WATTS WATER TECHNOLOGIES INC
Form 10-Q
November 04, 2015
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 September 27, 2015**

**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**<br>(State or Other Jurisdiction of Incorporation or Organization) | **04-2916536**<br>(I.R.S. Employer Identification No.) |
| **815 Chestnut Street, North Andover, MA**<br>(Address of Principal Executive Offices) | **01845**<br>(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<br>(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 November 2, 2015** |
|---|---|
| Class A Common Stock, $0.10 par value | 28,133,911 |
| Class B Common Stock, $0.10 par value | 6,379,290 |

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)

| | September 27, 2015 | December 31, 2014 |
|---|---|---|
| **ASSETS** | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | **$ 288.8** | $ 301.1 |
| Trade accounts receivable, less allowance for doubtful accounts of $11.5 million at September 27, 2015 and $10.6 million at December 31, 2014 | **220.8** | 207.8 |
| Inventories, net: | | |
| Raw materials | **93.2** | 104.8 |
| Work in process | **16.4** | 16.7 |
| Finished goods | **144.7** | 170.1 |
| Total Inventories | **254.3** | 291.6 |
| Prepaid expenses and other assets | **32.8** | 27.4 |
| Deferred income taxes | **54.4** | 45.3 |
| Assets held for sale | **2.2** | 1.1 |
| Total Current Assets | **853.3** | 874.3 |
| PROPERTY, PLANT AND EQUIPMENT: | | |
| Property, plant and equipment, at cost | **495.4** | 526.7 |
| Accumulated depreciation | **(310.3)** | (323.4) |
| Property, plant and equipment, net | **185.1** | 203.3 |
| OTHER ASSETS: | | |
| Goodwill | **613.9** | 639.0 |
| Intangible assets, net | **189.6** | 210.1 |
| Deferred income taxes | **4.5** | 4.7 |
| Other, net | **11.9** | 16.6 |
| TOTAL ASSETS | **$ 1,858.3** | $ 1,948.0 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| CURRENT LIABILITIES: | | |
| Accounts payable | **$ 103.6** | $ 120.8 |
| Accrued expenses and other liabilities | **141.9** | 138.8 |
| Accrued pension plan settlements | | 40.0 |
| Accrued compensation and benefits | **47.6** | 44.2 |
| Current portion of long-term debt | **226.4** | 1.9 |
| Total Current Liabilities | **519.5** | 345.7 |
| LONG-TERM DEBT, NET OF CURRENT PORTION | **351.6** | 577.8 |
| DEFERRED INCOME TAXES | **95.2** | 77.4 |
| OTHER NONCURRENT LIABILITIES | **31.3** | 34.7 |
| STOCKHOLDERS EQUITY: | | |
| Preferred Stock, $0.10 par value; 5,000,000 shares authorized; no shares issued or outstanding | | |
| | **2.8** | 2.9 |

| | | | | |
|---|---|---|---|---|
| Class A Common Stock, $0.10 par value; 80,000,000 shares authorized; 1 vote per share; issued and outstanding 28,162,869 shares at September 27, 2015 and 28,552,065 shares at December 31, 2014 | | | | |
| Class B Common Stock, $0.10 par value; 25,000,000 shares authorized; 10 votes per share; issued and outstanding, 6,479,290 shares at September 27, 2015 and December 31, 2014 | | **0.6** | | 0.6 |
| Additional paid-in capital | | **508.3** | | 497.4 |
| Retained earnings | | **454.5** | | 500.6 |
| Accumulated other comprehensive loss | | **(105.5)** | | (89.1) |
| Total Stockholders Equity | | **860.7** | | 912.4 |
| TOTAL LIABILITIES AND STOCKHOLDERS EQUITY | **$** | **1,858.3** | $ | 1,948.0 |

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)

| | Third Quarter Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | **September 27, 2015** | **September 28, 2014** | **September 27, 2015** | **September 28, 2014** |
| Net sales | **$ 366.3** | $ 376.0 | **$ 1,109.4** | $ 1,137.2 |
| Cost of goods sold | **224.1** | 237.9 | **690.9** | 726.8 |
| GROSS PROFIT | **142.2** | 138.1 | **418.5** | 410.4 |
| Selling, general and administrative expenses | **166.6** | 95.0 | **378.6** | 298.1 |
| Restructuring | **5.8** | 0.4 | **12.5** | 7.2 |
| OPERATING (LOSS) INCOME | **(30.2)** | 42.7 | **27.4** | 105.1 |
| Other (income) expense: | | | | |
| Interest income | **(0.3)** | (0.1) | **(0.7)** | (0.4) |
| Interest expense | **6.2** | 4.8 | **18.0** | 14.6 |
| Other (income) expense, net | **(0.2)** | 1.6 | **(0.8)** | 1.9 |
| Total other expense | **5.7** | 6.3 | **16.5** | 16.1 |
| (LOSS) INCOME BEFORE INCOME TAXES | **(35.9)** | 36.4 | **10.9** | 89.0 |
| (Benefit) provision for income taxes | **(10.2)** | 13.8 | **5.7** | 31.0 |
| NET (LOSS) INCOME | **$ (25.7)** | $ 22.6 | **$ 5.2** | $ 58.0 |
| | | | | |
| **BASIC EPS** | | | | |
| Net (loss) income per share: | | | | |
| NET (LOSS) INCOME | **$ (0.73)** | $ 0.64 | **$ 0.15** | $ 1.64 |
| Weighted average number of shares | **35.0** | 35.3 | **35.0** | 35.3 |
| | | | | |
| **DILUTED EPS** | | | | |
| Net (loss) income per share: | | | | |
| NET (LOSS) INCOME | **$ (0.73)** | $ 0.64 | **$ 0.15** | $ 1.64 |
| Weighted average number of shares | **35.0** | 35.4 | **35.1** | 35.4 |
| | | | | |
| Dividends per share | **$ 0.17** | $ 0.15 | **$ 0.49** | $ 0.43 |

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)

| | Third Quarter Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | **September 27, 2015** | **September 28, 2014** | **September 27, 2015** | **September 28, 2014** |
| Net (loss) income | **$ (25.7)** | $ 22.6 | **$ 5.2** | $ 58.0 |
| | | | | |
| Other comprehensive income (loss): | | | | |
| Foreign currency translation adjustments | **(5.8)** | (44.4) | **(52.5)** | (53.0) |
| Defined benefit pension plans, net of tax: | | | | |
| Actuarial loss, net of tax of $0.7 and $6.6 in 2015 and 2014, respectively | **(1.2)** | (10.5) | **(1.2)** | (10.5) |
| Settlement, net of tax of $23.0 | **36.7** | | **36.7** | |
| Amortization of net losses included in net periodic pension cost | **0.2** | 0.2 | **0.6** | 0.5 |
| Defined benefit pension plans, net of tax | **35.7** | (10.3) | **36.1** | (10.0) |
| Other comprehensive income (loss) | **29.9** | (54.7) | **(16.4)** | (63.0) |
| Comprehensive income (loss) | **$ 4.2** | $ (32.1) | **$ (11.2)** | $ (5.0) |

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)

| | Nine Months Ended | |
|---|---|---|
| | **September 27, 2015** | **September 28, 2014** |
| **OPERATING ACTIVITIES** | | |
| Net income | **$ 5.2** | $ 58.0 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | **23.8** | 24.7 |
| Amortization of intangibles | **15.9** | 11.1 |
| Loss on disposal and impairment of goodwill, property, plant and equipment and other | **1.6** | 0.1 |
| Stock-based compensation | **7.7** | 6.0 |
| Deferred income tax benefit | **(11.3)** | 1.1 |
| Defined benefit plans settlement | **59.7** | |
| Changes in operating assets and liabilities, net of effects from business acquisitions and divestitures: | | |
| Accounts receivable | **(20.0)** | (18.5) |
| Inventories | **7.3** | (5.3) |
| Prepaid expenses and other assets | **(5.3)** | 17.9 |
| Accounts payable, accrued expenses and other liabilities | **(42.7)** | (21.6) |
| Net cash provided by operating activities | **41.9** | 73.5 |
| **INVESTING ACTIVITIES** | | |
| Additions to property, plant and equipment | **(19.2)** | (16.1) |
| Proceeds from the sale of property, plant and equipment | **0.1** | 0.4 |
| Net proceeds from the sale of assets, and other | **33.8** | |
| Net cash provided by (used in) investing activities | **14.7** | (15.7) |
| **FINANCING ACTIVITIES** | | |
| Payments of long-term debt | **(1.3)** | (1.6) |
| Payment of capital leases and other | **(3.4)** | (3.3) |
| Proceeds from share transactions under employee stock plans | **2.1** | 10.5 |
| Tax benefit of stock awards exercised | **0.2** | 1.9 |
| Payments to repurchase common stock | **(32.0)** | (29.1) |
| Debt issue costs | | (2.0) |
| Dividends | **(17.2)** | (15.2) |
| Net cash used in financing activities | **(51.6)** | (38.8) |
| Effect of exchange rate changes on cash and cash equivalents | **(17.3)** | (14.5) |
| (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS | **(12.3)** | 4.5 |
| Cash and cash equivalents at beginning of year | **301.1** | 267.9 |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | **$ 288.8** | $ 272.4 |
| | | |
| CASH PAID FOR: | | |
| Interest | **$ 12.6** | **$** 9.6 |
| Income taxes | **$ 18.6** | $ 21.7 |

See accompanying notes to consolidated financial statements.

6

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 September 27, 2015, the Consolidated Statements of Operations for the third quarters and nine months ended September 27, 2015 and September 28, 2014, the Consolidated Statements of Comprehensive Income (Loss) for the third quarters and nine months ended September 27, 2015 and September 28, 2014, and the Consolidated Statements of Cash Flows for the nine months ended September 27, 2015 and September 28, 2014.

The consolidated balance sheet at December 31, 2014 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, 2014. 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, 2014. Operating results for the interim periods presented are not necessarily indicative of the results to be expected for the year ending December 31, 2015.

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 or 39-week period, respectively.

## 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*

During the second quarter of 2015, $4.1 million of goodwill in the Americas segment was reclassified to assets held for sale and included in the net assets sold during the third quarter of 2015. Refer to Note 6 Sale of Business, for further discussion. Also during the second quarter of 2015, the working capital adjustment relating to the AERCO International, Inc. ( AERCO ) acquisition was finalized resulting in a $0.7 million reduction in the purchase price and goodwill recorded in the Americas segment. Both of these reductions to goodwill have been included in the Foreign Currency Translation and Other category in the table below.

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

| | September 27, 2015 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Gross Balance | | | | Accumulated Impairment Losses | | | Net Goodwill |
| | Balance January 1, 2015 | Acquired During the Period | Foreign Currency Translation and Other | Balance September 27, 2015 | Balance January 1, 2015 | Impairment Loss During the Period | Balance September 27, 2015 | September 27, 2015 |
| | (in millions ) | | | | | | | |
| Americas | $ 398.0 | $ | $ (6.4) | $ 391.6 | $ (24.5) | $ | $ (24.5) | $ 367.1 |
| Europe, Middle East and Africa (EMEA) | 265.5 | | (18.7) | 246.8 | | | | 246.8 |
| Asia-Pacific | 12.9 | | | 12.9 | (12.9) | | (12.9) | |
| Total | $ 676.4 | $ | $ (25.1) | $ 651.3 | $ (37.4) | $ | $ (37.4) | $ 613.9 |

Table of Contents

| | September 28, 2014 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Gross Balance | | | | Accumulated Impairment Losses | | | Net Goodwill |
| | Balance January 1, 2014 | Acquired During the Period | Foreign Currency Translation and Other | Balance September 28, 2014 | Balance January 1, 2014 | Impairment Loss During the Period | Balance September 28, 2014 | September 28, 2014 |
| | (in millions) | | | | | | | |
| Americas | $ 224.7 | $ | $ (0.5) | $ 224.2 | $ (24.5) | $ | $ (24.5) | $ 199.7 |
| EMEA | 301.3 | | (21.3) | 280.0 | | | | 280.0 |
| Asia-Pacific | 13.3 | | (0.2) | 13.1 | | | | 13.1 |
| Total | $ 539.3 | $ | $ (22.0) | $ 517.3 | $ (24.5) | $ | $ (24.5) | $ 492.8 |

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.

The EMEA reporting unit represents the EMEA geographic segment excluding the Blücher reporting unit and had a goodwill balance of $182.2 million as of September 27, 2015. The Company continues to monitor the impact the current economic environment in Europe is having on the EMEA reporting unit s operating results and growth expectations. At the most recent annual impairment date of October 26, 2014, the Company performed a qualitative fair value assessment, including an evaluation of certain key assumptions. The Company concluded that the fair value of the EMEA reporting unit continued to exceed its carrying value.

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 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:

| | September 27, 2015 | | | December 31, 2014 | | |
|---|---|---|---|---|---|---|
| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| | (in millions) | | | | | |
| Patents | **$ 16.2** | **$ (14.0)** | **$ 2.2** | $ 16.2 | $ (13.3) | $ 2.9 |
| Customer relationships | **204.4** | **(98.5)** | **105.9** | 206.7 | (87.5) | 119.2 |
| Technology | **41.5** | **(15.3)** | **26.2** | 42.1 | (12.9) | 29.2 |
| Trade Names | **20.4** | **(5.9)** | **14.5** | 20.6 | (4.2) | 16.4 |
| Other | **9.4** | **(5.8)** | **3.6** | 9.5 | (5.7) | 3.8 |
| Total amortizable intangibles | **291.9** | **(139.5)** | **152.4** | 295.1 | (123.6) | 171.5 |
| Indefinite-lived intangible assets | **37.2** | | **37.2** | 38.6 | | 38.6 |

| | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Total | **$** | **329.1** | **$** | **(139.5)** | **$** | **189.6** | $ | 333.7 | $ | (123.6) | $ | 210.1 |

Aggregate amortization expense for amortizable intangible assets for the third quarters of 2015 and 2014 was $5.6 million and $3.7 million, respectively, and for the first nine months of 2015 and 2014 was $15.9 million and $11.1 million, respectively. Additionally, future amortization expense for the next five years on amortizable intangible assets is expected to be approximately $4.7 million for the remainder of 2015, $19.1 million for 2016, $18.8 million for 2017, $15.6 million for 2018 and $11.8 million for 2019. 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 12.0 years. Patents, customer relationships, technology, trade names and other amortizable intangibles have weighted-average remaining lives of 3.9 years, 11.7 years, 9.8 years, 14.4 years and 32.7 years, respectively. Indefinite-lived intangible assets primarily include trademarks and trade names.

*Stock-Based Compensation*

The Company maintains one stock incentive plan, the Second Amended and Restated 2004 Stock Incentive Plan (the 2004 Stock Incentive Plan ). Under this plan, key employees have been granted nonqualified stock options to purchase the Company s Class A common stock. Options typically become exercisable over a four-year period at the rate of 25% per year and expire ten years after the grant date. However, with the introduction in 2014 of performance stock units discussed below, most options granted in 2014 become exercisable over a three-year period at the rate of one-third per year. Options granted under the plan may have exercise prices of not

8

Table of Contents

less than 100% of the fair market value of the Class A common stock on the date of grant. The Company s practice has been to grant all options at fair market value on the grant date. The Company did not issue any stock options in the first nine months of 2015 and issued 114,211 stock options during the first nine months of 2014.

The Company grants 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. However, with the introduction in 2014 of performance stock units discussed below, most restricted stock awards and deferred shares granted in 2014 vest over a two-year period at the rate of 50% 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 174,575 and 150,577 shares of restricted stock in the first nine months of 2015 and 2014, respectively.

Beginning in 2014, the Company also grants performance stock units to key employees under the 2004 Stock Incentive Plan. Performance stock units vest at the end of the performance period set by the Compensation Committee of our Board of Directors at the time of grant. Upon vesting, the number of shares of the Company s Class A common stock awarded to each performance stock unit recipient will be determined based on the Company s performance relative to certain performance goals set at the time the performance stock units were granted. The recipient of a performance stock unit award may earn from no shares to twice the number of target shares awarded to such recipient. The performance stock units are amortized to expense over the vesting period, and based on the Company s performance relative to the performance goals, may be adjusted. If the performance goals are not met, no awards are earned and previously recognized compensation expense is reversed. The Company awarded 631 and 117,619 performance stock units in the first nine months of 2015 and 2014, respectively.

The Company 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. Beginning with annual incentive compensation for 2016, the purchase price for RSUs will be increased to 80% of the fair market value of the Company s Class A common stock. 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 59,995 RSUs and 30,561 RSUs in the first nine months of 2015 and 2014, 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:

| | 2015 | 2014 |
|---|---|---|
| Expected life (years) | **3.0** | 3.0 |
| Expected stock price volatility | **23.4%** | 31.2% |
| Expected dividend yield | **1.2%** | 0.9% |
| Risk-free interest rate | **1.1%** | 0.7% |

The above assumptions were used to determine the RSUs weighted average grant-date fair value of $19.04 and $22.57 in 2015 and 2014, 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, 2014.

*Shipping and Handling*

The Company s shipping and handling costs included in selling, general and administrative expenses were $12.9 million and $15.8 million for the third quarters of 2015 and 2014, respectively, and were $41.1 million and $46.3 million for the first nine months of 2015 and 2014, respectively.

*Research and Development*

Research and development costs included in selling, general and administrative expenses were $5.6 million and $5.3 million for the third quarters of 2015 and 2014, respectively, and were $18.3 million and $17.2 million for the first nine months of 2015 and 2014, 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.

Table of Contents

*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 September 2015, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) 2015-16, Business Combinations: Simplifying the Accounting for Measurement-Period Adjustments . ASU 2015-16 eliminates the requirement to retrospectively adjust the financial statements for measurement-period adjustments that occur in periods after a business combination is consummated. ASU 2015-16 is effective in the first quarter of 2016 for public companies with calendar year ends, and should be applied prospectively with early adoption permitted. The adoption of this guidance is not expected to have a material impact on the Company s financial statements.

In July 2015, the FASB issued ASU 2015-11, Inventory: Simplifying the Measurement of Inventory . This new standard changes inventory measurement from lower of cost or market to lower of cost and net realizable value. The standard eliminates the requirement to consider replacement cost or net realizable value less a normal profit margin when measuring inventory. ASU 2015-11 is effective in the first quarter of 2017 for public companies with calendar year ends, and should be applied prospectively with early adoption permitted. The adoption of this guidance is not expected to have a material impact on the Company s financial statements.

In April 2015, the FASB issued ASU 2015-03, Interest Imputation of Interest: Simplifying the Presentation of Debt Issuance Costs . Under ASU 2015-03, debt issuance costs related to a recognized debt liability will be presented on the balance sheet as a direct deduction from the debt liability, similar to the presentation of debt discounts. The cost of issuing debt will no longer be recorded as a separate asset, except when incurred before receipt of the funding from the associated debt liability. ASU 2015-03 is effective in the first quarter of 2016 for public companies with calendar year ends, with early adoption permitted. The ASU requires retrospective application to all prior periods presented in the financial statements. The adoption of this guidance is not expected to have a material impact on the Company s financial statements.

In January 2015, the FASB issued ASU 2015-01, Income Statement Extraordinary and Unusual Items: Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items . ASU 2015-01 eliminates from U.S. GAAP the concept of extraordinary items as part of its initiative to reduce complexity in accounting standards. ASU 2015-01 is effective in the first quarter of 2016 for public companies with calendar year ends, with early adoption permitted provided that the guidance is applied from the beginning of the fiscal year of adoption. The ASU may be applied prospectively or retrospectively to all prior periods presented. The adoption of this guidance is not expected to have a material impact on the Company s financial statements.

## 3. Acquisitions

On December 1, 2014, the Company completed the acquisition of AERCO in a share purchase transaction. The aggregate purchase price was $271.5 million and was financed from a borrowing under the Company s Credit Agreement. During the second quarter of 2015, the working capital adjustment was finalized resulting in a $0.7 million reduction in the final purchase price.

The Company accounted for the transaction as a business combination. The Company completed a purchase price allocation that resulted in the recognition of $173.3 million in goodwill and $102.4 million in intangible assets. The goodwill balance was reduced during the second quarter of 2015 primarily related to the finalization of the working capital adjustment. Intangible assets consist primarily of customer relationships valued at $78.5 million with estimated lives of 16 years, developed technology valued at $15.8 million with estimated lives of 10 years and trade name valued at $7.4 million with a 20 year life. The goodwill is attributable to the workforce of AERCO and the strategic platform adjacency that will allow the Company to extend its product offerings as a result of the acquisition. Approximately $19.4 million of the goodwill is deductible for tax purposes. The following table summarizes the value of the assets and liabilities acquired (in millions):

Table of Contents

| | | |
|---|---|---|
| Accounts receivable | $ | 17.2 |
| Inventory | | 16.3 |
| Fixed assets | | 7.7 |
| Deferred tax assets | | 8.2 |
| Other assets | | 7.6 |
| Intangible assets | | 102.4 |
| Goodwill | | 173.3 |
| Accounts payable | | (6.8) |
| Accrued expenses and other | | (18.4) |
| Deferred tax liability | | (36.0) |
| Purchase price | $ | 271.5 |

The consolidated statement of operations for the third quarter and the nine months ended September 27, 2015 includes the results of AERCO. The third quarter and the nine months ended September 27, 2015 results include $34.9 million and $89.5 million of revenues, respectively, and $7.8 million and $15.1 million of operating income, respectively, attributable to AERCO. The nine months ended September 27, 2015 operating income of AERCO includes $0.9 million of purchase accounting charges.

*Supplemental pro-forma information*

Had the acquisition of AERCO been completed at the beginning of 2014, the Company s consolidated net sales, net income and earnings per share would have been as follows:

| **Amounts in millions (except per share information)** | | **Third Quarter Ended September 28, 2014** | | **Nine Months Ended September 27, 2015** | | **Nine Months Ended September 28, 2014** |
|---|---|---|---|---|---|---|
| Net sales | $ | 408.2 | **$** | **1,109.4** | $ | 1,218.0 |
| Net income | $ | 26.2 | **$** | **5.9** | $ | 63.9 |
| Net income per share: | | | | | | |
| Basic EPS | $ | 0.74 | **$** | **0.17** | $ | 1.81 |
| Diluted EPS | $ | 0.74 | **$** | **0.17** | $ | 1.81 |

Net income for the third quarter and nine months ended September 28, 2014 was adjusted to include $0.9 million and $2.5 million, respectively, of net interest expense related to the financing of the acquisition and $1.1 million and $3.3 million, respectively, of net amortization expense resulting from the estimated allocation of purchase price to amortizable tangible and intangible assets. Net income for the nine months ended September 27, 2015 was also adjusted to exclude $0.7 million of net acquisition-related and purchase accounting charges.

## 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 September 27, 2015 and December 31, 2014.

The fair values of these certain financial assets and liabilities were determined using the following inputs at September 27, 2015 and December 31, 2014:

| | Fair Value Measurements at September 27, 2015 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) | $ 3.3 | $ 3.3 | $ | $ |
| Total assets | $ 3.3 | $ 3.3 | $ | $ |
| Liabilities | | | | |
| Plan liability for deferred compensation(2) | $ 3.3 | $ 3.3 | $ | $ |
| Total liabilities | $ 3.3 | $ 3.3 | $ | $ |

Table of Contents

| | Total | Fair Value Measurements at December 31, 2014 Using: 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) | $ 4.0 | $ 4.0 | $ | $ |
| Total assets | $ 4.0 | $ 4.0 | $ | $ |
| Liabilities | | | | |
| Plan liability for deferred compensation(2) | $ 4.0 | $ 4.0 | $ | $ |
| Contingent consideration(3) | 2.5 | | | 2.5 |
| Total liabilities | $ 6.5 | $ 4.0 | $ | $ 2.5 |

(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 December 31, 2014.

*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.

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 fair value of the Company s 5.85% senior notes due 2016 and 5.05% senior notes due 2020 is based on quoted market prices of similar notes (level 2). The fair value of the Company s borrowings outstanding under the Credit Agreement and 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:

| | September 27, 2015 | December 31, 2014 |
|---|---|---|
| | (in millions) | |
| Carrying amount | **$ 578.0** | $ 579.7 |
| Estimated fair value | **$ 590.1** | $ 599.3 |

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 generally uses a layering methodology whereby at the end of any quarter, the Company has generally entered into forward exchange contracts which hedge approximately 50% of the projected intercompany purchase transactions for the next twelve months. The Company presently does not have any open forward exchange contracts.

Table of Contents

## 5. Restructuring

The Company s Board of Directors approves all major restructuring programs that may 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 liability is incurred. These costs are included in restructuring and other charges in the Company s consolidated statements of operations.

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

| | Third Quarter Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | **September 27, 2015** | **September 28 2014** | **September 27, 2015** | **September 28, 2014** |
| | | **(in millions)** | | |
| Restructuring costs: | | | | |
| 2015 Actions | **$ 5.0** | $ | **$ 10.3** | $ |
| 2013 Actions | | 0.4 | **0.5** | 2.9 |
| Other Actions | **0.8** | | **1.7** | 4.3 |
| Total restructuring | **$ 5.8** | $ 0.4 | **$ 12.5** | $ 7.2 |

The Company recorded pre-tax restructuring in its business segments as follows:

| | Third Quarter Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | **September 27, 2015** | **September 28, 2014** | **September 27, 2015** | **September 28, 2014** |
| | | **(in millions)** | | |
| Americas | **$ 4.8** | $ | **$ 6.8** | $ 2.3 |
| EMEA | **0.8** | 0.4 | **2.3** | 4.1 |
| Asia-Pacific | **0.2** | | **3.5** | |
| Corporate | | | **(0.1)** | 0.8 |
| Total | **$ 5.8** | $ 0.4 | **$ 12.5** | $ 7.2 |

*2015 Actions*

On February 17, 2015, the Board of Directors of the Company approved the initial phase of a transformation program relating to the Company s Americas and Asia-Pacific businesses, which primarily involves product line rationalization efforts relating to non-core products ( phase one ). The Company expects to ultimately eliminate between $175 million to $200 million of the combined Americas and Asia-Pacific net sales primarily within the Company s do-it-yourself (DIY) distribution channel. The total estimated pre-tax cost for phase one is $33 million, including restructuring of $9.4 million, goodwill and intangible asset impairments of $13.4 million and other transformation and deployment costs of $10.2 million. Total phase one program costs of $27.6 million have been incurred to date. Total phase one non-cash charges are estimated to be $18 million, and after-tax charges are estimated to be $28 million.

On October 26, 2015, the Board of Directors of the Company completed its approval of the second phase of the Company s transformation program related to its Americas and Asia-Pacific businesses ( phase two ). Phase two involves reducing the square footage of the Company s North American facilities, which together with phase one, is expected to reduce the Americas net operating footprint by approximately 30%. Phase two is designed to improve the utilization of the Company s remaining facilities, better leverage the Company s cost structure, reduce working capital, and improve execution of customer delivery requirements. The total estimated pre-tax cost for phase two is $30 million to $35 million, including restructuring of $12 million and other transformation and deployment costs of $18 million to $23 million. Total phase two program costs of $2.8 million have been incurred to date. Total phase two non-cash charges are estimated to be $5 million, and after-tax charges are estimated to be $18 million to $22 million.

On a combined basis, the total estimated pre-tax cost for phase one and phase two is $63 million to $68 million, including restructuring costs of $21.4 million, goodwill and intangible asset impairments of $13.4 million and other transformation and deployment costs of $28.2 to $33.2 million. The other transformation and deployment costs include consulting and project management fees and other associated costs. Costs of the program are expected to be incurred through 2017.

The following table summarizes by type, the total expected, incurred and remaining pre-tax restructuring costs for phase one and phase two combined:

Table of Contents

| | Severance | Legal and consultancy | Asset write-downs (in millions) | Facility exit and other | Total |
|---|---|---|---|---|---|
| Costs incurred first quarter 2015 | $ | $ | $ | $ 1.3 | $ 1.3 |
| Costs incurred second quarter 2015 | 3.7 | | 0.3 | | 4.0 |
| **Costs incurred third quarter 2015** | **2.5** | **0.3** | **0.9** | **1.3** | **5.0** |
| **Remaining costs to be incurred** | **2.6** | **0.2** | **1.8** | **6.5** | **11.1** |
| **Total restructuring costs** | **$ 8.8** | **$ 0.5** | **$ 3.0** | **$ 9.1** | **$ 21.4** |

The following table summarizes total incurred for the three and nine months ended September 27, 2015, incurred program to date and expected pre-tax restructuring costs by business segment for the Company s Americas and Asia-Pacific 2015 transformation program:

| | Third Quarter Ended September 27, 2015 | Nine Months Ended September 27, 2015 (in millions) | Incurred to Date | Total Expected Costs |
|---|---|---|---|---|
| Asia-Pacific | $ 0.2 | $ 3.5 | $ 3.5 | $ 3.7 |
| Americas | 4.8 | 6.8 | 6.8 | 17.7 |
| **Total restructuring costs** | **$ 5.0** | **$ 10.3** | **$ 10.3** | **$ 21.4** |

Details of the restructuring reserve activity for the Company s Americas and Asia-Pacific 2015 transformation program for the nine months ended September 27, 2015 are as follows:

| | Severance | Legal and consultancy | Asset write-downs (in millions) | Facility exit and other | Total |
|---|---|---|---|---|---|
| Balance at December 31, 2014 | $ | $ | $ | $ | $ |
| Net pre-tax restructuring charges | | | | 1.3 | 1.3 |
| Utilization and foreign currency impact | | | | | |
| Balance at March 29, 2015 | $ | $ | $ | $ 1.3 | $ 1.3 |
| Net pre-tax restructuring charges | 3.7 | | 0.3 | | 4.0 |
| Utilization and foreign currency impact | | | (0.3) | | (0.3) |
| Balance at June 28, 2015 | $ 3.7 | $ | $ | $ 1.3 | $ 5.0 |
| **Net pre-tax restructuring charges** | **2.5** | **0.3** | **0.9** | **1.3** | **5.0** |
| **Utilization and foreign currency impact** | **(1.1)** | **(0.1)** | **(0.9)** | **(0.7)** | **(2.8)** |
| **Balance at September 27, 2015** | **$ 5.1** | **$ 0.2** | **$** | **$ 1.9** | **$ 7.2** |

*Other Actions*

The Company also periodically initiates other actions which are not part of a major program. In the fourth quarter of 2014, management initiated certain restructuring actions and strategic initiatives with respect to the Company s EMEA segment in response to the ongoing economic challenges in Europe and additional product rationalization. The restructuring actions primarily include expected severance benefits and limited costs relating to asset write offs, professional fees and relocation. The total pre-tax charge for these restructuring initiatives is expected to be approximately $9.9 million, of which approximately $8.3 million were incurred as of September 27, 2015 for the program to date. The remaining expected costs relate to severance, asset write-offs and relocation costs and are expected to be completed by the end of the fourth quarter of fiscal 2016.

The following table summarizes total expected, incurred and remaining pre-tax restructuring costs for the EMEA 2014 restructuring actions:

| | Severance | Legal and consultancy | Asset write-downs (in millions) | Facility exit and other | Total |
|---|---|---|---|---|---|
| Costs incurred 2014 | $ 6.9 | $ | $ | $ | $ 6.9 |
| Costs incurred first quarter 2015 | | 0.2 | 0.1 | | 0.3 |
| Costs incurred second quarter 2015 | 0.5 | | | | 0.5 |
| **Costs incurred third quarter 2015** | **0.5** | | **0.1** | | **0.6** |
| **Remaining costs to be incurred** | **0.9** | | **0.6** | **0.1** | **1.6** |
| **Total restructuring costs** | **$ 8.8** | **$ 0.2** | **$ 0.8** | **$ 0.1** | **$ 9.9** |

Table of Contents

Details of the Company s EMEA 2014 restructuring reserve activity for the nine months ended September 27, 2015 are as follows:

| | Severance | Legal and consultancy | Asset write-downs | Total |
|---|---|---|---|---|
| | | (in millions) | | |
| Balance at December 31, 2014 | $ 6.9 | $ | $ | $ 6.9 |
| Net pre-tax restructuring charges | | 0.2 | 0.1 | 0.3 |
| Utilization and foreign currency impact | (0.8) | (0.2) | (0.1) | (1.1) |
| Balance at March 29, 2015 | $ 6.1 | $ | $ | $ 6.1 |
| Net pre-tax restructuring charges | 0.5 | | | 0.5 |
| Utilization and foreign currency impact | (0.2) | | | (0.2) |
| Balance at June 28, 2015 | $ 6.4 | $ | $ | $ 6.4 |
| **Net pre-tax restructuring charges** | **0.5** | | **0.1** | **0.6** |
| **Utilization and foreign currency impact** | **(1.1)** | | **(0.1)** | **(1.2)** |
| **Balance at September 27, 2015** | **$ 5.8** | **$** | **$** | **$ 5.8** |

## 6. Sale of Business

*Sale of Certain Americas Product Lines*

On September 15, 2015, the Company completed the sale of certain assets related to the Company s fittings, brass and tubular and vinyl tubing product lines to Sioux Chief Mfg. Co., Inc. in an all-cash transaction. The Company received net cash proceeds of approximately $33.1 million, after inventory adjustments and transaction fees. Total net assets sold were $33.4 million with a pre-tax loss on the sale of approximately $0.3 million.

The carrying amounts of the net assets sold were as follows:

| | September 27, 2015 (in millions) |
|---|---|
| Inventories, net | **$ 21.9** |
| Other assets | **3.1** |
| Property, plant and equipment, net | **4.3** |
| Goodwill | **4.1** |
| Total net assets sold | **$ 33.4** |

## 7. Earnings per Share

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

| | For the Third Quarter Ended September 27, 2015 | | | For the Third Quarter Ended September 28, 2014 | | |
|---|---|---|---|---|---|---|
| | (Loss) Income (Numerator) | Shares (Denominator) | Per Share Amount | Income (Numerator) | Shares (Denominator) | Per Share Amount |
| | (amounts in millions, except per share amounts) | | | | | |
| Basic EPS: | | | | | | |
| Net (loss) income | **$ (25.7)** | **35.0** | **$ (0.73)** | $ 22.6 | 35.3 | $ 0.64 |
| Effect of dilutive securities: | | | | | | |
| Common stock equivalents | | | | | 0.1 | |
| Diluted EPS: | | | | | | |