Mueller Water Products, Inc.
Form 10-Q
May 09, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2006.

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

Commission File Number 333-131536

MUELLER WATER PRODUCTS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**20-3547095**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer identification No.)

4211 W. Boy Scout Blvd.
Tampa, FL 33607
(Address of principal executive offices)

(813) 871-4811

(Registrant s telephone number, including area code)

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer o Accelerated Filer o Non-accelerated Filer x

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

None of the Registrant s voting stock was held by non-affiliates as of May 9, 2006. As of May 9, 2006, Mueller Water Products, Inc. had one unit outstanding.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

MUELLER WATER PRODUCTS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

	March 31, 2006	September 30, 2005
	(dollars in millions)	
Assets		
Cash and cash equivalents	$ 41.1	$
Receivables, net of allowance for doubtful accounts of $6.5 million and $0.9 million at March 31, 2006 and September 30, 2005, respectively	272.7	118.5
Inventories	460.3	147.2
Deferred income taxes	58.1	11.1
Prepaid expenses	31.1	1.5
Total current assets	863.3	278.3
Property, plant and equipment, net	340.7	149.2
Deferred financing fees	30.7	
Deferred income taxes		9.5
Due from parent, Walter Industries	20.0	
Identifiable intangibles, net	849.0	
Goodwill	855.5	58.4
Other long-term assets	5.6	
Total assets	$ 2,964.8	$ 495.4
Liabilities and Shareholder s Equity (Deficit)		
Current portion of long-term debt	$ 11.5	$
Accounts payable	110.3	52.5
Accrued expenses and other liabilities	109.3	34.7
Payable to affiliate, Sloss Industries	4.4	2.5
Total current liabilities	235.5	89.7
Long-term debt	1,537.8	
Payable to parent, Walter Industries	2.9	443.6
Accrued pension liability, net	105.4	53.6
Accumulated postretirement benefits obligation	48.3	51.1
Deferred income taxes	294.6	
Other long-term liabilities	23.6	12.6
Total liabilities	2,248.1	650.6
Commitments and contingencies (Note 13)		
Shareholder s equity (deficit):		
Membership unit:		
(1 unit outstanding at March 31, 2006 and September 30, 2005)		
Capital in excess of par value	988.3	68.3
Accumulated deficit	(228.7)	(178.1)
Accumulated other comprehensive loss	(42.9)	(45.4)
Total shareholder s equity (deficit)	716.7	(155.2)
Total liabilities and shareholder s equity (deficit)	$ 2,964.8	$ 495.4

The accompanying notes are an integral part of the condensed consolidated financial statements.

1

MUELLER WATER PRODUCTS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three months ended March 31, 2006 (dollars in millions)	March 31, 2005
Net sales	$ 434.9	$ 124.7
Cost of sales	340.3	114.1
Gross profit	94.6	10.6
Operating expenses:		
Selling, general and administrative	60.8	5.1
Related party corporate charges	2.0	1.8
Facility rationalization, restructuring and related costs	4.3	
Total operating expenses	67.1	6.9
Income from operations	27.5	3.7
Interest expense arising from related party payable to Walter Industries		(5.1)
Interest expense, net of interest income	(30.1)	(0.2)
Loss before income taxes	(2.6)	(1.6)
Income tax benefit	(0.8)	(0.4)
Net loss	$ (1.8)	$ (1.2)

	Six months ended March 31, 2006 (dollars in millions)	March 31, 2005
Net sales	$ 915.3	$ 265.9
Cost of sales	777.2	242.6
Gross profit	138.1	23.3
Operating expenses:		
Selling, general and administrative	117.9	18.3
Related party corporate charges	3.8	3.7
Facility rationalization, restructuring and related costs	28.4	
Total operating expenses	150.1	22.0
Income (loss) from operations	(12.0)	1.3
Interest expense arising from related party payable to Walter Industries		(11.0)
Interest expense, net of interest income	(62.3)	(0.3)
Loss before income taxes	(74.3)	(10.0)
Income tax expense (benefit)	(23.7)	0.7
Net loss	$ (50.6)	$ (10.7)

The accompanying notes are an integral part of the condensed consolidated financial statements.

MUELLER WATER PRODUCTS, INC.
CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDER S EQUITY (DEFICIT) AND

COMPREHENSIVE LOSS

FOR THE SIX MONTHS ENDED MARCH 31, 2006
(UNAUDITED)

	Capital in Excess of Par Value	Accumulated Deficit	Comprehensive Income (Loss)	Accumulated Other Comprehensive Loss	Total
Balance at September 30, 2005	$ 68.3	$ (178.1)		$ (45.4)	$ (155.2)
Walter s investment in subsidiary	932.9				932.9
Dividend to Walter	(444.5)				(444.5)
Dividend to Walter for acquisition costs	(12.0)				(12.0)
Forgiveness of U.S. Pipe payable to Walter	443.6				443.6
Comprehensive income (loss)					
Net loss		(50.6)	(50.6)		(50.6)
Other comprehensive income (loss), net of tax					
Unrealized gain on interest rate swaps, net of tax			2.6	2.6	2.6
Foreign currency translation adjustments			(0.1)	(0.1)	(0.1)
Comprehensive loss			$ (48.1)		
Balance at March 31, 2006	$ 988.3	$ (228.7)		$ (42.9)	$ 716.7

The accompanying notes are an integral part of the condensed consolidated financial statements.

3

MUELLER WATER PRODUCTS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Six months ended March 31, 2006 (dollars in millions)	March 31, 2005
OPERATING ACTIVITIES		
Net loss	$ (50.6)	$ (10.7)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation	34.4	13.1
Amortization of intangibles	13.6	
Amortization of deferred financing fees	2.5	
Accretion on debt	6.6	
Gain on disposal of property, plant and equipment	(0.3)	
Stock-based compensation expense	0.3	
Impairments of property, plant and equipment	21.3	
Provision for deferred income taxes	(26.1)	8.5
Gain on interest rate swaps	(0.5)	
Changes in assets and liabilities, net of the effects of acquisitions:		
Receivables	23.4	20.9
Inventories	62.1	(42.4)
Income taxes payable		2.0
Prepaid expenses and other current assets	1.8	(0.1)
Pension and other long-term liabilities	3.5	2.7
Accounts payable, accrued expenses and other current liabilities	(28.9)	(1.0)
Net cash provided by (used in) operating activities	63.1	(7.0)
INVESTING ACTIVITIES		
Additions to property, plant and equipment	(30.9)	(11.2)
Acquisitions of businesses, net of cash acquired	(15.5)	
Increase in amounts due to (from) Walter	(15.6)	18.2
Net cash provided by (used in) investing activities	(62.0)	7.0
FINANCING ACTIVITIES		
Increase (decrease) in dollar value of bank checks outstanding	9.7	(0.1)
Proceeds from short-term borrowings	55.9	
Retirement of short-term debt	(55.9)	
Proceeds from long-term debt	1,050.0	
Retirement of long-term debt, including capital lease obligations	(617.9)	
Payment of deferred financing fees	(21.6)	
Dividend to Walter	(444.5)	
Dividend to Walter for acquisition costs	(12.0)	
Walter contribution of Predecessor Mueller s cash	76.3	
Net cash provided by (used in) financing activities	40.0	(0.1)
Net increase (decrease) in cash and cash equivalents	41.1	(0.1)
Cash and cash equivalents at beginning of period		0.1
Cash and cash equivalents at end of period	$ 41.1	$

4

MUELLER WATER PRODUCTS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
(UNAUDITED)

Schedule of non-cash investing and financing activities:

On October 3, 2005, the Company s parent Walter Industries, purchased all the outstanding common stock of Predecessor Mueller.

	(dollars in millions)
Contribution of Predecessor Mueller by Walter	$ 932.9
Less: Cash of Predecessor Mueller received	(76.3)
Total net assets received excluding cash	$ 856.6

Subsequent to the Acquisition, the Company s parent, Walter Industries, forgave an intercompany receivable with U.S. Pipe of $443.6 million.

The accompanying notes are an integral part of the condensed consolidated financial statements.

5

MUELLER WATER PRODUCTS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

AS OF AND FOR THE THREE AND SIX MONTHS ENDED MARCH 31, 2006 AND MARCH 31, 2005

(UNAUDITED)

Note 1. Organization

The registrant is Mueller Water Products, Inc., a Delaware corporation (Mueller Water or the Company). The Company is the surviving corporation of the merger on February 2, 2006 of Mueller Water Products, LLC (Commission File Number: 333-116590) and Mueller Water Products Co-Issuer, Inc. with and into Mueller Holding Company, Inc., a Delaware corporation.

On October 3, 2005, through a series of transactions (the Acquisition), Walter Industries, Inc. (Walter), through a wholly-owned subsidiary, acquired all outstanding shares of capital stock of Mueller Water Products, Inc. (Predecessor Mueller), which immediately was converted into Mueller Water Products, LLC, a Delaware limited liability company and contributed United States Pipe and Foundry Company, LLC, (U.S. Pipe), owned by Walter since 1969, to the acquired company. In accordance with generally accepted accounting principles, for accounting purposes U.S. Pipe is treated as the acquirer of Predecessor Mueller. Accordingly, effective October 3, 2005, U.S. Pipe s basis of accounting is used for the Company and all financial data for periods prior to October 3, 2005 of the Company included in this report on Form 10-Q, is that of U.S. Pipe. The results of operations of Predecessor Mueller are included in the Consolidated Statements of Operations beginning October 3, 2005.

The Company was originally organized as United States Pipe and Foundry Company, Inc. (Inc.) and was a wholly-owned subsidiary of Walter Industries, Inc., a diversified New York Stock Exchange traded company (NYSE: WLT). On September 23, 2005, Inc. was dissolved and United States Pipe and Foundry Company, LLC was organized in the state of Alabama, and the operations of Inc. were conducted under the form of a limited liability company.

In December 2005, U.S. Pipe changed its fiscal year-end to September 30, which coincides with the fiscal year end of Predecessor Mueller. Beginning with the quarter ended December 31, 2005, the Company has three operating segments which are named after its leading brands in each segment: Mueller, U.S. Pipe, and Anvil.

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q. 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. Operating results for the three-month and six-month periods ended March 31, 2006 are not necessarily indicative of the results that may be expected for the year ending September 30, 2006.

The balance sheet at September 30, 2005, has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

Certain amounts in the prior period s consolidated financial statements have been reclassified to conform to the current-period presentation. On the Consolidated Balance Sheet as of September 30, 2005, prepaid pension cost of $19.3 million has been netted against accrued pension liability of $72.9 million and is presented as accrued pension liability, net of $53.6 million.

Note 2. Summary of Significant Accounting Policies

Revenue Recognition *The* Company recognizes revenue based on the recognition criteria set forth in the Securities and Exchange Commission s Staff Accounting Bulletin 104 Revenue Recognition in Financial Statements , which is when delivery of product has occurred or services have been rendered and there is persuasive evidence of a sales arrangement, selling prices are fixed or determinable, and collectibility from the customer is reasonably assured. Revenue from the sale of products via rail or truck is recognized when title passes upon delivery to the customer. Revenue earned for shipments via ocean vessel is recognized under international shipping standards as defined by Incoterms 2000 when title and risk of loss transfer to the customer. Sales are recorded net of estimated cash discounts and rebates.

Shipping and Handling *Costs* to ship products to customers are included in cost of sales in the Consolidated Statements of Operations. Amounts billed to customers, if any, to cover shipping and handling costs are included in net sales.

Customer Rebates *Customer* rebates are applied against net sales at the time the sales are recorded based on estimates with respect to the deductions to be taken.

Cash and Cash Equivalents *The* Company considers all highly liquid investments with original maturities of ninety days or less when purchased to be cash equivalents. Outstanding checks are netted against cash when there is a sufficient balance of cash available in the Company s accounts at the bank to cover the outstanding amount and the right of offset exists. Where there is no right of offset against cash balances, outstanding checks are classified along with accounts payable. At March 31, 2006 and September 30, 2005 checks issued but not yet presented to the banks for payment (i.e. the dollar value of bank checks outstanding) were $9.7 million and zero, respectively, and were recorded in accounts payable.

Receivables *Receivables* relate primarily to amounts due from customers located in North America. To reduce credit risk, credit investigations are performed prior to accepting an order and, when necessary, letters of credit are required to ensure payment.

The estimated allowance for doubtful accounts receivable is based, in large part, upon judgments and estimates of expected losses and specific identification of problem trade accounts. Significantly weaker than anticipated industry or economic conditions could impact customers ability to pay such that actual losses may be greater than the amounts provided for in these allowances. The periodic evaluation of the adequacy of the allowance for doubtful accounts is based on an analysis of prior collection experience, specific customer creditworthiness and current economic trends within the industries served. In circumstances where a specific customer s inability to meet its financial obligation is known to the Company (e.g., bankruptcy filings or substantial downgrading of credit ratings), the Company records a specific allowance to reduce the receivable to the amount the Company reasonably believes will be collected.

Inventories *Inventories* are recorded at the lower of cost (first-in, first-out) or market value. Additionally, the Company evaluates its inventory in terms of excess and obsolete exposures. This evaluation includes such factors as anticipated usage, inventory turnover, inventory levels and ultimate product sales value. Inventory cost includes an overhead component that can be affected by levels of production and actual costs incurred. Management periodically evaluates the effects of production levels and actual costs incurred on the costs capitalized as part of inventory.

Property, plant and equipment *Property,* plant and equipment is recorded at cost, less accumulated depreciation and amortization. Depreciation is recorded on the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized on the straight-line method over the lesser of the useful life of the improvement or the remaining lease term. Estimated useful lives used in computing depreciation expense are 2 to 20 years for machinery and equipment and 3 to 50 years for land

improvements and buildings. Gains and losses upon disposition are reflected in the Consolidated Statements of Operations in the period of disposition.

Direct internal and external costs to implement computer systems and software are capitalized as incurred. Capitalized costs are amortized over the estimated useful life of the system or software, beginning when site installations or module development is complete and ready for its intended use, which generally is 3 to 5 years.

The Company accounts for its asset retirement obligations related to plant and landfill closures in accordance with Statement of Financial Accounting Standards No. 143 (SFAS 143). Under SFAS 143, liabilities are recognized at fair value for an asset retirement obligation in the period in which it is incurred and the carrying amount of the related long-lived asset is correspondingly increased. Over time, the liability is accreted to its future value. The corresponding asset capitalized at inception is depreciated over the useful life of the asset.

Tooling Prepaid expenses include maintenance and tooling inventory costs. Perishable tools and maintenance items are expensed when put into service. More durable items are depreciated over their estimated useful lives, ranging from 4 to 10 years.

Environmental Expenditures The Company capitalizes environmental expenditures that increase the life or efficiency of property or that reduce or prevent environmental contamination. The Company accrues for environmental expenses resulting from existing conditions that relate to past operations when the costs are probable and reasonably estimable. The Company is indemnified by Tyco for all environmental liabilities associated with Predecessor Mueller as it existed as of August 16, 1999, whether known or not.

Accounting for the Impairment of Long-Lived Assets Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the book value of the asset may not be recoverable. Goodwill and intangible assets that have an indefinite life are not amortized, but instead are tested for impairment annually (or more frequently if events or circumstances indicate possible impairments) using both a discounted cash flow method and a market comparable method.

Workers Compensation The Company is self-insured for workers compensation benefits for work-related injuries. Liabilities, including those related to claims incurred but not reported, are recorded principally using annual valuations based on discounted future expected payments and using historical data or combined insurance industry data when historical data is limited. Pursuant to the terms of the Tyco Purchase Agreement, Predecessor Mueller is indemnified by Tyco for all liabilities that occurred prior to August 16, 1999. Workers compensation liabilities were as follows:

	March 31, 2006	**September 30, 2005**
	(dollars in millions)	
Workers compensation liability recorded on a discounted basis	$ 24.4	$ 11.9

A one-percentage-point increase in the discount rate on the discounted claims liability would decrease the liability by $0.1 million, while a one-percentage-point decrease in the discount rate would increase the liability by $0.1 million.

Warranty Costs The Company accrues for U.S. Pipe segment warranty expenses that include customer costs of repair and/or replacement, including labor, materials, equipment, freight and reasonable overhead costs, determined on a case-by-case basis, whenever the Company s products and/or services fail to comply with published industry standards or mutually agreed upon customer requirements.

The Company accrues for the estimated cost of product warranties of the Mueller and Anvil segments at the time of sale based on historical experience. Adjustments to obligations for warranties are made as changes in the obligations become reasonably estimable.

Activity in accrued warranty, included in the caption accrued expenses in the accompanying Consolidated Balance Sheets, was as follows (in millions):

	Three months ended		Six months ended	
	March 31, 2006	**March 31, 2005**	**March 31, 2006**	**March 31, 2005**
Accrued balance at beginning of period	$ 5.0	$ 1.7	$ 4.7	$ 1.8
Accrued warranty of Predecessor Mueller			1.6	
Warranty expense	1.4	0.9	1.8	1.7
Settlement of warranty claims	(2.0)	(0.8)	(3.7)	(1.7)
Balance at end of period	$ 4.4	$ 1.8	$ 4.4	$ 1.8

Deferred Financing Fees Costs of debt financing included in other non-current assets are amortized over the life of the related loan agreements, which range from five to ten years. Such costs are reassessed when amendments occur, in accordance with Emerging Issues Task Force (EITF) 96-19, Debtors Accounting for a Modification or Exchange of Debt Instruments.

Income Taxes *Deferred* tax liabilities and assets are recognized for the expected future tax consequences of events that have been included in the financial statements or tax returns. Deferred tax liabilities and assets are determined based on the differences between the financial statements and the tax basis of assets and liabilities, using tax rates in effect for the years in which the differences are expected to reverse. A valuation allowance is provided to offset any net deferred tax assets if, based upon the available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized.

Research and Development *Research* and development expenditures are expensed when incurred.

Advertising *Advertising* costs are expensed when incurred.

Translation of Foreign Currency *Assets* and liabilities of the Company s businesses operating outside of the United States of America which maintains accounts in a functional currency other than U.S. dollars are translated into U.S. dollars using year-end exchange rates. Revenues and expenses are translated at the average exchange rates effective during the year. Foreign currency translation gains and losses are included as a separate component of stockholders equity. Gains and losses resulting from foreign currency transactions are included in either cost of sales or selling, general and administrative expense, as appropriate.

Derivative Instruments and Hedging Activities *The* Company currently uses interest rate swaps as required in the 2005 Mueller Credit Agreement to reduce the risk of interest rate volatility. The amount to be paid or received from interest rate swaps is charged or credited to interest expense over the lives of the interest rate swap agreements. Changes in the fair value of derivatives are recorded each period in earnings or Accumulated Other Comprehensive Income (Loss), depending on whether or not a derivative is designated and effective as part of a hedge transaction and meets the applicable requirements associated with Statement of Financial Accounting Standards No. 133 (SFAS 133) (see Note 6).

Additionally, the Company utilizes forward contracts to mitigate its exposure to changes in foreign currency exchange rates from third party and intercompany transactions. The primary currency to which the Company is exposed and to which it hedges the exposure is the Canadian Dollar. The effective portion of unrealized gains and losses associated with forward contracts are deferred as a component of

Accumulated Other Comprehensive Income (Loss) until the underlying hedged transactions are reported in the Company s Consolidated Statements of Operations.

Related Party Transactions The Company purchases foundry coke from an affiliate, Sloss Industries, Inc. for an amount that approximates the market value of comparable transactions. Costs included in cost of sales related to purchases from Sloss Industries, Inc. were $5.4 million and $6.6 million for the three months ended March 31, 2006 and 2005, respectively, and $10.8 million and $10.3 million for the six months ended March 31, 2006 and 2005, respectively.

Other services that Sloss Industries, Inc. provides to the Company include the delivery of electrical power to one of the Company s facilities, rail car switching and the leasing of a distribution facility. The total of these other services included in the Company s operating expenses were $0.4 million and $0.4 million for the three months ended March 31, 2006 and 2005, respectively, and $0.8 million and $0.7 million for the six months ended March 31, 2006 and 2005, respectively.

Related Party Allocations Certain costs incurred by Walter such as insurance, executive salaries, professional service fees, human resources, transportation, healthcare and other centralized business functions are allocated to its subsidiaries. Certain costs that were considered directly related to the U.S. Pipe segment were charged to the Company and included in selling, general and administrative expenses. These costs were approximately $0.6 million and $0.4 million for the three months ended March 31, 2006 and 2005, respectively, and approximately $1.0 million and $0.8 million for the six months ended March 31, 2006 and 2005, respectively. Costs incurred by Walter that cannot be directly attributed to its subsidiaries are allocated to them based on estimated annual revenues. Such costs were allocated to the Company and are recorded in the caption, related party corporate charges, in the accompanying Consolidated Statements of Operations and were approximately $2.0 million and $1.8 million for the three months ended March 31, 2006 and 2005, respectively, and approximately $3.8 million and $3.7 million for the six months ended March 31, 2006 and 2005, respectively.

While the Company considers the allocation of such costs to be reasonable, in the event the Company was not affiliated with Walter, these costs may increase or decrease.

Certain of the Company s employees have been granted Walter restricted stock units and stock options under Walter s stock-based compensation plans. The Company has expensed $0.2 million and $0.2 million related to the stock-based compensation costs allocated from Walter for the three and six months ended March 31, 2006, respectively.

Note 3. Acquisitions

Hunt Industries, Inc.

On January 4, 2006, the Company acquired Hunt Industries, Inc. (Hunt) for $6.8 million in cash. Hunt, based in Murfreesboro, Tennessee, is a manufacturer of meter pits and meter yokes which are sold by the Company s Mueller segment.

The estimated fair values of the assets and liabilities acquired are as follows (dollars in millions):

Current assets	$ 0.2
Goodwill	6.8
Current liabilities	(0.2)
Net assets acquired	$ 6.8

CCNE, L.L.C.

On January 27, 2006, the Company acquired the operating assets of CCNE, L.L.C., a Connecticut-based manufacturer of check valves for sale to the water and wastewater treatment markets, for $8.8 million in cash.

The estimated fair values of the assets and liabilities acquired are as follows (dollars in millions):

Inventory	$ 2.1
Intangible assets	6.7
Net assets acquired	$ 8.8

The intangible assets acquired represent purchased technology and are being amortized over an estimated useful life of 55 months.

Acquisition of Predecessor Mueller by Walter Industries

On October 3, 2005, pursuant to the agreement dated June 17, 2005, Walter acquired all of the outstanding common stock of Predecessor Mueller for $943.4 million and assumed $1.05 billion of indebtedness. Predecessor Mueller was converted into a limited liability company on October 3, 2005 and was merged with and into the Company on February 2, 2006. Transaction costs included in the acquisition price were $14.8 million. In conjunction with the acquisition, U.S. Pipe was contributed in a series of transactions to Mueller Group, LLC (Mueller Group or Group), a wholly-owned subsidiary of the Company, on October 3, 2005. On February 23, 2006, Walter received $10.5 million based on the final closing cash and working capital, adjusting the purchase price to $932.9 million.

Walter s acquisition of Predecessor Mueller has been accounted for as a business combination with U.S. Pipe considered the acquirer for accounting purposes. Assets acquired and liabilities assumed were recorded at their fair values as of October 3, 2005. The total purchase price of $932.9 million is comprised of (dollars in millions):

Acquisition of the outstanding common stock of Predecessor Mueller	$ 918.1
Acquisition-related transaction costs	14.8
Total purchase price	$ 932.9

Acquisition-related transaction costs include investment banking, legal and accounting fees and other external costs directly related to the Acquisition.

Under business combination accounting, the purchase price was allocated to Predecessor Mueller s net tangible and identifiable intangible assets based on their fair values as of October 3, 2005. The excess of the purchase price over the net tangible and identifiable intangible assets was recorded as goodwill. Based on estimated fair values, the purchase price was allocated as follows (dollars in millions):

Receivables, net	$ 177.4
Inventory	373.2
Property, plant and equipment	215.7
Identifiable intangible assets	855.9
Goodwill	790.4
Net other assets	376.1
Net deferred tax liabilities	(283.1)
Debt	(1,572.7)
Total purchase price allocation	$ 932.9

The purchase price allocation is preliminary and is subject to future adjustments to goodwill for the execution of certain restructuring plans identified by Walter prior to the acquisition date primarily related to Predecessor Mueller facility rationalization actions. Costs related to these facility rationalization actions will be recorded to goodwill through October 3, 2006.

Receivables are short-term trade receivables and their net book value approximates current fair value.

Finished goods inventory is valued at estimated selling price less cost of disposal and reasonable profit allowance for the selling effort. Work in process inventory is valued at estimated selling price of finished goods less costs to complete, cost of disposal and a reasonable profit allowance for the completing and selling effort. Raw materials are valued at book value, which approximates current replacement cost. The carrying value of inventories include $70.2 million in excess of Predecessor Mueller s carrying value, of which $11.8 million was charged to cost of sales during the three months ended March 31, 2006 and $70.2 million was charged to cost of sales during the six months ended March 31, 2006.

Property, plant and equipment are valued at the current replacement cost as follows (in millions):

		Depreciation Period
Land	$ 14.1	Indefinite
Buildings	51.8	5 to 14 years
Machinery and equipment	136.6	3 to 5 years
Other	13.2	3 years
Total property, plant and equipment	$ 215.7	

Identifiable intangible assets acquired consist of trade name, trademark, technology and customer relationships and were valued at their current fair value. Trade name and trademark relate to Mueller®, Anvil®, Hersey , Henry Pratt and James Jones . Technology represents processes related to the design and development of products. Customer relationships represent the recurring nature of sales to current distributors, municipalities, contractors and other end customers regardless of their contractual nature.

Identifiable intangible assets were as follows (dollars in millions):

		Amortization Period
Trade name and trademark	$ 403.0	Indefinite
Technology	56.3	10 years
Customer relationships	396.6	19 years
Total identifiable intangible assets	$ 855.9	

Goodwill represents the excess of the purchase price over the fair value of tangible and identifiable intangible assets acquired. Goodwill is not amortized, but rather is tested for impairment at least annually. In the event that the Company determines the book value of goodwill has become impaired, the Company will incur an accounting charge for the amount of impairment during the fiscal quarter in which such determination is made. The Company s goodwill is not tax deductible.

Net other assets include cash, prepaid expenses, deferred financing fees, accounts payable, accrued expenses and accrued pension liability and were valued at their approximate current fair value. After the purchase price allocation Predecessor Mueller paid a $444.5 million dividend to Walter.

Net deferred tax liabilities include the tax effects of fair value adjustments related to identifiable intangible assets and net tangible assets.

Debt is valued at fair market value as of October 3, 2005, which resulted in a $36.0 million and an $18.9 million fair value increase to the senior discount notes and the senior subordinated notes, respectively.

The following table of unaudited pro forma results of operations of Predecessor Mueller and U.S. Pipe for the three and six months ended March 31, 2005 is presented as if the Acquisition and borrowings under the 2005 Mueller Credit Agreement had taken place on October 1, 2004 and were carried forward through March 31, 2005.

The unaudited pro forma amounts are not intended to represent or be indicative of the consolidated results of operations that would have been reported had the Acquisition and borrowings under the 2005 Mueller Credit Agreement been completed as of the dates presented, and should not be taken as representative of the future consolidated results of operations of the Company.

	Three months ended	Six months ended
	March 31, 2005	March 31, 2005
	(dollars in millions)	
	(unaudited)	
Net Sales	$ 409.9	$ 807.2
Net income (loss)	$ 1.3	$ (10.1)

The pro forma amounts are based on the historical results of operations and are adjusted for amortization of definite-lived intangibles of $5.9 million and $11.8 million for the three and six months ended March 31, 2005, respectively; depreciation of property, plant and equipment of ($0.2) million and ($0.4) million for the three and six months ended March 31, 2005, respectively; interest expense of $5.1 million and $10.6 million for the three and six months ended March 31, 2005, respectively; and amortization of financing fees related to the 2005 Mueller Credit Agreement of ($0.1) million and $2.4 million for the three and six months ended March 31, 2005, respectively.

Note 4. Facility Rationalization, Restructuring and Related Costs

On January 26, 2005, the Company announced the closure of the Henry Pratt (Pratt) valve manufacturing facility in Dixon, Illinois, which is included in the Company s Mueller segment. The eventual closure of the facility is expected to occur by the end of the fiscal year 2006, resulting in the termination of approximately 100 employees. Total estimated costs related to this closure are $2.2 million, of which $1.4 million, consisting of termination benefits, is expected to be recorded as an adjustment to goodwill. The remaining other costs include costs to transfer and install equipment and temporary outsourcing of manufacturing and will be expensed when incurred. During the quarter ended March 31, 2006, $0.3 million of termination benefits was recorded as an adjustment to goodwill. The restructuring costs are recorded to goodwill as the overall plan to close the facility was approved prior to the Acquisition.

On October 26, 2005, Walter announced plans to close U.S. Pipe s Chattanooga, Tennessee plant and transfer the valve and hydrant production of that plant to Mueller s Chattanooga, Tennessee and Albertville, Alabama plants. The eventual closure of the U.S. Pipe Chattanooga plant is expected to occur in calendar 2006, resulting in the termination of approximately 340 employees. Total exit costs are expected to approximate $47.6 million of which approximately $29.3 million qualify as restructuring and impairment charges. The remaining exit costs of $18.3 million were comprised of an inventory write-down totaling $10.7 million and a $7.6 million write-off of unabsorbed overhead costs, of which $2.4 million and $18.3 million were recognized in cost of sales during the three months and six months ended March 31, 2006, respectively.

Total estimated restructuring and impairment charges and the amounts recorded to restructuring expenses are as follows (in millions):

	Total estimated restructuring costs (dollars in millions)	Restructuring & impairment charges expensed For the three months ended March 31, 2006	For the six months ended March 31, 2006
Termination benefits	$ 3.6	$ 0.4	$ 3.4
Other employee-related costs			