %
Segment		7.6 %		11 %
Corp. Expense as % of Rev		(2.0)%		(1.4)%
Total		5.6 %		10 %

Secular Winner: Growing in the Downturn

Since the downturn, FBHS has been aggressively winning new business and increasing its marketplace position through product innovations. As a result, the company has experienced organic growth in every quarter since Q1 2010 - even in this difficult housing market

Winning New Business:

- ▶ **Martha Stewart Living cabinetry line at Home Depot**
- ▶ **In-stock cabinetry at Lowe's rolling out in 2011**
- ▶ **Waterloo storage products rolling out Husky Garage Organization at Home Depot**

Driving Sales through Innovation:

- ▶ **Moen "Spot Resist" finish**
 - Developed new finish that eliminates water spotting and finger printing
 - Strong product receptivity in the market
- ▶ **Cabinetry: Paper laminate technology**
 - Fashionable color and textures at affordable prices

Strong Balance Sheet Allows for Flexibility

The Company has significantly less financial leverage than its peers allowing it to acquire smaller building products companies that are currently operating at trough levels of profitability

Total Debt / EBITDA ⁽¹⁾:



Peer Average²



FBHS:

- ✓ \$520mm of total debt
- ✓ LTM EBITDA - Capex: \$194mm
- ✓ No liquidity concerns

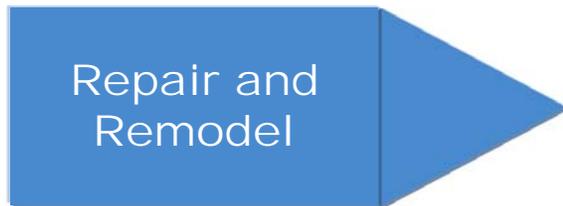
(1) Peer average based on Moody's. Peers include Armstrong, Lennox, Masco, Mohawk, Owens Corning, Stanley Black & Decker and Whirlpool. FBHS leverage based on 12/31/2010 pro forma metrics.

Housing Market Review

Long-term Housing Market Drivers



- ▶ **Positive population / immigration growth**
- ▶ **Increased levels of household formation**
- ▶ **Favorable housing affordability**



- ▶ **Aging housing stock (average of 40 years), particularly homes > 12 years**
- ▶ **Existing home sales**

Economic factors that enable a recovery:

- ▶ **Consumer confidence**
- ▶ **Unemployment—at the local market level**
- ▶ **Credit availability**
- ▶ **Stability in home prices**

Note: This page is taken from FBHS investor presentation dated September 6, 2011

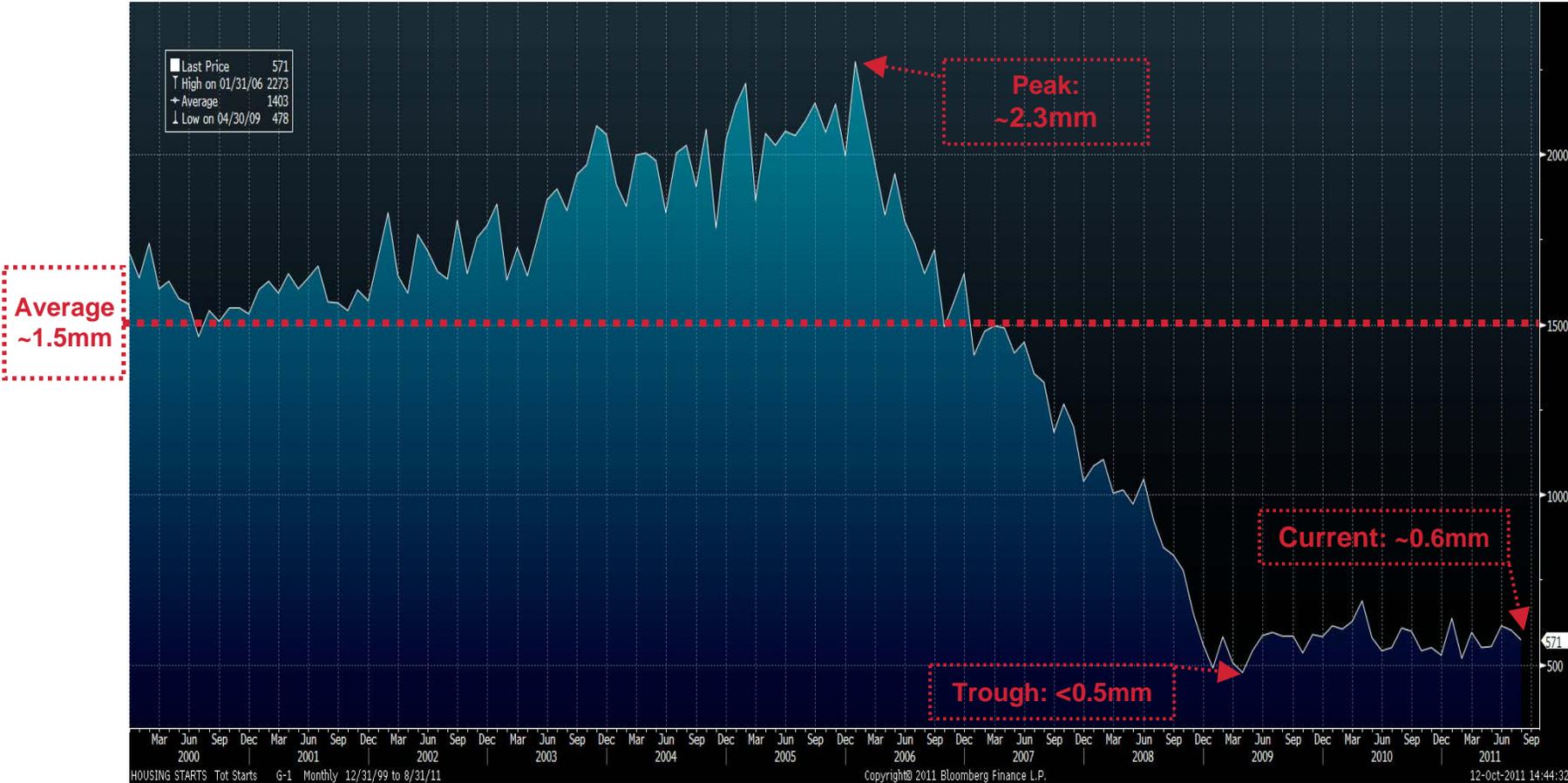
Historical Housing Starts: 1965 to Present

Housing starts are currently at the lowest levels in the last 40 years and well below the long term annual average of ~1.5mm



We are in Year Five of the Housing Recession

Housing starts are currently at ~25% of peak levels achieved in 2006 and have been below the long-term trend of sustainable housing demand for nearly 4 years



Source: Bloomberg

What a Housing Recovery Might Look Like

Although the pace of the housing recovery is difficult to predict, we believe a recovery over the next several years is highly likely

- ▶ **We believe that the current level of excess supply is ~2mm to 2.5mm housing units and normalized housing demand is approximately 1.5mm**
- ▶ **At a normalized level of housing demand:**
 - Excess housing supply could be eliminated in roughly 2.5 years if housing starts remain at ~600k
- ▶ **At the depressed level of housing demand (~1m):**
 - Excess supply could be eliminated in ~ 5.5 years if housing starts remain at ~600k

(Units in 000s, except years)	Depressed	Normalized
Housing Demand	1,000	1,500
Housing Starts	600	600
Annual Reduction of Excess Supply	400	900
Current Excess Supply	2,250	2,250
Years to Zero Excess Supply	5.6	2.5

Repair/Remodel Market Overview

▶ **Repair / Remodeling projects are generally discretionary**

- Certain replacement projects can wait: Cabinets, tiling (versus more critical items such as doors, windows, roofing)
- Weak existing home sales are hurting the R&R market - new homeowners spend 2x the average repair/remodel level
- Despite the weak market, there is pent-up demand from an aging housing stock

▶ **Today the ticket matters a lot**

- Big ticket remodel items (cabinets, tiling) are weak
- Small ticket remodel items (faucets, paint) are showing strength

▶ **Longer term, Repair / Remodel growth rates tend to trend in line with GDP**

Housing Market Summary

- ▶ **Housing starts are currently at the lowest levels in 40 years**
- ▶ **Long-term average of housing starts is ~1.5mm versus today of 600k**
- ▶ **Repair and remodel market is likely facing pent-up demand given aging housing stock**
- ▶ **Before housing starts return to their long-term trend, we need to absorb the current excess supply of homes – a matter of time**
- ▶ **The current level of housing starts (~600k) is unsustainable over the longer term**
 - Historical levels of annual household formation are far in excess of 600k
- ▶ **We think a meaningful recovery in housing starts could happen in the next several years**
 - However, new homes will likely be smaller and more affordable (cheaper products) than in recent years
 - FBHS's market position may improve, given the Company's skew to more value-priced products

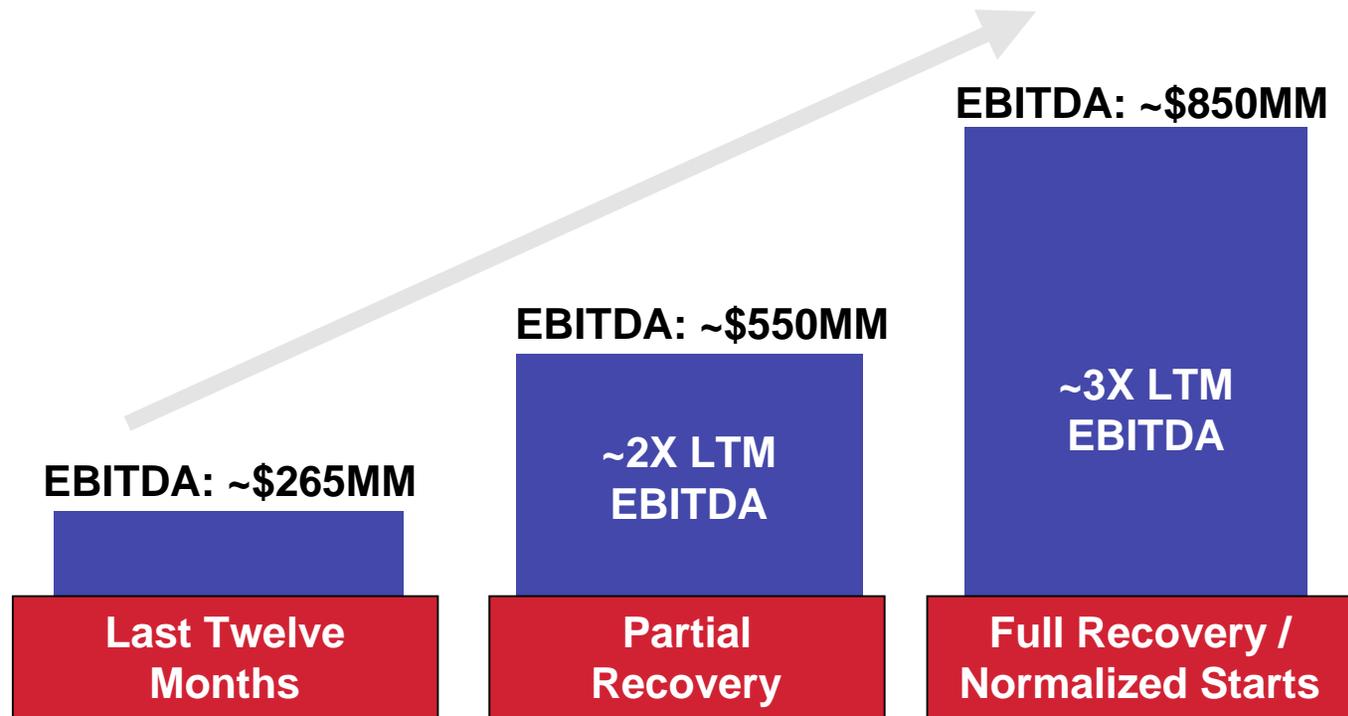
“The only way a correction takes place is to have household formation exceed new construction by a significant amount for a significant period of time. We've had it for quite a while. And when you see these figures of 500,000 or 600,000, that means we're sopping up housing inventory. And I don't know exactly when that hits equilibrium, but it isn't five years from now. I know that. And I think it actually could be reasonably soon.”

--Warren Buffett (July 8, 2011 Bloomberg TV interview)

Valuation

Upside Case: Housing Recovery

Management estimates that when housing starts recover to ~1mm to 1.5mm, EBITDA will be 2 to 3x current levels



Home Starts	~0.6M	1MM	1.5MM
Revenue	\$3B	\$4B	\$5B
EBITDA Margin	8%	~14%	~17%

Note: Partial Recovery assumes 2-3% Repair & Remodel CAGR and Full Recovery assumes 4-6% CAGR

Downside: What if there is No Housing Recovery?

If housing starts were to stay at depressed levels (~600k) for the longer term, we believe FBHS could right-size the business to achieve a more normalized level of profitability

- ▶ **FBHS has maintained excess capacity to position itself for a housing rebound**
- ▶ **If it fails to materialize, we believe management can right-size the cost structure and achieve a ~10% EBIT margin**

FY 2011E Revenue	\$3.3bn
Normalized EBIT Margin	10%
EBIT	\$330mm
Plus: D&A (reduced capacity)	70mm
EBITDA	\$400mm

We estimate that FBHS can generate at least \$400MM in EBITDA on today's sales base by cutting capacity and excess cost

Current Trading Multiples

FBHS currently trades ~9.7x LTM EBITDA and ~16.5x LTM cash earnings. If no recovery occurs, FBHS is trading at ~10x our estimate of cash earnings. If a recovery occurs, FBHS trades at ~4x to 7x our estimates of cash earnings, depending on the strength of recovery

	LTM	No Recovery (Cut Capacity)	Recovery	
			Partial	Full
Housing Starts (000s)	569	600	1,000	1,500
EBITDA	\$264	\$400	\$550	\$850
EBITDA - Capex	\$194	\$330	\$450	\$750
EPS	\$0.57	\$1.26	\$1.76	\$3.00
FCF per Share	\$0.79	\$1.26	\$1.76	\$3.00
EV / EBITDA	9.7 x	6.4 x	4.7 x	3.0 x
EV / EBITDA-Capex	13.2 x	7.8 x	5.7 x	3.4 x
P/E	23.0 x	10.3 x	7.4 x	4.3 x
P/FCF	16.5 x	10.3 x	7.4 x	4.3 x

Memo: Market Capitalization

Recent Stock Price	\$13.00
Diluted Shares (mm)	157
Market Cap	\$2,045
Plus: Net Debt	520
Enterprise Value	\$2,565

Note: EPS and FCF per share based on a 35% normalized tax rate.

Valuing FBHS in a Recovery

Assuming a 7x Forward EBITDA multiple, even if the recovery is protracted or prolonged, we believe we will earn an attractive IRR at the current share price

		Total Return		
		1.0M	1.3M	1.5M
Housing Starts		1.0M	1.3M	1.5M
EBITDA		\$550	\$700	\$850
Recovery Year	2014	83 %	139 %	196 %
	2015	92 %	151 %	209 %
	2016	101 %	162 %	223 %
	2017	111 %	174 %	237 %

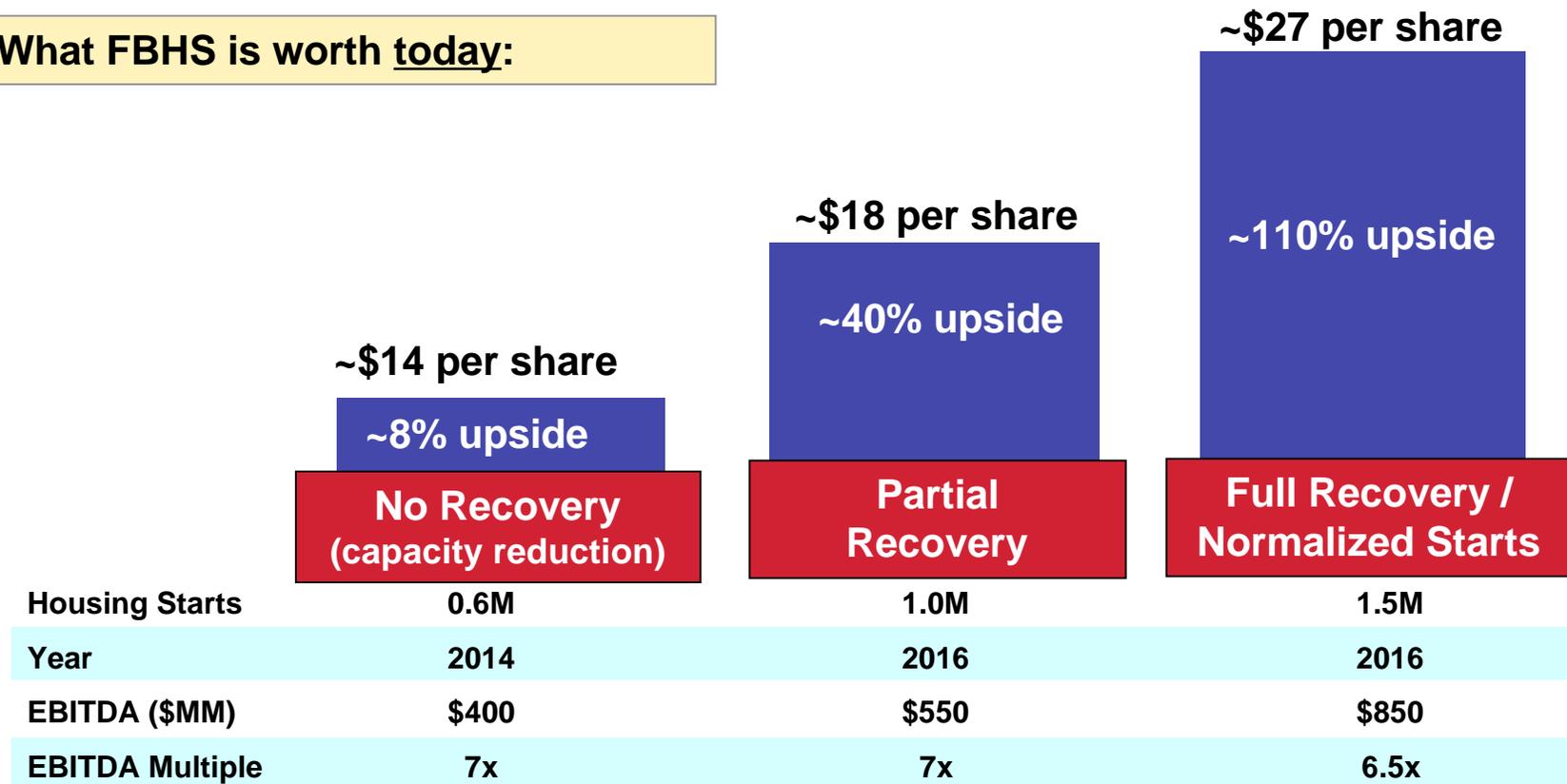
		IRR		
		1.0M	1.3M	1.5M
Housing Starts		1.0M	1.3M	1.5M
EBITDA		\$550	\$700	\$850
Recovery Year	2014	35 %	55 %	72 %
	2015	24 %	36 %	46 %
	2016	19 %	27 %	34 %
	2017	16 %	22 %	28 %

Note: Assumes 7x EBITDA exit multiple and includes the value of annual free cash flow generated until exit. Based on R&M CAGR of 2-3%, 3-4%, and 4-6% for housing starts of 1.0m, 1.3m, and 1.5m

Stock Price at Various Levels of Recovery

Assuming on a housing recovery over the next several years, we believe FBHS is worth ~\$18 to \$27 per share today. The midpoint valuation is \$22/share today, which is up ~70% from the recent share price of \$13. If the housing market never recovers, we believe FBHS is still worth nearly \$14 per share today

What FBHS is worth today:



Note: Assumes 157MM shares, \$520MM of net debt, and uses a 10% discount rate to discount the future stock price to today. Includes the value of annual free cash flow generated until exit.

Conclusion

- ▶ **Pace and strength of a housing recovery is difficult to predict**
 - However, at some point, the housing markets will recover
- ▶ **Investing in FBHS is a low-risk way to profit from an eventual housing market recovery**
 - Pure-play residential building products company
 - Best operators in the business
 - Improving marketplace position, even in tough housing markets
 - Many of its competitors are on the defensive
 - No liquidity concerns and currently generating a healthy FCF yield of 6%
 - Downside is limited, given clean balance sheet and Company's ability to reduce capacity, if necessary
 - Upside potential is enormous, as cyclical growth will not require capital investment above normal levels