MASCO CORP /DE/
Form 10-K
February 14, 2014

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended December 31, 2013 Commission File Number 1-5794

MASCO CORPORATION

(Exact name of Registrant as Specified in its Charter)

Delaware	**38-1794485**
(State of Incorporation)	(I.R.S. Employer Identification No.)
21001 Van Born Road, Taylor, Michigan	**48180**
(Address of Principal Executive Offices)	(Zip Code)

Registrant's telephone number, including area code: 313-274-7400
Securities Registered Pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange On Which Registered
Common Stock, $1.00 par value	New York Stock Exchange, Inc.

Securities Registered Pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes þ No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes o No þ

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 þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, 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 such shorter period that the registrant was required to submit and post such files). Yes þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

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. (Check one):

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

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

The aggregate market value of the Registrant's Common Stock held by non-affiliates of the Registrant on June 28, 2013 (based on the closing sale price of $19.49 of the Registrant's Common Stock, as reported by the New York Stock Exchange on such date) was approximately $6,794,823,000.

Number of shares outstanding of the Registrant's Common Stock at January 31, 2014:

356,404,200 shares of Common Stock, par value $1.00 per share

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's definitive Proxy Statement to be filed for its 2014 Annual Meeting of Stockholders are incorporated by reference into Part III of this Form 10-K.

Masco Corporation
2013 Annual Report on Form 10-K

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PART I

Item 1. Business.

Masco Corporation manufactures, distributes and installs home improvement and building products, with an emphasis on brand-name consumer products and services holding leadership positions. We are among the largest manufacturers in North America of a number of home improvement and building products, including faucets, cabinets, architectural coatings and windows, and we are one of the largest installers of insulation for new home construction. We provide broad product offerings in a variety of styles and price points and distribute products through multiple channels, including directly to homebuilders and wholesale and retail channels. Approximately 81 percent of our 2013 sales were generated by our North American operations.

Sales of home improvement and building products at retailers increased by almost 6 percent during 2013, despite continued economic uncertainties, weak consumer confidence and modest consumer spending. Housing starts increased approximately 18 percent during 2013, with the pace slowing in the second half of the year.

Throughout 2013, we continued to focus on our four strategic initiatives to improve our performance, and we achieved gains in each of those areas. First, we are extending and expanding our product leadership positions by leveraging our brands and introducing innovative new and improved products. We believe that we gained market share in our North American plumbing business with our DELTA®, PEERLESS®, and BRIZO® brands, and internationally with our HANSGROHE® products. Our decorative architectural products businesses focused on the professional segment with BEHRPRO® paint and KILZ® PRO-X product lines. BEHR® paint also expanded its product offering by introducing its MARQUEE exterior paint and PREMIUM DECKOVER® solid color coating for wood and concrete surfaces and by pursuing international opportunities. Milgard Manufacturing, our manufacturer of windows in the western U.S., and our U.K. Window Group continued to gain share in their markets. Our Masco Contractor Services business continued to achieve share gains in the installation of insulation for the new home construction, retrofit and commercial channels.

Another strategic initiative is to improve our performance by reducing costs, primarily through supply chain savings, and implementing lean principles and production process improvements. Over the last several years, we have taken out over $600 million of fixed costs, on a gross basis. We continue to seek improvements in our global supply chain to realize cost savings by or through simplifying the purchasing process and coordinating logistical operations.

Another strategic initiative is to improve our underperforming businesses, and during 2013, we saw our Cabinets and Related Products and our Installation and Other Services segments return to profitability. Approximately one third ($200 million) of our fixed cost reduction was attributable to our cabinetry businesses and one third came from our insulation businesses. By lowering our breakeven point, each of these segments saw a return to profitability during 2013 at much lower levels of revenue than historically. By reducing our fixed costs, we believe that we are strengthening the foundation for continued growth. Our Installation segment continued its improvement during 2013 through incremental new home construction activity, cost reductions from lean processes, leveraging our ERP system and supply chain savings.

Our final strategic initiative is strengthening our balance sheet through net debt reduction and maintaining strong liquidity through continued working capital improvements. We continued to reduce our debt by approximately $200 million through the retirement of notes due in August. At December 31, 2013, we had approximately $1.5 billion of cash, cash investments and short-term bank deposits.

We believe that we have managed our businesses successfully through the economic crisis and subsequent recession of recent years. We believe that our focus on our strategic initiatives of expanding our product leadership positions, reducing costs, improving our underperforming businesses and

strengthening our balance sheet have improved our performance and, as we continue to focus on these initiatives, will position us well as our markets continue to recover.

Recent Developments

On January 8, 2014, we announced that Timothy Wadhams is retiring from his position as the Company's President and Chief Executive Officer, effective February 14, 2014. Our Board of Directors has elected Keith J. Allman, age 51, to succeed Mr. Wadhams as President and Chief Executive Officer and to join the Company's Board of Directors, effective as of February 14, 2014. Mr. Allman joined the Company in 1998 and has served most recently as a Group President, with responsibilities for our Plumbing and North American Cabinet businesses. We thank Mr. Wadhams for his 37 years of service.

Our Business Segments

We report our financial results in five business segments aggregated by similarity in products and services. The following table sets forth the contribution of our segments to net sales and operating profit (loss) for the three years ended December 31, 2013. Additional financial information concerning our operations by segment and by geographic regions, as well as general corporate expense, net, as of and for the three years ended December 31, 2013, is set forth in Note P to our consolidated financial statements included in Item 8 of this Report.

	(In Millions) Net Sales (1)		
	2013	**2012**	**2011**
Cabinets and Related Products	$ 1,014	$ 939	$ 934
Plumbing Products	3,183	2,955	2,913
Installation and Other Services	1,412	1,209	1,077
Decorative Architectural Products	1,927	1,818	1,670
Other Specialty Products	637	574	576
Total	$ 8,173	$ 7,495	$ 7,170

	Operating Profit (Loss) (1)(2)(3)(4)		
	2013	**2012**	**2011**
Cabinets and Related Products	$ (10)	$ (89)	$ (126)
Plumbing Products	394	307	322
Installation and Other Services	37	(19)	(79)
Decorative Architectural Products	351	329	196
Other Specialty Products	35	(31)	(401)
Total	$ 807	$ 497	$ (88)

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(1) Amounts exclude discontinued operations.

(2)

Operating profit (loss) is before general corporate expense, net, and gain on sale of fixed assets, net.

(3)

Operating profit (loss) is before net charges of $77 million regarding the 2012 litigation settlement, primarily in the Installation and Other Services segment and $9 million regarding the 2011 litigation settlements in the Cabinets and Related Products and the Other Specialty Products segments.

(4)

Operating profit (loss) includes impairment charges for goodwill and other intangible assets as follows: For 2012 Other Specialty Products $42 million. For 2011 Plumbing Products $1 million; Decorative Architectural Products $75 million; and Other Specialty Products $374 million.

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All of our operating segments, except the Plumbing Products segment, normally experience stronger sales during the second and third calendar quarters, corresponding with the peak season for new home construction and repair and remodel activity.

Cabinets and Related Products

In North America, we manufacture and sell value-priced, stock and semi-custom assembled cabinetry for kitchen, bath, storage, home office and home entertainment applications in a broad range of styles and price points to address consumer preferences. We have also expanded our product offerings in this segment to include the manufacture and sale of kitchen countertops, as well as an integrated bathroom vanity and countertop solution. In the United Kingdom, we manufacture and sell assembled and ready-to-assemble kitchen, bath, and storage cabinetry. Our KRAFTMAID® brand is sold primarily to dealers, home centers and mass merchants and our MERILLAT®, MOORES and QUALITY CABINETS brands are sold primarily to dealers and homebuilders for both home improvement and new home construction. Cabinet sales are significantly affected by levels of activity in both new home construction and retail consumer spending, particularly spending for major kitchen and bathroom renovation projects. A significant portion of our sales for home improvement are made through home center retailers.

Our Cabinet segment was particularly affected by the economic downturn and decline in new home construction and repair and remodel activity. While improving, consumer spending for big ticket remodeling projects, including large kitchen and bath remodeling projects, continues to be below normal levels, which impacts our profitability. Although home construction is improving and is expected to continue to improve, the demand for new homes remains below the historic average and demand has increased for multi-family housing units, which are smaller than single-family housing units and require fewer cabinets for the kitchen and bathrooms. We continue our strategy to increase sales in this segment through brand building, new product introductions aimed to provide differentiated products to our multiple sales channels, and product innovation. We also continue to focus on our cost structure in this segment and improving cabinet production efficiencies.

The cabinet manufacturing industry in the United States and the United Kingdom includes several large competitors and numerous local and regional competitors. In recent years, we have experienced significant competition in the form of discounts and new product offerings by our competitors, which have impacted the segment's results of operations. We also face competition from foreign manufacturers. In addition to price, we believe that competition in this industry is based largely on product quality, responsiveness to customer needs, product features and selection. Our North American competitors include American Woodmark Corporation and Fortune Brands Home & Security, Inc.

The raw materials used in this segment are primarily hardwood lumber, plywood and particleboard, and are available from multiple sources, both domestic and foreign.

Plumbing Products

The businesses in our Plumbing Products segment sell a wide variety of faucet, bathing and showering devices that are manufactured by or for us. The majority of our plumbing products are sold in North America and Europe under the brand names DELTA®, PEERLESS®, HANSGROHE®, AXOR®, BRIZO®, BRASSTECH®, BRISTAN , GINGER®, NEWPORT BRASS and PLUMB SHOP®. Our products include single-handle and double-handle faucets, showerheads, handheld showers, valves, bathing units and toilets. These products are sold to major retail accounts and to wholesalers and distributors that, in turn, sell our products to plumbers, building contractors, remodelers, smaller retailers and others.

In 2013, we began the process of integrating our plumbing products sold under our AQUA GLASS® and AMERICAN SHOWER & BATH brands into the DELTA and PEERLESS brands. As a result of the integration, we exited the wholesale plumbing distribution channel for these bath products. Our

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INNOVEX® and acrylic tub and shower systems, bath and shower enclosure units, shower trays and laundry tubs are now manufactured and sold under the Delta and Peerless, Aqua Glass, American Shower & Bath and MIROLIN® brand names. These products are sold primarily to home center retailers for home improvement and new home construction in North America, although the Mirolin products are also sold to wholesalers and distributors in Canada.

Our spas are manufactured and sold under HOT SPRING®, CALDERA® and other trademarks directly to independent dealers. Major competitors include Kohler, Aquatic, Maax and Jacuzzi. We sell HÜPPE® shower enclosures through wholesale channels in Europe. HERITAGE ceramic and acrylic bath fixtures and faucets are principally sold in the United Kingdom directly to select retailers.

Also included in our Plumbing Products segment are brass and copper plumbing system components and other plumbing specialties, which are sold to plumbing, heating and hardware wholesalers and to home center retailers, hardware stores, building supply outlets and other mass merchandisers. These products are marketed in North America for the wholesale trade under our BRASSCRAFT® and BRASSTECH® trademarks and for "do-it-yourself" consumers under our MASTER PLUMBER® and PLUMB SHOP® trademarks, and are also sold under private label.

We believe that our plumbing products are among the leaders in sales in North America and Europe, with American Standard, Kohler, Moen and Pfister as major competitors. We are also experiencing competition from foreign manufacturers, including GROHE, particularly in Germany, China and the Middle East. We face significant competition from private label products (including house brands sold by certain of our customers). Many of the faucet and showering products with which our products compete are manufactured by foreign manufacturers that are putting downward pressures on price, particularly in the emerging markets we are entering. The businesses in our Plumbing Products segment source products primarily from Asia and manufacture products in the United States, Europe and Asia. In addition to price, we believe that competition for our plumbing products is based largely on brand reputation, product quality, product innovation and features and breadth of product offering.

A substantial portion of our plumbing products contain brass, the major components of which are copper and zinc. We have multiple sources, both domestic and foreign, for the raw materials used in this segment, and sufficient raw materials have been available for our needs. We have encountered price volatility for brass, brass components and any components containing copper and zinc; therefore, we have implemented a hedging strategy to minimize the impact of this volatility. Federal legislation mandating a national standard for lead content in plumbing products used to convey drinking water became effective in January 2014. Faucet and water supply valve manufacturers, including our plumbing product companies, are required to obtain adequate supplies of lead-free brass or suitable alternative materials for continued production of faucets and certain of our other plumbing products. Our plumbing products that are affected by this legislation meet the federal standards. Our Delta Faucet business uses DIAMOND SEAL TECHNOLOGY, which reduces the number of potential leak points in a faucet, simplifies installation and satisfies legislation regarding the acceptable lead content in plumbing products.

Installation and Other Services

Our Installation and Other Services segment sells installed building products and distributes building products primarily for new home construction, and, to a lesser extent, retrofit and commercial construction, throughout the United States. In addition to insulation, we sell installed gutters, after-paint products, garage doors and fireplaces. The installation and distribution of insulation comprised approximately twelve percent, eleven percent and nine percent of our consolidated net sales in 2013, 2012 and 2011, respectively. Installed building products are supplied primarily to homebuilders by our network of branches located across the United States. Our distributed products include insulation, insulation accessories, gutters and roofing, among others. Distributed products are sold primarily to contractors and dealers (including lumber yards) from distribution centers in various parts of the United States.

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In response to the economic downturn and resulting decline in new home construction, we expanded our ability to serve the residential retrofit and light commercial channels. Within the Installation and Other Services segment, we have several initiatives related to improved residential energy efficiency, including retrofit installation services (primarily insulation) delivered directly to homeowners and traditional remodeler contractors, as well as through retailers and dealer outlets.

In addition to price, we believe that competition in this industry is based largely on customer service and the quality of installation service. We believe that we are a leading provider of installed insulation in the new home construction industry in the United States. Our competitors include several regional contractors, as well as numerous local contractors and lumber yards. We believe that our capabilities and financial resources are substantial compared to regional and local contractors.

We procure the materials used by this segment, primarily insulation, from multiple sources.

Decorative Architectural Products

We produce architectural coatings including paints, primers, specialty paint products, stains and waterproofing products. The products are sold in the United States, Canada, China, Mexico and South America under the brand names BEHR® and KILZ® to "do-it-yourself" and professional customers through home centers, paint stores and other retailers. Net sales of architectural coatings comprised approximately 21 percent in 2013 and approximately 20 percent of our consolidated net sales in each of 2012 and 2011. Our competitors include large national and international brands such as Benjamin Moore, Glidden, Olympic, Sherwin-Williams, Valspar and Zinsser, as well as many regional and other national brands. In addition to price, we believe that competition in this industry is based largely on product quality, technology and product innovation, customer service and brand reputation. In 2013, Behr introduced MARQUEE exterior paint with enhanced stain-blocking and fade-resistant properties, and PREMIUM DECKOVER , a deck resurfacing product which conceals cracks and splinters in wood surfaces and helps to create a slip-resistant finish for decks.

Our BEHR products are principally sold through The Home Depot, this segment's and our largest customer. The loss of this segment's sales to The Home Depot would have a material adverse effect on this segment's business and on our consolidated business as a whole.

Titanium dioxide is a major ingredient in the manufacture of paint. The price for titanium dioxide can fluctuate as a result of surges in global demand and production capacity limitations, which can impact our operating results in this segment. Petroleum products are also used in the manufacture of architectural coatings. Significant increases in the cost of crude oil and natural gas lead to higher raw material costs (e.g., for resins, solvents and packaging, as well as titanium dioxide), which can adversely affect the segment's results of operations. We have agreements with the significant suppliers of the major raw materials used in this segment which are intended to help assure continued availability.

Our Decorative Architectural Products segment also includes LIBERTY® and BRAINERD® branded cabinet, door, window and other hardware, which is manufactured for us and sold to home centers, other retailers, original equipment manufacturers and wholesalers. Key competitors in North America include Amerock, Top Knobs and house brands. Decorative bath hardware and shower accessories are sold under the brand names DELTA®, FRANKLIN BRASS® and DECOR BATHWARE® to distributors, home centers and other retailers. Competitors include Moen, Gatco and house brands sold by certain of our customers.

Other Specialty Products

We manufacture and sell vinyl, fiberglass and aluminum windows and patio doors, as well as the ESSENCE SERIES® windows and doors, which combines a wood interior with a fiberglass exterior, under the MILGARD® brand name for home improvement and new home construction, principally in the western United States. MILGARD products are sold primarily through dealers and, to a lesser extent,

directly to production and custom homebuilders and through lumber yards and home centers. This segment's competitors in North America include national brands, such as Jeld-Wen, Marvin, Pella and Andersen, and numerous regional brands.

In the United Kingdom, we manufacture and sell windows, related products and components under several brand names including GRIFFIN , PREMIER and DURAFLEX . Sales are primarily through dealers and wholesalers to the repair and remodeling markets, although our DURAFLEX products are also sold to other window fabricators. United Kingdom competitors include many small and mid-sized firms and a few large, vertically integrated competitors.

In addition to price, we believe that competition in this industry in both the domestic and foreign markets is based largely on customer service, product quality and brand reputation.

We manufacture and sell a complete line of manual and electric staple gun tackers, staples and other fastening tools under the brand names ARROW® and POWERSHOT®. We sell these products through various distribution channels including home centers and other retailers and wholesalers. Our principal North American competitor in this product line is Stanley Black & Decker.

The raw materials used in this segment have been available from multiple sources.

Additional Information

We hold U.S. and foreign patents, patent applications, licenses, trademarks, trade names, trade secrets and proprietary manufacturing processes. As a manufacturer and distributor of brand name products, we view our trademarks and other intellectual property rights as important, but do not believe that there is any reasonable likelihood of a loss of such rights that would have a material adverse effect on our present business as a whole.

We are subject to U.S. and foreign government regulations, particularly those pertaining to health and safety (including protection of employees and consumers), climate disruption and environmental issues. In addition to our responsibilities for environmental remediation, our businesses are subject to other requirements regarding protection of the environment and worker health and safety. Our businesses are subject to requirements relating to the emission of volatile organic compounds which may impact our sourcing of particleboard, require that we install special equipment in manufacturing facilities or that we reformulate paint products. As described above, our Plumbing Products segment is subject to restrictions on lead content in some of its products. Compliance with such laws and regulations could significantly affect product performance as well as our production costs. We monitor applicable laws and regulations relating to the protection of the environment, climate disruption and worker health and safety, and incur ongoing expense relating to compliance. We do not expect compliance with the federal, state and local regulations relating to the discharge of materials into the environment, or otherwise relating to the protection of the environment and worker health and safety, will result in material capital expenditures or have a material adverse effect on our earnings or competitive position.

We do not consider backlog orders to be material in any of our segments.

At December 31, 2013, we employed approximately 32,000 people. We have generally experienced satisfactory relations with our employees.

Available Information

Our website is www.masco.com. Our periodic reports and all amendments to those reports required to be filed or furnished pursuant to Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934 are available free of charge through our website as soon as reasonably practicable after those reports are electronically filed with or furnished to the Securities and Exchange Commission. This Report is being posted on our website concurrently with its filing with the Securities and Exchange Commission. Material contained on our website is not incorporated by reference into this Report.

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Item 1A. Risk Factors.

There are a number of business risks and uncertainties that could affect our business. These risks and uncertainties could cause our actual results to differ from past performance or expected results. We consider the following risks and uncertainties to be most relevant to our specific business activities. Additional risks and uncertainties not presently known to us, or that we currently believe to be immaterial, also may adversely impact our business, financial condition and results of operations.

A significant portion of our business relies on home improvement and new home construction activity, both of which are cyclical.

A significant portion of our business relies on home improvement, including spending on repair and remodeling projects, and new home construction activity, principally in North America and Europe. Macroeconomic conditions including consumer confidence levels, fluctuations in home prices, unemployment and underemployment levels, and the availability of home equity loans and mortgages and the interest rates for such loans, affect both consumers' discretionary spending on home improvement projects as well as new home construction activity. Adverse changes or uncertainty regarding these macroeconomic conditions could result in a decline in spending on home improvement projects and a decline in demand for new home construction, both of which could adversely affect our results of operations and our financial position. While improving, both new home construction and consumer spending for big ticket remodeling projects continues to be well below historic average levels, which affect our results of operations.

If we do not maintain strong brands or respond to changing consumer preferences and purchasing practices, we could lose share and our results could be adversely affected.

Our competitive advantage is due, in part, to our ability to maintain our strong brands and to develop and introduce innovative new and improved products. While we continue to invest in brand building and brand awareness, these initiatives may not be successful. The uncertainties associated with developing and introducing new and improved products, such as gauging changing consumer preferences and successfully developing, manufacturing, marketing and selling these products, may impact the success of our product introductions. If we do not introduce new or improved products in a timely manner or if these products do not gain widespread acceptance, we could lose share, which could negatively impact our operating results.

The volatile and challenging economic environment of recent years has caused shifts in consumer preferences and purchasing practices and changes in the business models and strategies of our customers. For example, consumers are increasingly using the internet and mobile technology to research home improvement products and to inform and enhance their purchasing and ownership experience for these products, particularly with consumer-initiated messaging. E-business is a rapidly developing area, and development of a successful e-business strategy involves significant time, investment and resources. If we are unable to successfully execute our e-business strategy, our brands may lose share.

Similarly, the quantity, type and prices of products demanded by consumers and our customers have shifted. For example, demand has increased for multi-family housing units such as apartments and condominiums, which typically have smaller kitchens and smaller and fewer bathrooms, each with fewer cabinets and faucets, as well less insulation, than single-family houses. While the economy is recovering, we are experiencing growth in certain channels for lower price point products. These shifts have negatively impacted our sales and/or our profitability, and it is uncertain whether these shifts represent long-term changes in consumer preferences.

If we do not timely and effectively identify and respond to these changing consumer preferences and purchasing practices, our relationships with our customers and with consumers could be harmed, the

demand for our brands and products could be reduced and our results of operations could be negatively affected.

Our actions to improve our underperforming businesses have been costly and may not yield all of the anticipated benefits.

The downturn in home improvement and new home construction activity during the recent recession impacted our results, particularly in our Cabinets and Related Products and Installation and Other Services segments and certain businesses in our Plumbing Products segment. In response, we implemented initiatives to reduce costs and increase sales; however, there is no assurance that our efforts will yield all of the anticipated benefits. Our cost-saving initiatives, including rationalizing our businesses, closing plants and reducing headcount have been complex, time-consuming and expensive. The consolidation of our North American Cabinet businesses, in particular, has involved the integration of multiple manufacturing processes and information technology platforms. While we have experienced positive results from these initiatives, there is no assurance that these benefits will continue.

Our strategy to increase our sales in the Cabinets and Related Products segment through brand building and new product introductions requires time to develop, implement and assess. Further, this segment faces pricing pressures, competition from low-cost manufacturers and a shift in the mix of products in certain channels to more value-priced products. If we cannot successfully implement these initiatives or respond to these changing market dynamics, our results of operations may continue to be negatively impacted.

Further, if the economy recovers faster than expected, we may not be able to increase our manufacturing and installation capacity to support demand, which could result in lost share and, ultimately, could negatively impact our operating results.

Our sales are concentrated with two significant customers.

The size and importance of individual customers to our businesses continues to increase. In 2013, sales to our largest customer, The Home Depot, were $2.3 billion (approximately 28 percent of consolidated net sales). Lowe's is our second largest customer. In 2013, sales to Lowe's were less than ten percent of our consolidated net sales. These home center customers may reduce the number of vendors they purchase from and can make significant changes in their volume of purchases. Additionally, home centers can significantly affect the prices we receive for our products and services, our cost of doing business with them and the terms and conditions on which we do business. Although homebuilders, dealers and other retailers represent other channels of distribution for our products and services, the loss of a substantial portion of our sales to The Home Depot or the loss of our sales to Lowe's would have a material adverse effect on our business.

Further, as some of our customers expand their markets and their targeted customers, conflicts between our existing distribution channels have and will continue to occur, which could impact our results of operations. In addition, we may undermine the business relationships we have with our current customers if we increase the amount of business we transact directly with consumers. In addition, our large retail customers are increasingly requesting product exclusivity, which may affect our ability to offer products to other customers and may diminish our ability to leverage economies of scale.

We face significant competition.

Our products and services face significant competition. We believe that we compete on the basis of price, product and service quality, brand reputation, customer service and product features and innovation. Home centers continue to purchase select products in our segments directly from low-cost foreign manufacturers for sale as private label and house brand merchandise. Additionally, home

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centers, which have historically concentrated their sales efforts on retail consumers and remodelers, are increasingly marketing directly to professional contractors and installers, which may impact our margins on our products that contractors and installers would otherwise buy through our dealers and wholesalers.

In our other distribution channels, we compete with foreign manufacturers in a variety of our product groups. These foreign manufacturers are putting downward pressures on price, particularly in the emerging markets we are entering. In some of our segments, we are experiencing a shift in the mix of products we sell toward more value-priced or opening price point products, which may impact our ability to maintain or gain share and our profitability.

Our ability to maintain our competitive position in our industries and to grow our businesses depends upon successfully maintaining our relationships with major customers, implementing growth strategies and entering new geographic areas, including successful international penetration, developing a successful e-business strategy, maintaining strong brands, managing our cost structure, accommodating shorter life-cycles for our products, and developing and innovating products, none of which is assured.

If we experience increased commodity costs or limited availability of commodities, our operating results could be negatively impacted.

We buy various commodities to manufacture our products, including, among others, wood, brass (made of copper and zinc), titanium dioxide and resins. Fluctuations in the availability and prices of these commodities could increase our costs to manufacture our products. Further, increases in energy costs could increase our production costs as well as our transportation costs, each of which could negatively affect our financial condition and operating results.

It has been, and likely will continue to be, difficult for us to pass on to customers cost increases to cover our increased commodity and production costs. Our existing arrangements with customers, competitive considerations and customer resistance to price increases may delay or make us unable to adjust selling prices. If we are not able to increase the prices of our products or achieve cost savings to offset increased commodity and production costs, our financial condition and operating results could be negatively impacted. If we are able to increase our selling prices, sustained price increases for our products may lead to sales declines and loss of share, particularly if our competitors do not increase their prices. When commodity prices decline, we may receive pressure from our customers to reduce our prices.

To minimize price volatility associated with certain anticipated commodity purchases, we use derivative instruments, including commodity futures and swaps. This strategy may increase the possibility that we may make commitments to purchase these commodities at prices that subsequently exceed their market prices, which could adversely affect our financial condition and operating results.

We are dependent on third-party suppliers and manufacturers, and the loss of a key supplier or manufacturer could negatively affect our operating results.

Our ability to offer a wide variety of products depends on our ability to obtain an adequate supply of products and components from manufacturers and other suppliers. We rely heavily or, in certain cases, exclusively, on third-party suppliers for some of our products and key components. Failure by our suppliers to provide us quality products on commercially reasonable terms, or to comply with applicable legal requirements, could have a material adverse effect on our financial condition or operating results. Resourcing these products and components to another supplier could take time and involve significant costs. Accordingly, the loss of a key supplier, or a substantial decrease in the availability of products or components from our suppliers, could disrupt our business and adversely impact our operating results.

Further, we manufacture products in Asia and source products and components from third parties in Asia. The distances involved in these arrangements, together with differences in business practices,

shipping and delivery requirements, the limited number of suppliers, and laws and regulations, have increased the complexity of our supply chain logistics and the potential for interruptions in our production scheduling. If we are unable to effectively manage our supply chain, our operating results could be negatively affected.

International political, monetary, economic and social developments affect our business.

Approximately 20 percent of our sales are made outside of North America (principally in Europe) and are transacted in currencies other than U.S. dollars (principally the Euro and the British pound sterling). Increased international sales make up an important part of our future strategic plans. In addition, we manufacture products in Asia and source products, components and raw materials from third parties in Asia. We face risks associated with changes in political, monetary, economic and social environments, labor conditions and practices, the laws, regulations and policies of foreign governments, cultural differences and differences in enforcement of contract and intellectual property rights. U.S. laws and regulations affecting activities of U.S. companies doing business abroad, including tax laws, laws regulating various business practices, and trade regulations which may include duties and tariffs can also impact us. Our international operating results may also be influenced by economic conditions in Europe. The financial reporting of our consolidated operating results is affected by fluctuations in currency exchange rates, which may present challenges in comparing operating performance from period to period.

The long-term performance of our businesses relies on our ability to attract, develop and retain talented personnel.

To be successful, we must attract, develop and retain highly qualified and talented personnel who have the experience, knowledge and expertise to successfully implement our key business strategies. We compete for employees with a broad range of employers in many different industries, including large multinational firms, and we invest significant resources in recruiting, developing, motivating and retaining them. The failure to attract and retain key employees, or to develop effective succession planning to assure smooth transitions of those employees and the knowledge and expertise they possess, could negatively affect our competitive position and our operating results. Further, as the economy continues to recover, if we are unable to recruit, train and retain sufficient skilled labor, we may not be able to adequately satisfy increased demand for our products and services, which could impact our operating results.

Claims and litigation could be costly.

We are, from time to time, involved in various claims, litigation matters and regulatory proceedings that arise in the ordinary course of our business and which could have a material adverse effect on us. These matters may include contract disputes, automobile liability and other personal injury claims, warranty disputes, environmental claims or proceedings, other tort claims, employment and tax matters and other proceedings and litigation, including class actions.

We are subject to product safety regulations, recalls and direct claims for product liability that can result in significant liability and, regardless of the ultimate outcome, can be costly to defend or manage. Also, we rely on other manufacturers to provide us with products or components for products that we sell. Due to the difficulty of controlling the quality of products or components sourced from other manufacturers, we are exposed to risks relating to the quality of such products and to limitations on our recourse against such suppliers.

We have also experienced class action lawsuits in recent years predicated upon claims for antitrust violations, product liability and wage and hour issues. We have generally denied liability and have vigorously defended these cases. Due to their scope and complexity, however, these lawsuits can be

particularly costly to defend and resolve, and we have and may continue to incur significant costs as a result of these types of lawsuits.

Our homebuilder customers are subject to construction defect and home warranty claims in the ordinary course of their business. Our contractual arrangements with these customers may include our agreement to defend and indemnify them against various liabilities. These claims, often asserted several years after completion of construction, can result in complex lawsuits or claims against the homebuilders and many of their subcontractors, including us, and may require us to incur defense and indemnity costs even when our products or services are not the principal basis for the claims.

Although we intend to defend all claims and litigation matters vigorously, given the inherently unpredictable nature of claims and litigation, we cannot predict with certainty the outcome or effect of any claim or litigation matter.

We maintain insurance against some, but not all, of these risks of loss resulting from claims and litigation. We may elect not to obtain insurance if we believe the cost of available insurance is excessive relative to the risks presented. The levels of insurance we maintain may not be adequate to fully cover any and all losses or liabilities. If any significant accident, judgment, claim or other event is not fully insured or indemnified against, it could have a material adverse impact on our business, financial condition and results of operations.

See Note U to the consolidated financial statements included in Item 8 of this Report for additional information about litigation involving our businesses.

If we are required to take additional significant non-cash charges, our financial resources could be reduced and our financial flexibility may be negatively affected.

We have recorded significant goodwill and other intangible assets related to prior business combinations on our balance sheet. The valuation of these assets is largely dependent upon the expectations for future performance of our businesses. In recent years, we have recorded significant non-cash impairment charges for financial investments, goodwill and other intangible assets. While new home construction and home improvement activity are improving, the extent of the recovery remains uncertain.

Expectations about the recovery may impact whether we are required to recognize additional non-cash, pre-tax impairment charges for goodwill and other indefinite-lived intangible assets or other long-lived assets. If the value of our goodwill or other intangible assets is further impaired, our earnings and shareholders' equity would be adversely affected.

We have also recorded a valuation allowance related to our deferred tax assets. A return to sustainable profitability in our U.S. operations is required before we would change our judgment regarding the need for this valuation allowance. While we believe that we may reverse all or a portion of the valuation allowance as early as the second half of 2014, this is not assured. Until such time, the profits from our U.S. operations will be offset by the net operating loss carryforward, resulting in a lower U.S. effective tax rate than we would normally incur.

Further, our credit agreement contains financial covenants we must comply with, including covenants regarding limits on our debt to total capitalization ratio. If we are required to record additional non-cash impairment charges, our shareholders' equity would be reduced, and our borrowing capacity under our credit agreement may be limited. In the past we have negotiated amendments to our credit agreement to allow for the add-back to shareholders' equity for impairment charges we have taken. There can be no assurance that in the future we would be able to further amend our credit agreement, that alternative financing would be available on acceptable terms and at acceptable rates, or that we would be permitted to obtain alternative financing under the terms of our existing financing arrangements.

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Compliance with government regulation and industry standards could impact our capital expenditures and operating results.

We are subject to U.S. and foreign government regulations, particularly those pertaining to health and safety (including protection of employees and consumers), climate disruption and environmental issues. In addition to complying with current requirements and requirements that will become effective at a future date, even more stringent requirements could be imposed on our industries in the future. Additionally, some of our products must be certified by industry organizations. Compliance with these regulations and industry standards may require us to alter our manufacturing and installation processes and our sourcing, which could adversely impact our competitive position. Further, if we do not effectively and timely comply with such regulations and industry standards, our operating results could be negatively affected.

Item 1B. Unresolved Staff Comments.

None.

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Item 2. Properties.

The table below lists our principal North American properties for segments other than Installation and Other Services.

Business Segment	Manufacturing	Warehouse and Distribution
Cabinets and Related Products	8	8
Plumbing Products	18	4
Decorative Architectural Products	8	8
Other Specialty Products	10	5
Totals	44	25

Most of our North American facilities range from single warehouse buildings to complex manufacturing facilities. We own most of our North American manufacturing facilities, none of which are subject to significant encumbrances. A substantial number of our warehouse and distribution facilities are leased.

Our Installation and Other Services segment operates approximately 190 installation branch locations and approximately 70 distribution centers in the United States, most of which are leased.

The table below lists our principal properties outside of North America.

Business Segment	Manufacturing	Warehouse and Distribution
Cabinets and Related Products	1	1
Plumbing Products	11	26
Decorative Architectural Products		
Other Specialty Products	7	
Totals	19	27

Most of our international facilities are located in China, Germany and the United Kingdom. We own most of our international manufacturing facilities, none of which are subject to significant encumbrances. A substantial number of our international warehouse and distribution facilities are leased.

Our corporate headquarters are located in Taylor, Michigan and are owned by us. We own an additional building near our corporate headquarters that is used by our Masco Technical Services (research and development) department. We continue to lease an office facility in Luxembourg which serves as a headquarters for most of our foreign operations.

Each of our operating divisions assesses the manufacturing, distribution and other facilities needed to meet its operating requirements. Our buildings, machinery and equipment have been generally well maintained and are in good operating condition. We believe our facilities have sufficient capacity and are adequate for our production and distribution requirements.

Item 3. Legal Proceedings.

Information regarding legal proceedings involving us is set forth in Note U to our consolidated financial statements included in Item 8 of this Report and is incorporated herein by reference.

Item 4. Mine Safety Disclosures.

Not applicable.

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PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

The New York Stock Exchange is the principal market on which our common stock is traded. The following table indicates the high and low sales prices of our common stock as reported by the New York Stock Exchange and the cash dividends declared per common share for the periods indicated:

	Market Price		Dividends
Quarter	**High**	**Low**	**Declared**
2013			
Fourth	$ 22.90	$ 19.11	$ .075
Third	22.94	18.27	.075
Second	22.83	18.43	.075
First	21.07	16.91	.075
Total			$ .30
2012			
Fourth	$ 17.19	$ 14.06	$ .075
Third	16.48	11.53	.075
Second	14.68	11.55	.075
First	14.41	10.75	.075
Total			$ .30

On January 31, 2014, there were approximately 4,779 holders of record of our common stock.

We expect that our practice of paying quarterly dividends on our common stock will continue, although the payment of future dividends is at the discretion of our Board of Directors and will depend upon our earnings, capital requirements, financial condition and other factors.

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Performance Graph

The table below compares the cumulative total shareholder return on our common stock with the cumulative total return of (i) the Standard & Poor's 500 Composite Stock Index ("S&P 500 Index"), (ii) The Standard & Poor's Industrials Index ("S&P Industrials Index") and (iii) the Standard & Poor's Consumer Durables & Apparel Index ("S&P Consumer Durables & Apparel Index"), from December 31, 2008 through December 31, 2013, when the closing price of our common stock was $22.77. The graph assumes investments of $100 on December 31, 2008 in our common stock and in each of the three indices and the reinvestment of dividends.

The table below sets forth the value, as of December 31 for each of the years indicated, of a $100 investment made on December 31, 2008 in each of our common stock, the S&P 500 Index, the S&P Industrials Index and the S&P Consumer Durables & Apparel Index and includes the reinvestment of dividends.

	2009	2010	2011	2012	2013
Masco	$ 128.21	$ 120.32	$ 102.45	$ 165.80	$ 229.59
S&P 500 Index	$ 125.92	$ 144.58	$ 147.60	$ 171.04	$ 225.85
S&P Industrials Index	$ 120.19	$ 151.89	$ 150.97	$ 173.87	$ 243.73
S&P Consumer Durables & Apparel Index	$ 136.29	$ 177.91	$ 191.64	$ 232.84	$ 316.28

In July 2007, our Board of Directors authorized the purchase of up to 50 million shares of our common stock in open-market transactions or otherwise. At December 31, 2013, we had remaining authorization to repurchase up to 22.6 million shares. During the first quarter of 2013, we repurchased and retired 1.7 million shares of our common stock, for cash aggregating $35 million to offset the dilutive impact of the 2013 grant of 1.7 million shares of long-term stock awards. We have not purchased any shares since March 2013.

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Item 6. Selected Financial Data.

	Dollars in Millions (Except Per Common Share Data)				
	2013	**2012**	**2011**	**2010**	**2009**
Net Sales **(1)**	$ 8,173	$ 7,495	$ 7,170	$ 7,183	$ 7,297
Operating profit (loss) **(1)(2)(3)(4)(5)**	$ 673	$ 302	$ (215)	$ (466)	$ 57
Income (loss) from continuing operations attributable to Masco Corporation **(1)(2)(3)(4)(5)**	$ 282	$ (53)	$ (394)	$ (1,027)	$ (145)
Income (loss) per common share from continuing operations:					
Basic	$ .79	$ (.16)	$ (1.14)	$ (2.95)	$ (.42)
Diluted	$ .78	$ (.16)	$ (1.14)	$ (2.95)	$ (.42)
Dividends declared	$ .30	$ .30	$ .30	$ .30	$ .30
Dividends paid	$ .30	$ .30	$ .30	$ .30	$ .46
At December 31:					
Total assets	$ 6,933	$ 6,875	$ 7,297	$ 8,140	$ 9,175
Long-term debt	3,421	3,422	3,222	4,032	3,604
Shareholders' equity	763	534	742	1,582	2,817

(1) Amounts exclude discontinued operations.

(2) The year 2012 includes non-cash impairment charges for other intangible assets aggregating $27 million after tax ($42 million pre-tax).

(3) The year 2011 includes non-cash impairment charges for goodwill and other intangible assets aggregating $291 million after tax ($450 million pre-tax).

(4) The year 2010 includes non-cash impairment charges for goodwill and other intangible assets aggregating $586 million after tax ($698 million pre-tax). The year 2010 also includes a valuation allowance on U.S. deferred tax assets of $372 million.

(5) The year 2009 includes non-cash impairment charges for goodwill aggregating $180 million after tax ($262 million pre-tax).

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The financial and business analysis below provides information which we believe is relevant to an assessment and understanding of our consolidated financial position, results of operations and cash flows. This financial and business analysis should be read in conjunction with the consolidated financial statements and related notes.

The following discussion and certain other sections of this Report contain statements reflecting our views about our future performance and constitute "forward-looking statements" under the Private Securities Litigation Reform Act of 1995. Forward-looking statements can be identified by words such as "anticipate," "intend," "plan," "believe," "estimate," "expect," "assume," "seek," "appear," "may," "should," "will," "forecast" and similar references to future periods. These views involve risks and uncertainties that are difficult to predict and, accordingly, our actual results may differ materially from the results discussed in such forward-looking statements. We caution you against relying on any of these forward-looking statements. In addition to the various factors included in the "Executive Level Overview," "Critical Accounting Policies and Estimates" and "Outlook for the Company" sections, our future performance may be affected by our reliance on new home construction and home improvement, our reliance on key customers, the cost and availability of raw materials, shifts in consumer preferences and purchasing practices, our ability to improve our underperforming businesses and our ability to maintain our competitive position in our industries. These and other factors are discussed in detail in Item 1A "Risk Factors" of this Report. Any forward-looking statement made by us speaks only as of the date on which it was made. 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.

Executive Level Overview

We manufacture, distribute and install home improvement and building products. These products are sold for home improvement and new home construction through mass merchandisers, hardware stores, home centers, homebuilders, distributors and other outlets for consumers and contractors and direct to the consumer.

2013 Results. Net sales were positively affected by increased new home construction and repair and remodel activity in the U.S. and Europe. Our results of operations were positively affected by increased sales volume and the related absorption of fixed costs, as well as a more favorable relationship between selling prices and commodity costs. Also, all of our businesses were positively affected by the benefits associated with the business rationalizations and process improvement initiatives that we have implemented over the last several years.

Our Cabinets and Related Products segment was affected by increased sales volume and selling prices, partially offset by a less favorable product mix. Our Plumbing Products segment results were favorably affected by increased sales volume and increased selling prices of our North American and International operations, partially offset by the loss of a portion of our bath products business. The Decorative Architectural Products segment was affected by increased sales volume, partially offset by a less favorable relationship between selling prices and commodity costs. The Installation and Other Services and Other Specialty Products segments were positively affected by increased sales volume and increased selling prices.

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Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The preparation of these financial statements requires us to make certain estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of any contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. We regularly review our estimates and assumptions, which are based upon historical experience, as well as current economic conditions and various other factors that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of certain assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates and assumptions.

We believe that the following critical accounting policies are affected by significant judgments and estimates used in the preparation of our consolidated financial statements.

Revenue Recognition and Receivables

We recognize revenue as title to products and risk of loss is transferred to customers or when services are rendered. We record revenue for unbilled services performed based upon estimates of material and labor incurred in the Installation and Other Services segment; such amounts are recorded in Receivables. We record estimated reductions to revenue for customer programs and incentive offerings, including special pricing and co-operative advertising arrangements, promotions and other volume-based incentives. We maintain allowances for doubtful accounts receivable for estimated losses resulting from the inability of customers to make required payments. In addition, we monitor our customer receivable balances and the credit worthiness of our customers on an on-going basis. During downturns in our markets, declines in the financial condition and creditworthiness of customers impact the credit risk of the receivables involved and we have incurred bad debt expense related to customer defaults. Our bad debt expense was $8 million, $14 million and $12 million for the years ended December 31, 2013, 2012 and 2011, respectively.

Inventories

We record inventories at the lower of cost or net realizable value, with expense estimates made for obsolescence or unsaleable inventory equal to the difference between the recorded cost of inventories and their estimated market value based upon assumptions about future demand and market conditions. On an on-going basis, we monitor these estimates and record adjustments for differences between estimates and actual experience. Historically, actual results have not significantly deviated from those determined using these estimates.

Financial Investments

We follow accounting guidance that defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements for our financial investments and liabilities. This guidance defines fair value as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date." Further, it defines a fair value hierarchy, as follows: Level 1 inputs as quoted prices in active markets for identical assets or liabilities; Level 2 inputs as observable inputs other than Level 1 prices, such as quoted market prices for similar assets or liabilities or other inputs that are observable or can be corroborated by market data; and Level 3 inputs as unobservable inputs that are supported by little or no market activity and that are financial instruments whose value is determined using pricing models or instruments for which the determination of fair value requires significant management judgment or estimation.

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If applicable, we record investments in available-for-sale securities at fair value, and unrealized gains or losses (that are deemed to be temporary) are recognized, net of tax effect, through shareholders' equity, as a component of other comprehensive income in our consolidated balance sheet.

In the past, we have invested excess cash in auction rate securities. Auction rate securities are investment securities that have interest rates which are reset every 7, 28 or 35 days. At December 31, 2013, our investment in auction rate securities was $22 million; we have not increased our investment in auction rate securities since 2007. The fair value of auction rate securities is estimated, on a recurring basis, using a discounted cash flow model (Level 3 input). If we changed the discount rate used in the fair value estimate by 75 basis points, the value of the auction rate securities would change by approximately $1 million.

We have maintained investments in a number of private equity funds, which aggregated $63 million at December 31, 2013. We carry our investments in private equity funds and other private investments at cost. It is not practicable for us to estimate a fair value for private equity funds and other private investments because there are no quoted market prices, and sufficient information is not readily available for us to utilize a valuation model to determine the fair value for each fund. These investments are evaluated, on a non-recurring basis, for potential other-than-temporary impairment when impairment indicators are present, or when an event or change in circumstances has occurred that may have a significant adverse effect on the fair value of the investment. Due to the significant unobservable inputs, the fair value measurements used to evaluate impairment are a Level 3 input.

Impairment indicators we consider include the following: whether there has been a significant deterioration in earnings performance, asset quality or business prospects; a significant adverse change in the regulatory, economic or technological environment; a significant adverse change in the general market condition or geographic area in which the investment operates; industry and sector performance; current equity and credit market conditions; and any bona fide offers to purchase the investment for less than the carrying value. We also consider specific adverse conditions related to the financial health of and business outlook for the fund, including industry and sector performance. The significant assumptions utilized in analyzing a fund for potential other-than-temporary impairment include current economic conditions, market analysis for specific funds and performance indicators in the applicable sectors.

We have and will continue to reduce our investments in long-term financial assets. At December 31, 2013, we have investments in 14 venture capital funds, with an aggregate carrying value of $15 million. The venture capital funds have invested in start-up or smaller, early-stage established businesses, principally in the information technology, bio-technology and health care sectors. At December 31, 2013, we also have investments in 15 buyout funds, with an aggregate carrying value of $48 million. The buyout funds have invested in later-stage, established businesses and no buyout fund has a concentration in a particular sector.

Since there is no active trading market for these investments, they are for the most part illiquid. These investments, by their nature, can also have a relatively higher degree of business risk, including financial leverage, than other financial investments. The timing of distributions from the funds, which depends on particular events related to the underlying investments, as well as the funds' schedules for making distributions and their needs for cash, can be difficult to predict. As a result, the amount of income we record from these investments can vary substantially from quarter to quarter. Future changes in market conditions, the future performance of the underlying investments or new information provided by private equity fund managers could affect the recorded values of these investments and the amounts realized upon liquidation.

We record an impairment charge to earnings when an investment has experienced a decline in fair value that is deemed to be other-than-temporary.

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Goodwill and Other Intangible Assets

We record the excess of purchase cost over the fair value of net tangible assets of acquired companies as goodwill or other identifiable intangible assets. In the fourth quarter of each year, or as events occur or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount, we complete the impairment testing of goodwill utilizing a discounted cash flow method. We selected the discounted cash flow methodology because we believe that it is comparable to what would be used by other market participants. We have defined our reporting units and completed the impairment testing of goodwill at the operating segment level, as defined by accounting guidance. Our operating segments are reporting units that engage in business activities for which discrete financial information, including five-year forecasts, is available.

Determining market values using a discounted cash flow method requires us to make significant estimates and assumptions, including long-term projections of cash flows, market conditions and appropriate discount rates. Our judgments are based upon historical experience, current market trends, consultations with external valuation specialists and other information. While we believe that the estimates and assumptions underlying the valuation methodology are reasonable, different estimates and assumptions could result in different outcomes. In estimating future cash flows, we rely on internally generated five-year forecasts for sales and operating profits, including capital expenditures, and generally a one to three percent long-term assumed annual growth rate of cash flows for periods after the five-year forecast. We generally develop these forecasts based upon, among other things, recent sales data for existing products, planned timing of new product launches, estimated housing starts and estimated repair and remodel activity.

In 2013, we utilized estimated housing starts, from independent industry sources, growing from current levels to 1.5 million units in 2018 (terminal growth year) and operating profit margins improving to approximate historical levels for those business units by 2018 (terminal growth year). We utilize our weighted average cost of capital of approximately 10 percent as the basis to determine the discount rate to apply to the estimated future cash flows. Our weighted average cost of capital increased in 2013 due to improving market conditions and an increased stock price. In 2013, due to improving market conditions and based upon our assessment of the risks impacting each of our businesses, we applied a risk premium to increase the discount rate to a range of 11.5 percent to 13.5 percent for most of our reporting units.

In the fourth quarter of 2013, we estimated that future discounted cash flows projected for all of our reporting units were greater than the carrying values. Any increases in estimated discounted cash flows would have no effect on the reported value of goodwill.

If the carrying amount of a reporting unit exceeds its fair value, we measure the possible goodwill impairment based upon an allocation of the estimate of fair value of the reporting unit to all of the underlying assets and liabilities of the reporting unit, including any previously unrecognized intangible assets (Step Two Analysis). The excess of the fair value of a reporting unit over the amounts assigned to its assets and liabilities is the implied fair value of goodwill. An impairment loss is recognized to the extent that a reporting unit's recorded goodwill exceeds the implied fair value of goodwill.

In 2013, we did not recognize any impairment charges for goodwill.

A 10 percent decrease in the estimated fair value of our reporting units at December 31, 2013 would not have resulted in any additional analysis of goodwill impairment for any additional business unit.

We review our other indefinite-lived intangible assets for impairment annually, in the fourth quarter, or as events occur or circumstances change that indicate the assets may be impaired without regard to the reporting unit. We consider the implications of both external (e.g., market growth, competition and local economic conditions) and internal (e.g., product sales and expected product growth) factors and their potential impact on cash flows related to the intangible asset in both the near- and long-term. In 2013, we did not recognize any impairment charges for other indefinite-lived intangible assets.

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Intangible assets with finite useful lives are amortized using the straight-line method over their estimated useful lives. We evaluate the remaining useful lives of amortizable identifiable intangible assets at each reporting period to determine whether events and circumstances warrant a revision to the remaining periods of amortization.

Stock-Based Compensation

Our 2005 Plan provides for the issuance of stock-based incentives in various forms to employees and non-employee Directors. At December 31, 2013, outstanding stock-based incentives were in the form of long-term stock awards, stock options, phantom stock awards and stock appreciation rights.

Long-Term Stock Awards

We grant long-term stock awards to key employees and non-employee Directors and do not cause net share dilution inasmuch as we generally continue the practice of repurchasing and retiring an equal number of shares on the open market. We measure compensation expense for stock awards at the market price of our common stock at the grant date. There was $69 million (8 million common shares) of total unrecognized compensation expense related to unvested stock awards at December 31, 2013, which was included as a reduction of common stock and paid-in capital. We recognize this expense ratably over the shorter of the vesting period of the stock awards, typically five to ten years, or the length of time until the grantee becomes retirement-eligible at age 65. Pre-tax compensation expense for the annual vesting of long-term stock awards was $34 million for 2013.

Stock Options

We grant stock options to 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 ten years after the grant date.

We measure compensation expense for stock options using a Black-Scholes option pricing model. We recognize this compensation expense ratably over the shorter of the vesting period of the stock options, typically five years, or the length of time until the grantee becomes retirement-eligible at age 65. Pre-tax compensation expense for stock options was $13 million for 2013.

We estimated the fair value of stock options at the grant date using a Black-Scholes option pricing model with the following assumptions for 2013: risk-free interest rate 1.22%, dividend yield 1.47%, volatility factor 49.07% and expected option life six years. For expense calculation purposes, the weighted average grant-date fair value of option shares granted in 2013 was $8.35 per option share.

If we increased our assumptions for the risk-free interest rate and the volatility factor by 50 percent, the expense related to the fair value of stock options granted in 2013 would increase by 42 percent. If we lowered our assumptions for the risk-free interest rate and the volatility factor by 50 percent, the expense related to the fair value of stock options granted in 2013 would decrease by 52 percent.

Employee Retirement Plans

Effective January 1, 2010, we froze all future benefit accruals under substantially all of our domestic qualified and non-qualified defined-benefit pension plans. As a result of this action, the liabilities for these plans were remeasured; in addition, certain assumptions appropriate for on-going plans (e.g., turnover, mortality and compensation increases) have been modified or eliminated for the remeasurement.

Accounting for defined-benefit pension plans involves estimating the cost of benefits to be provided in the future, based upon vested years of service, and attributing those costs over the time period each employee works. We develop our pension costs and obligations from actuarial valuations. Inherent in

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these valuations are key assumptions regarding inflation, expected return on plan assets, mortality rates and discount rates for obligations and expenses. We consider current market conditions, including changes in interest rates, in selecting these assumptions. Changes in assumptions used could result in changes to reported pension costs and obligations within our consolidated financial statements.

In December 2013, we increased our discount rate for obligations to an average of 4.40 percent from 3.80 percent. The discount rate for obligations is based upon the expected duration of each defined-benefit pension plan's liabilities matched to the December 31, 2013 Towers Watson Rate Link curve. The discount rates we use for our defined-benefit pension plans ranged from 1.75 percent to 4.80 percent, with the most significant portion of the liabilities having a discount rate for obligations of 4.20 percent or higher. The assumed asset return was primarily 7.25 percent, reflecting the expected long-term return on plan assets.

Our net underfunded amount for our qualified defined-benefit pension plans, which is the difference between the projected benefit obligation and plan assets, decreased to $324 million at December 31, 2013 from $462 million at December 31, 2012, primarily due to increased asset returns, as well as higher rates of return in the bond market in 2013, which decreased our long-term pension liabilities. In accordance with accounting guidance, the underfunded amount has been recognized on our consolidated balance sheets at December 31, 2013 and 2012. Qualified domestic pension plan assets in 2013 had a net gain of 13.6 percent compared to average gains of 12 percent for the InvestorForce Defined Benefit Plan Universe.

Our projected benefit obligation for our unfunded non-qualified defined-benefit pension plans was $163 million at December 31, 2013 compared with $181 million at December 31, 2012. In accordance with accounting guidance, this unfunded amount has been recognized on our consolidated balance sheets at December 31, 2013 and 2012.

At December 31, 2013, we reported a net liability of $487 million, of which $163 million was related to our non-qualified, supplemental retirement plans, which are not subject to the funding requirements of the Pension Protection Act of 2006. In accordance with the Pension Protection Act, the Adjusted Funding Target Attainment Percentage ("AFTAP") for the various defined-benefit pension plans ranges from 74 percent to 82 percent.

We expect pension expense for our qualified defined-benefit pension plans to be $18 million in 2014 compared with $23 million in 2013. If we assumed that the future return on plan assets was one-half percent lower than the assumed asset return and the discount rate decreased by 50 basis points, the 2014 pension expense would increase by $5 million. We expect pension expense for our non-qualified defined-benefit pension plans to be $8 million in 2014 compared with $8 million in 2013.

We anticipate that we will be required to contribute approximately $60 million to $70 million in 2014 to our qualified and non-qualified defined-benefit plans.

Income Taxes

The accounting guidance for income taxes requires that the future realization of deferred tax assets depends on the existence of sufficient taxable income in future periods. Possible sources of taxable income include taxable income in carryback periods, the future reversal of existing taxable temporary differences recorded as a deferred tax liability, tax-planning strategies that generate future income or gains in excess of anticipated losses in the carryforward period and projected future taxable income.

If, based upon all available evidence, both positive and negative, it is more likely than not (more than 50 percent likely) such deferred tax assets will not be realized, a valuation allowance is recorded. Significant weight is given to positive and negative evidence that is objectively verifiable. A company's three-year cumulative loss position is significant negative evidence in considering whether deferred tax assets are realizable and the accounting guidance restricts the amount of reliance we can place on projected taxable income to support the recovery of the deferred tax assets.

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In the fourth quarter of 2010, we recorded a $372 million valuation allowance against our U.S. Federal deferred tax assets as a non-cash charge to income tax expense. In reaching this conclusion, we considered the weaker retail sales of certain of our building products and the slower than anticipated recovery in the U.S. housing market which led to U.S. operating losses and significant U.S. goodwill impairment charges, that primarily occurred in the fourth quarter of 2010, causing us to be in a three-year cumulative U.S. loss position.

During 2012 and 2011, objective and verifiable negative evidence, such as U.S. operating losses and significant impairment charges for U.S. goodwill in 2011 and other intangible assets, continued to outweigh positive evidence necessary to reduce the valuation allowance. As a result, we recorded increases of $65 million and $89 million in the valuation allowance related to our U.S. Federal deferred tax assets as a non-cash charge to income tax expense in 2012 and 2011, respectively.

A return to sustainable profitability in the U.S. is required before we would change our judgment regarding the need for a valuation allowance against our deferred tax assets.

Although the re