WATTS WATER TECHNOLOGIES INC
Form 10-Q
August 09, 2012
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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 July 1, 2012

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	**04-2916536**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
815 Chestnut Street, North Andover, MA	**01845**
(Address of Principal Executive Offices)	(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 July 31, 2012**
Class A Common Stock, $0.10 par value	27,764,589
Class B Common Stock, $0.10 par value	6,953,680

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Amounts in millions, except share information)

(Unaudited)

		July 1, 2012		December 31, 2011
ASSETS				
CURRENT ASSETS:				
Cash and cash equivalents	**$**	**167.8**	$	250.6
Short-term investment securities		**4.1**		4.1
Trade accounts receivable, less allowance for doubtful accounts of $9.7 million at July 1, 2012 and $9.1 million at December 31, 2011		**223.3**		207.1
Inventories, net:				
Raw materials		**104.6**		107.7
Work in process		**22.3**		28.7
Finished goods		**159.9**		147.8
Total Inventories		**286.8**		284.2
Prepaid expenses and other assets		**35.8**		26.6
Deferred income taxes		**27.8**		28.3
Assets held for sale		**14.7**		4.6
Total Current Assets		**760.3**		805.5
PROPERTY, PLANT AND EQUIPMENT:				
Property, plant and equipment, at cost		**487.6**		494.8
Accumulated depreciation		**(275.5)**		(268.1)
Property, plant and equipment, net		**212.1**		226.7
OTHER ASSETS:				
Goodwill		**490.5**		490.4
Intangible assets, net		**149.5**		154.6
Deferred income taxes		**9.1**		10.2
Other, net		**9.8**		10.1
TOTAL ASSETS	$	**1,631.3**	$	1,697.5
LIABILITIES AND STOCKHOLDERS EQUITY				
CURRENT LIABILITIES:				
Accounts payable	$	**125.9**	$	126.5
Accrued expenses and other liabilities		**117.4**		109.2
Accrued compensation and benefits		**39.5**		45.9
Current portion of long-term debt		**77.0**		2.0
Total Current Liabilities		**359.8**		283.6
LONG-TERM DEBT, NET OF CURRENT PORTION		**308.1**		397.4
DEFERRED INCOME TAXES		**55.9**		58.2
OTHER NONCURRENT LIABILITIES		**38.4**		38.5
STOCKHOLDERS EQUITY:				
Preferred Stock, $0.10 par value; 5,000,000 shares authorized; no shares issued or outstanding				

Class A Common Stock, $0.10 par value; 80,000,000 shares authorized; 1 vote per share; issued and outstanding, 27,844,816 shares at July 1, 2012 and 29,471,414 shares at December 31, 2011		**2.8**		2.9
Class B Common Stock, $0.10 par value; 25,000,000 shares authorized; 10 votes per share; issued and outstanding, 6,953,680 shares at July 1, 2012 and at December 31, 2011		**0.7**		0.7
Additional paid-in capital		**432.3**		420.1
Retained earnings		**475.2**		515.1
Accumulated other comprehensive loss		**(41.9)**		(19.0)
Total Stockholders Equity		**869.1**		919.8
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$	**1,631.3**	$	1,697.5

See accompanying notes to consolidated financial statements.

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WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(Amounts in millions, except per share information)

(Unaudited)

	Second Quarter Ended		Six Months Ended	
	July 1, 2012	**July 3, 2011**	**July 1, 2012**	**July 3, 2011**
Net sales	$ **371.1**	$ 375.7	**$** **735.3**	$ 705.6
Cost of goods sold	**239.3**	245.4	**473.9**	454.3
GROSS PROFIT	**131.8**	130.3	**261.4**	251.3
Selling, general & administrative expenses	**96.9**	98.2	**197.9**	195.2
Restructuring and other charges	**1.2**	5.5	**2.9**	6.6
OPERATING INCOME	**33.7**	26.6	**60.6**	49.5
Other (income) expense:				
Interest income	**(0.2)**	(0.2)	**(0.4)**	(0.5)
Interest expense	**6.1**	6.7	**12.3**	12.6
Other expense, net		0.6	**(0.9)**	0.7
Total other expense	**5.9**	7.1	**11.0**	12.8
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	**27.8**	19.5	**49.6**	36.7
Provision for income taxes	**9.3**	6.6	**15.4**	12.7
NET INCOME FROM CONTINUING OPERATIONS	**18.5**	12.9	**34.2**	24.0
Income from discontinued operations, net of taxes		1.7		1.7
NET INCOME	$ **18.5**	$ 14.6	**$** **34.2**	$ 25.7
BASIC EPS				
Net income per share:				
Continuing operations	**$** **0.51**	$ 0.34	**$** **0.93**	$ 0.64
Discontinued operations		0.05		0.05
NET INCOME	**$** **0.51**	$ 0.39	**$** **0.93**	$ 0.69
Weighted average number of shares	**36.5**	37.6	**36.7**	37.6
DILUTED EPS				
Net income per share:				
Continuing operations	**$** **0.51**	$ 0.34	**$** **0.93**	**$** 0.64
Discontinued operations		0.05		0.05
NET INCOME	**$** **0.51**	$ 0.39	**$** **0.93**	$ 0.68
Weighted average number of shares	**36.6**	37.8	**36.8**	37.7
Dividends per share	**$** **0.11**	$ 0.11	**$** **0.22**	$ 0.22

See accompanying notes to consolidated financial statements.

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WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Amounts in millions)

(Unaudited)

	Second Quarter Ended		Six Months Ended	
	July 1, 2012	**July 3, 2011**	**July 1, 2012**	**July 3, 2011**
Net income	**$ 18.5**	$ 14.6	**$ 34.2**	$ 25.7
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	**(39.7)**	14.7	**(23.2)**	48.7
Defined benefit pension plans:				
Amortization of prior service cost included in net periodic pension cost		0.1		0.2
Amortization of net losses included in net periodic pension cost	**0.1**	0.7	**0.3**	1.4
Defined benefit pension plans	**0.1**	0.8	**0.3**	1.6
Other comprehensive income (loss), net of tax	**(39.6)**	15.5	**(22.9)**	50.3
Comprehensive income (loss)	**$ (21.1)**	$ 30.1	**$ 11.3**	$ 76.0

See accompanying notes to consolidated financial statements.

WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in millions)

(Unaudited)

	Six Months Ended	
	July 1, 2012	**July 3, 2011**
OPERATING ACTIVITIES		
Net income	**$ 34.2**	$ 25.7
Less: Income from discontinued operations, net of taxes		1.7
Net income from continuing operations	**34.2**	24.0
Adjustments to reconcile net income from continuing operations to net cash provided by continuing operating activities:		
Depreciation	**16.7**	16.1
Amortization	**8.4**	9.3
Stock-based compensation	**2.5**	5.8
Deferred income taxes benefit	**(0.5)**	(4.7)
Loss on disposal and impairment of property, plant and equipment and other	**0.4**	0.5
Changes in operating assets and liabilities, net of effects from business acquisitions and divestitures:		
Accounts receivable	**(21.4)**	(14.0)
Inventories	**(9.7)**	(14.7)
Prepaid expenses and other assets	**(9.2)**	(4.0)
Accounts payable, accrued expenses and other liabilities	**2.5**	2.4
Net cash provided by continuing operations	**23.9**	20.7
INVESTING ACTIVITIES		
Additions to property, plant and equipment	**(9.6)**	(12.0)
Proceeds from the sale of property, plant and equipment	**1.0**	0.6
Purchase of short-term investment securities		(4.1)
Proceeds from the sale of short-term investment securities		4.1
Business acquisitions, net of cash acquired	**(17.5)**	(162.9)
Net cash used in investing activities	**(26.1)**	(174.3)
FINANCING ACTIVITIES		
Proceeds from long-term debt	**9.2**	184.0
Payments of long-term debt	**(22.8)**	(99.9)
Payment of capital leases and other	**(1.2)**	(1.3)
Proceeds from share transactions under employee stock plans	**6.0**	3.0
Tax benefit of stock awards exercised	**0.4**	0.4
Dividends	**(8.2)**	(8.3)
Payments to repurchase common stock	**(63.2)**	
Net cash provided by (used in) financing activities	**(79.8)**	77.9
Effect of exchange rate changes on cash and cash equivalents	**(0.8)**	13.2
DECREASE IN CASH AND CASH EQUIVALENTS	**(82.8)**	(62.5)
Cash and cash equivalents at beginning of year	**250.6**	329.2
CASH AND CASH EQUIVALENTS AT END OF PERIOD	**$ 167.8**	$ 266.7
NON-CASH INVESTING AND FINANCING ACTIVITIES		
Acquisition of businesses:		
Fair value of assets acquired	**$ 27.7**	$ 218.8

Cash paid, net of cash acquired		**17.5**		162.9
Liabilities assumed	**$**	**10.2**	$	55.9
Acquisition of fixed assets under financing agreements	**$**	**0.6**	$	4.3
Issuance of stock under management stock purchase plan	**$**	**0.4**	$	0.4
CASH PAID FOR:				
Interest	**$**	**12.5**	$	12.2
Income taxes	**$**	**14.0**	$	20.1

See accompanying notes to consolidated financial statements.

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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 July 1, 2012, the Consolidated Statements of Operations for the second quarter and six months ended July 1, 2012 and July 3, 2011, the Consolidated Statements of Comprehensive Income for the second quarter and six months ended July 1, 2012 and July 3, 2011, and the Consolidated Statements of Cash Flows for the six months ended July 1, 2012 and July 3, 2011.

The balance sheet at December 31, 2011 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, 2011. 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, 2011. Operating results for the interim period presented are not necessarily indicative of the results to be expected for the year ending December 31, 2012.

The Company operates on a 52-week fiscal year ending on December 31st. Any quarterly or six- month data contained in this Quarterly Report on Form 10-Q generally reflect the results of operations for a 13-week period or 26-week period, respectively.

Certain amounts in the 2011 consolidated financial statements have been reclassified to permit comparison with the 2012 presentation. These reclassifications had no effect on reported results of operations or stockholders equity.

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:

	Gross Balance				Accumulated Impairment Losses			Net Goodwill
	Balance January 1, 2011	Acquired During the Period	Foreign Currency Translation and Other	Balance July 3, 2011	Balance January 1, 2011	Impairment Loss During the Period	Balance July 3, 2011	July 3, 2011
				(in millions)				
North America	$ 213.8	$ 2.5	$	$ 216.3	$ (22.0)	$	$ (22.0)	$ 194.3
Europe, Middle East and Africa (EMEA)	228.1	62.5	17.2	307.8				307.8
Asia	8.1	4.3	0.2	12.6				12.6
Total	$ 450.0	$ 69.3	$ 17.4	$ 536.7	$ (22.0)	$	$ (22.0)	$ 514.7

	Gross Balance				Accumulated Impairment Losses			Net Goodwill
	Balance January 1, 2012	Acquired During the Period	Foreign Currency Translation and Other	Balance July 1, 2012	Balance January 1, 2012	Impairment Loss During the Period	Balance July 1, 2012	July 1, 2012
				(in millions)				
North America	**$ 215.6**	**$ 13.1**	**$ (2.1)**	**$ 226.6**	**$ (23.2)**	**$**	**$ (23.2)**	**$ 203.4**
EMEA	**285.3**		**(10.8)**	**274.5**				**274.5**
Asia	**12.7**		**(0.1)**	**12.6**				**12.6**
Total	**$ 513.6**	**$ 13.1**	**$ (13.0)**	**$ 513.7**	**$ (23.2)**	**$**	**$ (23.2)**	**$ 490.5**

On January 31, 2012, the Company completed the acquisition of tekmar Control Systems (tekmar) in a share purchase transaction. A designer and manufacturer of control systems used in heating, ventilation, and air conditioning applications, tekmar is expected to enhance the Company s hydronic systems product offerings in the U.S. and Canada. The initial purchase price paid was CAD $18.0 million, with post-closing adjustments related to working capital and an earn-out based on the attainment of certain future earnings

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levels. The total purchase price will not exceed CAD $26.2 million. The Company is accounting for the transaction as a business combination. The Company completed a preliminary purchase price allocation that resulted in the recognition of $13.1 million in goodwill and $10.1 million in intangible assets. Intangible assets consist primarily of acquired technology with an estimated life of 10 years, distributor relationships with an estimated life of 7 years, and a trade name with an estimated life of 20 years. The goodwill is not expected to be deductible for tax purposes.

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 impairment assessment of goodwill and indefinite-lived intangible assets in the fourth quarter of each year.

As of October 30, 2011, the annual impairment analysis date, the fair value of the Company s Europe, Middle East and Africa (EMEA) reporting unit exceeded the carrying value by approximately 9%. Operating results for the EMEA reporting unit have been hindered by the downturn in the economic environment in Europe and continued to fall below expectations during the six months ended July 1, 2012, triggering the decision to update the impairment analysis. As a result of the updated fair value assessment, it was determined that the fair value of the EMEA reporting unit continues to exceed its carrying value, a result of a decrease in discount rate and a reduction of net debt offset by lower short-term projections. The Company also performed an analysis on the long-lived assets in the EMEA reporting unit as a result of the triggering event and concluded that these assets were not impaired.

Should the EMEA reporting unit s operating results decline further because the European marketplace deteriorates beyond our current expectations or should interest rates increase significantly, then the reporting unit s goodwill may be at risk for impairment in the future. The EMEA reporting unit s goodwill balance as of July 1, 2012 was $202.7 million.

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:

	July 1, 2012			December 31, 2011		
	Gross Carrying Amount	**Accumulated Amortization**	**Net Carrying Amount**	**Gross Carrying Amount**	**Accumulated Amortization**	**Net Carrying Amount**
			(in millions)			
Patents	**$ 16.3**	**$ (11.2)**	**$ 5.1**	$ 16.5	$ (10.8)	$ 5.7
Customer relationships	**132.1**	**(63.9)**	**68.2**	135.8	(57.7)	78.1
Technology	**28.1**	**(8.2)**	**19.9**	19.8	(7.1)	12.7

Trade Names		**13.0**		**(1.3)**		**11.7**		13.4		(0.8)		12.6
Other		**8.6**		**(5.5)**		**3.1**		8.5		(5.4)		3.1
Total amortizable intangibles		**198.1**		**(90.1)**		**108.0**		194.0		(81.8)		112.2
Indefinite-lived intangible assets		**41.5**				**41.5**		42.4				42.4
Total	**$**	**239.6**	**$**	**(90.1)**	**$**	**149.5**	$	236.4	$	(81.8)	$	154.6

Aggregate amortization expense for amortizable intangible assets for the second quarters of 2012 and 2011 was $4.2 million and $5.3 million, respectively, and for the first six months of 2012 and 2011 was $8.4 million and $9.3 million, respectively. Additionally, future amortization expense for the next five years on amortizable intangible assets is expected to be approximately $7.6 million for the remainder of 2012, $15.0 million for 2013, $14.8 million for 2014, $14.5 million for 2015 and $14.1 million for 2016. 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 10.0 years. Patents, customer relationships, technology, trade names and other amortizable intangibles have weighted-average remaining lives of 6.9 years, 7.0 years, 12.2 years, 12.1 years and 42.1 years, respectively. Intangible assets not subject to amortization consist of certain trademarks and trade names.

Stock-Based Compensation

The Company maintains three stock incentive plans under which key employees and non-employee members of the Company s Board of Directors have been granted incentive stock options (ISOs) and nonqualified stock options (NSOs) to purchase the Company s Class A Common Stock. Only one plan, the 2004 Stock Incentive Plan, is currently available for the grant of new stock options, which are currently being granted only to employees. Under the 2004 Stock Incentive Plan, options 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

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prices of not less than 100% and 50% of the fair market value of the Class A Common Stock on the date of grant, respectively. The Company s current practice is to grant all options at fair market value on the grant date. The Company did not issue any stock options during the first six months of 2012 and 2011.

The Company has also granted shares of restricted stock to key employees and stock awards to non-employee members of the Company s Board of Directors under the 2004 Stock Incentive Plan, which vest either immediately, or over a three-year period at the rate of one-third per year. The restricted stock awards are amortized to expense on a straight-line basis over the vesting period. The Company did not issue any restricted stock in the first six months of 2012 and issued 1,400 shares of restricted stock in the first six months of 2011.

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 annually over a three-year period from 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 63,739 RSUs and 96,454 RSUs in the first six months of 2012 and 2011, 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:

	2012	2011
Expected life (years)	**3.0**	3.0
Expected stock price volatility	**38.3%**	44.9%
Expected dividend yield	**1.1%**	1.2%
Risk-free interest rate	**0.4%**	1.2%

The above assumptions were used to determine the weighted average grant-date fair value of RSUs of $15.68 and $16.25 in 2012 and 2011, respectively.

A more detailed description of each of these stock and stock option 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, 2011.

On May 23, 2012, William C. McCartney provided notice of his intention to retire as Chief Financial Officer of the Company. On June 14, 2012, the Company entered into a retention agreement with Mr. McCartney. Pursuant to the retention agreement, Mr. McCartney will continue employment with the Company until December 14, 2012 and will assist the Company in identifying a successor and transitioning his responsibilities and duties to the new Chief Financial Officer. Pursuant to Mr. McCartney fulfilling his duties under the retention agreement, the Company will record a pre-tax charge of approximately $1.5 million over the retention period, consisting of expected cash payments of $0.7 million and a non-cash charge of $0.8 million for the modification of stock options and restricted stock awards. In addition, Mr. McCartney will receive a performance bonus he would have been entitled to had he been employed by the Company through December 31, 2012. The charge recorded in the second quarter related to the retention agreement was immaterial.

On January 26, 2011, Patrick S. O Keefe resigned from his positions as Chief Executive Officer, President and Director. Pursuant to a separation agreement, the Company recorded a charge of $6.3 million, consisting of $3.3 million in expected cash severance and a non-cash charge of $3.0 million for the modification of stock options and restricted stock awards.

Shipping and Handling

The Company s shipping costs included in selling, general and administrative expenses were $8.9 million and $9.9 million for the second quarters of 2012 and 2011, respectively, and were $18.8 million and $18.7 million for the first six months of 2012 and 2011, respectively.

Research and Development

Research and development costs included in selling, general and administrative expenses were $5.3 million and $5.7 million for the second quarters of 2012 and 2011, respectively, and were $10.7 million for both the first six months of 2012 and 2011, 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.

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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 December 2011, the Financial Accounting Standards Board (FASB) issued an amendment to the accounting guidance for disclosure of offsetting assets and liabilities and related arrangements. The amendment expands the disclosure requirements in that entities will be required to disclose both gross information and net information about both instruments and transactions eligible for offset in the statement of financial position and instruments and transactions subject to an agreement similar to a master netting arrangement. The amendment is effective for fiscal years, and interim periods within those years, beginning on or after January 1, 2013, and shall be applied retrospectively. The Company does not expect the adoption of this accounting pronouncement will have a material impact on its financial statements.

In July 2012, the FASB issued an amendment to the requirements for indefinite-lived intangible asset impairment testing. The Company has 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 an indefinite-lived intangible asset is less than its carrying amount. If, after assessing the totality of events or circumstances, the Company determines it is more likely than not that the fair value of an indefinite-lived intangible asset is greater than its carrying amount, then performing the impairment test is unnecessary. The Company intends to adopt this new standard effective with its annual impairment testing date of October 30, for the year ending December 31, 2012.

3. Discontinued Operations and Assets Held For Sale

In the first quarter of 2010, the Company recorded an estimated reserve of $5.3 million in discontinued operations in connection with its investigation of potential violations of the Foreign Corrupt Practices Act (FCPA) at Watts Valve (Changsha) Co., Ltd. (CWV), a former indirect wholly-owned subsidiary of the Company in China. On October 13, 2011, the Company entered into a settlement for $3.8 million with the Securities and Exchange Commission to resolve allegations concerning potential violations of the FCPA at CWV. During the quarter ended July 3, 2011, the Company revised the reserve to $3.8 million based on the pending settlement. See Note 3 of the Company s Annual Report on Form 10-K for the year ended December 31, 2011.

	Second Quarter Ended		**Six Months Ended**	
	July 1, 2012	**July 3, 2011**	**July 1, 2012**	**July 3, 2011**
	(in millions)			
Reserve release - FCPA matter (CWV)	**$**	$ 1.7	**$**	$ 1.7
Gain on disposal TEAM		0.3		0.3

Income (loss) before income taxes				2.0				2.0
Income tax expense				0.3				0.3
Income from discontinued operations, net of taxes	**$**		$	1.7	**$**		$	1.7

During the quarter ended July 1, 2012, the Company s Board of Directors approved the disposal of an operation within the Company s North America segment. The Company evaluated the fair value less cost to sell the net assets and determined that the fair value exceeded the carrying value. The Company recorded the net assets of $10.9 million, representing gross assets of $14.0 million less liabilities of $3.1 million, as assets held for sale. The revenues and results of operations are not material to the Company. The Company will not have continuing involvement after a sale is completed.

4. Financial Instruments and Derivative Instruments

The Company measures certain financial assets and liabilities at fair value on a recurring basis, including foreign currency derivatives, deferred compensation plan assets and related liability, and contingent consideration. There were no cash flow hedges as of July 1, 2012. The fair values of these certain financial assets and liabilities were determined using the following inputs at July 1, 2012 and December 31, 2011:

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	Total	Fair Value Measurements at July 1, 2012 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)	$ 4.1	$ 4.1	$	$
Total assets	$ 4.1	$ 4.1	$	$
Liabilities				
Plan liability for deferred compensation(2)	$ 4.1	$ 4.1	$	$
Contingent consideration(3)	6.1			6.1
Total liabilities	$ 10.2	$ 4.1	$	$ 6.1

	Total	Fair Value Measurements at December 31, 2011 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)	1.1			1.1
Total liabilities	$ 5.1	$ 4.0	$	$ 1.1

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

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

(3) Included in other noncurrent liabilities and accrued expenses and other liabilities on the Company s consolidated balance sheet.

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, 2011 to July 1, 2012.

	Balance December 31, 2011	Purchases, sales, settlements, net	Total realized and unrealized gains (losses) included in: Earnings	Comprehensive income	Balance July 1, 2012
			(in millions)		
Contingent consideration	$ 1.1	$ 5.1	$ 0.1	$ (0.2)	$ 6.1

In 2010, a contingent liability of $1.9 million was recognized as an estimate of the acquisition date fair value of the contingent consideration in the BRAE acquisition. This liability was classified as Level 3 under the fair value hierarchy as it was based on the weighted probability of achievement of a future performance metric as of the date of the acquisition, which was not observable in the market. During the year ended December 31, 2011, the estimate of the fair value of the contingent consideration was reduced to $1.1 million based on the revised probability of achievement of the future performance metric. Failure to meet the performance metric would reduce this liability to zero, while complete achievement would increase this liability to the full remaining purchase price of $4.8 million.

In connection with the tekmar Control Systems acquisition in 2012, a contingent liability of $5.1 million was recognized as the estimate of the acquisition date fair value of the contingent consideration (see Note 12). 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 CAD $8.2 million.

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Short-term investment securities as of July 1, 2012 consist of a certificate of deposit with a remaining maturity of greater than three months at the date of purchase, for which the carrying amount is a reasonable estimate of fair value.

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. 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 primarily uses this strategy for the purchases between Canada and the U.S. The average volume of contracts can vary but generally is approximately $2 million to $15 million in open contracts at the end of any given quarter. At July 1, 2012, the Company had contracts for notional amounts aggregating approximately $2.0 million. The Company accounts for the forward exchange contracts as an economic hedge. Realized and unrealized gains and losses on the contracts are recognized in other (income) expense in the consolidated statement of operations. These contracts do not subject the Company to significant market risk from exchange movement because they offset gains and losses on the related foreign currency denominated transactions. The fair value of these contracts as of July 1, 2012 was not material.

Fair Value

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

The fair values of the Company s 5.47% senior notes due 2013, 5.85% senior notes due 2016 and 5.05% senior notes due 2020, are based on a discounted cash flow model using like 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:

	July 1, 2012	December 31, 2011
	(in millions)	

Carrying amount	**$**	**385.1**	$	399.4
Estimated fair value	**$**	**422.7**	$	440.5

5. Restructuring and Other Charges

The Company s Board of Directors approves all major restructuring programs that involve the discontinuance of product lines or the shutdown of 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. In April 2011, the Board approved an integration program in association with the acquisition of Danfoss Socla S.A.S. (Socla). The program was designed to integrate certain operations and management structures of Socla with a total estimated pre-tax cost of $6.4 million with costs being incurred through 2012. As of July 1, 2012, the Company revised its forecast to $4.4 million due to lower than expected severance costs.

The Company also periodically initiates other actions which are not part of a major program. In 2011, the Company initiated restructuring activities with respect to the Company s operating facilities in Europe, which included the closure of a facility. The Europe restructuring activities are expected to include pre-tax costs of approximately $2.6 million, including costs for severance and shut-down costs. The total net after-tax charge is $1.8 million with costs being incurred through 2012. In 2012, the Company commenced restructuring activities in North America to relocate certain production activities, which include the closure of two manufacturing sites occurring through 2013. Total expected costs are $2.8 million, including severance and shutdown costs. The net after tax charge of $1.8 million will be incurred through the middle of 2013.

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

	Second Quarter Ended		Six Months Ended	
	July 1, 2012	July 3, 2011	July 1, 2012	July 3, 2011
	(in millions)			
Restructuring costs:				
2010 Actions	**$ 0.1**	$ 1.8	**$ 0.1**	$ 2.7
2011 Actions	**0.1**	3.4	**0.6**	3.6
Other Actions	**0.9**		**1.6**	
Total restructuring charges	**1.1**	5.2	**2.3**	6.3
Other charges related to impairments	**0.1**	0.3	**0.6**	0.3
Total restructuring and other charges	**$ 1.2**	$ 5.5	**$ 2.9**	$ 6.6

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

	Second Quarter Ended		Six Months Ended	
	July 1, 2012	July 3, 2011	July 1, 2012	July 3, 2011
	(in millions)			
North America	**$ 0.4**	$	**$ 0.8**	$ 0.1
EMEA	**0.8**	5.3	**2.1**	6.3
Asia.		0.2		0.2
Total	**$ 1.2**	$ 5.5	**$ 2.9**	$ 6.6

2011 Actions

The following table summarizes the total expected, incurred and remaining pre-tax severance costs for the 2011 Socla integration program:

Reportable Segment	Total Expected Costs	Incurred through July 1, 2012 (in millions)	Remaining Costs at July 1, 2012
EMEA	$ 4.2	$ 3.5	**$ 0.7**
Asia	0.2	0.2	
Total	$ 4.4	$ 3.7	**$ 0.7**

The Company expects to spend the remaining costs by the end of 2012.

Details of the Company s 2011 Socla integration reserves for severance for the six months ended July 1, 2012 are as follows:

		Six Months Ended July 1, 2012 (in millions)
Balance at December 31, 2011	$	0.4
Net pre-tax restructuring charges		0.5
Utilization and foreign currency impact		(0.3)
Balance at April 1, 2012	$	0.6
Net pre-tax restructuring charges		**0.1**
Utilization and foreign currency impact		**(0.6)**
Balance at July 1, 2012	**$**	**0.1**

The Company expects to exhaust the remaining reserve by the end of 2012.

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The following table summarizes expected, incurred and remaining severance costs for 2011 Socla integration actions:

		Incurred through July 1, 2012 (in millions)
Expected costs	$	4.4
Costs incurred 2011		(3.1)
Costs incurred quarter ended April 1, 2012		(0.5)
Costs incurred quarter ended July 1, 2012		**(0.1)**
Remaining costs at July 1, 2012	**$**	**0.7**

6. Earnings per Share

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

	For the Second Quarter Ended July 1, 2012					For the Second Quarter Ended July 3, 2011				
	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	**$**	**18.5**	**36.5**	**$**	**0.51**	$	12.9	37.6	$	0.34
Discontinued operations							1.7			0.05
Net income	**$**	**18.5**		**$**	**0.51**	$	14.6		$	0.39
Effect of dilutive securities										
Common stock equivalents			**0.1**					0.2		
Diluted EPS										
Net income:										
Continuing operations	**$**	**18.5**		**$**	**0.51**	$	12.9		$	0.34
Discontinued operations							1.7			0.05
Net income	**$**	**18.5**	**36.6**	**$**	**0.51**	$	14.6	37.8	$	0.39

Options to purchase 0.4 million and 0.3 million shares of Class A Common Stock were outstanding during the second quarters of 2012 and 2011, respectively, but were not included in the computation of diluted EPS because to do so would be anti-dilutive.

	For the Six Months Ended July 1, 2012					For the Six Months Ended July 3, 2011				
	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	**$**	**34.2**	**36.7**	**$**	**0.93**	$	24.0	37.6	$	0.64
Discontinued operations							1.7			0.05

Net income	**$ 34.2**		**$ 0.93**	$ 25.7		$ 0.69
Effect of dilutive securities						
Common stock equivalents		**0.1**			0.1	
Diluted EPS						
Net income:						
Continuing operations	**$ 34.2**		**$ 0.93**	$ 24.0		$ 0.64
Discontinued operations				1.7		0.05
Net income	**$ 34.2**	**36.8**	**$ 0.93**	$ 25.7	37.7	$ 0.68

Options to purchase 0.4 million and 0.3 million shares of Class A Common Stock were outstanding during the first six months of 2012 and 2011, respectively, but were not included in the computation of diluted EPS because to do so would be anti-dilutive.

On May 16, 2012, the Board of Directors authorized a stock repurchase program of up to two million shares of the Company s Class A Common Stock. During the quarter ended July 1, 2012, the Company repurchased approximately 1.9 million shares of Class A common stock at a cost of approximately $63.2 million. The stock repurchase program was completed in July 2012.

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7. Segment Information

The Company operates in three geographic segments: North America, EMEA, and Asia. 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.

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

	Second Quarter Ended		Six Months Ended	
	July 1, 2012	**July 3, 2011**	**July 1, 2012**	**July 3, 2011**
		(in millions)		
Net Sales				
North America	**$ 221.8**	$ 212.0	**$ 431.8**	$ 414.1
EMEA	**142.8**	157.8	**292.0**	281.8
Asia	**6.5**	5.9	**11.5**	9.7
Consolidated net sales	**$ 371.1**	$ 375.7	**$ 735.3**	$ 705.6
Operating income (loss)				
North America	**$ 26.7**	$ 26.3	**$ 46.9**	$ 53.0
EMEA	**12.0**	6.9	**24.8**	16.6
Asia	**2.1**	0.9	**3.5**	1.7
Subtotal reportable segments	**40.8**	34.1	**75.2**	71.3
Corporate (*)	**(7.1)**	(7.5)	**(14.6)**	(21.8)
Consolidated operating income	**33.7**	26.6	**60.6**	49.5
Interest income	**0.2**	0.2	**0.4**	0.5
Interest expense	**(6.1)**	(6.7)	**(12.3)**	(12.6)
Other		(0.6)	**0.9**	(0.7)
Income from continuing operations before income taxes	**27.8**	$ 19.5	**$ 49.6**	$ 36.7
Capital Expenditures				
North America	**$ 1.8**	$ 1.9	**$ 4.4**	$ 5.3
EMEA	**2.4**	3.2	**4.6**	6.3
Asia	**0.5**	0.3	**0.6**	0.4
Consolidated capital expenditures	**$ 4.7**	$ 5.4	**$ 9.6**	$ 12.0
Depreciation and Amortization				
North America	**$ 5.2**	$ 5.2	**$ 10.0**	$ 9.6
EMEA	**6.8**	8.4	**14.1**	14.8
Asia	**0.5**	0.5	**1.0**	1.0
Consolidated depreciation and amortization	**$ 12.5**	$ 14.1	**$ 25.1**	$ 25.4
Identifiable Assets (at end of period)				
North America			**$ 790.0**	$ 844.9

EMEA		**750.5**		948.8
Asia		**90.8**		85.1
Discontinued operations				1.6
Consolidated identifiable assets	**$**	**1,631.3**	$	1,880.4
Property, plant and equipment, net (at end of period)				
North America	**$**	**73.7**	$	83.8
EMEA		**123.9**		153.1
Asia		**14.5**		15.3
Consolidated property, plant and equipment, net	**$**	**212.1**	$	252.2

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* Corporate expenses are primarily for administrative compensation expense, internal controls costs, professional fees, including legal and audit expenses, shareholder services and benefit administration costs. These costs are not allocated to the geographic segments as they are viewed as corporate functions that support all activities.

The above operating segments are presented on a basis consistent with the presentation included in the Company s December 31, 2011 consolidated financial statements included in its Annual Report on Form 10-K.

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

	Second Quarter Ended		Six Months Ended	
	July 1, 2012	**July 3, 2011**	**July 1, 2012**	**July 3, 2011**
	(in millions)			
U.S. net sales	**$ 199.7**	$ 192.5	**$ 389.7**	$ 375.4
U.S. property, plant and equipment (at end of period)			**$ 71.6**	$ 78.6

The following includes intersegment sales for North America, EMEA and Asia:

	Second Quarter Ended		Six Months Ended	
	July 1, 2012	**July 3, 2011**	**July 1, 2012**	**July 3, 2011**
	(in millions)			
Intersegment Sales				
North America	**$ 1.2**	$ 0.8	**$ 2.6**	$ 1.7
EMEA	**2.0**	2.3	**4.6**	4.2
Asia	**35.3**	37.2	**66.4**	67.9
Intersegment sales	**$ 38.5**	$ 40.3	**$ 73.6**	$ 73.8

The North America segment includes $14.7 million in assets held for sale at July 1, 2012. The North America segment and the Asia segment include $3.8 million and $6.2 million, respectively, in assets held for sale at July 3, 2011.

The Company sells its products into various end markets around the world and groups net sales to third parties into four product categories. Because many of the Company s sales are through distributors and third-party manufacturers representatives, a portion of the product categorization is based on management s understanding of final product use and, as such, allocations have been made to align sales into a product category. Net sales to third parties for the four product categories are as follows:

	Second Quarter Ended		Six Months Ended	
	July 1, 2012	**July 3, 2011**	**July 1, 2012**	**July 3, 2011**
	(in millions)			
Net Sales				
Residential & commercial flow control	**$ 211.3**	$ 199.2	**$ 412.5**	$ 365.6
HVAC & gas	**106.8**	122.1	**216.6**	235.6
Drains & water re-use	**35.0**	36.6	**68.7**	67.7
Water quality	**18.0**	17.8	**37.5**	36.7
Consolidated net sales	**$ 371.1**	$ 375.7	**$ 735.3**	$ 705.6

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, 2011	**$ 5.6**	**$ (24.6)**	**$ (19.0)**
Change in period	**16.5**	**0.2**	**16.7**
Balance April 1, 2012	**$ 22.1**	**$ (24.4)**	**$ (2.3)**
Change in period	**(39.7)**	**0.1**	**(39.6)**
Balance July 1, 2012	**$ (17.6)**	**$ (24.3)**	**$ (41.9)**
Balance December 31, 2010	$ 24.9	$ (25.2)	$ (0.3)
Change in period	34.0	0.8	34.8
Balance April 3, 2011	$ 58.9	$ (24.4)	$ 34.5
Change in period	14.7	0.8	15.5
Balance July 3, 2011	$ 73.6	$ (23.6)	$ 50.0

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Accumulated other comprehensive income (loss) in the consolidated balance sheets as of July 1, 2012 and July 3, 2011 consists primarily of cumulative translation adjustments and pension related net actuarial loss and prior service costs.

9. Debt

The Company s credit agreement (the Credit Agreement) provides for a multi-currency $300.0 million, five-year, senior unsecured revolving credit facility which may be increased by an additional $150.0 million under certain circumstances and subject to the terms of the Credit Agreement. The Credit Agreement has a sublimit of up to $75.0 million in letters of credit.

Borrowings outstanding under the Credit Agreement bear interest at a fluctuating rate per annum equal to (i) in the case of Eurocurrency rate loans, the British Bankers Association LIBOR rate plus an applicable percentage, ranging from 1.70% to 2.30%, determined by reference to the Company s consolidated leverage ratio plus, in the case of certain lenders, a mandatory cost calculated in accordance with the terms of the Credit Agreement, or (ii) 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 Bank of America, N.A. as its prime rate, and (c) the British Bankers Association LIBOR rate plus 1.0%, plus an applicable percentage, ranging from 0.70% to 1.30%, 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, a 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 Credit Agreement matures on June 18, 2015. 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 July 1, 2012, the Company was in compliance with all covenants related to the Credit Agreement and had $265.4 million of unused and available credit under the Credit Agreement and $34.6 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 July 1, 2012.

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, 2011. 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 July 1, 2012, the Company was in compliance with all covenants regarding these note agreements. The note agreements include $75.0 million of unsecured senior notes maturing on May 15, 2013 which have been included in the current portion of long-term debt in the Company s balance sheet.

10. Contingencies and Environmental Remediation

As disclosed in Part I, Item 1, Product Liability, Environmental and Other Litigation Matters of the Company s Annual Report on Form 10-K for the year ended December 31, 2011, the Company was party to certain litigation. There have been no material developments with respect to the Company s contingencies and environmental remediation proceedings during the quarter ended July 1, 2012 except as noted below.

On March 8, 2012, Watts Water Technologies, Inc., Watts Regulator Co., and Watts Plumbing Technologies, Inc. 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.

The Company is unable to estimate a range of reasonably possible loss for the above matter in which damages have not been specified because: (i) the proceedings are in the early stages; (ii) there is uncertainty as to the likelihood of a class being certified or the ultimate size of the class; (iii) there is uncertainty as to pending motions; (iv) there are significant factual issues to be resolved; and (v) there are novel legal issues presented. However, based on information currently known to the Company, it does not believe that these proceedings will have a material effect on its financial position, results of operations, cash flows or liquidity.

11. Employee 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 of additional benefits effective December 31, 2011 under both the Company s Pension Plan and Supplemental Employees Retirement Plan. In 2011, the Company recorded a curtailment charge of approximately $1.5 million to write-off previously unrecognized prior service costs and reduced the projected benefit obligation by $12.5 million.

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The components of net periodic benefit cost are as follows:

	Second Quarter Ended		Six Months Ended	
	July 1, 2012	**July 3, 2011**	**July 1, 2012**	**July 3, 2011**
		(in millions)		
Service cost benefits earned and administrative costs	**$ 0.2**	$ 1.3	**$ 0.4**	$ 2.6
Interest costs on benefits obligation	**1.4**	1.5	**2.8**	3.0
Expected return on assets	**(1.7)**	(1.8)	**(3.5)**	(3.6)
Prior service costs and net actuarial loss amortization	**0.1**	0.8	**0.3**	1.6
Net periodic benefit cost	**$**	$ 1.8	**$**	$ 3.6

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

	Six Months Ended	
	July 1, 2012	**July 3, 2011**
	(in millions)	
Employer contributions	**$ 0.4**	$ 5.1

The Company expects to contribute approximately $0.3 million to its pension plans for the remainder of 2012.

12. Acquisitions

On April 29, 2011, the Company completed the acquisition of Socla and the related water controls business of certain other entities controlled by Danfoss A/S, in a share and asset purchase transaction. The final consideration paid was EUR 116.3 million. The purchase price was financed with cash on hand and euro-based borrowings under our Credit Agreement. The purchase price was equal to approximately $172.4 million based on the exchange rate of Euro to U.S. dollars as of April 29, 2011.

The Company accounted for the transaction as a business combination. The Company completed a purchase price allocation that resulted in the recognition of $79.7 million in goodwill and $39.9 million in intangible assets. Intangible assets consist primarily of customer relationships with estimated lives of 10 years and trade names with either 20-year lives or indefinite lives. The goodwill is attributable to the workforce of Socla and the synergies that are expected to arise as a result of the acquisition. The goodwill is not expected to be deductible for tax purposes. The following table summarizes the final value of the assets and liabilities acquired (in millions):

Cash	$ 7.4
Accounts receivable	28.2
Inventory	24.6

Fixed assets		46.8
Other assets		6.5
Intangible assets		39.9
Goodwill		79.7
Accounts payable		(8.2)
Accrued expenses and other		(19.4)
Deferred tax liability		(22.3)
Debt		(10.8)
Purchase price	$	172.4

The consolidated statement of operations for the second quarter and six months ended July 1, 2012 includes the results of Socla. The results include $34.4 million and $69.2 million of revenues and $3.2 million and $5.7 million of operating income, respectively, which includes restructuring charges of $0.1 million and $0.6 million, respectively.

Supplemental pro-forma information (unaudited)

Had the Company completed the acquisition of Socla at the beginning of 2011, net sales, net income from continuing operations and earnings per share would have been as follows:

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Amounts in millions (except per share information)		Second Quarter Ended July 3, 2011		Six Months Ended July 3, 2011
Net sales	$	389.7	$	753.0
Net income from continuing operations	$	15.7	$	29.0
Net income per share:				
Basic EPS continuing operations	$	0.42	$	0.77
Diluted EPS continuing operations	$	0.41	$	0.77

Net income from continuing operations for the second quarter and six months ended July 3, 2011 was adjusted to include $0.2 million and $0.7 million, respectively, of net interest expense related to the financing and $0.2 million and $0.9 million, respectively, of net amortization expense resulting from the estimated allocation of purchase price to amortizable tangible and intangible assets. Net income for the second quarter and six months ended July 3, 2011 was also adjusted to exclude $2.4 million and $3.5 million, respectively, of net acquisition-related charges and third-party costs.

On January 31, 2012, the Company completed the acquisition of tekmar Control Systems (tekmar) in a share purchase transaction. A designer and manufacturer of control systems used in heating, ventilation, and air conditioning application, tekmar is expected to enhance the Company s hydronic systems product offerings in the U.S. and Canada. The initial purchase price paid was CAD $18.0 million, with an earn-out based on future earnings levels being achieved. The total purchase price will not exceed CAD $26.2 million. Sales for tekmar in 2011 approximated CAD $11.0 million. The results of tekmar are included in the Company s North America segment since the acquisition date and are not material to the Company s consolidated financial statements. See Note 2 for additional information on purchase price allocations.

13. Subsequent Event

Dividend Declared

On July 31, 2012, the Company declared a quarterly dividend of eleven cents ($0.11) per share on each outstanding share of Class A Common Stock and Class B Common Stock payable on August 31, 2012 to stockholders of record at the close of business on August 20, 2012.

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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 refers to Watts Water Technologies, Inc. and its consolidated subsidiaries.

We operate on a 52-week fiscal year ending on December 31. Any quarterly or six-month data contained in this Quarterly Report on Form 10-Q generally reflects the results of operations for a 13-week or 26-week period, respectively.

We are a leading supplier of products for use in the water quality, water safety, water flow control and water conservation markets in both North America and EMEA (Europe, Middle East and Africa), with a growing presence in Asia. For over 137 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: North America, EMEA and Asia. 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 had an effect on our sales and operating income is fluctuation in foreign currency exchange rates, as approximately 46% of our

sales and certain portions of our costs, assets and liabilities are denominated in currencies other than the U.S. dollar.

During the second quarter of 2012, sales decreased $4.6 million primarily from the depreciation of the euro against the dollar of $16.2 million offset by acquired sales of $13.1 million resulting from our acquisitions of Socla and tekmar. Organic sales decreased by 0.4% compared to last year s comparable period, with increased sales in our North American wholesale and DIY markets being offset by reduced sales in EMEA s OEM and wholesale markets. Organic sales in the second quarter of 2012 increased over the second quarter of 2011 in North America by $7.6 million, or 3.6%, increased in Asia by $0.2 million, or 3.4%, and decreased in EMEA by $9.3 million, or 5.9%. 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. Organic net sales increases in North America were driven mainly by volume increases in certain markets, offset by lower volumes in EMEA. Gross margins increased in the second quarter of 2012 as compared to 2011 by 0.8 percentage points, driven principally by reduced acquisition-related costs. We continued with the conversion of our U.S. manufacturing facilities to lead-free production, which caused inefficiencies from pre-production costs and product outsourcing. However, the effect of this conversion on gross margins decreased during the second quarter of 2012 as compared to the first quarter of 2012. Our transition to lead-free products is in response to the federal *Reduction of Lead in Drinking Water Act,* which requires the weighted average lead content of the wetted surfaces of pipes, plumbing fittings and plumbing fixtures used in potable water applications to be reduced to no greater than 0.25% by January 2014. Commodity costs during the quarter were fairly stable. Operating income of $33.7 million increased by 26.7% in the second quarter of 2012 as compared to the second quarter of 2011, driven by lower restructuring costs, lower acquisition-related costs and contributions from acquisitions. Foreign exchange movements primarily related to a weakening of the euro against the U.S. dollar negatively affected operating earnings by $1.6 million, when compared to the same period of 2011.

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We believe that the factors relating to our future growth include the demand for clean water around the world, 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, the successful completion of selective acquisitions, both in our core markets as well as in new complementary markets, and a healthy economic environment, that fosters residential and commercial construction. Our acquisition strategy focuses on businesses that manufacture preferred brand name products that address our themes of water quality, water conservation, water safety, water flow control, HVAC and related complementary markets. We target businesses that will provide us with one or more of the following: an entry into new markets, an increase in shelf space 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 and commercial construction markets.

We have completed 36 acquisitions since divesting our industrial and oil and gas business in 1999. On January 31, 2012, we completed the acquisition of tekmar Control Systems (tekmar) in a share purchase transaction. A designer and manufacturer of control systems used in heating, ventilation, and air conditioning applications, tekmar is expected to enhance our hydronic systems product offerings in the U.S. and Canada. The initial purchase price paid was CAD $18.0 million, with an earn-out based on the achievement of certain future earnings levels. The total purchase price will not exceed CAD $26.2 million. Sales for tekmar in 2011 were approximately CAD $11.0 million. On April 29, 2011, we completed the acquisition of Danfoss Socla S.A.S. (Socla) and the related water controls business of certain other entities controlled by Danfoss A/S, in a share and asset purchase transaction. The net purchase price of EUR 116.3 million was financed with cash on hand and euro-based borrowings under our Credit Agreement. The net purchase price was approximately $172.4 million based on the exchange rate of Euro to U.S. dollars as of April 29, 2011. Socla is a manufacturer of water protection valves and flow control solutions for the water market and the heating, ventilation and air conditioning market. Its major product lines include backflow preventers, check valves and pressure reducing valves. Socla is based in France, and its products are distributed worldwide for commercial, residential, municipal and industrial use. Socla s annual revenue for 2010 was approximately $130.0 million. Socla expands our residential and commercial plumbing and flow control product lines in EMEA and also adds to our HVAC product line.

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. We believe that the product development, product testing capability and investment in plant and equipment needed to manufacture products in compliance with code requirements, represent a competitive advantage for us.

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 are committed to maintaining our capital equipment at a level consistent with current technologies, and thus we expect to spend an aggregate of approximately $36.0 million during 2012 for purchases of capital equipment.

Recent Events

Stock Repurchase Program

We completed the previously announced stock repurchase program during the first week of July 2012. We purchased two million shares of our Class A Common stock for an aggregate cost of $65.8 million. During the quarter ended July 1, 2012, we repurchased approximately 1.9 million shares for approximately $63.2 million, at an average purchase price of approximately $32.88 per share.

Dividend Declared

On July 31, 2012, we declared a quarterly dividend of eleven cents ($0.11) per share on each outstanding share of Class A Common Stock and Class B Common Stock payable on August 31, 2012 to stockholders of record at the close of business on August 20, 2012.

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Results of Operations

Second Quarter Ended July 1, 2012 Compared to Second Quarter Ended July 3, 2011

Net Sales. Our business is reported in three geographic segments: North America, EMEA and Asia. Our net sales in each of these segments for each of the second quarters of 2012 and 2011 were as follows:

	Second Quarter Ended July 1, 2012		Second Quarter Ended July 3, 2011			% Change to Consolidated
	Net Sales	% Sales	Net Sales	% Sales	Change	Net Sales
			(dollars in millions)			
North America	**$ 221.8**	**59.8%**	$ 212.0	56.4%	$ 9.8	2.6%
EMEA	**142.8**	**38.5**	157.8	42.0	(15.0)	(4.0)
Asia	**6.5**	**1.7**	5.9	1.6	0.6	0.2
Total	**$ 371.1**	**100.0%**	$ 375.7	100.0%	$ (4.6)	(1.2)%

The change in net sales was attributable to the following:

					Change As a % of Consolidated Net Sales				Change As a % of Segment Net Sales		
	North America	EMEA	Asia	Total	North America	EMEA	Asia	Total	North America	EMEA	Asia
					(dollars in millions)						
Organic	$ 7.6	$ (9.3)	$ 0.2	$ (1.5)	2.0%	(2.5)%	0.1%	(0.4)%	3.6%	(5.9)%	3.4%
Foreign exchange	(0.9)	(15.5)	0.2	(16.2)	(0.2)	(4.1)		(4.3)	(0.4)	(9.8)	3.4
Acquired	3.1	9.8	0.2	13.1	0.8	2.6	0.1	3.5	1.4	6.2	3.4