

WATTS WATER TECHNOLOGIES INC  
Form PRE 14A  
March 09, 2007  
UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

**SCHEDULE 14A**

Proxy Statement Pursuant to Section 14(a) of  
the Securities Exchange Act of 1934 (Amendment No. )

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material Pursuant to §240.14a-12

**WATTS WATER TECHNOLOGIES, INC.**

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- No fee required.
- Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.
  - (1) Title of each class of securities to which transaction applies:
  - (2) Aggregate number of securities to which transaction applies:
  - (3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):
  - (4) Proposed maximum aggregate value of transaction:
  - (5) Total fee paid:
- Fee paid previously with preliminary materials.
- Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.
  - (1) Amount Previously Paid:
  - (2) Form, Schedule or Registration Statement No.:
  - (3) Filing Party:
  - (4) Date Filed:

**Watts Water Technologies, Inc.**

**March 30, 2007**

Dear Stockholder:

We cordially invite you to attend our 2007 Annual Meeting of Stockholders, which will be held on Wednesday, May 2, 2007 at 10:00 a.m. at The Andover Country Club, 60 Canterbury Street, Andover, Massachusetts 01810.

On the pages following this letter you will find the notice of our 2007 Annual Meeting, which lists the business matters to be considered at the meeting, and the proxy statement, which describes the matters listed in the notice. We have also enclosed your proxy card and our annual report for the year ended December 31, 2006.

Your support of our efforts is important to the other directors and to me regardless of the number of shares you own. I hope you will vote as soon as possible. If you are a stockholder of record, you may vote by completing, signing and mailing the enclosed proxy card in the envelope provided. If your shares are held in street name that is, held for your account by a broker or other nominee you will receive instructions from the holder of record that you must follow for your shares to be voted.

Following completion of the scheduled business at the 2007 Annual Meeting, we will report on our operations and answer questions from stockholders. We hope that you will be able to join us on May 2nd.

Sincerely,

PATRICK S. O'KEEFE  
*President and Chief Executive Officer*

**WATTS WATER TECHNOLOGIES, INC.**  
**815 Chestnut Street**  
**North Andover, MA 01845**

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**NOTICE OF ANNUAL MEETING OF STOCKHOLDERS**

**To Be Held on May 2, 2007**

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To the Stockholders of  
Watts Water Technologies, Inc.

Notice is hereby given that the 2007 Annual Meeting of Stockholders of Watts Water Technologies, Inc., a Delaware corporation, will be held at The Andover Country Club, 60 Canterbury Street, Andover, Massachusetts 01810, on Wednesday, May 2, 2007, at 10:00 a.m., local time, for the following purposes:

1. To elect eight directors to our Board of Directors, each to hold office until our 2008 Annual Meeting of Stockholders and until such director's successor is duly elected and qualified;
2. To approve an amendment to our Restated Certificate of Incorporation, as amended, to increase the number of authorized shares of class A common stock from 80,000,000 shares to 200,000,000 shares and to increase the number of authorized shares of capital stock from 110,000,000 shares to 230,000,000 shares;
3. To amend our Management Stock Purchase Plan, as amended and restated, to increase the number of shares of class A common stock available for issuance thereunder from 1,000,000 shares to 2,000,000 shares; and
4. To ratify the selection of KPMG LLP as our independent registered public accounting firm for the current fiscal year.

The stockholders will also consider and act upon any other matters that may properly come before the Annual Meeting.

Only stockholders of record at the close of business on March 26, 2007 are entitled to notice of and to vote at the meeting or any adjournment or postponement thereof.

By Order of the Board of Directors

LESTER J. TAUFEN  
*Secretary*

North Andover, Massachusetts  
March 30, 2007

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WATTS WATER TECHNOLOGIES, INC.

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ANNUAL MEETING OF STOCKHOLDERS

May 2, 2007

PROXY STATEMENT

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INFORMATION CONCERNING SOLICITATION AND VOTING

This proxy statement is furnished in connection with the solicitation of proxies by the Board of Directors of Watts Water Technologies, Inc. for use at our 2007 Annual Meeting of Stockholders to be held on Wednesday, May 2, 2007 at 10:00 a.m., local time, at The Andover Country Club, 60 Canterbury Street, Andover, Massachusetts 01810 and at any adjournment or postponement of the Annual Meeting.

**We are mailing this proxy statement and the enclosed proxy on or about March 30, 2007 to our stockholders of record as of March 26, 2007. We are also mailing our Annual Report for the fiscal year ended December 31, 2006 to such stockholders concurrently with this proxy statement. We will furnish, upon written request of any stockholder and the payment of an appropriate processing fee, copies of the exhibits to our Annual Report on Form 10-K for the fiscal year ended December 31, 2006. Please address all such requests to Lester J. Taufen, Secretary, Watts Water Technologies, Inc., 815 Chestnut Street, North Andover, MA 01845.**

Only stockholders of record at the close of business on March 26, 2007 are entitled to receive notice of and to vote at the Annual Meeting. Each share of our class A common stock, par value \$.10 per share, outstanding on the record date is entitled to one vote, and each share of our class B common stock, par value \$.10 per share, outstanding on the record date is entitled to ten votes. As of the close of business on March 26, 2007, there were outstanding and entitled to vote \_\_\_\_\_ shares of class A common stock and \_\_\_\_\_ shares of class B common stock.

If your shares are held in street name by a bank or brokerage firm, your bank or brokerage firm, as the record holder of your shares, is required to vote your shares according to your instructions. In order to vote your shares, you will need to follow the directions your bank or brokerage firm provides you. Many banks and brokerage firms also offer the option of voting over the Internet or by telephone, instructions for which would be provided by your bank or brokerage firm on your voting instruction form. Under the rules of the New York Stock Exchange if you do not give instructions to your bank or brokerage firm, it will still be able to vote your shares with respect to discretionary items, but it will not be allowed to vote your shares with respect to non-discretionary items. In the case of non-discretionary items, your unvoted shares will be treated as broker non-votes. The election of directors (proposal 1), the approval of the amendment to our Certificate of Incorporation (proposal 2), and the ratification of the selection of KPMG LLP as our independent registered public accounting firm (proposal 4) are considered to be discretionary items. The approval of the amendment to our Management Stock Purchase Plan (proposal 3) is considered to be a non-discretionary item. Accordingly, if you do not give your bank or brokerage firm instructions on how to vote your shares with respect to proposal 3, or if your bank or brokerage firm does not exercise its discretionary authority to vote your shares with respect to proposals 1, 2 or 4, your shares will be treated as broker non-votes on the particular matter.

The presence, in person or by proxy, of outstanding shares of class A common stock and class B common stock representing a majority of the total votes entitled to be cast is necessary to constitute a quorum for the transaction of business at our Annual Meeting. Shares that reflect abstentions will be counted for purposes of determining whether a quorum is present for the transaction of business at the Annual Meeting.

The eight nominees for director receiving the highest number of votes FOR election will be elected as directors. This is called a plurality. As discussed above, if your shares are held in street name, and if you do not vote your shares, your brokerage firm has discretionary authority under the rules of the New York Stock Exchange to vote your unvoted shares on proposal 1. You may vote for all of the director nominees,

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withhold your vote from all of the director nominees or withhold your vote from any one or more of the director nominees. Votes that are withheld will not be included in the vote tally for the election of directors and will have no effect on the results of the vote.

Approval of the amendment to our Certificate of Incorporation requires the affirmative vote of the holders of a majority of the votes represented by the outstanding shares of class A common stock and class B common stock, voting together as a class. In addition, the amendment requires the affirmative vote of the holders of a majority of the issued and outstanding shares of class A common stock and the holders of a majority of the issued and outstanding shares of class B common stock, each voting as a separate class. As discussed above, if your shares are held in street name, and if you do not vote your shares, your bank or brokerage firm has discretionary authority under the rules of the New York Stock Exchange to vote your unvoted shares on proposal 2. Because shares that abstain are nonetheless considered outstanding shares, abstentions on proposal 2 will have the same effect as a vote against the proposed amendment to our Certificate of Incorporation.

Approval of the amendment to our Management Stock Purchase Plan requires the affirmative vote of the holders of a majority of the votes present or represented at the annual meeting and entitled to be cast on the proposal. In addition, the rules of the New York Stock Exchange provide that the minimum vote that will constitute stockholder approval for listing purposes is a majority of votes cast on the proposal, provided that the total votes cast on the proposal represents over 50% in interest of all shares entitled to vote on the proposal. As discussed above, if your shares are held in street name, and if you do not vote your shares, your bank or brokerage firm does not have discretionary authority under the rules of the New York Stock Exchange to vote your unvoted shares on proposal 3 and your shares will be treated as broker non-votes. However, broker non-votes will have no effect on the vote because they will not be considered to have been entitled to vote on proposal 3. If you vote to abstain on proposal 3, your shares will not be voted in favor of such proposal, although your shares will be considered to have been entitled to vote on the proposal. As a result, voting to abstain on proposal 3 has the effect of voting against such proposal.

Ratification of the selection of KPMG as our independent registered public accounting firm for 2007 requires the affirmative vote of a majority of all the votes present or represented at the Annual Meeting and entitled to be cast on the proposal. As discussed above, if your shares are held in street name, and if you do not vote your shares, your bank or brokerage firm has discretionary authority under the rules of the New York Stock Exchange to vote your unvoted shares on proposal 4. If you vote to abstain on proposal 4, your shares will not be voted in favor of such proposal, although your shares will be considered to have been entitled to vote on the proposal. As a result, voting to abstain on proposal 4 has the effect of voting against such proposal.

Shares represented by duly executed proxies received by us and not revoked will be voted at the Annual Meeting in accordance with the instructions contained therein. If no instructions are given, properly executed proxies will be voted for the election of each of the nominees named herein for director, for the amendment to our Certificate of Incorporation, for the amendment to our Management Stock Purchase Plan, and for the ratification of the selection of KPMG as our independent registered public accounting firm for the current fiscal year.

You may revoke your proxy at any time before it is voted on any matter by (1) giving written notice of such revocation to the Secretary of Watts Water Technologies, Inc. at the address set forth below, (2) signing and duly delivering a proxy bearing a later date, or (3) attending our Annual Meeting and voting in person. Your attendance at our Annual Meeting will not, by itself, revoke your previously submitted proxy.

We will bear the expenses of preparing, printing and assembling the materials used in the solicitation of proxies. In addition to the solicitation of proxies by use of the mail, we may also use the services of some of our officers and employees (who will receive no compensation for such services in addition to their

regular salaries) to solicit proxies personally and by telephone and email. Brokerage houses, nominees, fiduciaries and other custodians will be requested to forward solicitation materials to the beneficial owners of shares held of record by them and we will reimburse them for their reasonable expenses.

Our management does not know of any business other than the matters set forth in the Notice of Annual Meeting of Stockholders and described above that will be presented for consideration at the Annual Meeting. If any other business should come before the Annual Meeting, the proxies will be voted in accordance with the direction of the proxy holders. Each of the persons appointed by the enclosed form of proxy present and acting at the meeting, in person or by substitute, may exercise all of the powers and authority of the proxies in accordance with their judgment.

Our principal executive offices are located at 815 Chestnut Street, North Andover, Massachusetts 01845.

**PROPOSAL 1  
ELECTION OF DIRECTORS**

Our Board has fixed the number of directors at eight and nominated each of the individuals named below for election as a director. If elected, each nominee will serve until our 2008 Annual Meeting of Stockholders and until such director's successor has been duly elected and qualified. Proxies will be voted for each of the nominees named below unless otherwise specified in the proxy. All of the nominees are presently members of our Board. Management does not contemplate that any of the nominees will be unable to serve, but in that event, proxies solicited hereby may be voted for a substitute nominee designated by our Board or our Board may choose to reduce the number of directors serving on the Board. Holders of shares representing votes sufficient to elect each of the nominees named below have indicated to us their intention to vote in favor of such nominees.

**Our Board of Directors recommends that stockholders vote FOR the election of each nominee as a director of Watts Water Technologies, Inc.**

**INFORMATION AS TO NOMINEES FOR DIRECTOR**

Set forth below is the name and age of each nominee for director, his principal occupation for at least the past five years, the year each became a member of our Board of Directors and certain other information. The information is as of February 1, 2007.

<b>Name</b>	<b>Age</b>	<b>Present Principal Employment and Prior Business Experience</b>	<b>Director Since</b>
Robert L. Ayers	61	Mr. Ayers was Senior Vice President of ITT Industries and President of ITT Industries Fluid Technology from October 1999 until September 2005. Mr. Ayers continued to be employed by ITT Industries from September 2005 until his retirement in September 2006, during which time he focused on special projects for the company. ITT Industries Fluid Technology manufactures a broad range of pumps, mixers, controls and treatment systems. Mr. Ayers originally joined ITT Industries in 1998 as President of ITT Industries Industrial Pump Group. Before joining ITT Industries, Mr. Ayers was President of Sulzer Industrial USA and Chief Executive Officer of Sulzer Bingham.	2006
Timothy P. Horne	68	Mr. Horne served as Chairman of our Board of Directors from April 1986 to August 2002. He served as our Chief Executive Officer from 1978 to August 2002 and our President from 1976 to 1978, from 1994 to April 1997 and from October 1999 to August 2002. Mr. Horne joined Watts in 1959, and retired on December 31, 2002. Since his retirement, Mr. Horne has continued to serve Watts as a consultant.	1962
Ralph E. Jackson, Jr.	65	Mr. Jackson worked for Cooper Industries, Inc., a manufacturer of electrical products, from 1985 until his retirement in December 2003. Prior to joining Cooper Industries, Mr. Jackson worked for the Bussmann and Air Comfort divisions of McGraw-Edison from 1976 until McGraw-Edison was acquired by Cooper Industries in 1985. While with Cooper Industries, Mr. Jackson served as Chief Operating Officer from 2000 to December 2003, Executive Vice President, Electrical Operations from 1992 to 2000, and President, Bussmann Division from 1985 to 1992. Mr. Jackson served as a member of the Board of Directors of Cooper Industries from 2000 to December 2003.	2004
Kenneth J. McAvoy	66	Mr. McAvoy served as our Chief Financial Officer and Treasurer from 1986 to 1999; our Vice President of Finance from 1984 to 1994; our Executive Vice President of European Operations from 1994 to 1996; and our Secretary from 1985 to 1999. Mr. McAvoy originally joined Watts in 1981 as Corporate Controller and retired on December 31, 1999.	1994

John K. McGillicuddy	63	Mr. McGillicuddy was employed by KPMG LLP, a public accounting firm, from June 1965 until his retirement in June 2000. In June 1975, Mr. McGillicuddy was elected into the Partnership of KPMG LLP, where he served as Audit Partner, SEC Reviewing Partner, Partner-in-Charge of Professional Practice, Partner-in-Charge of College Recruiting and Partner-in-Charge of Staff Scheduling. Mr. McGillicuddy is a director of Brooks Automation, Inc.	2003
Gordon W. Moran	68	Mr. Moran has served as non-executive Chairman of our Board since August 2002. He has served as Chairman of Hollingsworth & Vose Company, a paper manufacturer, since 1997 and served as its President and Chief Executive Officer from 1983 to 1998.	1990
Daniel J. Murphy, III	65	Mr. Murphy has served as Chairman of Northmark Bank, a commercial bank he founded, since August 1987. Prior to forming Northmark Bank in 1987, Mr. Murphy was a Managing Director of Knightsbridge Partners, Inc., a venture capital firm, from January to August 1987 and President and a director of Arltru Bancorporation, a bank holding company, and its wholly owned subsidiary, Arlington Trust Company, from 1980 to 1986.	1986
Patrick S. O Keefe	54	Mr. O Keefe became our President and Chief Executive Officer in August 2002. From 1999 to 2001, Mr. O Keefe served as President, Chief Executive Officer and director of Industrial Distribution Group, a supplier of maintenance, repair, operating and production products. From 1997 to 1999, he was Chief Executive Officer of Zep Manufacturing, a unit of National Services Industries and a manufacturer of specialty chemicals. From 1994 to 1997, Mr. O Keefe held various senior management positions with Crane Co.	2002

## DIRECTOR COMPENSATION

Members of our Board of Directors who are employees of Watts receive no compensation for their service as directors. Non-employee directors are compensated for their service as directors.

Prior to its quarterly meeting held on February 5, 2007, the Compensation Committee reviewed the compensation paid to our non-employee directors. The Compensation Committee compared non-employee director compensation arrangements to compensation paid to non-employee directors of companies in the peer group we use for executive compensation comparison purposes. A list of the companies included in this peer group and a description of the criteria used in selecting these companies is provided elsewhere in this proxy statement under Compensation Discussion and Analysis Compensation Philosophy Benchmarking. The Compensation Committee also considered the recommendations of Watson Wyatt & Company, a compensation consultant retained by the Compensation Committee during 2006, and reviewed the responsibilities of our non-employee directors and the amount



of time required to perform those responsibilities. Based on its analysis, the Compensation Committee recommended, and the Board approved, a change in the annual compensation paid to our non-employee directors for 2007. Set forth below is a description of the annual compensation arrangements for our non-employee directors in effect for 2006 and the new annual compensation arrangements for 2007.

	2006(\$)	2007(\$)
Annual retainer	30,000	30,000
Regularly scheduled Board meetings attended in person	1,000	2,000
Regularly scheduled committee meetings attended in person	1,000	None
Additional annual retainer for the Chairman of the Board of Directors	None	5,000
Additional annual retainer for the Chairman of the Audit Committee	10,000	10,000
Additional annual retainer for the Chairman of each of the Compensation Committee and the Nominating and Corporate Governance Committee	3,000	3,000
Fair market value of annual grant of class A common stock	30,000	45,000

For 2006, fees for attendance at regularly scheduled Board and/or committee meetings were limited to \$1,000 per day for each non-employee director. In 2007, non-employee directors will receive a single fee of \$2,000 for attending each regularly scheduled Board meeting in person and will not receive additional compensation for attendance at committee meetings. Non-employee directors will not receive any additional compensation for participation in meetings held by telephone conference call. We reimburse non-employee directors for reasonable out-of-pocket expenses incurred in connection with attending Board and committee meetings and for fees and reasonable out-of-pocket expenses for their attendance at director education seminars and programs they attend at the request of the Board.

The restricted stock awards granted in 2006 vest in three equal annual installments beginning one year from the date of grant. If a non-employee director's service as a director is terminated for any reason (other than death or disability), any shares of restricted stock that have not vested are automatically forfeited upon termination of such service as a director. The Board granted 852 shares of restricted stock to each of Mr. Horne, Mr. Jackson, Mr. McAvoy, Mr. McGillicuddy, Mr. Moran and Mr. Murphy as of August 4, 2006 and 729 shares of restricted stock to Mr. Ayers as of November 3, 2006 in connection with his election as a member of the Board. Beginning in 2007, non-employee directors will receive awards of class A common stock that are not subject to vesting or forfeiture. All stock awards are granted under our 2004 Stock Incentive Plan. Our Board typically approves the grants of stock awards to non-employee directors at its regularly scheduled third quarter meeting. We have adopted a practice that stock awards for non-employee directors are granted on the third business day following the release of our second quarter earnings to the public. The purpose for setting the grant date of stock awards on the third business day following the release of our most recent quarterly earnings to the public is to ensure that we are using a date when the public markets have a maximum amount of information about our financial performance and have had a sufficient amount of time to understand and react to such information.

The following table contains information on compensation for the non-employee members of our Board of Directors during the fiscal year ended December 31, 2006.

#### 2006 DIRECTOR COMPENSATION

Name	Fees Earned or Paid in Cash(\$)	Stock Awards(\$)(1)	Option Awards\$(2)	All Other Compensation(\$)	Total(\$)
Robert L. Ayers	9,500 (3)	1,667			11,167
Timothy P. Horne	40,000	24,165		647,724 (4)	711,889
Ralph E. Jackson, Jr.	42,000	24,148			66,148
Kenneth J. McAvoy	39,000	24,165		96,904 (5)	160,069
John K. McGillicuddy	50,000	24,165			74,165
Gordon W. Moran	51,635 (6)	24,165			75,800
Daniel J. Murphy, III	43,000	24,165			67,165

(1) The amounts in this column reflect the dollar amount recognized for financial statement reporting purposes for the year ended December 31, 2006 in accordance with Financial Accounting Standards Board Statement of Financial Accounting Standards No. 123 (revised 2004) *Share-Based Payments*, or FAS 123R, of restricted stock awards under our 2004 Stock Incentive Plan and thus include amounts attributable to restricted stock awards granted in and prior to 2006. A discussion of the assumptions used in calculating the amounts in this column may be found in Note 13 to our audited consolidated financial statements for the year ended December 31, 2006 included in our Annual Report on Form 10-K filed with the SEC on March 1, 2007. The grant date fair value of each restricted stock award made to our non-employee directors during 2006 as determined in accordance with FAS 123R was \$29,990, except for the value of the restricted stock award granted to Mr. Ayers, which was \$29,998. The following table shows the aggregate number of unvested shares of restricted stock held by each of our non-employee directors as of December 31, 2006.

Name	Unvested Shares of Restricted Stock(#)
Robert L. Ayers	729
Timothy P. Horne	1,876
Ralph E. Jackson, Jr.	1,854
Kenneth J. McAvoy	1,876
John K. McGillicuddy	1,876
Gordon W. Moran	1,876
Daniel J. Murphy, III	1,876

(2) There were no stock options granted to our non-employee directors during 2006, and, with respect to stock options, no dollar amounts were recognized for financial statement reporting purposes under FAS 123R for the year ended December 31, 2006. The following table shows the aggregate number of stock options held by each of our non-employee directors as of December 31, 2006. All of the stock options were fully vested prior to 2006.

Name	Stock Options (#)
Robert L. Ayers	0
Timothy P. Horne	3,094
Ralph E. Jackson, Jr.	0
Kenneth J. McAvoy	9,282
John K. McGillicuddy	3,094
Gordon W. Moran	21,658
Daniel J. Murphy, III	21,658

(3) Mr. Ayers was elected as a member of our Board of Directors on October 31, 2006 and received a prorated portion of the annual retainer payable to non-employee directors.

(4) The amount indicated for Mr. Horne under All Other Compensation consists of the following:

Description of Payment	Amount(\$)
Consulting fees	460,113
Retirement benefit payments under our employee pension plan	146,154
Cost of secretarial services for personal business	6,975
Tax and financial planning expenses	25,081
Health insurance premiums	7,901
Club membership	1,500

(5) Consists of retirement benefit payments under our employee pension plan and supplemental employee retirement plan.

(6) Includes payment of \$12,635 of deferred director fees and accrued interest.

In September 1996, we entered into a Supplemental Compensation Agreement with Timothy P. Horne, who was at that time our Chief Executive Officer and President, which provided that Mr. Horne would provide consulting services to us and receive certain compensation following his retirement as an employee of Watts. Mr. Horne retired on December 31, 2002. Under the agreement, as amended, Mr. Horne has agreed to provide consulting services to us for 300 to 500 hours per year so long as he is physically able. We agreed to pay Mr. Horne the greater of (i) one-half of the average of Mr. Horne's annual base salary as an employee of Watts during the three years immediately prior to his retirement or (ii) \$400,000 for each calendar year following Mr. Horne's retirement until the date of his death, subject to certain cost-of-living increases each year. The agreement also provides for a supplemental payment to Mr. Horne of \$10,668 for 2006. In the event of a change of control of Watts, Mr. Horne has the right to elect to receive a lump-sum payment instead of the payments described above. If Mr. Horne elects to receive the lump-sum payment, his obligation to provide consulting services to us terminates. The lump-sum payment would equal the present value of \$23,650 monthly for life and would be determined with reference to discount rates and mortality tables applicable under our pension plan and an adjustment for inflation. If Mr. Horne elects to receive a lump-sum payment following a change of control of Watts, we also agreed to make a tax gross-up payment to him to cover all federal, state and local taxes payable by him with respect to the lump-sum payment. We also agreed to provide lifetime benefits to Mr. Horne, including use of secretarial services, use of an office at our corporate headquarters, retiree health insurance,

reimbursement of tax and financial planning expenses, automobile maintenance expenses, one club membership, a customary director indemnification agreement and travel expenses when visiting our facilities. Our obligations to make the above-described payments to Mr. Horne and to provide the above-described benefits will not be affected or limited by Mr. Horne's physical inability to provide consulting services to us if such disability should occur. During 2006, Mr. Horne did not seek reimbursement for any automobile expenses or for any travel expenses other than for business travel undertaken at our request. Pursuant to our agreement with Mr. Horne, we employ a secretary who works part time for Mr. Horne. The cost of secretarial services included in the All Other Compensation column for Mr. Horne represents 10% of the compensation and benefits cost of Mr. Horne's secretary, which we estimate is the portion of her time that she spends working on personal matters for Mr. Horne.

As former employees of Watts, Mr. Horne and Mr. McAvoy each receive retirement benefit payments under our pension plan and, with respect to Mr. McAvoy, our supplemental employee retirement plan. Retirement benefit payments received by each of Mr. Horne and Mr. McAvoy pursuant to these plans are reflected in the All Other Compensation column in the above table.

Beginning in 1992 and continuing through the end of 1999, we agreed to defer payment of director fees earned by Mr. Moran for his service as a member of our Board of Directors. The deferred payments accrue interest in June and December of each year at the short term annual applicable federal rate. Mr. Moran stopped deferring payment of his director fees at the beginning of 2000 and since that time we have paid him 10% of the deferred fees balance plus accrued interest twice each year. The Fees Earned or Paid in Cash column of the above table includes the amount of deferred fees and interest paid to Mr. Moran during 2006. As of December 31, 2006, the remaining balance of deferred fees was \$54,560.

## **CORPORATE GOVERNANCE**

### **Our Commitment to Good Corporate Governance**

We believe that good corporate governance and an environment of the highest ethical standards are important for us to achieve business success and to create value for our stockholders. Our Board is committed to high governance standards and continually works to improve them. We periodically review our corporate governance policies and practices and compare them to those suggested by various authorities on corporate governance and other public companies. We also review guidance and interpretations provided from time to time by the Securities and Exchange Commission, or SEC, and the New York Stock Exchange and consider changes to our corporate governance policies and practices in light of such guidance and interpretations.

### **Role of Our Board of Directors**

Our Board monitors overall corporate performance and the integrity of our financial controls and legal compliance procedures. It elects senior management and oversees succession planning and senior management's performance and compensation. Our Board oversees the development of fundamental operating, financial and other corporate plans, strategies and objectives, and conducts a year-long process which culminates in Board review and approval each year of a business plan, a capital expenditures budget and other key financial and business objectives.

Members of our Board keep informed about our business through discussions with our Chief Executive Officer and other members of our senior management team, by reviewing materials provided to them on a regular basis and in preparation for Board and committee meetings and by participating in meetings of the Board and its committees. We regularly review key portions of the business with the Board, and we introduce our executives to the Board so that the Board can become familiar with our key employees. In addition, we hold periodic strategy sessions between members of senior management and

the Board, during which members of the senior management team provide in-depth reviews of various aspects of our business operations and discuss our strategy with respect to such operations.

In 2006, our Board met eight times. During 2006, each director attended at least 75% of the total number of meetings of the Board and all committees of the Board on which the director served.

### **Performance of Our Board**

Our Board considers it important to continually evaluate and improve its effectiveness and that of its committees. Our Board and each of its standing committees conducts an annual self-evaluation. The Nominating and Corporate Governance Committee oversees our Board's self-evaluation process. The results of each committee's annual self-evaluation are reported to the full Board.

### **Business Ethics and Compliance**

We have adopted a Code of Business Conduct and Ethics applicable to all officers, employees and Board members. The Code of Business Conduct and Ethics is posted in the Investor Relations section of our website at [www.wattswater.com](http://www.wattswater.com), and a print copy will be made available free of charge on written request to Lester J. Taufen, Secretary, Watts Water Technologies, Inc., 815 Chestnut Street, North Andover, MA 01845. Any amendments to, or waivers of, the Code of Business Conduct and Ethics which apply to our Chief Executive Officer, Chief Financial Officer, Corporate Controller or any person performing similar functions will be disclosed on our website promptly following the date of such amendment or waiver.

### **Independence of Non-Employee Directors**

The listing standards of the New York Stock Exchange require companies listed on the New York Stock Exchange to have a majority of independent directors. The New York Stock Exchange listing standards generally provide that a director will not be independent unless such director has no material relationship with us (either directly or as a partner, shareholder or officer of an organization that has a relationship with us). In addition, a director is not independent if (1) the director is, or has been within the last three years, employed by us, or an immediate family member is, or has been within the last three years, one of our executive officers, (2) the director or a member of the director's immediate family has received during any twelve-month period within the last three years more than \$100,000 in direct compensation from us other than director and committee fees and pension or other deferred compensation for prior service as an employee, **(3) the director or an immediate family member is a current partner of a firm that is our internal or external auditor, the director is a current employee of such a firm, the director has an immediate family member who is a current employee of such a firm and who participates in the firm's audit, assurance or tax compliance practice, or the director or an immediate family member was within the last three years a partner or employee of such a firm and personally worked on our audit within that time, (4) the director or a member of the director's immediate family is, or has been within the last three years, employed as an executive officer of another company where one of our executive officers at the same time serves or served on the compensation committee of such company, or (5) the director is a current employee, or an immediate family member is a current executive officer, of a company that has made payments to, or received payments from, us for property or services in an amount which, in any of the last three fiscal years, exceeds the greater of \$1 million, or 2% of such other company's consolidated gross revenues.**

Our Board has reviewed all relationships between Watts and each non-employee director to determine compliance with the New York Stock Exchange standards described above and to evaluate whether there are any other facts or circumstances that might impair a director's independence. As part of its review of Mr. Murphy's independence, the Board considered that Watts maintains deposit accounts

with Northmark Bank, of which Mr. Murphy serves as Chairman. The Board determined that Mr. Murphy's position as chairman of a bank where Watts maintains certain of its funds, but with which Watts has no additional banking relationship or credit facility and from which Watts has borrowed no funds, does not constitute a material relationship with Watts that would affect Mr. Murphy's independence. Based on its review, the Board determined that Mr. Ayers, Mr. Jackson, Mr. McAvoy, Mr. McGillicuddy, Mr. Moran and Mr. Murphy are independent directors.

### **Corporate Governance Guidelines**

Our Board has adopted Corporate Governance Guidelines that govern the structure and functioning of the Board and set out the Board's policies on governance issues. The Corporate Governance Guidelines are posted in the Investor Relations section of our website at [www.wattswater.com](http://www.wattswater.com), and a print copy will be made available free of charge on written request to Lester J. Taufen, Secretary, Watts Water Technologies, Inc., 815 Chestnut Street, North Andover, MA 01845.

### **Executive Sessions**

In accordance with our Corporate Governance Guidelines, our non-management directors meet in executive session at least quarterly. At least one executive session includes only independent directors. The Chairman of the Board or, in his absence, a director chosen by the non-management directors in attendance, presides at such meetings.

### **Communications with the Board**

Our Board welcomes the submission of any comments or concerns from stockholders and any interested parties. Communications should be in writing and addressed to Lester J. Taufen, Secretary, Watts Water Technologies, Inc., 815 Chestnut Street, North Andover, MA 01845 and marked to the attention of the Board or any of its committees, individual directors or non-management directors as a group. All correspondence will be forwarded to the intended recipient(s).

### **Annual Meeting Attendance**

Directors are encouraged to attend our annual meetings of stockholders. Five of our seven directors attended the 2006 Annual Meeting of Stockholders.

### **Committees of the Board**

Our Board currently has three standing committees: the Audit Committee, the Compensation Committee and the Nominating and Corporate Governance Committee. Each committee is composed solely of directors determined by the Board to be independent under the applicable New York Stock Exchange and SEC rules. The Board has adopted a written charter for each standing committee. You may find copies of the charters of the Audit Committee, the Compensation Committee and the Nominating and Corporate Governance Committee in the Investor Relations section of our website at [www.wattswater.com](http://www.wattswater.com), and print copies will be made available free of charge on written request to Lester J. Taufen, Secretary, Watts Water Technologies, Inc., 815 Chestnut Street, North Andover, MA 01845. The Board also appoints from time to time ad hoc committees to address specific matters.

*Audit Committee.* The Audit Committee consists of Mr. McGillicuddy (Chair), Mr. Ayers and Mr. McAvoy. The current members of the Audit Committee were appointed by the Board on October 31, 2006. Prior to October 31, 2006, the members of the Audit Committee were Mr. McGillicuddy (Chair), Mr. Jackson, Mr. Moran and Mr. Murphy. The Board has made a determination that each of the members of the Audit Committee satisfies the independence requirements of the New York Stock Exchange as well as Rule 10A-3 under the Securities Exchange Act of 1934. In addition, the Board has determined that each of

Mr. McGillicuddy and Mr. McAvoy is an audit committee financial expert, as defined by SEC rules. During 2006, the Audit Committee held five meetings. Our Audit Committee assists the Board in its oversight of the integrity of our financial statements, our compliance with legal and regulatory requirements, the qualifications, independence and performance of our independent registered public accounting firm, and the performance of our internal audit function. This includes the selection and evaluation of our independent registered public accounting firm, the oversight of our systems of internal accounting and financial controls, the review of the annual independent audit of our financial statements, the review of our Code of Business Conduct and Ethics, the establishment of whistle-blowing procedures, and the oversight of other compliance matters.

*Compensation Committee.* The Compensation Committee consists of Mr. Murphy (Chair), Mr. Jackson and Mr. Moran. The current members of the Compensation Committee were appointed by the Board on October 31, 2006. Prior to October 31, 2006, the members of the Compensation Committee were Mr. Murphy (Chair), Mr. Jackson, Mr. McGillicuddy and Mr. Moran. During 2006, the Compensation Committee held five meetings. Our Compensation Committee is responsible for shaping the principles, strategies and compensation philosophy that guide the design and implementation of our employee compensation programs and arrangements. Its primary responsibilities are to:

- evaluate the performance of our Chief Executive Officer and, either as a committee or together with the independent members of our Board of Directors, determine the compensation of our Chief Executive Officer;
- review management's proposals for the compensation of our other executive officers and submit its recommendations regarding base salaries and target bonus amounts to our Board of Directors for review and approval;
- review annual performance bonus objectives with management and approve annual bonus amounts paid to our executive officers under our Executive Incentive Bonus Plan;
- approve all stock awards granted under our 2004 Stock Incentive Plan and the participants in our Management Stock Purchase Plan;
- review and submit its recommendations to our Board of Directors on compensation for non-employee directors;
- review and discuss with management the Compensation Discussion and Analysis to be included in the proxy statement; and
- monitor our policies and practices for the development and succession of senior management.

The Compensation Committee holds one regularly scheduled meeting each quarter and schedules additional meetings as often as necessary in order to perform its duties and responsibilities. Mr. Murphy, the Chairman of the Compensation Committee, works with Mr. O'Keefe, our Chief Executive Officer, to establish the agenda for each meeting. Compensation Committee members receive and review materials in advance of each meeting. These materials include information that management believes will be helpful to the Compensation Committee as well as materials that members of the Compensation Committee have requested. The Compensation Committee may establish and delegate authority to one or more subcommittees consisting of one or more of its members when the Compensation Committee deems it appropriate to do so in order to carry out its responsibilities.

The Compensation Committee is authorized under its charter to retain consultants to assist it in the evaluation of executive compensation and to approve the fees and other retention terms for its consultants. During 2006 and for the past several years, the Compensation Committee has engaged Watson Wyatt & Company as a compensation consultant to review our compensation programs and provide advice with respect to the aggregate level of our executive compensation as well as the mix of elements used to

compensate our executive officers. As appropriate, the Compensation Committee also looks to our human resources department to support the Compensation Committee in its work and to provide necessary information. In addition to its engagement as a consultant to the Compensation Committee, Watson Wyatt provides substantial advisory and actuarial services to Watts with respect to our pension plans and other employee benefits and compensation programs. The Compensation Committee has periodically reviewed the services provided to Watts by Watson Wyatt and evaluated the impact of this relationship on Watson Wyatt's independence and on the quality and objectivity of the advice provided to the Compensation Committee by Watson Wyatt. Although the Compensation Committee believes that the advice it has received from Watson Wyatt has been objective and of high quality, in October 2006 the Compensation Committee determined that it should retain a new compensation consultant that does not perform any other work for Watts. The Compensation Committee is in the process of interviewing and evaluating potential compensation consultants. As part of its selection criteria, the Compensation Committee is seeking a compensation consultant that has not performed any work for Watts and has no prior relationship with our management. The new compensation consultant will report directly to the Compensation Committee but will be authorized to communicate with management and other employees of Watts to obtain necessary information.

In February 2007, the Compensation Committee conducted a review of its charter and recommended to the Board that it amend the Compensation Committee charter to (i) reflect the responsibility of the Compensation Committee to review and discuss with management the Compensation Discussion and Analysis section included in our annual meeting proxy statement and incorporated by reference into our annual report on Form 10-K, (ii) clarify that the Compensation Committee shall determine the compensation of our Chief Executive Officer either as a committee or together with the other independent directors, (iii) provide that the Compensation Committee has primary responsibility for reviewing our management succession policies and plans, and (iv) remove the authority of the Compensation Committee to delegate to executive officers the power to grant stock awards to our non-executive employees. In response to the Compensation Committee's recommendations, the Board adopted a revised charter for the Compensation Committee on February 6, 2007, which incorporated the Compensation Committee's recommended changes.

*Nominating and Corporate Governance Committee.* Our Nominating and Corporate Governance Committee consists of Mr. McAvoy (Chair), Mr. Ayers, Mr. Jackson and Mr. Moran. The current members of the Nominating and Corporate Governance Committee were appointed by the Board on October 31, 2006. Prior to October 31, 2006, the members of the Nominating and Corporate Governance Committee were Mr. Jackson (Chair), Mr. McGillicuddy, Mr. Moran and Mr. Murphy. During 2006, the Nominating and Corporate Governance Committee held four meetings. The Nominating and Corporate Governance Committee is responsible for identifying individuals qualified to become Board members, consistent with criteria approved by the Board, and recommending that the Board select the director nominees for election at each annual meeting of stockholders. The Nominating and Corporate Governance Committee is also responsible for periodically reviewing our Corporate Governance Guidelines and recommending any changes thereto, overseeing the evaluation of the Board and management, and approving related person transactions.

The Nominating and Corporate Governance Committee will consider for nomination to the Board candidates recommended by stockholders. Recommendations should be sent to the Nominating and Corporate Governance Committee, c/o Lester J. Taufen, Secretary, Watts Water Technologies, Inc., 815 Chestnut Street, North Andover, MA 01845. In order to be considered for inclusion as a nominee for director in our proxy statement for our 2008 Annual Meeting of Stockholders, a recommendation must be received no later than December 1, 2007. Recommendations must be in writing and must contain the information set forth in Section IV.C of the Nominating and Corporate Governance Committee charter, which is available in the Investor Relations section of our website at [www.wattswater.com](http://www.wattswater.com) or on written



request to Lester J. Taufen, Secretary, Watts Water Technologies, Inc., 815 Chestnut Street, North Andover, MA 01845. The minimum qualifications and specific qualities and skills required for a nominee for director are that the nominee shall have the highest personal and professional integrity, shall have demonstrated exceptional ability and judgment, and shall be most effective, in conjunction with the other nominees to the Board, in collectively serving the long-term interests of the stockholders. Additional factors to be considered by the Nominating and Corporate Governance Committee in selecting nominees for the Board are set forth in Exhibit A to the Nominating and Corporate Governance Committee charter. In addition to considering candidates suggested by stockholders, the Nominating and Corporate Governance Committee may consider potential candidates suggested by current directors, company officers, employees, third-party search firms and others. The Nominating and Corporate Governance Committee screens all potential candidates in the same manner regardless of the source of the recommendation. The Nominating and Corporate Governance Committee's review is typically based on any written materials provided with respect to the potential candidate. The Nominating and Corporate Governance Committee determines whether the candidate meets our minimum qualifications and specific qualities and skills for directors and whether requesting additional information or an initial screening interview is appropriate.

Stockholders also have the right under our bylaws to directly nominate director candidates, without any action or recommendation on the part of the Nominating and Corporate Governance Committee or the Board, by following the procedures described later in this proxy statement under Stockholder Proposals .

Mr. Ayers, who is standing for election as a member of our Board of Directors for the first time at this Annual Meeting, was recommended for nomination to the Nominating and Corporate Governance Committee by our Chief Executive Officer.

#### **LEGAL PROCEEDING INVOLVING DIRECTOR**

The SEC commenced a civil action on August 15, 2002 against Timothy P. Horne, a member of our Board, our controlling stockholder, and former Chief Executive Officer and Chairman, alleging that Mr. Horne received confidential information as an officer of Watts and used it to profit from trading he did in shares of Central Sprinkler Corp. in May 1999. The complaint alleged violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder based on insider trading.

On February 21, 2003, Mr. Horne entered into an agreement with the SEC to settle the civil action. Pursuant to the agreement, Mr. Horne, without admitting or denying the allegations of the complaint filed by the SEC, consented to the entry of a final judgement against him which required him to disgorge profits gained as a result of the conduct alleged in the complaint, pay prejudgment interest, plus a civil money penalty, and which permanently restrains and enjoins him from violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder.

#### **PRINCIPAL STOCKHOLDERS**

The following table sets forth information regarding the beneficial ownership of our class A and class B common stock as of February 1, 2007, by:

- each person or entity known by us to own beneficially more than 5% of either class of our common stock;
- each of our directors;
- each of the executive officers named in the summary compensation table; and
- all of our directors and executive officers as a group.

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In accordance with SEC rules, we have included in the number of shares beneficially owned by each stockholder all shares over which such stockholder has sole or shared voting or investment power, and we have included all shares that the stockholder has the right to acquire within 60 days after February 1, 2007 through the exercise of stock options, the settlement of restricted stock units or any other right. Unless otherwise indicated, each stockholder has sole voting and investment power with respect to shares beneficially owned by that stockholder. For purposes of determining the equity and voting percentages for each stockholder, any shares that such stockholder has the right to acquire within 60 days after February 1, 2007 are deemed to be outstanding, but are not deemed to be outstanding for the purpose of determining the percentages for any other stockholder.

Name of Beneficial Owner(1)	Shares Beneficially Owned(2)		Percent of Class A Common Stock	Percent of Class B Common Stock	Percent of Voting Power
	Number				
Timothy P. Horne	7,229,962	(3)(4)	18.8 %	99.0 %	69.3 %
Daniel W. Horne	1,210,840	(5)	3.7	16.6	11.6
Deborah Horne	1,210,840	(5)	3.7	16.6	11.6
Peter W. Horne	1,135,840	(6)	3.5	15.6	10.9
Gabelli Funds, LLC, et al.	4,432,714	(7)	14.2	0	4.3
Robert L. Ayers	729	(8)	*	0	*
J. Dennis Cawte	43,450	(9)	*	0	*
Ralph E. Jackson, Jr.	14,521	(10)	*	0	*
Paul A. Lacourciere	33,284	(11)	*	0	*
William D. Martino	12,500	(12)	*	0	*
Kenneth J. McAvoy	12,270	(13)	*	0	*
William C. McCartney	101,668	(14)	*	0	*
John K. McGillicuddy	5,682	(15)	*	0	*
Gordon W. Moran	28,910	(16)	*	0	*
Daniel J. Murphy III	31,455	(17)	*	0	*
Patrick S. O Keefe	169,284	(18)	*	0	*
All executive officers and directors (17 persons)	7,839,639	(19)	20.1	99.0	69.6

\* Represents less than 1%

(1) The address of each stockholder in the table is c /o Watts Water Technologies, Inc., 815 Chestnut Street, North Andover, Massachusetts 01845, except that the address of Gabelli Funds, LLC et al. is One Corporate Center, Rye, NY 10580.

(2) The number of shares and percentages has been determined as of February 1, 2007 in accordance with Rule 13d-3 of the Securities Exchange Act of 1934. At that date, a total of 38,532,991 shares were outstanding, of which 31,239,111 were shares of class A common stock and 7,293,880 were shares of class B common stock. Each share of class A common stock is entitled to one vote and each share of class B common stock is entitled to ten votes. Each share of class B common stock is convertible into one share of class A common stock. A holder of shares of class B common stock is deemed to beneficially own the shares of class A common stock into which the class B shares are convertible. Shares of class A common stock are not convertible. The table's voting percentage reflects the applicable beneficial owner's one vote per share of class A common stock plus ten votes per share of class B common stock, if any, divided by the total number of possible votes.

(3) Consists of (i) 1,601,220 shares of class B common stock and 1,112 shares of class A common stock held by Timothy P. Horne (for purposes of this footnote 3, Mr. Horne), (ii) 1,210,840 shares of class B common stock held by a revocable trust for the benefit of Daniel W. Horne, Mr. Horne's brother,

for which Mr. Horne serves as sole trustee, (iii) 1,210,840 shares of class B common stock held by a revocable trust for the benefit of Deborah Horne, Mr. Horne's sister, for which Mr. Horne serves as sole trustee, which trust is revocable with the consent of the trustee, (iv) 1,085,840 shares of class B common stock held by a revocable trust for the benefit of Peter W. Horne, Mr. Horne's brother, for which Peter W. Horne serves as sole trustee, (v) 1,924,600 shares of class B common stock held for the benefit of the estate of George B. Horne, Mr. Horne's late father, under a revocable trust for which Mr. Horne serves as sole trustee, (vi) 22,600 and 20,200 shares of class B common stock held for the benefit of Tiffany Rae Horne and Tara V. Horne (Mr. Horne's daughters), respectively, under irrevocable trusts for which Mr. Horne serves as trustee, (vii) 147,740 shares of class B common stock held by a revocable trust for the benefit of Tiffany Rae Horne, (viii) 3,094 shares of class A common stock issuable upon the exercise of stock options within 60 days after February 1, 2007, and (ix) 1,876 shares of class A common stock issued to Mr. Horne as a restricted stock award under the Company's 2004 Stock Incentive Plan, which remain subject to certain restrictions on the transfer and disposition of such shares. All of the shares of class B common stock noted in clauses (i) through (vii) (7,223,880 shares of class B common stock in the aggregate) are subject to The Amended and Restated George B. Horne Voting Trust Agreement (1997 (1997 Voting Trust)) for which Mr. Horne serves as trustee. (See footnote 4 for a description of the 1997 Voting Trust).

(4) 7,223,880 shares of class B common stock in the aggregate (see footnote 3) are subject to the terms of the 1997 Voting Trust. Under the terms of the 1997 Voting Trust, the trustee (currently Timothy P. Horne) has sole power to vote all shares subject to the 1997 Voting Trust. Timothy P. Horne, for so long as he is serving as trustee of the 1997 Voting Trust, has the power to determine in his sole discretion whether or not proposed actions to be taken by the trustee of the 1997 Voting Trust shall be taken, including the trustee's right to authorize the withdrawal of shares from the 1997 Voting Trust (for purposes of this footnote, the Determination Power). In the event that Timothy P. Horne ceases to serve as trustee of the 1997 Voting Trust, no trustee thereunder shall have the Determination Power except in accordance with a duly adopted amendment to the 1997 Voting Trust. Under the terms of the 1997 Voting Trust, in the event that Timothy P. Horne ceases to serve as trustee of the 1997 Voting Trust, then Daniel J. Murphy III, a director of the Company, and Walter J. Flowers, a partner in the law firm of Flowers and Manning (each, a Successor Trustee and collectively, the Successor Trustees), shall thereupon become co-trustees of the 1997 Voting Trust. If a Successor Trustee shall cease to serve as such for any reason, then a third person shall become a co-trustee with the remaining two Successor Trustees, in accordance with the following line of succession: first, any individual designated as the Primary Designee, next, any individual designated as the Secondary Designee, and then, an individual appointed by the holders of a majority in interest of the voting trust certificates then outstanding. In the event that the Successor Trustees do not unanimously concur on any matter not specifically contemplated by the terms of the 1997 Voting Trust, the vote of a majority of the Successor Trustees shall be determinative. The 1997 Voting Trust expires on August 26, 2021, subject to extension on or after August 26, 2019 by stockholders (including the trustee of any trust stockholder, whether or not such trust is then in existence) who deposited shares of class B common stock in the 1997 Voting Trust and are then living or, in the case of shares in the 1997 Voting Trust the original depositor of which (or the trustee of the original depositor of which) is not then living, the holders of voting trust certificates representing such shares. The 1997 Voting Trust may be amended by vote of the holders of a majority of the voting trust certificates then outstanding and by the number of trustees authorized to take action at the relevant time or, if the trustees (if more than one) do not concur with respect to any proposed amendment at any time when any trustee holds the Determination Power, then by the trustee having the Determination Power. Amendments to the extension, termination and amendment provisions of the 1997 Voting Trust require the approval of each individual depositor. Shares may not be removed from the 1997 Voting Trust during its term without the consent of the requisite number of trustees required

to take action under the 1997 Voting Trust. Voting trust certificates are subject to restrictions on transfer applicable to the stock that they represent. Timothy P. Horne holds 22.2% of the total beneficial interest in the 1997 Voting Trust (the Beneficial Interest ) individually, 16.8% of the Beneficial Interest as trustee of a revocable trust for the benefit of Daniel W. Horne, 16.8% of the Beneficial Interest as trustee of a revocable trust for the benefit of Deborah Horne, 15.0% of the Beneficial Interest as trustee of a revocable trust for the benefit of Peter W. Horne, 26.6% of the Beneficial Interest as trustee of a revocable trust for the benefit of the estate of George B. Horne, 0.3% and 0.3% of the Beneficial Interest as trustee of two irrevocable trusts for the benefit of Tiffany Rae Horne and Tara V. Horne, respectively, and 2.1% of the Beneficial Interest as trustee of the 1997 Voting Trust to which shares held in a revocable trust for the benefit of Tiffany Rae Horne are subject (representing an aggregate of 100% of the Beneficial Interest). Tara V. Horne as beneficiary of an irrevocable trust holds 0.3% of the Beneficial Interest. Tiffany R. Horne as beneficiary of an irrevocable trust holds 0.3% of the Beneficial Interest.

(5) All of the shares are class B common stock and are held in a revocable trust for which Timothy P. Horne serves as sole trustee. All of the shares are subject to the 1997 Voting Trust (see footnote 4 for a description of the 1997 Voting Trust).

(6) All of the shares are class B common stock and are held in a revocable trust for which Peter W. Horne serves as sole trustee. 1,085,840 of the shares are subject to the 1997 Voting Trust (see footnote 4 for a description of the 1997 Voting Trust).

(7) The amount shown and the following information is based on a Schedule 13D/A filed with the SEC on February 12, 2007 by Gabelli Funds, LLC, GAMCO Investors, Inc., MJG Associates, Inc., Gabelli Securities, Inc., Gabelli Advisers, Inc., GGCP, Inc., GAMCO Asset Management Inc., and Mario J. Gabelli reporting their aggregate holdings of shares of class A common stock. Mario J. Gabelli directly and indirectly controls the entities filing the Schedule 13D, which entities are primarily investment advisors to various institutional and individual clients, including registered investment companies and pension plans, as broker/dealer and as general partner of various private investment partnerships. Each of the reporting persons and other related entities has the sole power to vote or direct the vote and sole power to dispose or to direct the disposition of the securities reported for it, either for its own benefit or for the benefit of its investment clients or its partners, except that (i) GAMCO Asset Management Inc. does not have the authority to vote 133,100 of the reported shares; (ii) Gabelli Funds has sole dispositive and voting power with respect to the shares of the Company held by each of the funds for which Gabelli Funds provides discretionary managed account services (collectively, the Funds ) so long as the aggregate voting interest of all joint filers does not exceed 25% of their total voting interest in the Company and, in that event, the proxy voting committee of each Fund shall respectively vote that Fund's shares; (iii) at any time, the proxy voting committee of each Fund may take and exercise in its sole discretion the entire voting power with respect to the shares held by such Fund under special circumstances such as regulatory considerations; and (iv) the power of Mario J. Gabelli, Gabelli Asset Management Inc. and Gabelli Group Capital Partners, Inc. is indirect with respect to the class A common stock beneficially owned directly by other persons referenced above.

(8) Consists of shares of class A common stock issued as a restricted stock award under the Company's 2004 Stock Incentive Plan, which are subject to certain restrictions with respect to the transfer and disposition of such shares.

(9) Consists of 32,250 shares of class A common stock issuable upon the exercise of stock options within 60 days after February 1, 2007, 8,700 shares of class A common stock issuable upon settlement of restricted stock units within 60 days after February 1, 2007, and 2,500 shares of class A common stock



issued as a restricted stock award under the Company's 2004 Stock Incentive Plan, which are subject to certain restrictions with respect to the transfer and disposition of such shares.

(10) Consists of 12,667 shares of class A common stock held by Mr. Jackson and 1,854 shares of class A common stock issued as a restricted stock award under the Company's 2004 Stock Incentive Plan, which are subject to certain restrictions with respect to the transfer and disposition of such shares.

(11) Consists of 23,500 shares of class A common stock issuable upon the exercise of stock options within 60 days after February 1, 2007, 6,451 shares of class A common stock issuable upon settlement of restricted stock units within 60 days after February 1, 2007, and 3,333 shares of class A common stock issued as a restricted stock award under the Company's 2004 Stock Incentive Plan, which are subject to certain restrictions with respect to the transfer and disposition of such shares.

(12) Consists of 7,500 shares of class A common stock issuable upon the exercise of stock options within 60 days after February 1, 2007, and 5,000 shares of class A common stock issued as a restricted stock award under the Company's 2004 Stock Incentive Plan, which are subject to certain restrictions with respect to the transfer and disposition of such shares.

(13) Consists of 1,112 shares of class A common stock held by Mr. McAvoy, 9,282 shares of class A common stock issuable upon the exercise of stock options within 60 days after February 1, 2007, and 1,876 shares of class A common stock issued as a restricted stock award under the Company's 2004 Stock Incentive Plan, which are subject to certain restrictions with respect to the transfer and disposition of such shares.

(14) Consists of 7,000 shares of class A common stock held by Mr. McCartney, 83,750 shares of class A common stock issuable upon the exercise of stock options within 60 days after February 1, 2007, 6,751 shares of class A common stock issuable upon settlement of restricted stock units within 60 days after February 1, 2007, and 4,167 shares of class A common stock issued as a restricted stock award under the Company's 2004 Stock Incentive Plan, which are subject to certain restrictions with respect to the transfer and disposition of such shares.

(15) Consists of 712 shares of class A common stock held by Mr. McGillicuddy, 3,094 shares of class A common stock issuable upon the exercise of stock options within 60 days after February 1, 2007, and 1,876 shares of class A common stock issued as a restricted stock award under the Company's 2004 Stock Incentive Plan, which are subject to certain restrictions with respect to the transfer and disposition of such shares.

(16) Consists of 5,376 shares of class A common stock held by Mr. Moran, 21,658 shares of class A common stock issuable upon the exercise of stock options within 60 days after February 1, 2007, and 1,876 shares of class A common stock issued as a restricted stock award under the Company's 2004 Stock Incentive Plan, which are subject to certain restrictions with respect to the transfer and disposition of such shares.

(17) Consists of 7,521 shares of class A common stock held by Mr. Murphy, 400 shares of class A common stock beneficially owned by Mr. Murphy as trustee of a trust, 21,658 shares of class A common stock issuable upon the exercise of stock options within 60 days after February 1, 2007, and 1,876 shares of class A common stock issued as a restricted stock award under the Company's 2004 Stock Incentive Plan, which are subject to certain restrictions with respect to the transfer and disposition of such shares.

(18) Consists of 16,666 shares of class A common stock held by Mr. O'Keefe, 107,500 shares of class A common stock issuable upon the exercise of stock options within 60 days after February 1, 2007, 28,451 shares of class A common stock issuable upon settlement of restricted stock units within 60 days after February 1, 2007, and 16,667 shares of class A common stock issued as a restricted stock



award under the Company's 2004 Stock Incentive Plan, which are subject to certain restrictions with respect to the transfer and disposition of such shares.

(19) Consists of 76,526 shares of class A common stock, 7,223,880 shares of class B common stock, 419,921 shares of class A common stock issuable upon the exercise of stock options within 60 days after February 1, 2007, 63,516 shares of class A common stock issuable upon settlement of restricted stock units within 60 days after February 1, 2007, and 55,796 shares of class A common stock issued as restricted stock awards under the Company's 2004 Stock Incentive Plan, which are subject to certain restrictions with respect to the transfer and disposition of such shares.

## COMPENSATION DISCUSSION AND ANALYSIS

### Compensation Philosophy

Our compensation philosophy and strategy is intended to align compensation levels closely with achievement of business performance objectives and creation of shareholder value, and to attract and retain talented and effective executives. The Compensation Committee believes that a significant portion of executive compensation should be tied directly and primarily to the performance of the business and secondarily to individual performance goals. To this end, our overall compensation strategies and specific compensation arrangements have been developed to tie a significant portion of executive compensation to the performance of either the business as a whole or a particular business segment or unit for which an executive is primarily responsible. The key objectives of our compensation strategy are to:

- reward superior business performance at competitive levels;
- be simple, transparent and easy to communicate;
- support our efforts to attract and retain executive talent by allowing the flexibility to vary base compensation levels according to individual performance and potential; and
- provide an appropriate balance of risk and reward.

### Compensation Mix

We believe that a significant portion of executive compensation should be variable, performance-based compensation as opposed to fixed compensation. Variable compensation includes cash bonuses under our Executive Incentive Bonus Plan for achievement of specified company-wide or business segment performance objectives and stock-based compensation whose value is dependent upon long-term appreciation in stock price. Fixed compensation consists primarily of an executive officer's base salary.

In general, we pay our executive officers modest base salaries relative to the other elements of compensation, and the amount of the performance bonus determines whether the aggregate cash compensation paid to our executives meets, exceeds or falls short of the median cash compensation paid to those holding similar positions at comparable companies. Our intention is that if we achieve 100% of our bonus objectives, then the total cash compensation, including base salary and performance bonus, paid to an executive officer should be at approximately the midpoint in the total cash compensation range for similar positions at comparable companies. Accordingly, if we achieve greater than 100% of our bonus objectives, then our executive officers should receive total cash compensation above the midpoint of this range and if we achieve less than 100% of our bonus objectives, then our executive officers should receive total cash compensation below the midpoint of this range.

During 2006, we achieved significantly greater than 100% of our company-wide bonus objectives and almost all of our executive officers were rewarded with total cash compensation that exceeded the midpoint of total cash compensation for similar positions at comparable companies. During 2006, our revenues increased by 33% over 2005 to \$1.23 billion, primarily through contributions from acquired



companies and organic growth. Income from continuing operations increased 40% during 2006 and diluted earnings per share from continuing operations increased 37%. We accomplished this despite significant inflation in the cost of many of the commodities we use in the manufacture of our products. We strengthened our capital structure during 2006 by generating \$82.2 million of cash flow from continuing operations, successfully completing a \$225 million offering of senior notes, refinancing our revolving line of credit and raising approximately \$219 million in an underwritten public offering of our class A common stock. In addition, we acquired five companies in 2006 and made significant progress in integrating the nine companies we acquired during 2005. Based on this performance, we believe the compensation earned by our executives in 2006 was consistent with our philosophy and supports a pay-for-performance compensation program and culture.

The value of our variable, performance-based compensation is split between short-term compensation in the form of a cash performance bonus and long-term compensation in the form of stock awards that vest over time. The annual cash performance bonus is intended to provide an incentive to our executives to achieve near-term operational objectives. The stock awards provide an incentive for our executives to achieve longer-term strategic business goals, which should lead to higher stock prices and increased stockholder value. Despite the roughly equal initial split between short-term variable compensation and long-term variable compensation, we encourage our executives to shift all or a portion of their short-term variable compensation into the form of long-term compensation in order to more closely align their behavior with long-term value creation. We do this by giving our executives the option to invest all or a portion of their cash performance bonus in Watts stock through our Management Stock Purchase Plan. Stock purchased under the Management Stock Purchase Plan vests over three years, and receipt of the stock can be deferred by the executive for an additional number of years beyond the three-year vesting period. The Management Stock Purchase Plan is discussed in greater detail below under [Elements of Compensation](#) [Stock Plans](#) [Management Stock Purchase Plan](#).

#### *Benchmarking*

Benchmarking is only one factor, among many, that we rely on in establishing our compensation levels and program design. We use information regarding pay practices at other comparable companies in two respects. First, we use benchmarking information to evaluate whether our compensation practices are competitive in the marketplace in which we compete for executive talent and financial capital. Second, this marketplace information is one of the many factors that we consider in assessing the reasonableness of our executive compensation.

In 2006, we reviewed compensation levels for our executive officers against compensation levels at companies identified in market compensation surveys and at the companies in a peer group identified by Watson Wyatt with management input and approved by the Compensation Committee. Watson Wyatt considered three primary factors in selecting the companies included in our peer group. The first factor was the type of products made or sold by the companies in the peer group. There are few publicly traded companies that manufacture products for the water technologies market similar to those manufactured by Watts. Given this, Watson Wyatt expanded its search to focus on companies providing similar types of products that are not specific to the water technologies markets, such as valves and other types of flow control products not specifically designed for water applications, as these companies reflect similar characteristics to Watts and our market for executive talent. The second factor was the size and performance of the companies in the peer group, as measured by annual revenues, market capitalization, revenue growth, total return to stockholders and numbers of employees. Annual revenues of the companies included in our peer group range from approximately 0.5 times to 2.5 times Watts' annual revenue, or approximately \$500 million to approximately \$2.5 billion with a median of approximately \$1.2 billion. The third factor was the economic and industrial classification of the companies included in the peer group. Watson Wyatt focused its search on companies within the durable goods manufacturing

and industrial machinery industries, which are the industries in which Watts is typically included for financial comparisons by outside ratings agencies, stockholders and other third parties. Based on this selection criteria, the following companies were included in our peer group for fiscal 2006: A.O. Smith Corporation, Albany International Corp., Ametek, Inc., CIRCOR International, Inc., Flowserve Corporation, Gardner Denver, Inc., Graco Inc., IDEX Corporation, Modine Manufacturing Company, Mueller Industries, Inc., Robbins & Myers, Inc., Roper Industries, Inc. and Waters Corporation.

The Compensation Committee intends to review the current peer group with its new compensation consultant prior to its review of compensation adjustments for our executive officers during 2007. The companies included in the peer group may change based on their size, relevance or a change in one or more of the factors used to select the members of the peer group.

### **Elements of Compensation**

Our executive compensation program consists of three key components, each of which is intended to serve the overall compensation philosophy: base salary, an annual performance bonus, and stock incentive awards, including the purchase of restricted stock units and grants of stock options and restricted stock. In addition, we provide our executive officers with limited perquisites, which are primarily intended to maintain our competitive position for attracting and retaining executive talent. Each of these programs is discussed in greater detail below.

#### *Base Salary*

The Compensation Committee meets with members of management at its regularly scheduled third quarter meeting to review the recommendations of senior management regarding adjustments in the base salary amounts for our executive officers other than our Chief Executive Officer. As part of its review, the Compensation Committee receives and discusses with management the following information:

- reports on financial performance versus budget and compared to prior-period performance;
- individual performance evaluations of our executive officers;
- tally sheets setting forth the total compensation of our executive officers, including base salary, bonus potential, equity awards, pension values, perquisites and other compensation; and
- information regarding compensation programs and compensation levels for executive officers and non-employee directors of companies in our benchmarking peer group and other comparable companies.

In general, the performance of executive officers with functional or administrative responsibilities is considered by reviewing the extent to which the function made a positive contribution to the achievement of our financial and strategic goals. In the case of executive officers with responsibility for one or more business segments or units, the business results of those segments or units are also considered. Management and the Compensation Committee also consider, where appropriate, certain non-financial performance measures, such as market expansion, corporate development and acquisitions, achievement of manufacturing efficiencies, product quality and/or relations with customers, suppliers or employees. Base salaries for new executive officers are initially determined by evaluating the scope, complexity and degree of challenge associated with the position held and the experience of the individual, coupled with a review of the compensation for similar positions at companies in our peer group and other comparable companies. Based on management's recommendations, the materials presented for its review, and its own evaluation of the performance of our executive officers, the Compensation Committee submits a recommendation to the full Board of Directors on the base salary amounts of our executive officers other than our Chief Executive Officer for its review and approval.

In 2006, management implemented the following guidelines for salary level increases in making its recommendations:

	<b>Current Salary is Substantially More Than 10% Below Target Compensation Level</b>	<b>Current Salary is Approximately at Target Compensation Level (+/- 10%)</b>	<b>Current Salary is Substantially More Than 10% Above Target Compensation Level</b>
<b>Performance Exceeds Requirements</b>	8% - 12%	4% - 8%	2% - 4%
<b>Performance Meets Requirements</b>	4% - 8%	2% - 4%	0% - 2%
<b>Performance Does Not Meet Requirements</b>	0%	0%	0%

The target compensation level used by management in making its recommendations is the midpoint in the base salary range for similar positions at companies in our peer group and other comparable companies. Based on management's performance evaluations, the performance of all of our executive officers for 2006 either met or exceeded their job requirements. Management recommended increases in the base salaries of all our executive officers other than our Chief Executive Officer and our Executive Vice President of Human Resources ranging from 3.6% to 7.4%. Management did not recommend an increase in the base salary of our Executive Vice President of Human Resources because he began his employment with us during the second quarter of 2006. The Compensation Committee accepted management's recommendations, and our Board of Directors approved the recommended increases at its regularly scheduled meeting held on August 1, 2006.

The Compensation Committee and the Nominating and Corporate Governance Committee jointly reviewed the performance of our Chief Executive Officer during the third quarter of 2006. This evaluation included a review of all of the materials provided to the Compensation Committee in connection with its review and evaluation of the compensation of our executive officers and a separate discussion with our Chief Executive Officer regarding his performance and individual performance goals. Based on the strong performance of Watts, its evaluation of Mr. O'Keefe's individual contributions in achieving that performance, and an analysis prepared by Watson Wyatt that placed Mr. O'Keefe's total compensation in the lowest quartile compared to the total compensation paid to the chief executive officers of the companies in our peer group, the Compensation Committee approved a 15% increase in Mr. O'Keefe's base salary to \$635,000.

#### *Annual Performance Bonus*

Under the Executive Incentive Bonus Plan, each of our executive officers is eligible for an annual cash bonus. Corporate performance objectives are established during the first quarter of each fiscal year by our Chief Executive Officer and Chief Financial Officer in consultation with the Compensation Committee. The participants are generally assigned three objectives consisting of a sales objective, an economic value added, or EVA, objective, and an earnings objective. For purposes of our Executive Incentive Bonus Plan, EVA is defined as net operating profits after taxes minus a charge for the cost of capital necessary to generate those profits, excluding goodwill and intangible assets. High EVA correlates with high returns on invested capital. Our earnings objective consists of operating earnings excluding costs associated with our manufacturing restructuring plan. These objectives are intended to align the interests of our management with the interests of our stockholders. We believe that the capital markets evaluate companies in our industry based primarily on their ability to grow their businesses profitably while maintaining adequate returns on their invested capital. Our bonus objectives provide an incentive to management to maintain a balanced approach to growth, with equal emphasis on revenues, profitability and return on capital. If we

are successful in meeting or exceeding our goals under these three objectives, we believe that this will lead to the creation of additional value for our stockholders.

In the event that an executive officer's position is substantially tied to a business segment or unit, such officer's goals with respect to each of the above described objectives may be based on the performance of such segment or unit. For 2006, Mr. O'Keefe's and Mr. McCartney's bonuses were based on the performance of our company as a whole, Mr. Martino's and Mr. Lacourciere's bonuses were based on the combined performance of our North America and China segments, and Mr. Cawte's bonus was based on the performance of our Europe segment. In the discretion of the Compensation Committee, an executive officer may be assigned alternative goals based on individual performance objectives or alternative business objectives. For 2006, Mr. Cawte was assigned a working capital objective instead of an EVA objective because improved working capital management is a key element in increasing our EVA performance and management has targeted working capital management as an area for improvement within our Europe segment.

Each of our executive officers has a target bonus percentage expressed as a percentage of base salary, but actual bonus opportunity ranges from 0% to 200% of target depending on our performance with respect to the above described objectives. Each of the three company-wide objectives carries a percentage weight of 33 1/3% of the executive officer's bonus. If participants are assigned alternative objectives, the Compensation Committee, in consultation with the Chief Executive Officer, determines the relative weight to be assigned to each objective. In determining Mr. Martino's and Mr. Lacourciere's bonuses for 2006, the sales and EVA objectives for our North America and China segments were each assigned a percentage weight of 25%, and the earnings objective was assigned a percentage weight of 50%. The Compensation Committee believes that the target bonus for each executive officer should generally allow such officer to achieve the midpoint in the total cash compensation range for similar positions at comparable companies when we achieve 100% of the performance objectives. Correspondingly, executive officers should receive total cash compensation above the midpoint of such range when we achieve greater than 100% of the performance objectives and below the midpoint of such range when we achieve less than 100% of the performance objectives.

For 2006, we set the following performance targets under our bonus objectives for the company as a whole:

Percentage of Target Bonus	Sales Objective	EVA Objective	Earnings Objective
0%	\$ 924,346,000	\$ 28,523,000	\$ 107,600,000
100%	\$ 1,084,000,000	\$ 35,087,000	\$ 113,000,000
200%	\$ 1,138,200,000	\$ 38,252,000	\$ 118,650,000

For 2006, we exceeded 200% of each of the company-wide performance objective targets. Our actual results with respect to each company-wide performance objective for 2006 were as follows:

Sales	EVA	Earnings
\$1,230,777,000	\$ 44,428,000	\$ 129,506,000

Because the Executive Incentive Bonus Plan limits the maximum bonus potential for each performance objective to 200% of the target bonus amount attributable to that objective, the percentages of the objectives achieved for purposes of the total bonus percentage calculations were each limited to 200%, for an aggregate bonus equal to 200% of the target bonus amount. Accordingly, Mr. O'Keefe and Mr. McCartney each earned 200% of his target bonus amount. For 2006, we achieved 200% of each of the earnings and EVA performance objectives for our North America and China segments and 171% of our sales objective. Based on the performance of our North America and China segments with respect to their performance objectives, Mr. Martino and Mr. Lacourciere each earned 192% of his target bonus amount.

For 2006, our Europe segment achieved 184% of its sales objective, 200% of its earnings objective and 4% of its working capital objective. As a result, Mr. Cawte earned 68% of his target bonus amount under the Executive Incentive Bonus Plan. At the request of our Chief Executive Officer, the Compensation Committee approved an additional discretionary bonus payment to Mr. Cawte in the amount of \$50,333, which resulted in Mr. Cawte receiving 100% of his target bonus amount. The Compensation Committee determined that the discretionary bonus payment to Mr. Cawte was appropriate because our Europe segment did not achieve its working capital objective due in large part to our decision to increase inventory levels in Europe to protect against product shortages while we consolidated certain of our operations in Europe.

#### *Stock Plans*

We provided equity-based incentive compensation for executive officers during 2006 in the form of the purchase of restricted stock units under our Management Stock Purchase Plan and the grant of stock options and restricted stock awards under our 2004 Stock Incentive Plan. The Compensation Committee believes equity-based incentive compensation aligns executive and stockholder interests because (i) the use of a multi-year vesting schedules for restricted stock units, stock options and restricted stock awards encourages executive retention and emphasizes long-term growth, and (ii) paying a significant portion of management's compensation in equity provides management with an incentive to increase stockholder value over the long term.

*Management Stock Purchase Plan.* Our Management Stock Purchase Plan is intended to provide an incentive for our executives to purchase and hold more of our class A common stock, thereby more closely aligning their interests with the interests of our stockholders. The Compensation Committee approves the participants in the Management Stock Purchase Plan based on recommendations made by senior management. Under the Management Stock Purchase Plan, participants may elect to receive restricted stock units in lieu of all or a portion of their pre-tax annual incentive bonus and, in some circumstances, make after-tax contributions up to 100% of the participant's maximum bonus in exchange for restricted stock units. Participants are required to make an election no later than the last day of the fiscal year prior to the year in which such annual incentive bonus is earned. For 2006, Mr. O'Keefe, Mr. Martino and Mr. Cawte each elected to contribute 100% of their performance bonus to the purchase of restricted stock units, Mr. Lacourciere contributed 75% of his performance bonus to the purchase of restricted stock units, and Mr. McCartney contributed 50% of his performance bonus to the purchase of restricted stock units.

Each restricted stock unit represents the right to receive one share of class A common stock after a three-year vesting period, and a participant may elect to defer receipt of the underlying stock for an additional period of time after the end of the vesting period. The Management Stock Purchase Plan permits a participant to defer income and the taxes due thereon until the restricted stock units are converted to stock. Restricted stock units are granted at a discount of 33% from the closing sale price of our class A common stock on the date of grant. Under the terms of the Management Stock Purchase Plan, the date of grant is deemed to be the third business day after the date on which we release our year-end earnings to the public. The purpose for setting the grant date of restricted stock units three days following the release of our year-end earnings to the public is to ensure that we are using a date when the public markets have a maximum amount of information about our financial performance and have had a sufficient amount of time to understand and react to such information.

*Stock Options and Restricted Stock Awards.* The Compensation Committee typically grants stock options and restricted stock awards under the 2004 Stock Incentive Plan once each year at its regularly scheduled third quarter meeting. Senior management provides recommendations to the Compensation Committee on the number of stock options and restricted stock awards to be granted to our executive officers and employees, other than our Chief Executive Officer. The Compensation Committee determines the number of stock options and restricted stock awards to be granted to our Chief Executive Officer. The

Compensation Committee evaluates the size of stock option grants and restricted stock awards based on similar factors as used to determine base salaries and annual bonuses, and also reviews information on the stock ownership of our executive officers and their compliance with our stock ownership guidelines and information on equity compensation plan dilution. Stock options and restricted stock are intended to align the interests of our executives with those of our stockholders by motivating them to achieve long-term strategic goals and thereby increase the value of our stock.

In 2006, we moved from granting only stock options to granting a mix of stock options and restricted stock. This shift reflects the competitive practice of providing a balanced approach to long-term incentive compensation. Our intention is that half of the value of an executive's equity award should be in the form of stock options and half of the value should be in the form of restricted stock. Because recipients of restricted stock receive the full market value of their shares of restricted stock rather than just the amount of any appreciation in the value of our stock after the date of grant, a share of restricted stock is considered to have more value on the date of grant than an option to purchase a share of stock. The Compensation Committee has determined that one share of restricted stock is roughly equal in value to an option to purchase three shares of stock. Accordingly, the number of shares of restricted stock the Compensation Committee awarded to our executive officers is equal to one-third of the number of shares underlying their stock option grant. We will examine this ratio periodically to ensure that the intended value is being delivered appropriately through options and restricted stock.

Beginning in 2005, we adopted a practice that annual equity awards under the 2004 Stock Incentive Plan should be granted as of the third business day following the release of our most recent quarterly earnings to the public. The purpose for setting the grant date of stock options on a day following the release of our most recent quarterly earnings to the public is to ensure that we are using a date when the public markets have a maximum amount of information about our financial performance and have had a sufficient amount of time to understand and react to such information.

Stock options we grant under the 2004 Stock Incentive Plan may be either incentive or nonqualified options. In 2006, the Compensation Committee switched from granting incentive stock options to granting nonqualified stock options because the exercise of a nonqualified stock option results in a tax deduction for Watts that is not available in connection with the exercise of an incentive stock option. The stock options granted to our executive officers and employees in 2006 vest 25% per year over four years beginning with the first anniversary of the grant date. Under the 2004 Stock Incentive Plan, the exercise price for incentive stock option grants equals the market price of the class A common stock on the date of the grant with an exception for executives who own more than 10% of the combined voting power of our stock; for those employees, the exercise price is equal to 110% of the market price on the date of the grant. Under the 2004 Stock Incentive Plan, nonqualified stock options have an exercise price which may be no less than 50% of the market price on the date of the grant, although we have not granted any stock options under the 2004 Stock Incentive Plan with an exercise price below fair market value. We use the closing sale price of our class A common stock on the New York Stock Exchange on the date of grant to determine the exercise price of our stock options. Stock options granted under the 2004 Stock Incentive Plan generally vest 25% per year over four years beginning with the first anniversary of the grant date. The term of options under the 2004 Stock Incentive Plan is generally 10 years, with the exception of incentive stock option grants to owners of more than 10% of the combined voting power of our stock, in which case such grants terminate after five years. The Compensation Committee granted stock options for the purchase of an aggregate of 163,500 shares to 33 of our employees in 2006.

Restricted stock awarded under the 2004 Stock Incentive Plan vests 33 $\frac{1}{3}$ % per year over three years beginning with the first anniversary of the date of grant. The restricted stock award is an outright grant of stock to our employees at no cost to the employee. The stock is issued in the employee's name, the employee is able to vote the stock and the employee receives dividend payments on the stock. However, until the stock vests, the employee is not allowed to sell the stock, and any unvested shares of restricted

stock are automatically forfeited back to Watts if the recipient's employment is terminated other than as a result of death or disability. Unvested shares of restricted stock are held in the employee's name in a special restricted account by our transfer agent in order to ensure that the shares are not sold prior to vesting and to facilitate transfer of unvested shares back to Watts in the event the recipient's employment is terminated. When the shares of restricted stock vest, the vested shares are issued to the employee and are no longer subject to restrictions on transfer or forfeiture. The Compensation Committee granted an aggregate of 54,500 shares of restricted stock to 33 of our employees in 2006.

#### *Perquisites*

We provide our executive officers with a limited number of perquisites as part of their compensation arrangements. The perquisites we provide are primarily designed to maintain our competitive position in attracting and retaining executive talent. Our executive officers are given a choice of receiving a cash automobile allowance or the use of an automobile leased by Watts. The amount of the automobile allowance or the maximum amount of the lease payments for the automobile used by each executive officer is determined by our Chief Executive Officer, and the Compensation Committee determines the maximum amount of our Chief Executive Officer's automobile lease payments. We also pay maintenance expenses for the leased automobiles and provide automobile insurance coverage under our corporate umbrella policy. We believe that providing executives with a car allowance or leased automobile is a typical benefit provided to most executives at comparable companies.

We pay relocation expenses for newly hired executive officers whom we require to relocate as a condition to their employment by us. We also make tax gross-up payments to executives to cover income tax liability they incur as a result of our paying their relocation expenses. We believe that this is a typical benefit offered by comparable companies to executives who are asked to relocate and that we would be at a competitive disadvantage in trying to attract executives who would need to relocate in order to work for us if we did not offer relocation assistance and a corresponding tax gross-up payment.

#### **Employment Agreements**

None of our executive officers has an employment agreement with us.

We have entered into indemnification agreements with each of our directors and executive officers. The indemnification agreements provide indemnity, including the advancement of expenses, to our directors and executive officers against liabilities incurred in the performance of their duties to the fullest extent permitted by the General Corporation Law of the State of Delaware.

#### **Post-Termination Compensation and Change in Control Arrangements**

None of our executive officers has any arrangement that provides for severance payments.

We provide retirement benefits through a combination of a qualified defined benefit pension plan and a qualified defined contribution 401(k) plan for all of our full-time employees who are United States residents and a Nonqualified Deferred Compensation Plan for our employees whose base pay is \$90,000 or more and whose participation in our 401(k) plan is subject to certain restrictions. Benefits under our pension plan are determined by years of service and compensation amounts. For benefits under the pension plan, 25 years is the maximum number of years of service participants in the plan can accrue. Pension benefits are determined generally based on the highest five consecutive years of compensation within the last ten years of service. Employees who retire early receive reduced benefits under the pension plan. We discuss other material terms of the pension plan later in this proxy statement under Executive Compensation Pension Benefits. Because benefits under our pension plan increase with an employee's period of service and earnings, we believe the pension plan encourages our employees to make long-term commitments to Watts and thus serves as an important retention tool.