

WATTS WATER TECHNOLOGIES INC  
Form 10-Q  
May 06, 2015  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

**For the quarterly period ended March 29, 2015**

**or**

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

**For the transition period from            to**

**Commission file number 001-11499**

**WATTS WATER TECHNOLOGIES, INC.**

(Exact Name of Registrant as Specified in Its Charter)

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**Delaware**  
(State or Other Jurisdiction of Incorporation or  
Organization)

**04-2916536**  
(I.R.S. Employer Identification No.)

**815 Chestnut Street, North Andover, MA**  
(Address of Principal Executive Offices)

**01845**  
(Zip Code)

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company   
(Do not check if a smaller reporting company)

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

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

Class	Outstanding at May 4, 2015
Class A Common Stock, \$0.10 par value	28,389,517
Class B Common Stock, \$0.10 par value	6,479,290



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## WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

(Amounts in millions, except share information)

(Unaudited)

	March 29, 2015	December 31, 2014
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 261.8	\$ 301.1
Trade accounts receivable, less allowance for doubtful accounts of \$10.3 million at March 29, 2015 and \$10.6 million at December 31, 2014	220.5	207.8
Inventories, net:		
Raw materials	101.3	104.8
Work in process	15.9	16.7
Finished goods	165.5	170.1
Total Inventories	282.7	291.6
Prepaid expenses and other assets	25.9	27.4
Deferred income taxes	45.6	45.3
Asset held for sale	2.1	1.1
Total Current Assets	838.6	874.3
<b>PROPERTY, PLANT AND EQUIPMENT:</b>		
Property, plant and equipment, at cost	503.2	526.7
Accumulated depreciation	(313.7)	(323.4)
Property, plant and equipment, net	189.5	203.3
<b>OTHER ASSETS:</b>		
Goodwill	612.0	639.0
Intangible assets, net	199.4	210.1
Deferred income taxes	4.5	4.7
Other, net	15.9	16.6
<b>TOTAL ASSETS</b>	<b>\$ 1,859.9</b>	<b>\$ 1,948.0</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 113.0	\$ 120.8
Accrued expenses and other liabilities	133.8	138.8
Accrued pension plan settlements	40.4	40.0
Accrued compensation and benefits	39.7	44.2
Current portion of long-term debt	1.7	1.9
Total Current Liabilities	328.6	345.7
<b>LONG-TERM DEBT, NET OF CURRENT PORTION</b>	<b>577.2</b>	<b>577.8</b>
<b>DEFERRED INCOME TAXES</b>	<b>73.2</b>	<b>77.4</b>
<b>OTHER NONCURRENT LIABILITIES</b>	<b>33.5</b>	<b>34.7</b>
<b>STOCKHOLDERS EQUITY:</b>		
Preferred Stock, \$0.10 par value; 5,000,000 shares authorized; no shares issued or outstanding		

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Class A Common Stock, \$0.10 par value; 80,000,000 shares authorized; 1 vote per share; issued and outstanding 28,411,252 shares at March 29, 2015 and 28,552,065 shares at December 31, 2014	<b>2.8</b>	2.9
Class B Common Stock, \$0.10 par value; 25,000,000 shares authorized; 10 votes per share; issued and outstanding, 6,479,290 shares at March 29, 2015 and December 31, 2014	<b>0.6</b>	0.6
Additional paid-in capital	<b>501.0</b>	497.4
Retained earnings	<b>497.0</b>	500.6
Accumulated other comprehensive loss	<b>(154.0)</b>	(89.1)
Total Stockholders Equity	<b>847.4</b>	912.4
<b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>	<b>\$ 1,859.9</b>	<b>\$ 1,948.0</b>

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See accompanying notes to consolidated financial statements.

## WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS

(Amounts in millions, except per share information)

(Unaudited)

	First Quarter Ended	
	March 29, 2015	March 30, 2014
Net sales	\$ 356.2	\$ 365.2
Cost of goods sold	225.7	231.9
<b>GROSS PROFIT</b>	<b>130.5</b>	<b>133.3</b>
Selling, general and administrative expenses	105.7	103.3
Restructuring and other charges, net	2.0	4.2
<b>OPERATING INCOME</b>	<b>22.8</b>	<b>25.8</b>
Other (income) expense:		
Interest income	(0.2)	(0.1)
Interest expense	5.9	4.9
Other (income) expense, net	(0.2)	0.4
Total other expense	5.5	5.2
<b>INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES</b>	<b>17.3</b>	<b>20.6</b>
Provision for income taxes	5.7	6.5
<b>NET INCOME</b>	<b>\$ 11.6</b>	<b>\$ 14.1</b>
<b>BASIC EPS</b>		
Net income per share:		
<b>NET INCOME</b>	<b>\$ 0.33</b>	<b>\$ 0.40</b>
Weighted average number of shares	35.1	35.4
<b>DILUTED EPS</b>		
Net income per share:		
<b>NET INCOME</b>	<b>\$ 0.33</b>	<b>\$ 0.40</b>
Weighted average number of shares	35.2	35.5
Dividends per share	\$ 0.15	\$ 0.13

See accompanying notes to consolidated financial statements.

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WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Amounts in millions)

(Unaudited)

	First Quarter Ended	
	March 29, 2015	March 30, 2014
Net income	\$ 11.6	\$ 14.1
Other comprehensive income (loss):		
Foreign currency translation adjustments	(65.1)	(4.3)
Defined benefit pension plans, net of tax:		
Amortization of net losses included in net periodic pension cost	0.2	0.2
Other comprehensive loss, net of tax	(64.9)	(4.1)
Comprehensive (loss) income	\$ (53.3)	\$ 10.0

See accompanying notes to consolidated financial statements.



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## WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in millions)

(Unaudited)

	First Quarter Ended	
	March 29, 2015	March 30, 2014
<b>OPERATING ACTIVITIES</b>		
Net income from continuing operations	\$ 11.6	\$ 14.1
Adjustments to reconcile net income from continuing operations to net cash provided by (used in) continuing operating activities:		
Depreciation	7.9	8.2
Amortization of intangibles	5.1	3.7
Loss on disposal and impairment of goodwill, property, plant and equipment and other	1.1	0.1
Stock-based compensation	2.3	1.7
Deferred income tax benefit	(1.8)	(0.4)
Changes in operating assets and liabilities, net of effects from business acquisitions and divestitures:		
Accounts receivable	(21.6)	(11.8)
Inventories	(0.4)	(15.3)
Prepaid expenses and other assets	0.4	(1.3)
Accounts payable, accrued expenses and other liabilities	(3.8)	(17.7)
Net cash provided by (used in) continuing operations	0.8	(18.7)
<b>INVESTING ACTIVITIES</b>		
Additions to property, plant and equipment	(5.6)	(5.0)
Proceeds from the sale of property, plant and equipment		0.1
Net cash used in investing activities	(5.6)	(4.9)
<b>FINANCING ACTIVITIES</b>		
Payments of long-term debt	(0.3)	(0.4)
Payment of capital leases and other	(0.8)	(2.5)
Proceeds from share transactions under employee stock plans	0.5	0.4
Tax benefit of stock awards exercised	0.1	0.5
Payments to repurchase common stock	(9.4)	(9.4)
Debt issue costs		(2.0)
Dividends	(5.3)	(4.6)
Net cash used in financing activities	(15.2)	(18.0)
Effect of exchange rate changes on cash and cash equivalents	(19.3)	(1.3)
<b>DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(39.3)</b>	<b>(42.9)</b>
Cash and cash equivalents at beginning of year	301.1	267.9
<b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	<b>\$ 261.8</b>	<b>\$ 225.0</b>
<b>NON-CASH INVESTING AND FINANCING ACTIVITIES</b>		
Issuance of stock under management stock purchase plan	\$ 0.3	\$ 0.2
<b>CASH PAID FOR:</b>		
Interest	\$ 1.2	\$ 0.3
Income taxes	\$ 5.8	\$ 8.0

See accompanying notes to consolidated financial statements.

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**WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

**1. Basis of Presentation**

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included in the Watts Water Technologies, Inc. (the Company) Consolidated Balance Sheet as of March 29, 2015, the Consolidated Statements of Operations for the first quarters ended March 29, 2015 and March 30, 2014, the Consolidated Statements of Comprehensive Income (Loss) for the first quarters ended March 29, 2015 and March 30, 2014, and the Consolidated Statements of Cash Flows for the first quarters ended March 29, 2015 and March 30, 2014.

The consolidated balance sheet at December 31, 2014 has been derived from the audited consolidated financial statements at that date. The accounting policies followed by the Company are described in the Company's Annual Report on Form 10-K for the year ended December 31, 2014. The financial statements included in this report should be read in conjunction with the consolidated financial statements and notes included in the Annual Report on Form 10-K for the year ended December 31, 2014. Operating results for the interim periods presented are not necessarily indicative of the results to be expected for the year ending December 31, 2015.

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

**2. Accounting Policies**

*Estimates*

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

*Goodwill and Long-Lived Assets*

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

	March 29, 2015							Net Goodwill March 29, 2015
	Balance January 1, 2015	Gross Balance		Balance March 29, 2015	Accumulated Impairment Losses		Balance March 29, 2015	
		Acquired During the Period	Foreign Currency Translation and Other		Impairment Loss During the Period	Balance March 29, 2015		
	(in millions)							
Americas	\$ 398.0	\$	\$ (0.7)	\$ 397.3	\$ (24.5)	\$	\$ (24.5)	\$ 372.8
Europe, Middle East and Africa (EMEA)	265.5		(26.3)	239.2				239.2
Asia-Pacific	12.9			12.9	(12.9)		(12.9)	
Total	\$ 676.4	\$	\$ (27.0)	\$ 649.4	\$ (37.4)	\$	\$ (37.4)	\$ 612.0

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

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

On December 1, 2014, the Company completed the acquisition of AERCO International, Inc. ( AERCO ), in a share purchase transaction. The aggregate purchase price, including an estimated working capital adjustment, was approximately \$272.2 million and as of March 29, 2015 was subject to a final post-closing working capital adjustment. The Company accounted for the transaction as a business combination. The Company completed a preliminary purchase price allocation that resulted in the recognition of \$174.3 million in goodwill and \$102.4 million in intangible assets.

As of the end of the fourth quarter of 2014, management determined that it was more likely than not that a significant portion of the Asia-Pacific reporting unit's third party and intersegment net sales were expected to decline as a result of the initial phase of the Americas and Asia-Pacific transformation and restructuring program. Based on this factor, the Company performed a quantitative impairment analysis for the Asia-Pacific reporting unit. The Company completed a fair value assessment of the net assets of the reporting unit and recorded an impairment of \$12.9 million in the fourth quarter of 2014. The Company estimated the fair value of the reporting unit using the present value of expected future cash flows that reflect the impact of certain product line rationalization efforts associated with the initial phase of the Americas and Asia-Pacific transformation and restructuring program, including the sale of certain assets. In the second step of the impairment test, the carrying value of the goodwill exceeded the implied fair value of goodwill, resulting in a full impairment. There was no tax benefit associated with the impairment and the \$12.9 million charge eliminated all goodwill on the Asia-Pacific reporting unit.

Intangible assets with estimable lives and other long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable. Recoverability of intangible assets with estimable lives and other long-lived assets are measured by a comparison of the carrying amount of an asset or asset group to future net undiscounted pretax cash flows expected to be generated by the asset or asset group. If these comparisons indicate that an asset is not recoverable, the impairment loss recognized is the amount by which the carrying amount of the asset or asset group exceeds the related estimated fair value. Estimated fair value is based on either discounted future pretax operating cash flows or appraised values, depending on the nature of the asset. The Company determines the discount rate for this analysis based on the weighted average cost of capital based on the market and guideline public companies for the related business, and does not allocate interest charges to the asset or asset group being measured. Judgment is required to estimate future operating cash flows.

Intangible assets include the following:

	March 29, 2015			December 31, 2014		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
	(in millions)					
Patents	\$ 16.1	\$ (13.5)	\$ 2.6	\$ 16.2	\$ (13.3)	\$ 2.9
Customer relationships	203.5	(91.1)	112.4	206.7	(87.5)	119.2
Technology	41.8	(13.8)	28.0	42.1	(12.9)	29.2
Trade Names	20.3	(4.6)	15.7	20.6	(4.2)	16.4
Other	9.5	(5.7)	3.8	9.5	(5.7)	3.8
Total amortizable intangibles	291.2	(128.7)	162.5	295.1	(123.6)	171.5
	36.9		36.9	38.6		38.6

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Indefinite-lived intangible assets

Total	\$	328.1	\$	(128.7)	\$	199.4	\$	333.7	\$	(123.6)	\$	210.1
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The Company acquired \$102.4 million in intangible assets as part of the AERCO acquisition, consisting primarily of customer and manufacturing representative relationships valued at \$78.5 million, developed technology of \$15.8 million and the trade name of \$7.4 million. The weighted-average remaining life of total amortizable intangible assets is 15 years and by asset category of customer relationships, developed technology and trade name are 16 years, 10 years and 20 years, respectively.

Aggregate amortization expense for amortizable intangible assets for the first quarters of 2015 and 2014 was \$5.1 million and \$3.7 million, respectively. Additionally, future amortization expense for the next five years on amortizable intangible assets is expected to be approximately \$14.7 million for the remainder of 2015, \$19.2 million for 2016, \$18.9 million for 2017, \$15.7 million for 2018 and \$11.9 million for 2019. Amortization expense is recorded on a straight-line basis over the estimated useful lives of the intangible assets. The weighted-average remaining life of total amortizable intangible assets is 12.3 years. Patents, customer relationships,

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technology, trade names and other amortizable intangibles have weighted-average remaining lives of 4.9 years, 12.0 years, 10.2 years, 14.4 years and 33.2 years, respectively. Indefinite-lived intangible assets primarily include trademarks and trade names.

*Stock-Based Compensation*

The Company maintains one stock incentive plan, the Second Amended and Restated 2004 Stock Incentive Plan (the "2004 Stock Incentive Plan"). Under this plan, key employees have been granted nonqualified stock options to purchase the Company's Class A common stock. Options typically become exercisable over a four-year period at the rate of 25% per year and expire ten years after the grant date. However, most options granted in 2014 become exercisable over a three-year period at the rate of one-third per year. Options granted under the plan may have exercise prices of not less than 100% of the fair market value of the Class A common stock on the date of grant. The Company's current practice is to grant all options at fair market value on the grant date. The Company did not issue any stock options in the first three months of 2015 and issued 4,808 stock options during the first three months of 2014.

The Company grants shares of restricted stock and deferred shares to key employees and stock awards to non-employee members of the Company's Board of Directors under the 2004 Stock Incentive Plan. Stock awards to non-employee members of the Company's Board of Directors are fully vested upon grant. Employees' restricted stock awards and deferred shares typically vest over a three-year period at the rate of one-third per year, except that most restricted stock awards and deferred shares granted in 2014 vest over a two-year period at the rate of 50% per year. The restricted stock awards and deferred shares are amortized to expense on a straight-line basis over the vesting period. The Company issued 1,262 and 1,747 shares of restricted stock in the first three months of 2015 and 2014, respectively.

Beginning in 2014, the Company also granted performance stock units to key employees under the 2004 Stock Incentive Plan. Performance stock units vest at the end of a three-year performance period. Upon vesting, the number of shares of the Company's Class A common stock awarded to each performance stock unit recipient will be determined based on the Company's performance relative to certain performance goals set at the time the performance stock units were granted. The performance goals for the 2014 performance stock units are based on the compound annual growth rate of the Company's revenue over the three-year performance period and the Company's return on invested capital ("ROIC") for the third year of the performance period. The performance period for the 2014 performance stock units is January 1, 2014 through December 31, 2016. The 2014 performance stock units also provide an overall minimum ROIC threshold, which the Company must exceed in order for any shares of the Company's Class A common stock to be earned. The number of shares of Class A common stock that may be earned by a performance stock unit recipient ranges from 0% to 200% of a target number of shares designated for each recipient at the time of grant. The performance stock units are amortized to expense over the vesting period, and based on the Company's performance relative to the performance goals, may be adjusted. If such goals are not met, no awards are earned and previously recognized compensation expense is reversed. The Company issued 117,619 shares of performance stock units in 2014 under the 2004 Stock Incentive Plan. No shares of performance stock units were issued in the first three months of 2015.

The Company has a Management Stock Purchase Plan that allows for the purchase of restricted stock units (RSUs) by key employees. On an annual basis, key employees may elect to receive a portion of their annual incentive compensation in RSUs instead of cash. Each RSU represents one share of Class A common stock and is purchased by the employee at 67% of the fair market value of the Company's Class A common stock on the date of grant. RSUs vest either annually over a three-year period from the grant date or upon the third anniversary of the grant date and receipt of the shares underlying RSUs is deferred for a minimum of three years or such greater number of years as is chosen by the employee. An aggregate of 2,000,000 shares of Class A common stock may be issued under the Management Stock Purchase Plan. The Company granted 59,995 RSUs and 30,561 RSUs in the first three months of 2015 and 2014, respectively.

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

	2015	2014
Expected life (years)	3.0	3.0
Expected stock price volatility	23.4%	31.2%
Expected dividend yield	1.2%	