WATTS WATER TECHNOLOGIES INC
Form 10-Q
May 08, 2014
Table of Contents

[

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended March 30, 2014

or

o Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from to

Commission file number 001-11499

WATTS WATER TECHNOLOGIES, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	**04-2916536** (I.R.S. Employer Identification No.)
815 Chestnut Street, North Andover, MA (Address of Principal Executive Offices)	**01845** (Zip Code)

Registrant s Telephone Number, Including Area Code: **(978) 688-1811**

(Former Name, Former Address and Former Fiscal year, if changed since last report.)

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 x 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 for such shorter period that the registrant was required to submit and post such files). Yes x No o

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 x	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 x

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

Class	**Outstanding at May 5, 2014**
Class A Common Stock, $0.10 par value	28,682,611
Class B Common Stock, $0.10 par value	6,489,290

Table of Contents

WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

INDEX

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Amounts in millions, except share information)

(Unaudited)

		March 30, 2014		December 31, 2013
ASSETS				
CURRENT ASSETS:				
Cash and cash equivalents	**$**	**225.0**	$	267.9
Trade accounts receivable, less allowance for doubtful accounts of $9.7 million at March 30, 2014 and December 31, 2013		**224.0**		212.9
Inventories, net:				
Raw materials		**113.5**		111.3
Work in process		**18.7**		19.1
Finished goods		**191.6**		179.8
Total Inventories		**323.8**		310.2
Prepaid expenses and other assets		**36.9**		35.0
Deferred income taxes		**28.1**		29.8
Asset held for sale		**1.3**		1.3
Total Current Assets		**839.1**		857.1
PROPERTY, PLANT AND EQUIPMENT:				
Property, plant and equipment, at cost		**542.5**		539.2
Accumulated depreciation		**(326.5)**		(319.3)
Property, plant and equipment, net		**216.0**		219.9
OTHER ASSETS:				
Goodwill		**513.9**		514.8
Intangible assets, net		**128.2**		132.4
Deferred income taxes		**4.3**		3.8
Other, net		**13.7**		12.2
TOTAL ASSETS	$	**1,715.2**	$	1,740.2
LIABILITIES AND STOCKHOLDERS EQUITY				
CURRENT LIABILITIES:				
Accounts payable	$	**125.2**	$	145.6
Accrued expenses and other liabilities		**136.8**		135.2
Accrued compensation and benefits		**42.8**		43.9
Current portion of long-term debt		**2.2**		2.2
Total Current Liabilities		**307.0**		326.9
LONG-TERM DEBT, NET OF CURRENT PORTION		**305.1**		305.5
DEFERRED INCOME TAXES		**44.4**		45.9
OTHER NONCURRENT LIABILITIES		**58.0**		59.8
STOCKHOLDERS EQUITY:				
Preferred Stock, $0.10 par value; 5,000,000 shares authorized; no shares issued or outstanding				
		2.9		2.9

Class A Common Stock, $0.10 par value; 80,000,000 shares authorized; 1 vote per share; issued and outstanding 28,660,247 shares at March 30, 2014 and 28,824,779 shares at December 31, 2013				
Class B Common Stock, $0.10 par value; 25,000,000 shares authorized; 10 votes per share; issued and outstanding, 6,489,290 shares at March 30, 2014 and December 31, 2013		**0.6**		0.6
Additional paid-in capital		**477.0**		473.5
Retained earnings		**512.3**		513.1
Accumulated other comprehensive income		**7.9**		12.0
Total Stockholders Equity		**1,000.7**		1,002.1
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$	**1,715.2**	$	1,740.2

See accompanying notes to consolidated financial statements.

Table of Contents

WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(Amounts in millions, except per share information)

(Unaudited)

	First Quarter Ended			
		March 30, 2014		March 31, 2013
Net sales	$	**365.2**	$	358.9
Cost of goods sold		**231.9**		230.0
GROSS PROFIT		**133.3**		128.9
Selling, general and administrative expenses		**103.3**		98.1
Restructuring and other charges, net		**4.2**		2.2
OPERATING INCOME		**25.8**		28.6
Other (income) expense:				
Interest income		**(0.1)**		(0.1)
Interest expense		**4.9**		6.0
Other expense, net		**0.4**		
Total other expense		**5.2**		5.9
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES		**20.6**		22.7
Provision for income taxes		**6.5**		6.4
NET INCOME FROM CONTINUING OPERATIONS		**14.1**		16.3
Loss from discontinued operations, net of tax				(0.2)
NET INCOME	$	**14.1**	$	16.1
BASIC EPS				
Net income (loss) per share:				
Continuing operations	**$**	**0.40**	$	0.46
Discontinued operations				(0.01)
NET INCOME	**$**	**0.40**	$	0.45
Weighted average number of shares		**35.4**		35.5
DILUTED EPS				
Net income (loss) per share:				
Continuing operations	**$**	**0.40**	$	0.46
Discontinued operations				(0.01)
NET INCOME	**$**	**0.40**	$	0.45
Weighted average number of shares		**35.5**		35.6
Dividends per share	**$**	**0.13**	$	0.11

See accompanying notes to consolidated financial statements.

Table of Contents

WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Amounts in millions)

(Unaudited)

	First Quarter Ended	
	March 30, 2014	**March 31, 2013**
Net income	**$ 14.1**	$ 16.1
Other comprehensive income, net of tax:		
Foreign currency translation adjustments	**(4.3)**	(19.9)
Defined benefit pension plans:		
Amortization of net losses included in net periodic pension cost	**0.2**	0.2
Other comprehensive income, net of tax	**(4.1)**	(19.7)
Comprehensive income (loss)	**$ 10.0**	$ (3.6)

See accompanying notes to consolidated financial statements.

Table of Contents

WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in millions)

(Unaudited)

	First Quarter Ended	
	March 30, 2014	**March 31, 2013**
OPERATING ACTIVITIES		
Net income	**$ 14.1**	$ 16.1
Less: (Loss) income from discontinued operations, net of taxes		(0.2)
Net income from continuing operations	**14.1**	16.3
Adjustments to reconcile net income from continuing operations to net cash provided by continuing operating activities:		
Depreciation	**8.2**	8.5
Amortization of intangibles	**3.7**	3.7
Loss (gain) on disposal and impairment of goodwill, property, plant and equipment and other	**0.1**	(0.1)
Stock-based compensation	**1.7**	1.6
Deferred income tax benefit	**(0.4)**	(0.5)
Changes in operating assets and liabilities, net of effects from business acquisitions and divestures:		
Accounts receivable	**(11.8)**	(14.1)
Inventories	**(15.3)**	(11.8)
Prepaid expenses and other assets	**(1.3)**	(5.2)
Accounts payable, accrued expenses and other liabilities	**(17.7)**	(0.4)
Net cash used in continuing operations	**(18.7)**	(2.0)
INVESTING ACTIVITIES		
Additions to property, plant and equipment	**(5.0)**	(11.0)
Proceeds from the sale of property, plant and equipment	**0.1**	
Net cash used in investing activities	**(4.9)**	(11.0)
FINANCING ACTIVITIES		
Payments of long-term debt	**(0.4)**	(0.5)
Payment of capital leases and other	**(2.5)**	(1.3)
Proceeds from share transactions under employee stock plans	**0.4**	1.4
Tax benefit of stock awards exercised	**0.5**	0.5
Payments to repurchase common stock	**(9.4)**	
Debt issue costs	**(2.0)**	
Dividends	**(4.6)**	(3.9)
Net cash used in financing activities	**(18.0)**	(3.8)
Effect of exchange rate changes on cash and cash equivalents	**(1.3)**	(3.3)
Net cash used in operating activities of discontinued operations		(0.2)
DECREASE IN CASH AND CASH EQUIVALENTS	**(42.9)**	(20.3)
Cash and cash equivalents at beginning of year	**267.9**	271.3
CASH AND CASH EQUIVALENTS AT END OF PERIOD	**$ 225.0**	$ 251.0
NON-CASH INVESTING AND FINANCING ACTIVITIES		
Issuance of stock under management stock purchase plan	**$ 0.2**	$ 0.4
CASH PAID FOR:		

Interest	**$**	**0.3**	**$**	0.6
Income taxes	**$**	**8.0**	$	10.0

See accompanying notes to consolidated financial statements.

Table of Contents

WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included in the Watts Water Technologies, Inc. (the Company) Consolidated Balance Sheet as of March 30, 2014, the Consolidated Statements of Operations for the first quarters ended March 30, 2014 and March 31, 2013, the Consolidated Statements of Comprehensive Income (Loss) for the first quarters ended March 30, 2014 and March 31, 2013, and the Consolidated Statements of Cash Flows for the first quarters ended March 30, 2014 and March 31, 2013.

The consolidated balance sheet at December 31, 2013 has been derived from the audited consolidated financial statements at that date. The accounting policies followed by the Company are described in the Company s Annual Report on Form 10-K for the year ended December 31, 2013. The financial statements included in this report should be read in conjunction with the consolidated financial statements and notes included in the Annual Report on Form 10-K for the year ended December 31, 2013. Operating results for the interim periods presented are not necessarily indicative of the results to be expected for the year ending December 31, 2014.

The Company operates on a 52-week fiscal year ending on December 31st. Any quarterly data contained in this Quarterly Report on Form 10-Q generally reflect the results of operations for a 13-week period.

2. Accounting Policies

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Goodwill and Long-Lived Assets

The changes in the carrying amount of goodwill by geographic segment are as follows:

	March 30, 2014							
	Gross Balance				Accumulated Impairment Losses			Net Goodwill
	Balance January 1, 2014	Acquired During the Period	Foreign Currency Translation and Other	Balance March 30, 2014	Balance January 1, 2014	Impairment Loss During the Period	Balance March 30, 2014	March 30, 2014
	(in millions)							
Americas	$ 224.7	$	$ (0.4)	$ 224.3	$ (24.5)	$	$ (24.5)	$ 199.8
Europe, Middle East and Africa (EMEA)	301.3		(0.1)	301.2				301.2
Asia-Pacific	13.3		(0.4)	12.9				12.9
Total	$ 539.3	$	$ (0.9)	$ 538.4	$ (24.5)	$	$ (24.5)	$ 513.9

	March 31, 2013							
	Gross Balance				Accumulated Impairment Losses			Net Goodwill
	Balance January 1, 2013	Acquired During the Period	Foreign Currency Translation and Other	Balance March 31, 2013	Balance January 1, 2013	Impairment Loss During the Period	Balance March 31, 2013	March 31, 2013
	(in millions)							
Americas	$ 225.6	$	$ (0.3)	$ 225.3	$ (24.2)	$	$ (24.2)	$ 201.1
EMEA	289.7		(8.3)	281.4				281.4
Asia-Pacific	12.9			12.9				12.9
Total	$ 528.2	$	$ (8.6)	$ 519.6	$ (24.2)	$	$ (24.2)	$ 495.4

Goodwill and indefinite-lived intangible assets are tested for impairment at least annually or more frequently if events or circumstances indicate that it is more likely than not that they might be impaired, such as from a change in business conditions. The Company performs its annual goodwill and indefinite-lived intangible assets impairment assessment in the fourth quarter of each year.

Intangible assets with estimable lives and other long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable. Recoverability of intangible assets with estimable lives and other long-lived assets are measured by a comparison of the carrying amount of an asset or asset group to

Table of Contents

future net undiscounted pretax cash flows expected to be generated by the asset or asset group. If these comparisons indicate that an asset is not recoverable, the impairment loss recognized is the amount by which the carrying amount of the asset or asset group exceeds the related estimated fair value. Estimated fair value is based on either discounted future pretax operating cash flows or appraised values, depending on the nature of the asset. The Company determines the discount rate for this analysis based on the weighted average cost of capital based on the market and guideline public companies for the related business, and does not allocate interest charges to the asset or asset group being measured. Judgment is required to estimate future operating cash flows.

Intangible assets include the following:

	March 30, 2014			December 31, 2013		
	Gross Carrying Amount	**Accumulated Amortization**	**Net Carrying Amount**	**Gross Carrying Amount**	**Accumulated Amortization**	**Net Carrying Amount**
			(in millions)			
Patents	**$ 16.5**	**$ (12.8)**	**$ 3.7**	$ 16.6	$ (12.6)	$ 4.0
Customer relationships	**132.9**	**(79.1)**	**53.8**	133.0	(76.4)	56.6
Technology	**26.7**	**(11.4)**	**15.3**	26.9	(10.9)	16.0
Trade Names	**13.6**	**(3.3)**	**10.3**	13.7	(3.0)	10.7
Other	**8.8**	**(5.6)**	**3.2**	8.8	(5.6)	3.2
Total amortizable intangibles	**198.5**	**(112.2)**	**86.3**	199.0	(108.5)	90.5
Indefinite-lived intangible assets	**41.9**		**41.9**	41.9		41.9
Total	**$ 240.4**	**$ (112.2)**	**$ 128.2**	$ 240.9	$ (108.5)	$ 132.4

Aggregate amortization expense for amortizable intangible assets for both the first quarters of 2014 and 2013 was $3.7 million. Additionally, future amortization expense for the next five years on amortizable intangible assets is expected to be approximately $11.1 million for the remainder of 2014, $14.6 million for 2015, $14.2 million for 2016, $13.8 million for 2017 and $9.9 million for 2018. Amortization expense is recorded on a straight-line basis over the estimated useful lives of the intangible assets. The weighted-average remaining life of total amortizable intangible assets is 8.3 years. Patents, customer relationships, technology, trade names and other amortizable intangibles have weighted-average remaining lives of 5.5 years, 5.3 years, 11.3 years, 10.7 years and 38.4 years, respectively. Indefinite-lived intangible assets primarily include trademarks and trade names.

Stock-Based Compensation

The Company maintains one stock incentive plan under which key employees have been granted incentive stock options (ISOs) and nonqualified stock options (NSOs) to purchase the Company s Class A common stock. Under the 2004 Stock Incentive Plan, options typically become exercisable over a four-year period at the rate of 25% per year and expire ten years after the grant date. ISOs and NSOs granted under the plans may have exercise prices of not less than 100% of the fair market value of the Class A common stock on the date of grant. The Company s current practice is to grant all options at fair market value on the grant date. The Company issued 4,808 stock options and 2,000 stock options during the first three months of 2014 and 2013, respectively.

The Company has also granted shares of restricted stock and deferred shares to key employees and stock awards to non-employee members of the Company s Board of Directors under the 2004 Stock Incentive Plan. Stock awards to non-employee members of the Company s Board of

Directors are fully vested upon grant. Employees restricted stock awards and deferred shares typically vest over a three-year period at the rate of one-third per year. The restricted stock awards and deferred shares are amortized to expense on a straight-line basis over the vesting period. The Company issued 1,747 shares of restricted stock and 667 shares of restricted stock in the first three months of 2014 and 2013, respectively, under the 2004 Stock Incentive Plan.

The Company also has a Management Stock Purchase Plan that allows for the purchase of restricted stock units (RSUs) by key employees. On an annual basis, key employees may elect to receive a portion of their annual incentive compensation in RSUs instead of cash. Each RSU represents one share of Class A common stock and is purchased by the employee at 67% of the fair market value of the Company s Class A common stock on the date of grant. RSUs vest either annually over a three-year period from the grant date or upon the third anniversary of the grant date and receipt of the shares underlying RSUs is deferred for a minimum of three years or such greater number of years as is chosen by the employee. An aggregate of 2,000,000 shares of Class A common stock may be issued under the Management Stock Purchase Plan. The Company granted 30,561 RSUs and 44,777 RSUs in the first three months of 2014 and 2013, respectively.

The fair value of each RSU issued under the Management Stock Purchase Plan is estimated on the date of grant using the Black-Scholes-Merton Model based on the following weighted average assumptions:

	2014	**2013**
Expected life (years)	**3.0**	3.0
Expected stock price volatility	**31.2%**	34.1%
Expected dividend yield	**0.9%**	0.9%
Risk-free interest rate	**0.7%**	0.4%

Table of Contents

The above assumptions were used to determine the weighted average grant-date fair value of RSUs of $22.57 and $18.05 in 2014 and 2013, respectively.

A more detailed description of each of these plans can be found in Note 12 of Notes to Consolidated Financial Statements in the Company s Annual Report on Form 10-K for the year ended December 31, 2013.

Shipping and Handling

The Company s shipping and handling costs included in selling, general and administrative expenses were $14.7 million and $13.9 million for the first quarters of 2014 and 2013, respectively. The 2013 shipping and handling costs disclosed have been updated to include handling costs in order to be comparable with the current quarter.

Research and Development

Research and development costs included in selling, general and administrative expenses were $6.3 million and $5.4 million for the first quarters of 2014 and 2013, respectively.

Taxes, Other than Income Taxes

Taxes assessed by governmental authorities on sale transactions are recorded on a net basis and excluded from sales in the Company s consolidated statements of operations.

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

New Accounting Standards

In April 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-08, Presentation of Financial Statements and Property, Plant, and Equipment: Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity . ASU 2014-08 will change the definition of discontinued operations and limit discontinued operations presentation to disposals of components representing a strategic shift that will have a major effect on the operations and financial results of the issuer. ASU 2014-08 is effective in the first quarter of 2015 for public companies with calendar year ends, with early adoption permitted. The adoption of this guidance is not expected to have a material impact on the Company s financial statements.

3. Discontinued Operations

On August 1, 2013, the Company completed the sale of all of the outstanding shares of an indirectly wholly-owned subsidiary, Watts Insulation GmbH (Austroflex), receiving net cash proceeds of $7.9 million. The loss after tax on disposal of the business was approximately $2.2 million. The Company does not have a substantial continuing involvement in Austroflex s operations and cash flows, therefore Austroflex s results of operations have been presented as discontinued operations and all comparative periods presented have been adjusted in the consolidated interim financial statements to reflect Austroflex s results as discontinued operations.

Pretax profit or losses in discontinued operations are as follows:

	First Quarter Ended	
	March 30, 2014	**March 31, 2013**
	(in millions)	
Austroflex pretax (loss) profit in discontinued operations	**$**	$ (0.2)

Table of Contents

Revenues reported in discontinued operations are as follows:

	First Quarter Ended	
	March 30, 2014	March 31, 2013
	(in millions)	
Austroflex revenues	$	$ 3.2

4. Financial Instruments and Derivative Instruments

The Company measures certain financial assets and liabilities at fair value on a recurring basis, including deferred compensation plan assets and related liability, and contingent consideration. There were no designated cash flow hedges as of March 30, 2014 and December 31, 2013. The fair values of these certain financial assets and liabilities were determined using the following inputs at March 30, 2014 and December 31, 2013:

		Fair Value Measurements at March 30, 2014 Using:		
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(in millions)		
Assets				
Plan asset for deferred compensation(1)	**$ 4.4**	**$ 4.4**	**$**	**$**
Total assets	**$ 4.4**	**$ 4.4**	**$**	**$**
Liabilities				
Plan liability for deferred compensation(2)	**$ 4.4**	**$ 4.4**	**$**	**$**
Contingent consideration(3)	**2.1**			**2.1**
Total liabilities	**$ 6.5**	**$ 4.4**	**$**	**$ 2.1**

		Fair Value Measurements at December 31, 2013 Using:		
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(in millions)		
Assets				
Plan asset for deferred compensation(1)	$ 4.6	$ 4.6	$	$
Total assets	$ 4.6	$ 4.6	$	$
Liabilities				
Plan liability for deferred compensation(2)	$ 4.6	$ 4.6	$	$
Contingent consideration(3)	4.4			4.4
Total liabilities	$ 9.0	$ 4.6	$	$ 4.4

(1) Included on the Company s consolidated balance sheet in other assets (other, net).

(2) Included on the Company s consolidated balance sheet in accrued compensation and benefits.

(3) Included on the Company s consolidated balance sheet in accrued expenses and other liabilities as of March 30, 2014 and in other noncurrent liabilities and accrued expenses and other liabilities as of December 31, 2013.

The table below provides a summary of the changes in fair value of all financial assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the period December 31, 2013 to March 30, 2014.

				Total realized and unrealized (gains) losses included in:		
	Balance December 31, 2013	Purchases, sales, settlements, net	Net earnings adjustments (in millions)	Comprehensive income	Balance March 30, 2014
Contingent consideration	$ 4.4	$ (2.2)	$	$ (0.1)	$ 2.1

Table of Contents

On January 31, 2012, the Company completed the acquisition of tekmar Control Systems (tekmar) in a share purchase transaction. The initial purchase price paid was CAD $18.0 million, with post-closing adjustments related to working capital and an earnout based on the attainment of certain future earnings levels. A contingent liability of $5.1 million was recognized as the estimate of the acquisition date fair value of the contingent consideration. This liability was classified as Level 3 under the fair value hierarchy as it was based on the probability of achievement of a future performance metric as of the date of the acquisition, which was not observable in the market. Failure to meet the performance metrics would reduce this liability to zero; while complete achievement would increase this liability to the full remaining purchase price of $8.2 million. The contingent liability was increased by $1.0 million during 2013 based on a revised estimate of the fair value of the contingent consideration. A portion of the contingent consideration was paid out during the first quarter of 2014 and the second quarter of 2013, in the amount of $2.2 million and $1.2 million, respectively, based on performance metrics achieved. The earnout will be completed in fiscal year 2014.

Cash equivalents consist of instruments with remaining maturities of three months or less at the date of purchase and consist primarily of certificates of deposit and money market funds, for which the carrying amount is a reasonable estimate of fair value.

The Company uses financial instruments from time to time to enhance its ability to manage risk, including foreign currency and commodity pricing exposures, which exist as part of its ongoing business operations. The use of derivatives exposes the Company to counterparty credit risk for nonperformance and to market risk related to changes in currency exchange rates and commodity prices. The Company manages its exposure to counterparty credit risk through diversification of counterparties. The Company s counterparties in derivative transactions are substantial commercial banks with significant experience using such derivative instruments. The impact of market risk on the fair value and cash flows of the Company s derivative instruments is monitored and the Company restricts the use of derivative financial instruments to hedging activities. The Company does not enter into contracts for trading purposes nor does the Company enter into any contracts for speculative purposes. The use of derivative instruments is approved by senior management under written guidelines.

The Company has exposure to a number of foreign currency rates, including the Canadian dollar, the euro, the Chinese yuan and the British pound sterling. To manage this risk, the Company has in the past used a layering methodology and entered into forward exchange contracts which hedged approximately 50% of the projected intercompany purchase transactions for the next twelve months. The Company presently does not have any open forward exchange contracts.

Fair Value

The carrying amounts of cash and cash equivalents, trade receivables and trade payables approximate fair value because of the short maturity of these financial instruments.

The fair values of the Company s 5.85% senior notes due 2016, and 5.05% senior notes due 2020, are based on a discounted cash flow model using comparable industrial companies, the Company s credit metrics, the Company s size, as well as current market interest rates quoted in active markets and are classified within Level 2 of the valuation hierarchy. The fair value of the Company s variable rate debt approximates its carrying value. The carrying amount and the estimated fair market value of the Company s long-term debt, including the current portion, are as follows:

	March 30,	December 31,

		2014		2013
		(in millions)		
Carrying amount	$	**307.3**	$	307.7
Estimated fair value	$	**332.3**	$	333.4

5. Restructuring and Other Charges, Net

The Company s Board of Directors approves all major restructuring programs that involve the discontinuance of significant product lines or the shutdown of significant facilities. From time to time, the Company takes additional restructuring actions, including involuntary terminations that are not part of a major program. The Company accounts for these costs in the period that the individual employees are notified or the liability is incurred. These costs are included in restructuring and other charges in the Company s consolidated statements of operations.

2013 Actions

On July 30, 2013, the Board of Directors authorized a restructuring program with respect to the Company s EMEA segment to reduce its European manufacturing footprint, improve organizational and operational efficiency and better align costs with expected revenues in response to changing market conditions. The restructuring program is expected to include a pre-tax charge to earnings totaling approximately $14.0 million, approximately $10.3 million of which is expected to be recorded through fiscal 2014 and the remainder recorded during fiscal 2015. The total charge will include costs for severance benefits, relocation, site clean-up, professional fees and certain asset write-downs. The total net after-tax charge for the restructuring program is expected to be approximately $10.0 million. The restructuring program is expected to be completed by the end of the fourth quarter of fiscal 2015. Certain aspects of the restructuring program are subject to further analysis and determinations by local management and consultation and negotiation with various works councils. The net after-tax charge incurred in the first quarter of 2014 was $0.3 million.

Other Actions

The Company also periodically initiates other actions which are not part of a major program. In 2013 and 2014, the Company initiated restructuring activities in EMEA and the Americas to relocate certain manufacturing activities and reduce costs through a reduction-in-force. There are no remaining expected costs relating to these actions.

A summary of the pre-tax cost by restructuring program is as follows:

	First Quarter Ended			
	March 30, 2014		March 31, 2013	
	(in millions)			
Restructuring costs:				
2013 Actions		**0.4**		
Other Actions		**3.8**		2.2
Total restructuring and other charges, net	**$**	**4.2**	$	2.2

The Company recorded pre-tax restructuring and other charges, net in its business segments as follows:

	First Quarter Ended			
	March 30, 2014		March 31, 2013	
	(in millions)			
Americas	$	**1.9**	$	0.2
EMEA		**1.5**		2.0
Corporate		**0.8**		
Total	**$**	**4.2**	$	2.2

Details of the Company s 2013 European footprint program reserve, which for the first quarter ended March 30, 2014 relates only to severance, is as follows:

		First Quarter Ended March 30, 2014 (in millions)
Balance at December 31, 2013	$	2.0
Net pre-tax restructuring charges		**0.4**
Utilization and foreign currency impact		**(0.3)**
Balance at March 30, 2014	**$**	**2.1**

The following table summarizes total expected, incurred and remaining pre-tax costs for 2013 European footprint program actions by type, and all attributable to the EMEA reportable segment:

		Severance		Legal and consultancy		Asset write-downs (in millions)		Facility exit and other		Total
Expected costs	$	12.3	$	1.3	$	0.2	$	0.2	$	14.0
Costs incurred 2013		(4.1)								(4.1)
Costs incurred first quarter 2014		**(0.1)**				**(0.2)**		**(0.1)**		**(0.4)**
Remaining costs at March 30, 2014	**$**	**8.1**	**$**	**1.3**	**$**		**$**	**0.1**	**$**	**9.5**

Table of Contents

6. Earnings per Share

The following tables set forth the reconciliation of the calculation of earnings per share:

	For the First Quarter Ended March 30, 2014			For the First Quarter Ended March 31, 2013		
	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)	Per Share Amount
	(amounts in millions, except per share amounts)					
Basic EPS						
Net income:						
Continuing operations	**$ 14.1**	**35.4**	**$ 0.40**	$ 16.3	35.5	$ 0.46
Discontinued operations				(0.2)		(0.01)
Net income	**$ 14.1**		**$ 0.40**	$ 16.1		$ 0.45
Effect of dilutive securities						
Common stock equivalents		**0.1**			0.1	
Diluted EPS						
Net income:						
Continuing operations	**$ 14.1**		**$ 0.40**	$ 16.3		$ 0.46
Discontinued operations				(0.2)		(0.01)
Net income	**$ 14.1**	**35.5**	**$ 0.40**	$ 16.1	35.6	$ 0.45

Options to purchase 0.3 million and 0.4 million shares of Class A common stock were outstanding during the first quarters of 2014 and 2013, respectively, but were not included in the computation of diluted EPS because to do so would be anti-dilutive.

On April 30, 2013, the Company s Board of Directors authorized the repurchase of up to $90 million of the Company s Class A common stock from time to time on the open market or in privately negotiated transactions. The timing and number of any shares repurchased will be determined by the Company s management based on its evaluation of market conditions. Repurchases may also be made under a Rule 10b5-1 plan, which would permit shares to be repurchased when the Company might otherwise be precluded from doing so under insider trading laws. The repurchase program may be suspended or discontinued at any time, subject to the terms of any Rule 10b5-1 plan the Company may enter into with respect to the repurchase program. During the quarter ended March 30, 2014, the Company repurchased approximately 161,000 shares of Class A common stock at a cost of approximately $9.4 million.

7. Segment Information

The Company operates in three geographic segments: Americas, EMEA, and Asia-Pacific. Each of these segments is managed separately and has separate financial results that are reviewed by the Company s chief operating decision-maker. All intercompany sales transactions have been eliminated. Sales by region are based upon location of the entity recording the sale. The accounting policies for each segment are the same as those described in the summary of significant accounting policies.

As of January 1, 2014, the Company began allocating certain expenses to its three operating segments, Americas, EMEA and Asia-Pacific, that had previously been recorded as Corporate expenses. These expenses primarily include stock compensation, legal expenses and audit expenses that are directly attributable to and benefit the three operating segments. The 2013 results by segment have been retrospectively revised for comparative purposes.

The following is a summary of the Company s significant accounts and balances by segment, reconciled to the consolidated totals:

Table of Contents

	First Quarter Ended March 30, 2014	March 31, 2013
	(in millions)	
Net sales		
Americas	**$ 219.1**	$ 213.0
EMEA	**139.1**	139.2
Asia-Pacific	**7.0**	6.7
Consolidated net sales	**$ 365.2**	$ 358.9
Operating income (loss)		
Americas	**$ 22.6**	$ 22.1
EMEA	**8.9**	10.9
Asia-Pacific	**0.9**	2.9
Subtotal reportable segments	**32.4**	35.9
Corporate (*)	**(6.6)**	(7.3)
Consolidated operating income	**25.8**	28.6
Interest income	**0.1**	0.1
Interest expense	**(4.9)**	(6.0)
Other income (expense), net	**(0.4)**	
Income from continuing operations before income taxes	**$ 20.6**	$ 22.7
Capital expenditures		
Americas	**$ 2.2**	$ 8.2
EMEA	**2.5**	2.2
Asia-Pacific	**0.3**	0.6
Consolidated capital expenditures	**$ 5.0**	$ 11.0
Depreciation and amortization		
Americas	**$ 4.9**	$ 5.0
EMEA	**6.6**	6.5
Asia-Pacific	**0.4**	0.7
Consolidated depreciation and amortization	**$ 11.9**	$ 12.2
Identifiable assets (at end of period)		
Americas	**$ 767.9**	$ 810.8
EMEA	**875.9**	783.7
Asia-Pacific	**71.4**	91.8
Discontinued operations		11.8
Consolidated identifiable assets	**$ 1,715.2**	$ 1,698.1
Property, plant and equipment, net (at end of period)		
Americas	**$ 84.5**	$ 85.2
EMEA	**117.7**	120.5
Asia-Pacific	**13.8**	14.8
Consolidated property, plant and equipment, net	**$ 216.0**	$ 220.5

* Corporate expenses are primarily for administrative compensation expense, internal controls costs, professional fees, including corporate-related legal and audit expenses, shareholder services and benefit administration costs.

Apart from the change noted above resulting from allocating certain expenses to its three operating segments, the above operating segments are presented on a basis consistent with the presentation included in the Company s December 31, 2013 consolidated financial statements included in its Annual Report on Form 10-K.

The following includes U.S. net sales and U.S. property, plant and equipment of the Company s Americas segment:

	First Quarter Ended	
	March 30, 2014	**March 31, 2013**
	(in millions)	
U.S. net sales	**$ 201.6**	$ 192.8
U.S. property, plant and equipment (at end of period)	**$ 80.0**	$ 79.9

The following includes intersegment sales for Americas, EMEA and Asia-Pacific:

Table of Contents

	First Quarter Ended March 30, 2014		First Quarter Ended March 31, 2013
	(in millions)		
Intersegment Sales			
Americas	$ **1.2**	$	1.3
EMEA	**3.6**		2.7
Asia-Pacific	**39.0**		41.6
Intersegment sales	$ **43.8**	$	45.6

8. Accumulated Other Comprehensive Income (Loss)

Accumulated other comprehensive income (loss) consists of the following:

	Foreign Currency Translation	Pension Adjustment (in millions)	Accumulated Other Comprehensive Income (Loss)
Balance December 31, 2013	**$ 37.9**	**$ (25.9)**	**$ 12.0**
Change in period	**(4.3)**	**0.2**	**(4.1)**
Balance March 30, 2014	**$ 33.6**	**$ (25.7)**	**$ 7.9**
Balance December 31, 2012	$ 14.4	$ (25.2)	$ (10.8)
Change in period	(19.9)	0.2	(19.7)
Balance March 31, 2013	$ (5.5)	$ (25.0)	$ (30.5)

9. Debt

On February 18, 2014, the Company terminated its prior credit agreement and entered into a new Credit Agreement (the Credit Agreement) among the Company, certain subsidiaries of the Company who become borrowers under the Credit Agreement, JPMorgan Chase Bank, N.A., as Administrative Agent, Swing Line Lender and Letter of Credit Issuer, and the other lenders referred to therein. The Credit Agreement provides for a $500 million, five-year, senior unsecured revolving credit facility which may be increased by an additional $500 million under certain circumstances and subject to the terms of the Credit Agreement. The Credit Agreement has a sublimit of up to $100 million in letters of credit. The Credit Agreement matures on February 18, 2019.

Borrowings outstanding under the Credit Agreement bear interest at a fluctuating rate per annum equal to an applicable percentage equal to (1) in the case of Eurocurrency rate loans, the British Bankers Association LIBOR rate plus an applicable percentage, ranging from 0.975% to 1.45%, determined by reference to the Company s consolidated leverage ratio, or (2) in the case of base rate loans and swing line loans, the highest of (a) the federal funds rate plus 0.5%, (b) the rate of interest in effect for such day as announced by JPMorgan Chase Bank, N.A. as its prime rate, and (c) the British Bankers Association LIBOR rate plus 1.0%, plus an applicable percentage, ranging from 0.00% to 0.45%, determined by reference to the Company s consolidated leverage ratio. In addition to paying interest under the Credit Agreement, the Company is also required to pay certain fees in connection with the credit facility, including, but not limited to, an unused facility fee and letter of credit fees. Under the Credit Agreement, the Company is required to satisfy and maintain specified financial ratios and other financial condition tests.

The Company may repay loans outstanding under the Credit Agreement from time to time without premium or penalty, other than customary breakage costs, if any, and subject to the terms of the Credit Agreement. As of March 30, 2014, the Company was in compliance with all covenants related to the Credit Agreement and had $476.4 million of unused and available credit under the Credit Agreement and $23.6 million of stand-by letters of credit outstanding on the Credit Agreement. The Company did not have any borrowings outstanding under the Credit Agreement at March 30, 2014.

The Company is a party to several note agreements as further detailed in Note 10 of Notes to Consolidated Financial Statements of the Annual Report on Form 10-K for the year ended December 31, 2013. These note agreements require the Company to maintain a fixed charge coverage ratio of consolidated EBITDA plus consolidated rent expense during the period to consolidated fixed charges. Consolidated fixed charges are the sum of consolidated interest expense for the period and consolidated rent expense. As of March 30, 2014, the Company was in compliance with all covenants regarding these note agreements.

Table of Contents

10. Contingencies and Environmental Remediation

Accrual and Disclosure Policy

The Company is a defendant in numerous legal matters arising from its ordinary course of operations, including those involving product liability, environmental matters and commercial disputes.

The Company reviews its lawsuits and other legal proceedings on an ongoing basis and follows appropriate accounting guidance when making accrual and disclosure decisions. The Company establishes accruals for matters when the Company assesses that it is probable that a loss has been incurred and the amount of the loss can be reasonably estimated, net of any applicable insurance proceeds. The Company does not establish accruals for such matters when the Company does not believe both that it is probable that a loss has been incurred and the amount of the loss can be reasonably estimated. The Company s assessment of whether a loss is probable is based on its assessment of the ultimate outcome of the matter following all appeals.

Under the FASB issued ASC 450 Contingencies , an event is reasonably possible if the chance of the future event or events occurring is more than remote but less than likely and an event is remote if the chance of the future event or events occurring is slight . Thus, references to the upper end of the range of reasonably possible loss for cases in which the Company is able to estimate a range of reasonably possible loss mean the upper end of the range of loss for cases for which the Company believes the risk of loss is more than slight.

There may continue to be exposure to loss in excess of any amount accrued. When it is possible to estimate the reasonably possible loss or range of loss above the amount accrued for the matters disclosed, that estimate is aggregated and disclosed. The Company records legal costs associated with its legal contingencies as incurred, except for legal costs associated with product liability claims which are included in the product liability accrual.

As of March 30, 2014, the Company estimates that the aggregate amount of reasonably possible loss in excess of the amount accrued for its legal contingencies is approximately $11.5 million, pre-tax. With respect to the estimate of reasonably possible loss, management has estimated the upper end of the range of reasonably possible loss based on (i) the amount of money damages claimed, where applicable, (ii) the allegations and factual development to date, (iii) available defenses based on the allegations, and/or (iv) other potentially liable parties. This estimate is based upon currently available information and is subject to significant judgment and a variety of assumptions, and known and unknown uncertainties. The matters underlying the estimate will change from time to time, and actual results may vary significantly from the current estimate. In the event of an unfavorable outcome in one or more matters, the ultimate liability may be in excess of amounts currently accrued, if any, and may be material to the Company s operating results or cash flows for a particular quarterly or annual period. However, based on information currently known to it, management believes that the ultimate outcome of all matters, as they are resolved over time, is not likely to have a material adverse effect on the financial condition of the Company, though the outcome could be material to the Company s operating results for any particular period depending, in part, upon the operating results for such period.

Trabakoolas et al., v, Watts Water Technologies, Inc., et al., On March 8, 2012, Watts Water Technologies, Inc., Watts Regulator Co., and Watts Plumbing Technologies Co., Ltd., among other companies, were named as defendants in a putative nationwide class action complaint filed in the U.S. District Court for the Northern District of California seeking to recover damages and other relief based on the alleged failure of toilet connectors. The complaint seeks among other items, damages in an unspecified amount, replacement costs, injunctive relief, and attorneys fees and costs.

On December 12, 2013, the Company reached an agreement in principle to settle all claims. The total settlement amount is $23.0 million, of which the Company would be responsible for $14.0 million after insurance proceeds of $9.0 million. The settlement was subject to review by the Court at a preliminary approval hearing held on February 12, 2014. The Court granted preliminary approval on February 14, 2014. The settlement is subject to final court approval after a fairness hearing currently scheduled for July 16, 2014. Accordingly, there can be no assurance that the proposed settlement will be approved in its current form. If the settlement is not approved, the Company intends to continue to vigorously contest the allegations in this case.

During the fourth quarter of 2013, the Company recorded a liability of $22.6 million related to the Trabakoolas matter, of which $12.7 million was included in current liabilities and $9.9 million in other noncurrent liabilities. In addition, a $9.0 million receivable was recorded in current assets related to insurance proceeds due under a separate settlement agreement if the class action settlement is approved. The liability was reduced by $1.2 million for notice and claims administrator payments made during the first quarter of 2014 and as of March 30, 2014, the remaining liability was $21.4 million.

Product Liability

The Company is subject to a variety of potential liabilities in connection with product liability cases. The Company maintains product liability and other insurance coverage, which the Company believes to be generally in accordance with industry practices. For product liability cases in the U.S., management establishes its product liability accrual, which includes legal costs associated with accrued claims, by utilizing third-party actuarial valuations which incorporate historical trend factors and the Company s specific claims experience derived from loss reports provided by third-party claims administrators. Changes in the nature of claims, legal costs, or the actual settlement amounts could affect the adequacy of this estimate and require changes to the accrual. Because the liability is an estimate, the ultimate liability may be more or less than reported. In other countries, the Company maintains insurance coverage with relatively high deductible payments, as product liability claims tend to be smaller than those experienced in the U.S.

Environmental Remediation

The Company has been named as a potentially responsible party with respect to a limited number of identified contaminated sites. The levels of contamination vary significantly from site to site as do the related levels of remediation efforts. Environmental liabilities are recorded based on the most probable cost, if known, or on the estimated minimum cost of remediation. Accruals are not discounted to their present value, unless the amount and timing of expenditures are fixed and reliably determinable. The Company accrues estimated environmental liabilities based on assumptions, which are subject to a number of factors and uncertainties. Circumstances that can affect the reliability and precision of these estimates include identification of additional sites, environmental regulations, level of cleanup required, technologies available, number and financial condition of other contributors to remediation and the time period over which remediation may occur. The Company recognizes changes in estimates as new remediation requirements are defined or as new information becomes available. Environmental liabilities as of the first quarter ended 2014 and 2013 were not considered material.

Asbestos Litigation

The Company is defending 44 lawsuits in different jurisdictions, alleging injury or death as a result of exposure to asbestos. The complaints in these cases typically name a large number of defendants and do not identify any particular Company products as a source of asbestos exposure. To date, the Company has obtained a dismissal in every case before it has reached trial because discovery has failed to yield evidence of substantial exposure to any Company products.

Other Litigation

Other lawsuits and proceedings or claims, arising from the ordinary course of operations, are also pending or threatened against the Company.

11. Defined Benefit Plans

The Company sponsors funded and unfunded non-contributing defined benefit pension plans that together cover substantially all of its U.S. employees. Benefits are based primarily on years of service and employees compensation. The funding policy of the Company for these plans is to contribute an annual amount that does not exceed the maximum amount that can be deducted for federal income tax purposes. On October 31, 2011, the Company s Board of Directors voted to cease accruals effective December 31, 2011 under both the Company s Pension Plan and Supplemental Employees Retirement Plan. On April 28, 2014, the Company s Board of Directors voted to terminate the Company s Pension Plan and Supplemental Employees Retirement Plan (the SERP). Refer to Note 12 for further details.

The components of net periodic benefit cost are as follows:

	First Quarter Ended	
	March 30, 2014	**March 31, 2013**
	(in millions)	
Service cost administrative costs	**$ 0.2**	$ 0.1
Interest costs on benefits obligation	**1.5**	1.4
Expected return on assets	**(1.5)**	(1.7)
Net actuarial loss amortization	**0.3**	0.2
Net periodic benefit cost	**$ 0.5**	$

The information related to the Company s pension funds cash flow is as follows:

	First Quarter Ended	
	March 30, 2014	**March 31, 2013**
	(in millions)	
Employer contributions	**$ 0.2**	$ 0.2

Table of Contents

The Company expects to contribute approximately $0.6 million to its pension plans for the remainder of 2014.

12. Subsequent Events

Dividend Declared

On April 29, 2014, the Company declared a quarterly dividend of fifteen cents ($0.15) per share on each outstanding share of Class A common stock and Class B common stock payable on May 30, 2014 to stockholders of record at the close of business on May 19, 2014.

Termination of Pension Plans

On April 28, 2014, the Company s Board of Directors voted to terminate the Watts Water Technologies, Inc. Pension Plan (the Pension Plan) and the Watts Water Technologies, Inc. Supplemental Employees Retirement Plan (the SERP). These terminations follow amendments to the Pension Plan and SERP to cease (or freeze) benefit accruals for eligible employees under those plans effective December 31, 2011.

The Pension Plan will terminate effective July 31, 2014. Distribution of plan assets pursuant to the termination will not be made until the plan termination satisfies the regulatory requirements prescribed by the Internal Revenue Service and the Pension Benefit Guaranty Corporation, which is expected to occur in late 2015. The SERP will terminate effective May 15, 2014. The Company will settle all liabilities under the SERP in accordance with Section 409A of the Internal Revenue Code by paying lump sums to plan participants at least twelve and no more than twenty four months following the termination date. The Board of Directors authorized the Company to make such contributions to the Pension Plan and SERP as may be necessary to make the plans sufficient to settle all plan liabilities.

Appointment of Chief Executive Officer

On May 8, 2014, the Company s Board of Directors appointed Robert J. Pagano, Jr. as the Company s President and Chief Executive Officer effective upon the commencement of his employment with the Company on May 27, 2014, at which time the Company s interim President and Chief Executive Officer, Dean P. Freeman, will resume his role as Executive Vice President and Chief Financial Officer. The Company s Board of Directors also appointed Mr. Pagano as a member of the Company s Board of Directors effective upon the commencement of his employment with the Company.

Table of Contents

Item 2. Management s Discussion And Analysis Of Financial Condition And Results Of Operations

Overview

The following discussion and analysis are provided to increase understanding of, and should be read in conjunction with, the accompanying unaudited consolidated financial statements and notes. In this quarterly report on Form 10-Q, references to the Company, Watts, we, us or ou refer to Watts Water Technologies, Inc. and its consolidated subsidiaries.

We operate on a 52-week calendar year ending on December 31. Any quarterly data contained in this Quarterly Report on Form 10-Q generally reflect the results of operations for a 13-week period.

We are a leading supplier of products for use in the water quality, water safety, water flow control and water conservation markets in both the Americas and EMEA (Europe, Middle East and Africa), with a growing presence in Asia-Pacific. For 140 years, we have designed and manufactured products that promote comfort and safety of people and the quality and conservation of water used in commercial and residential applications. We earn revenue and income almost exclusively from the sale of our products. Our principal product lines are:

- Residential & commercial flow control products includes products typically sold into plumbing and hot water applications such as backflow preventers, water pressure regulators, temperature and pressure relief valves, and thermostatic mixing valves.

- HVAC & gas products includes hydronic and electric heating systems for under-floor radiant applications, hydronic pump groups for boiler manufacturers and alternative energy control packages, and flexible stainless steel connectors for natural and liquid propane gas in commercial food service and residential applications. HVAC is an acronym for heating, ventilation and air conditioning.

- Drains & water re-use products includes drainage products and engineered rain water harvesting solutions for commercial, industrial, marine and residential applications.

- Water quality products includes point-of-use and point-of-entry water filtration, conditioning and scale prevention systems for both commercial and residential applications.

Our business is reported in three geographic segments: Americas, EMEA and Asia-Pacific. We distribute our products through three primary distribution channels: wholesale, do-it-yourself (DIY) and original equipment manufacturers (OEMs). Interest rates, the unemployment rate and credit availability have an indirect effect on the demand for our products due to the effect such rates have on the number of new residential and commercial construction starts and remodeling projects. All of these activities have an impact on our levels of sales and earnings. An additional factor that has an effect on our sales and operating income is fluctuation in foreign currency exchange rates, as approximately 45% of our sales in the first quarter ended March 30, 2014, and certain portions of our costs, assets and liabilities are denominated in currencies other than the U.S. dollar.

During the first quarter of 2014, sales increased $6.3 million as compared to the first quarter of 2013, primarily from a favorable foreign exchange movement of $3.3 million and from an organic increase in sales of $3.0 million. The foreign exchange impact was primarily due to the appreciation of the euro against the U.S. dollar. Organic sales increased by 0.9% compared to last year s comparable period, primarily from increased sales in the Americas. Organic sales in the first quarter of 2014 increased in the Americas by $7.8 million, or 3.7%, and increased in Asia-Pacific by $0.1 million, or 1.5%, offset by a decrease in EMEA of $4.9 million, or 3.5%. Organic sales growth excludes the impacts of acquisitions, divestitures and foreign exchange from year-over-year comparisons. We believe this provides investors with a more complete understanding of underlying sales trends by providing sales growth on a consistent basis. Gross margin increased in the first quarter of 2014 as compared to 2013 by 0.6 percentage points. The increase is due primarily to production efficiencies in EMEA and increased volume in the Americas. Operating income of $25.8 million decreased by 9.8% in the first quarter of 2014 as compared to the first quarter of 2013, driven primarily by increased selling, general and administrative expenses and restructuring costs. Included in selling, general and administrative expenses for the quarter was $3.5 million of EMEA transformation deployment costs. The effect of foreign exchange movements was immaterial year to year on operating income.

The EMEA transformation program began in the fourth quarter of 2013 and is designed to refocus our European operations from being country specific to a pan European business unit operating strategy. Under this initiative, we intend to (1) develop better sales capabilities through improved product management and enhanced product cross-selling efforts, (2) drive more efficient European

Table of Contents

sourcing and logistics, and (3) enhance our focus on emerging market opportunities. We plan to align our legal and tax structure in accordance with our business structure and take advantage of favorable tax rates where possible. We expect this project to be ongoing through 2016. We incurred deployment costs of approximately $3.5 million in the first quarter of 2014 and $1.2 million in the fourth quarter of 2013. These non-recurring costs consist primarily of external consulting and IT related costs, and are exclusive of restructuring expense. A more detailed description of this program can be found in the Company s Annual Report on Form 10-K for the year ended December 31, 2013.

We believe that the factors relating to our future growth include the demand for clean water around the world, a healthy economic environment regulatory requirements relating to the quality and conservation of water, continued enforcement of plumbing and building codes, our ability to grow organically in select attractive market segments and geographic regions and the successful completion of selective acquisitions. Our acquisition strategy focuses on businesses that manufacture preferred brand name or specified products that address our themes of water quality, water conservation, water safety, water flow control, HVAC and related complementary markets and geographies. We target businesses that will provide us with one or more of the following: an entry into new markets and geographies, an increase in business with existing customers, a new or improved technology or an expansion of the breadth of our water quality, water conservation, water safety and water flow control and HVAC products for the residential, commercial and light industrial markets. We have completed 36 acquisitions since 1999.

Products representing a majority of our sales are subject to regulatory standards and code enforcement, which typically require that these products meet stringent performance criteria. Together with our commissioned manufacturers representatives, we have consistently advocated for the development and enforcement of such plumbing codes. We are focused on maintaining stringent quality control and testing procedures at each of our manufacturing facilities in order to manufacture products in compliance with code requirements and take advantage of the resulting demand for compliant products.

Historically, we have faced a risk relating to our ability to respond to raw material cost fluctuations. We manage this risk by monitoring related market prices, working with our suppliers to achieve the maximum level of stability in their costs and related pricing, seeking alternative supply sources when necessary, purchasing forward commitments for raw materials, when available, implementing cost reduction programs and passing increases in costs to our customers in the form of price increases.

Another risk we face in all areas of our business is competition. We consider brand preference, engineering specifications, code requirements, price, technological expertise, delivery times, quality and breadth of product offerings to be the primary competitive factors. We believe that product development, product testing capability, breadth of product offerings and investment in plant and equipment needed to manufacture products in compliance with code requirements represent a competitive advantage for us. We expect to spend approximately $25 to $30 million during 2014 for purchases of capital equipment to continue to improve our manufacturing capabilities.

Recent Events

Dividend Declared

On April 29, 2014, we declared a quarterly dividend of fifteen cents ($0.15) per share on each outstanding share of Class A common stock and Class B common stock payable on May 30, 2014 to stockholders of record at the close of business on May 19, 2014.

Termination of Pension Plans

On April 28, 2014, our Board of Directors voted to terminate the Watts Water Technologies, Inc. Pension Plan (the Pension Plan) and the Watts Water Technologies, Inc. Supplemental Employees Retirement Plan (the SERP). These terminations follow amendments to the Pension Plan and SERP to cease (or freeze) benefit accruals for eligible employees under those plans effective December 31, 2011.

The Pension Plan will terminate effective July 31, 2014. Distribution of plan assets pursuant to the termination will not be made until the plan termination satisfies the regulatory requirements prescribed by the Internal Revenue Service and the Pension Benefit Guaranty Corporation, which is expected to occur in late 2015. The SERP will terminate effective May 15, 2014. We will settle all liabilities under the SERP in accordance with Section 409A of the Internal Revenue Code by paying lump sums to plan participants at least twelve and no more than twenty four months following the termination date. The Board of Directors authorized us to make such contributions to the Pension Plan and SERP as may be necessary to make the plans sufficient to settle all plan liabilities.

Table of Contents

Appointment of Chief Executive Officer

On May 8, 2014, our Board of Directors appointed Robert J. Pagano, Jr. as our President and Chief Executive Officer effective upon the commencement of his employment with the Company on May 27, 2014, at which time our interim President and Chief Executive Officer, Dean P. Freeman, will resume his role as Executive Vice President and Chief Financial Officer. Our Board of Directors also appointed Mr. Pagano as a member of our Board of Directors effective upon the commencement of his employment with the Company.

Results of Operations

First Quarter Ended March 30, 2014 Compared to First Quarter Ended March 31, 2013

Net Sales. Our business is reported in three geographic segments: Americas, EMEA and Asia-Pacific. Our net sales in each of these segments for each of the first quarters of 2014 and 2013 were as follows:

	First Quarter Ended March 30, 2014		First Quarter Ended March 31, 2013			% Change to Consolidated
	Net Sales	% Sales	Net Sales	% Sales	Change	Net Sales
	(dollars in millions)					
Americas	**$ 219.1**	**60.0%**	$ 213.0	59.3%	$ 6.1	1.7%
EMEA	**139.1**	**38.1**	139.2	38.8	(0.1)	
Asia-Pacific	**7.0**	**1.9**	6.7	1.9	0.3	0.1
Total	**$ 365.2**	**100.0%**	$ 358.9	100.0%	$ 6.3	1.8%

The change in net sales was attributable to the following:

					Change As a % of Consolidated Net Sales				Change As a % of Segment Net Sales		
	Americas	EMEA	Asia-Pacific	Total	Americas	EMEA	Asia-Pacific	Total	Americas	EMEA	Asia-Pacific
	(dollars in millions)										
Organic	$ 7.8	$ (4.9)	$ 0.1	$ 3.0	2.2%	(1.3)%	%	0.9%	3.7%	(3.5)%	1.5%
Foreign exchange	(1.7)	4.8	0.2	3.3	(0.5)	1.3	0.1	0.9	(0.8)	3.4	3.0
Total	$ 6.1	$ (0.1)	$ 0.3	$ 6.3	1.7%	%	0.1%	1.8%	2.9%	(0.1)%	4.5%

Our products are sold to wholesalers, DIY chains, and OEMs. The change in organic net sales by channel was attributable to the following:

Change
As a % of Prior Year Sales

	Wholesale	DIY	OEMs	Total	Wholesale	DIY	OEMs
			(dollars in millions)				
Americas	$ 7.5	$ 0.1	$ 0.2	$ 7.8	5.0%	0.2%	1.1%
EMEA	(2.0)	(0.8)	(2.1)	(4.9)	(2.8)	(19.5)	(3.3)
Asia-Pacific	0.1			0.1	1.5		
Total	$ 5.6	$ (0.7)	$ (1.9)	$ 3.0			

Organic net sales in the Americas wholesale, DIY and OEM markets increased in the first quarter of 2014, compared to the first quarter of 2013, mainly due to increased pricing in residential and commercial flow product lines.

Organic net sales into the EMEA wholesale market and OEM market decreased as compared to the first quarter of 2013 primarily due to softening in the German market. These decreases were partially offset in the EMEA wholesale market by increased sales in pre-insulated pipe products due to a milder winter which allowed for more underground installations throughout the season and in the OEM market by increased sales in our electronic controls business.

The net increase in sales due to foreign exchange was primarily due to the appreciation of the euro against the U.S. dollar offset partially by the depreciation of the Canadian dollar against the U.S. dollar. We cannot predict whether foreign currencies will appreciate or depreciate against the U.S. dollar in future periods or whether future foreign exchange rate fluctuations will have a positive or negative impact on our net sales.

Gross Profit. Gross profit and gross profit as a percent of net sales (gross margin) for the first quarters of 2014 and 2013 were as follows:

Table of Contents

	First Quarter Ended	
	March 30, 2014	**March 31, 2013**
	(dollars in millions)	
Gross profit	**$ 133.3**	$ 128.9
Gross margin	**36.5%**	35.9%

Americas gross margin increased compared to the first quarter of 2013 due primarily to volume growth and product mix offset partially by increased customer rebates and DIY pricing pressure. EMEA s gross margin increased primarily due to production efficiencies offsetting lower overhead absorption related to reduced volumes. Asia-Pacific s gross margin decreased primarily due to reduced absorption driven by lower intersegment sales.

Selling, General and Administrative Expenses. Selling, general and administrative, or SG&A, expenses for the first quarter of 2014 increased $5.2 million, or 5.3%, compared to the first quarter of 2013. The increase in SG&A expenses was attributable to the following:

	(in millions)	**% Change**
Organic	$ 4.5	4.6%
Foreign exchange	0.7	0.7
Total	$ 5.2	5.3%

The organic increase in SG&A expenses was primarily due to EMEA transformation deployment costs of $3.5 million, a $1.9 million accrual for additional U.S. import duties and fees pertaining to activities during the previous five years and increased commission and freight costs of $1.6 million associated with increased sales, partially offset by decreased personnel costs of $0.4 million and decreased legal expense of $2.2 million. The non-recurring EMEA deployment costs of $3.5 million consist primarily of external consulting and IT related costs. Decreased personnel costs primarily relate to the benefit from the former CEO s forfeiture of unvested equity awards, offset by investments in new positions and increased stock incentive plan costs. The decrease in legal expense in the current quarter was primarily due to fewer ongoing legal matters and a favorable legal settlement of $1.5 million. The increase in SG&A expenses from foreign exchange was primarily due to the appreciation of the euro against the U.S. dollar in 2014. Total SG&A expenses, as a percentage of sales, were 28.3% in the first quarter of 2014 and 27.3% in the first quarter of 2013.

Restructuring and Other Charges, Net. In the first quarter of 2014, we recorded a net charge of $4.2 million primarily for involuntary terminations and other costs incurred as part of our EMEA restructuring plans and a reduction-in-force in the Americas and Corporate, as compared to $2.2 million of restructuring charges for the first quarter of 2013. For a more detailed description of our current restructuring plans, see Note 5 of Notes to Consolidated Financial Statements.

Operating Income. Operating income (loss) by geographic segment for the first quarters of 2014 and 2013 were as follows:

	First Quarter Ended			% Change to Consolidated Operating Income
	March 30, 2014	**March 31, 2013**	**Change**	
		(dollars in millions)		
Americas	**$ 22.6**	$ 22.1	$ 0.5	1.8%

EMEA	**8.9**	10.9	(2.0)	(7.0)
Asia-Pacific	**0.9**	2.9	(2.0)	(7.0)
Corporate	**(6.6)**	(7.3)	0.7	2.4
Total	**$ 25.8**	$ 28.6	$ (2.8)	(9.8)%

The increase (decrease) in operating income (loss) is attributable to the following:

						Change As a % of Consolidated Operating Income					Change As a % of Segment Operating Income			
	Americas	EMEA	Asia-Pacific	Corporate	Total	Americas	EMEA	Asia-Pacific	Corporate	Total	Americas	EMEA	Asia-Pacific	Corporate
								(dollars in millions)						
Organic	$ 2.5	$ (3.0)	$ (2.0)	$ 1.5	$ (1.0)	8.7%	(10.4)%	(7.0)%	5.2%	(3.5)%	11.3%	(27.5)%	(69.0)%	20.6
Foreign exchange	(0.3)	0.5			0.2	(1.0)	1.7			0.7	(1.3)	4.6		
Restructuring, impairment charges and other	(1.7)	0.5		(0.8)	(2.0)	(5.9)	1.7		(2.8)	(7.0)	(7.7)	4.6		(11.0)
Total	$ 0.5	$ (2.0)	$ (2.0)	$ 0.7	$ (2.8)	1.8%	(7.0)%	(7.0)%	2.4%	(9.8)%	2.3%	(18.3)%	(69.0)%	9.6

The decrease in consolidated operating income was due primarily to an increase in SG&A expenses and restructuring and other charges. The increase in Americas organic operating income was driven by higher sales volume offset by increased restructuring expenses. The EMEA organic operating income decrease was due to EMEA transformation deployment costs of $3.5 million offset

Table of Contents

by productivity efficiencies and SG&A expense reductions. Asia-Pacific s organic operating income decreased primarily due to the impact on gross margins from reduced absorption driven by lower intercompany sales.

Interest Expense. Interest expense decreased $1.1 million, or 18.3%, for the first quarter of 2014 as compared to the first quarter of 2013 primarily due to the retirement in mid-May 2013 of $75 million in unsecured senior notes and a lower outstanding balance on our stand-by letters of credit.

Other expense, net. Other expense, net increased $0.4 million for the first quarter of 2014 as compared to the first quarter of 2013, primarily due to foreign currency transaction losses as a result of the Canadian dollar weakening against the U.S. dollar offset by appreciation of the euro and Chinese yuan against the U.S. dollar in 2014 compared to 2013.

Income Taxes. Our effective income tax rate for continuing operations increased to 31.6% in the first quarter of 2014, from 28.2% for the first quarter of 2013. The increase was largely due to worldwide earnings mix as a result of the Americas contributing a larger portion of worldwide earnings in 2014 than in 2013. The lower rate for the first quarter of 2013 was also driven by research credits realized in the U.S.

Net Income. Net income from continuing operations for the first quarter of 2014 was $14.1 million, or $0.40 per common share, compared to $16.3 million, or $0.46 per common share, for the first quarter of 2013. Results for the first quarter of 2014 include an after-tax charge of $2.7 million, or $0.08 per common share, for restructuring and other charges, EMEA transformation deployment costs of $2.5 million or $0.07 per common share, compared to $1.5 million, or $0.04 per common share, for restructuring and other charges for the first quarter of 2013.

Liquidity and Capital Resources

We used $18.7 million of net cash from operating activities in the first quarter of 2014 as compared to $2.0 million in the first quarter of 2013. This increase in cash outflow is primarily due to the net change in working capital driven by increased inventory balances related to our lead-free transition and decreased accounts payable due to the timing of prior year inventory purchases and relate payments. Working capital (defined as current assets less current liabilities) as of March 30, 2014 was $532.1 million compared to $457.1 million as of March 31, 2013.

We used $4.9 million of net cash for investing activities for the first quarter of 2014 for the purchase of capital equipment. For the remainder of fiscal year 2014, we expect to invest approximately $20 to 25 million in capital equipment as part of our ongoing commitment to improve our operating capabilities.

We used $18.0 million of net cash for financing activities for the first quarter of 2014 primarily for the payments to repurchase approximately 161,000 shares of Class A common stock at a cost of approximately $9.4 million and payment of dividends of $4.6 million. For the remainder of fiscal year 2014, we expect to invest approximately $30 million in our stock repurchase program.

On February 18, 2014, we terminated a prior credit agreement and entered into a new Credit Agreement (the Credit Agreement) among the Company, certain subsidiaries of the Company who become borrowers under the Credit Agreement, JPMorgan Chase Bank, N.A., as Administrative Agent, Swing Line Lender and Letter of Credit Issuer, and the other lenders referred to therein. The Credit Agreement provides for a $500 million, five-year, senior unsecured revolving credit facility which may be increased by an additional $500 million under certain circumstances and subject to the terms of the Credit Agreement. The Credit Agreement has a sublimit of up to $100 million in letters of credit. The Credit Agreement matures on February 18, 2019.

Borrowings outstanding under the Credit Agreement bear interest at a fluctuating rate per annum equal to an applicable percentage equal to (1) in the case of Eurocurrency rate loans, the British Bankers Association LIBOR rate plus an applicable percentage, ranging from 0.975% to 1.45%, determined by reference to the Company s consolidated leverage ratio, or (2) in the case of base rate loans and swing line loans, the highest of (a) the federal funds rate plus 0.5%, (b) the rate of interest in effect for such day as announced by JPMorgan Chase Bank, N.A. as its prime rate, and (c) the British Bankers Association LIBOR rate plus 1.0%, plus an applicable percentage, ranging from 0.00% to 0.45%, determined by reference to our consolidated leverage ratio. In addition to paying interest under the Credit Agreement, we are also required to pay certain fees in connection with the credit facility, including, but not limited to, an unused facility fee and letter of credit fees. Under the Credit Agreement, we are required to satisfy and maintain specified financial ratios and other financial condition tests. We may repay loans outstanding under the Credit Agreement from time to time without premium or penalty, other than customary breakage costs, if any, and subject to the terms of the Credit Agreement. As of March 30, 2014, we had $23.6 million of stand-by letters of credit outstanding under the Credit Agreement. As of March 30, 2014, we were in compliance with all covenants related to the Credit Agreement and had $476.4 million of unused and available credit under the Credit Agreement.

Working capital as of March 30, 2014 was $532.1 million compared to $530.2 million as of December 31, 2013. Cash and cash equivalents decreased to $225.0 million as of March 30, 2014, compared to $267.9 million as of December 31, 2013. The decrease in

Table of Contents

cash and cash equivalents was driven primarily by the repurchase of stock, an increase in inventory and cash used in other operating activities. The ratio of current assets to current liabilities was 2.7 to 1 as of March 30, 2014 and 2.6 to 1 as of December 31, 2013.

As of March 30, 2014, we held $225.0 million in cash and cash equivalents. Of this amount, approximately $200.0 million of cash and cash equivalents was held by foreign subsidiaries. Our ability to fund U.S. operations from this balance could be limited by possible tax implications of moving proceeds across jurisdictions. Our U.S. operations currently generate sufficient cash flows to meet our domestic obligations. We also have the ability to borrow funds at reasonable interest rates or utilize the committed funds under our Credit Agreement. However, if amounts held by foreign subsidiaries were needed to fund operations in the United States, we could be required to accrue and pay taxes to repatriate these funds. Such charges may include a federal tax of up to 35.0% on dividends received in the U.S., potential state income taxes and an additional withholding tax payable to foreign jurisdictions of up to 10.0%. However, our intent is to permanently reinvest undistributed earnings of foreign subsidiaries through operations or acquisitions, and there are no current plans to repatriate the undistributed earnings to fund operations in the United States.

Non-GAAP Financial Measures

We believe free cash flow to be an appropriate supplemental measure of our operating performance because it provides investors with a measure of our ability to generate cash, repay debt, pay dividends, repurchase stock and fund acquisitions. Other companies may define free cash flow differently. Free cash flow does not represent cash generated from operating activities in accordance with U.S. Generally Accepted Accounting Principles (GAAP). Therefore it should not be considered an alternative to net cash provided by operations as an indication of our performance. The cash conversion rate of free cash flow to net income is also a measure of our performance in cash flow generation.

A reconciliation of net cash provided by operating activities to free cash outflow and calculation of our cash conversion rate is provided below:

	First Quarter Ended	
	March 30, 2014	March 31, 2013
	(in millions)	
Net cash used in operating activities	**$ (18.7)**	$ (2.0)
Less: additions to property, plant, and equipment	**(5.0)**	(11.0)
Plus: proceeds from the sale of property, plant, and equipment	**0.1**	
Free cash outflow	**$ (23.6)**	$ (13.0)
Net income from continuing operations	**$ 14.1**	$ 16.3
Cash conversion rate of free cash outflow to net income from continuing operations	**(167.4)%**	(79.8)%

Our free cash outflow increased in the first quarter of 2014 when compared to the first quarter of 2013 primarily due to an investment in working capital.

Our net debt to capitalization ratio (a non-GAAP financial measure) at March 30, 2014 was 7.6%, compared to 3.8% at December 31, 2013. The increase in net debt to capitalization ratio is due to an increase in net debt primarily driven by a reduction in cash and cash equivalents at March 30, 2014. Management believes the net debt to capitalization ratio is an appropriate supplemental measure because it helps investors understand our ability to meet our financing needs and serves as a basis to evaluate our financial structure. Our computation may not be comparable to other companies that may define their net debt to capitalization ratios differently.

A reconciliation of long-term debt (including current portion) to net debt and our net debt to capitalization ratio is provided below:

	March 30, 2014	December 31, 2013
	(in millions)	
Current portion of long-term debt	**$ 2.2**	$ 2.2
Plus: long-term debt, net of current portion	**305.1**	305.5
Less: cash and cash equivalents	**(225.0)**	(267.9)
Net debt	**$ 82.3**	$ 39.8

Table of Contents

		March 30, 2014		December 31, 2013
		(in millions)		
Net debt	$	**82.3**	$	39.8
Plus: total stockholders equity		**1,000.7**		1,002.1
Capitalization	$	**1,083.0**	$	1,041.9
Net debt to capitalization ratio		**7.6%**		3.8%

We maintain letters of credit that guarantee our performance or payment to third parties in accordance with specified terms and conditions. Amounts outstanding were approximately $23.6 million as of March 30, 2014 and at December 31, 2013. Our letters of credit are primarily associated with insurance coverage and, to a lesser extent, foreign purchases and generally expire within one year of issuance. These instruments may exist or expire without being drawn down; therefore they do not necessarily represent future cash flow obligations.

Off-Balance Sheet Arrangements

Except for operating lease commitments, we have no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors.

Application of Critical Accounting Policies and Key Estimates

The preparation of our consolidated financial statements in accordance with GAAP requires management to make judgments, assumptions and estimates that affect the amounts reported. A critical accounting estimate is an assumption about highly uncertain matters and could have a material effect on the consolidated financial statements if another, also reasonable, amount were used, or, a change in the estimate is reasonably likely from period to period. We base our assumptions on historical experience and on other estimates that we believe are reasonable under the circumstances. Actual results could differ significantly from these estimates. There were no changes in accounting policies or significant changes in accounting estimates during the first three months of 2014.

We periodically discuss the development, selection and disclosure of the estimates with our Audit Committee. Management believes the following critical accounting policies reflect its more significant estimates and assumptions.

Revenue recognition

We recognize revenue when all of the following criteria are met: (1) we have entered into a binding agreement, (2) the product has shipped and title has passed, (3) the sales price to the customer is fixed or is determinable and (4) collectability is reasonably assured. We recognize revenue based upon a determination that all criteria for revenue recognition have been met, which, based on the majority of our shipping terms, is considered to have occurred upon shipment of the finished product. Some shipping terms require the goods to be received by the customer before title passes. In those instances, revenues are not recognized until the customer has received the goods. We record estimated reductions to revenue for customer returns and allowances and for customer programs. Provisions for returns and allowances are made at the time of sale, derived from historical trends and form a portion of the allowance for doubtful accounts. Customer programs, which are primarily annual volume incentive plans, allow customers to earn credit for attaining agreed upon purchase targets from us. We record estimated reductions to revenue, made at the time of sale, for customer programs based on estimated purchase targets.

Allowance for doubtful accounts

The allowance for doubtful accounts is established to represent our best estimate of the net realizable value of the outstanding accounts receivable. The development of our allowance for doubtful accounts varies by region but in general is based on a review of past due amounts, historical write-off experience, as well as aging trends affecting specific accounts and general operational factors affecting all accounts. In addition, factors are developed in certain regions utilizing historical trends of sales and returns and allowances and cash discount activities to derive a reserve for returns and allowances and cash discounts.

We uniformly consider current economic trends and changes in customer payment terms when evaluating the adequacy of the allowance for doubtful accounts. We also aggressively monitor the creditworthiness of our largest customers, and periodically review customer credit limits to reduce risk. If circumstances relating to specific customers change or unanticipated changes occur in the general business environment, our estimates of the recoverability of receivables could be further adjusted.

Table of Contents

Inventory valuation

Inventories are stated at the lower of cost or market with costs determined primarily on a first-in first-out basis. We utilize both specific product identification and historical product demand as the basis for determining our excess or obsolete inventory reserve. We identify all inventories that exceed a range of one to four years in sales. This is determined by comparing the current inventory balance against unit sales for the trailing twelve months. New products added to inventory within the past twelve months are excluded from this analysis. A portion of our products contain recoverable materials, therefore the excess and obsolete reserve is established net of any recoverable amounts. Changes in market conditions, lower-than-expected customer demand, changes in regulation such as the lead to lead free requirements in the U.S., or changes in technology or features could result in additional obsolete inventory that is not saleable and could require additional inventory reserve provisions.

In certain countries, additional inventory reserves are maintained for potential shrinkage experienced in the manufacturing process. The reserve is established based on the prior year s inventory losses adjusted for any change in the gross inventory balance.

Goodwill and other intangibles

We have made numerous acquisitions over the years which included the recognition of a significant amount of goodwill. Goodwill is tested for impairment annually or more frequently if an event or circumstance indicates that an impairment loss may have been incurred. Application of the goodwill impairment test requires judgment, including the identification of reporting units, assignment of assets and liabilities to reporting units, and determination of the fair value of each reporting unit. We estimate the fair value of our reporting units using an income approach based on the present value of estimated future cash flows, and when appropriate, guideline public company and guideline transaction market approach. We have eight reporting units in continuing operations, including Residential and Commercial, Dormont, Drains & Water Re-use, Water Quality, EMEA, Blücher, BRAE and Asia. Our Water Quality and BRAE reporting units have no goodwill.

We review goodwill for impairment as of October month end, or earlier if there is a triggering event or circumstance that indicates that an impairment loss may have been incurred. Accounting guidance allows us to review goodwill for impairment utilizing either qualitative or quantitative analyses. We have the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events and circumstances, we determine it is more likely than not that the fair value of a reporting unit is greater than its carrying amount, then performing the two-step (quantitative) impairment test is unnecessary.

We first identify those reporting units that we believe could pass a qualitative assessment to determine whether further impairment testing is necessary. For each reporting unit identified, our qualitative analysis includes:

1) A review of the most recent fair value calculation to identify the extent of the cushion between fair value and carrying amount, to determine if a substantial cushion existed.

2) A review of events and circumstances that have occurred since the most recent fair value calculation to determine if those events or circumstances would have affected our previous fair value assessment. Items identified and reviewed include macroeconomic conditions, industry and market changes, cost factor changes, events that affect the reporting unit, financial performance against expectations and the reporting unit s performance relative to peers.

We then compile this information and make our assessment of whether it is more likely than not that the fair value of the reporting unit is less than its carrying amount. If we determine it is not more likely than not, then no further quantitative analysis is required.

The second analysis for goodwill impairment involves a quantitative two-step process. The first step of the impairment test requires a comparison of the fair value of each of our reporting units to the respective carrying value. If the carrying value of a reporting unit is less than its fair value, no indication of impairment exists and a second step is not performed. If the carrying amount of a reporting unit is higher than its fair value, there is an indication that impairment may exist and a second step must be performed. In the second step, the impairment is computed by comparing the implied fair value of the reporting unit s goodwill with the carrying amount of the goodwill. If the carrying amount of the reporting unit s goodwill is greater than the implied fair value of its goodwill, an impairment loss must be recognized for the excess and charged to operations.

Inherent in our development of the present value of future cash flow projections are assumptions and estimates derived from a review of our operating results, business plans, expected growth rates, cost of capital and tax rates. We also make certain assumptions about future economic conditions and other market data. We develop our assumptions based on our historical results including sales growth, operating profits, working capital levels and tax rates.

We believe that the discounted cash flow model is sensitive to the selected discount rate. We use third-party valuation specialists to help develop appropriate discount rates for each reporting unit. We use standard valuation practices to arrive at a weighted average cost of capital based on the market and guideline public companies. The higher the discount rate, the lower the discounted cash flows. While we believe that our estimates of future cash flows are reasonable, different assumptions could significantly affect our valuations and result in impairments in the future.

Table of Contents

Intangible assets such as trademarks and trade names are generally recorded in connection with a business acquisition. Values assigned to intangible assets are determined by an independent valuation firm based on our estimates and judgments regarding expectations of the success and life cycle of products and technology acquired. Revised accounting guidance issued in 2012 allows us to perform a qualitative impairment assessment of indefinite-lived intangible assets consistent with the goodwill guidance noted previously. For our 2013 impairment assessment, we performed quantitative assessments for all indefinite-lived intangible assets. The methodology we employed was the relief from royalty method, a subset of the income approach. Similar to goodwill, we review indefinite-lived intangible assets for impairment as of October month end, or earlier if there is a triggering event or circumstance that indicate that an impairment loss may have been incurred.

Product liability and workers compensation costs

Because of retention requirements associated with our insurance policies, we are generally self-insured for potential product liability claims and for workers compensation costs associated with workplace accidents. We are subject to a variety of potential liabilities in connection with product liability cases and we maintain product liability and other insurance coverage, which we believe to be generally in accordance with industry practices. For product liability cases in the U.S., management establishes its product liability accrual, which includes legal costs associated with accrued claims, by utilizing third-party actuarial valuations that incorporate historical trend factors and our specific claims experience derived from loss reports provided by third-party claims administrators. Changes in the nature of claims, legal costs, or the actual settlement amounts could affect the adequacy of this estimate and require changes to the accrual. Because the liability is an estimate, the ultimate liability may be more or less than reported. In other countries, we maintain insurance coverage with relatively high deductible payments, as product liability claims tend to be smaller than those experienced in the U.S.

Workers compensation liabilities in the U.S. are recognized for claims incurred (including claims incurred but not reported), legal costs associated with accrued claims, and for changes in the status of individual case reserves. At the time a workers compensation claim is filed, a liability is estimated to settle the claim. The liability for workers compensation claims is determined based on management s estimates of the nature and severity of the claims and based on analysis provided by third-party claims administrators and by various state statutes and reserve requirements. We have developed our own trend factors based on our specific claims experience, discounted based on risk-free interest rates. We employ third-party actuarial valuations to help us estimate our workers compensation accrual. In other countries where workers compensation costs are applicable, we maintain insurance coverage with limited deductible payments. Because the liability is an estimate, the ultimate liability may be more or less than reported and is subject to changes in discount rates.

We determine the trend factors for product liability and workers compensation liabilities based on consultation with outside actuaries.

We maintain excess liability insurance with outside insurance carriers to minimize our risks related to catastrophic claims in excess of all self-insured positions. Any material change in the aforementioned factors could have an adverse impact on our operating results.

Legal contingencies

We are a defendant in numerous legal matters including those involving environmental law and product liability as discussed in more detail in Part I, Item 1, Business - Product Liability, Environmental and Other Litigation Matters, of our Annual Report on Form 10-K for the year ended December 31, 2013. As required by GAAP, we determine whether an estimated loss from a loss contingency should be accrued by assessing whether a loss is deemed probable and the loss amount can be reasonably estimated, net of any applicable insurance proceeds. When it is possible to estimate reasonably possible loss or range of loss above the amount accrued, that estimate is aggregated and disclosed. Estimates of potential outcomes of these contingencies are developed in consultation with outside counsel. While this assessment is based upon all available information, litigation is inherently uncertain and the actual liability to fully resolve this litigation cannot be predicted with any assurance of accuracy. In the event of an unfavorable outcome in one or more legal matters, the ultimate liability may be in excess of amounts currently accrued, if any, and may be material to our operating results or cash flows for a particular quarterly or annual period.

Pension benefits

We account for our pension plans in accordance with GAAP, which involves recording a liability or asset based on the projected benefit obligation and the fair value of plan assets. Assumptions are made regarding the valuation of benefit obligations and the performance of plan assets. The primary assumptions are as follows:

Table of Contents

- Weighted average discount rate this rate is used to estimate the current value of future benefits. This rate is adjusted based on movement in long-term interest rates.

- Expected long-term rate of return on assets this rate is used to estimate future growth in investments and investment earnings. The expected return is based upon a combination of historical market performance and anticipated future returns for a portfolio reflecting the mix of equity, debt and other investments indicative of our plan assets.

We determine these assumptions based on consultation with outside actuaries and investment advisors. Any variance in these assumptions could have a significant impact on future recognized pension costs, assets and liabilities. On October 31, 2011, our Board of Directors voted to cease accruals of additional benefits effective December 31, 2011 under both the Pension Plan and Supplemental Employees Retirement Plan. On April 28, 2014, the Company s Board of Directors voted to terminate the Company s Pension Plan and Supplemental Employees Retirement Plan. Refer to Note 12 in Item 1. Financial Statement, for further details.

Income taxes

We estimate and use our expected annual effective income tax rates to accrue income taxes. Effective tax rates are determined based on budgeted earnings before taxes, including our best estimate of permanent items that will affect the effective rate for the year. Management periodically reviews these rates with outside tax advisors and changes are made if material variances from expectations are identified.

We recognize deferred taxes for the expected future consequences of events that have been reflected in the consolidated financial statements. Deferred tax assets and liabilities are determined based on differences between the book values and tax bases of particular assets and liabilities, using tax rates in effect for the years in which the differences are expected to reverse. A valuation allowance is provided to offset any net deferred tax assets if, based upon the available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized. We consider estimated future taxable income and ongoing prudent tax planning strategies in assessing the need for a valuation allowance.

New Accounting Standards

In April 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-08, Presentation of Financial Statements and Property, Plant, and Equipment: Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity . ASU 2014-08 will change the definition of discontinued operations and limit discontinued operations presentation to disposals of components representing a strategic shift that will have a major effect on the operations and financial results of the issuer. ASU 2014-08 is effective in the first quarter of 2015 for public companies with calendar year ends, with early adoption permitted. The adoption of this guidance is not expected to have a material impact on the Company s financial statements.

Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>

We use derivative financial instruments primarily to reduce exposure to adverse fluctuations in foreign exchange rates, interest rates and costs of certain raw materials used in the manufacturing process. We do not enter into derivative financial instruments for trading purposes. As a matter of policy, all derivative positions are used to reduce risk by hedging underlying economic exposure. The derivatives we use are instruments with liquid markets.

Our consolidated earnings, which are reported in United States dollars, are subject to translation risks due to changes in foreign currency exchange rates. This risk is concentrated primarily in the exchange rate between the U.S. dollar and the euro; the U.S. dollar and the Canadian dollar; and the U.S. dollar and the Chinese yuan.

Our foreign subsidiaries transact most business, including certain intercompany transactions, in foreign currencies. Such transactions are principally purchases or sales of materials and are denominated in European currencies or the U.S. or Canadian dollar. We use foreign currency forward exchange contracts to manage the risk related to intercompany purchases that occur during the course of a year and certain open foreign currency denominated commitments to sell products to third parties. Realized and unrealized gains and losses on the contracts we recognized in other (income) expense are not material.

We have historically had a low exposure on the cost of our debt to changes in interest rates. Information about our long-term debt, including principal amounts and related interest rates, appears in Notes 4 and 9 of this report and in Note 10 of Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2013.

Table of Contents

We purchase significant amounts of bronze ingot, brass rod, cast iron, steel and plastic, which are utilized in manufacturing our many product lines. Our operating results can be adversely affected by changes in commodity prices if we are unable to pass on related price increases to our customers. We manage this risk by monitoring related market prices, working with our suppliers to achieve the maximum level of stability in their costs and related pricing, seeking alternative supply sources when necessary, purchasing forward commitments for raw materials, when available, implementing cost reduction programs, value engineering, and passing increases in costs onto our customers in the form of price increases.

Item 4. Controls and Procedures

As required by Rule 13a-15(b) under the Securities Exchange Act of 1934, as amended, or Exchange Act, as of the end of the period covered by this report, we carried out an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer (our principal executive officer and principal financial officer, respectively), of the effectiveness of our disclosure controls and procedures. In designing and evaluating our disclosure controls and procedures, we recognize that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and our management necessarily applies its judgment in evaluating and implementing possible controls and procedures. The effectiveness of our disclosure controls and procedures is also necessarily limited by the staff and other resources available to us and the geographic diversity of our operations. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective, in that they provide reasonable assurance that information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms and are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act are accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

There was no change in our internal control over financial reporting that occurred during the quarter ended March 30, 2014, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. In connection with these rules, we will continue to review and document our disclosure controls and procedures, including our internal control over financial reporting, and may from time to time make changes aimed at enhancing their effectiveness and to ensure that our systems evolve with our business.

Part II. OTHER INFORMATION

Item l. Legal Proceedings

As disclosed in Part I, Item 1, Product Liability, Environmental and Other Litigation Matters of our Annual Report on Form 10-K for the year ended December 31, 2013, we are party to certain litigation. Except as included in Part I. Financial Statement Note 10 under Trabakoolas et al., v, Watts Water Technologies, Inc., et al., there have been no material developments with respect to our contingencies and environmental remediation proceedings during the quarter ended March 30, 2014.

Item 1A. Risk Factors

This report may include statements that are not historical facts and are considered forward-looking within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements reflect our current views about future results of operations and other forward-looking information. In some cases you can identify these statements by forward-looking words such as anticipate, believe, could, estimate, expect, intend, may, should and would or similar words. You should not rely on forward-looking statements because our actual may differ materially from those indicated by these forward-looking statements as a result of a number of important factors. These factors include, but are not limited to, the following: the effectiveness of our operational excellence initiatives and cost recovery actions; the current economic and financial condition, which can affect levels of housing starts and remodeling, affecting the markets where our products are sold, manufactured, or marketed; production inefficiencies related to our lead free foundry; shortages in and pricing of raw materials and supplies; loss of market share through competition; introduction of competing products by other companies; pressure on prices from competitors, suppliers, and/or customers; changes in variable interest rates on our borrowings; identification and disclosure of material weaknesses in our internal control over financial reporting; failure to expand our markets through acquisitions; failure or delay in developing new products; lack of acceptance of new products; failure to manufacture products that meet required performance and safety standards; foreign exchange rate fluctuations; cyclicality of industries, such as plumbing and heating wholesalers and home improvement retailers, in which we market certain of our products; environmental compliance costs; product liability risks; failure of the settlement in Trabakoolas v. Watts to gain approval; the results and timing of our restructuring plans; changes in the status of current litigation, and other risks and uncertainties discussed in Part I, Item 1A. Risk Factors and in Note 14 of the Notes to the Consolidated Financial Statements in our

Table of Contents

Annual Report on Form 10-K for the year ended December 31, 2013 filed with the Securities Exchange Commission, and in other reports we file from time to time with the Securities and Exchange Commission.

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

We satisfy the minimum withholding tax obligation due upon the vesting of shares of restricted stock and the conversion of restricted stock units into shares of Class A common stock by automatically withholding from the shares being issued a number of shares with an aggregate fair market value on the date of such vesting or conversion that would satisfy the withholding amount due.

The following table includes information with respect to shares of our Class A common stock withheld to satisfy withholding tax obligations during the three-month period ended March 30, 2014.

		Issuer Purchases of Equity Securities		
Period	**(a) Total Number of Shares (or Units) Purchased**	**(b) Average Price Paid per Share (or Unit)**	**(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs**	**(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs**
January 1, 2014 January 26, 2014		$		
January 27, 2014 February 23, 2014	1,794	$ 54.77		
February 24, 2014 March 30, 2014	14,931	$ 60.50		
Total	16,725	$ 59.88		

The following table includes information with respect to repurchases of our Class A common stock during the three-month period ended March 30, 2014 under our stock repurchase program.

		Issuer Purchases of Equity Securities		
Period	**(a) Total Number of Shares (or Units) Purchased (1)**	**(b) Average Price Paid per Share (or Unit)**	**(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs**	**(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs**
January 1, 2014 January 26, 2014	44,373	$ 59.39	44,373	$ 64,376,291
January 27, 2014 February 23, 2014	53,094	$ 56.40	53,094	$ 61,381,982
February 24, 2014 March 30, 2014	63,150	$ 59.15	63,150	$ 57,646,635
Total	160,617	$ 58.31	160,617	

(1) On April 30, 2013, the Board of Directors authorized a stock repurchase program of up to $90 million of the Company s Class A common stock to be purchased from time to time on the open market or in privately negotiated transactions. The timing and number of any shares repurchased will be determined by the Company s management based on its evaluation of market conditions. During the quarter ended March 30, 2014, we repurchased approximately $9.4 million of common stock.

Item 6. Exhibits

The exhibits listed in the Exhibit Index immediately preceding the exhibits are filed as part of this Quarterly Report on Form 10-Q and such Exhibit Index is incorporated herein by reference.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

	WATTS WATER TECHNOLOGIES, INC.	
Date: May 8, 2014	By:	/s/ Dean P. Freeman Dean P. Freeman Chief Executive Officer, President and Chief Financial Officer (principal financial officer)
Date: May 8, 2014	By:	/s/ Kenneth S. Korotkin Kenneth S. Korotkin Chief Accounting Officer (principal accounting officer)

Table of Contents

EXHIBIT INDEX

Listed and indexed below are all Exhibits filed as part of this report.

Exhibit No.	Description
3.1	Restated Certificate of Incorporation, as amended (1)
3.2	Amended and Restated By-Laws (2)
10.1	Form of 2014 Performance Stock Unit Award Agreement under the Watts Water Technologies, Inc. Second Amended and Restated 2004 Stock Incentive Plan
10.2	Credit Agreement, dated as of February 18, 2014, among the Registrant, certain subsidiaries of the Registrant as Borrowers, JP Morgan Chase Bank, N.A., as Administrative Agent, Swing Line Lender and L/C Issuer and the other lenders referred to therein (3)
10.3	Guaranty, dated as of February 18, 2014, by the Registrant and the subsidiaries of the Registrant set forth therein, in favor of JP Morgan Chase bank, N.A. and the other lenders referred to therein (3)
31	Certification of Principal Executive Officer and Principal Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended
32	Certification of Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. 1350
101.INS*	XBRL Instance Document.
101.SCH*	XBRL Taxonomy Extension Schema Document.
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document.

---

* Attached as Exhibit 101 to this report are the following formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Balance Sheets at March 30, 2014 and December 31, 2013, (ii) Consolidated Statements of Operations for the First Quarters Ended March 30, 2014 and March 31, 2013, (iii) Consolidated Statements of Comprehensive Income (Loss) for the First Quarters Ended March 30, 2014 and March 31, 2013, (iv) Consolidated Statements of Cash Flows for the First Quarters Ended March 30, 2014 and March 31, 2013, and (v) Notes to Consolidated Financial Statements.

(1) Incorporated by reference to the Registrant s Quarterly Report on Form 10-Q (File No. 001-11499) for the quarter ended July 3, 2005.

(2) Incorporated by reference to the Registrant s Current Report on Form 8-K (File No. 001-11499) dated April 29, 2013.

(3) Incorporated by reference to the Registrant s Current Report on Form 8-K (File No. 001-11499) dated February 18, 2014.