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)

Delaware	**04-2916536**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
815 Chestnut Street, North Andover, MA	**01845**
(Address of Principal Executive Offices)	(Zip Code)

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

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

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

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

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

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

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

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

Class	**Outstanding at 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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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Amounts in millions, except share information)

(Unaudited)

	March 29, 2015	December 31, 2014
ASSETS		
CURRENT ASSETS:		
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 $10.6 million at December 31, 2014	**220.5**	207.8
Inventories, net:		
Raw materials	**101.3**	104.8
Work in process	**15.9**	16.7
Finished goods	**165.5**	170.1
Total Inventories	**282.7**	291.6
Prepaid expenses and other assets	**25.9**	27.4
Deferred income taxes	**45.6**	45.3
Asset held for sale	**2.1**	1.1
Total Current Assets	**838.6**	874.3
PROPERTY, PLANT AND EQUIPMENT:		
Property, plant and equipment, at cost	**503.2**	526.7
Accumulated depreciation	**(313.7)**	(323.4)
Property, plant and equipment, net	**189.5**	203.3
OTHER ASSETS:		
Goodwill	**612.0**	639.0
Intangible assets, net	**199.4**	210.1
Deferred income taxes	**4.5**	4.7
Other, net	**15.9**	16.6
TOTAL ASSETS	**$ 1,859.9**	$ 1,948.0
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
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
LONG-TERM DEBT, NET OF CURRENT PORTION	**577.2**	577.8
DEFERRED INCOME TAXES	**73.2**	77.4
OTHER NONCURRENT LIABILITIES	**33.5**	34.7
STOCKHOLDERS EQUITY:		
Preferred Stock, $0.10 par value; 5,000,000 shares authorized; no shares issued or outstanding		

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

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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
GROSS PROFIT	**130.5**	133.3
Selling, general and administrative expenses	**105.7**	103.3
Restructuring and other charges, net	**2.0**	4.2
OPERATING INCOME	**22.8**	25.8
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
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	**17.3**	20.6
Provision for income taxes	**5.7**	6.5
NET INCOME	$ **11.6**	$ 14.1
BASIC EPS		
Net income per share:		
NET INCOME	**$ 0.33**	$ 0.40
Weighted average number of shares	**35.1**	35.4
DILUTED EPS		
Net income per share:		
NET INCOME	**$ 0.33**	$ 0.40
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**
OPERATING ACTIVITIES		
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 divestures:		
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)
INVESTING ACTIVITIES		
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)
FINANCING ACTIVITIES		
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)
DECREASE IN CASH AND CASH EQUIVALENTS	**(39.3)**	(42.9)
Cash and cash equivalents at beginning of year	**301.1**	267.9
CASH AND CASH EQUIVALENTS AT END OF PERIOD	**$ 261.8**	$ 225.0
NON-CASH INVESTING AND FINANCING ACTIVITIES		
Issuance of stock under management stock purchase plan	**$ 0.3**	$ 0.2
CASH PAID FOR:		
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

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

	March 29, 2015							
	Gross Balance				Accumulated Impairment Losses			Net Goodwill
	Balance January 1, 2015	Acquired During the Period	Foreign Currency Translation and Other	Balance March 29, 2015	Balance January 1, 2015	Impairment Loss During the Period	Balance March 29, 2015	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							
	Gross Balance				Accumulated Impairment Losses			Net Goodwill
	Balance January 1, 2014	Acquired During the Period	Foreign Currency Translation and Other	Balance March 30, 2014	Balance January 1, 2014	Impairment Loss During the Period	Balance March 30, 2014	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

Indefinite-lived intangible assets												
Total	**$**	**328.1**	**$**	**(128.7)**	**$**	**199.4**	$	333.7	$	(123.6)	$	210.1

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.

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

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

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

A more detailed description of each of these plans can be found in Note 12 of Notes to Consolidated Financial Statements in the Company s Annual Report on Form 10-K for the year ended December 31, 2014.

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Shipping and Handling

The Company s shipping and handling costs included in selling, general and administrative expenses were $14.4 million and $14.7 million for the first quarters of 2015 and 2014, respectively.

Research and Development

Research and development costs included in selling, general and administrative expenses were $6.4 million and $6.3 million for the first quarters of 2015 and 2014, respectively.

Taxes, Other than Income Taxes

Taxes assessed by governmental authorities on sale transactions are recorded on a net basis and excluded from sales in the Company s consolidated statements of operations.

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

New Accounting Standards

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

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

3. Acquisitions

On December 1, 2014, the Company completed the acquisition of AERCO in a share purchase transaction. The aggregate purchase price was approximately $272.2 million and was financed from a borrowing under the Company s Credit Agreement. The purchase price includes an estimated working capital adjustment of $7.7 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. Intangible assets consist primarily of customer relationships valued at $78.5 million with estimated lives of 16 years, developed technology valued at $15.8 million with estimated lives of 10 years and trade name valued at $7.4 million with a 20 year life. The goodwill is attributable to the workforce of AERCO and the strategic platform adjacency that will allow Watts to extend its product offerings as a result of the acquisition. Approximately $19.4 million of the goodwill is deductible for tax purposes. The following table summarizes the value of the assets and liabilities acquired (in millions):

Accounts receivable	$	16.7
Inventory		16.4
Fixed assets		7.6
Deferred tax assets		8.0
Other assets		7.6
Intangible assets		102.4
Goodwill		174.3
Accounts payable		(6.7)
Accrued expenses and other		(18.1)
Deferred tax liability		(36.0)
Purchase price	$	272.2

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The consolidated statement of operations for the first quarter ended March 29, 2015 includes the results of AERCO. The results include $22.2 million of revenues and $1.2 million of operating income, respectively, which includes $0.9 million of purchase accounting charges.

Supplemental pro-forma information

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

	First Quarter Ended			
Amounts in millions (except per share information)	**March 29, 2015**		**March 30, 2014**	
Net sales	**$**	**356.2**	$	383.7
Net income from continuing operations	**$**	**12.3**	$	13.3
Net income per share:				
Basic EPS continuing operations	**$**	**0.35**	$	0.38
Diluted EPS continuing operations	**$**	**0.35**	$	0.38

Net income from continuing operations for the quarter ended March 30, 2014 was adjusted to include $0.7 million of net interest expense related to the financing and $1.1 million of net amortization expense resulting from the estimated allocation of purchase price to amortizable tangible and intangible assets. Net income from continuing operations for the quarter ended March 29, 2015 was also adjusted to exclude $0.7 million of net acquisition-related charges and third-party costs.

4. Financial Instruments and Derivative Instruments

The Company measures certain financial assets and liabilities at fair value on a recurring basis, including deferred compensation plan assets and related liability, and contingent consideration. There were no designated cash flow hedges as of March 29, 2015 and December 31, 2014. The fair values of these certain financial assets and liabilities were determined using the following inputs at March 29, 2015 and December 31, 2014:

	Fair Value Measurements at March 29, 2015 Using:							
	Total		**Quoted Prices in Active Markets for Identical Assets (Level 1)**		**Significant Other Observable Inputs (Level 2)**		**Significant Unobservable Inputs (Level 3)**	
	(in millions)							
Assets								
Plan asset for deferred compensation(1)	**$**	**3.7**	**$**	**3.7**	**$**		**$**	
Total assets	**$**	**3.7**	**$**	**3.7**	**$**		**$**	
Liabilities								
Plan liability for deferred compensation(2)	**$**	**3.7**	**$**	**3.7**	**$**		**$**	
Contingent consideration(3)		**2.3**						**2.3**
Total liabilities	**$**	**6.0**	**$**	**3.7**	**$**		**$**	**2.3**

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	Fair Value Measurements at December 31, 2014 Using:			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(in millions)		
Assets				
Plan asset for deferred compensation(1)	$ 4.0	$ 4.0	$	$
Total assets	$ 4.0	$ 4.0	$	$
Liabilities				
Plan liability for deferred compensation(2)	$ 4.0	$ 4.0	$	$
Contingent consideration(3)	2.5			2.5
Total liabilities	$ 6.5	$ 4.0	$	$ 2.5

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

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

(3) Included on the Company s consolidated balance sheet in accrued expenses and other liabilities as of March 29, 2015 and December 31, 2014.

The table below provides a summary of the changes in fair value of all financial assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the period December 31, 2014 to March 29, 2015.

	Balance December 31, 2014	Settlements	Total realized and unrealized (gains) losses included in: Net earnings adjustments	Comprehensive income	Balance March 29, 2015
			(in millions)		
Contingent consideration	$ 2.5	$	$	$ (0.2)	$ 2.3

In connection with the tekmar Control Systems acquisition in 2012, a contingent liability of $5.1 million was recognized as the estimate of the acquisition date fair value of the contingent consideration. This liability was classified as Level 3 under the fair value hierarchy as it was based on the probability of achievement of a future performance metric as of the date of the acquisition, which was not observable in the market. The contingent liability was increased by $0.5 million during 2014 and by $1.0 million during 2013 based on revised estimates of the fair value of the contingent consideration. Portions of the contingent consideration were paid out during the first quarter of 2014 and the second quarter of 2013, in the amount of $2.2 million and $1.2 million, respectively, based on performance metrics achieved. The final contingent consideration payment of $2.3 million was completed in the second quarter of 2015 based on fiscal year 2014 earnings.

Cash equivalents consist of instruments with remaining maturities of three months or less at the date of purchase and consist primarily of certificates of deposit and money market funds, for which the carrying amount is a reasonable estimate of fair value.

The Company uses financial instruments from time to time to enhance its ability to manage risk, including foreign currency and commodity pricing exposures, which exist as part of its ongoing business operations. The use of derivatives exposes the Company to counterparty credit risk for nonperformance and to market risk related to changes in currency exchange rates and commodity prices. The Company manages its exposure to counterparty credit risk through diversification of counterparties. The Company s counterparties in derivative transactions are substantial commercial banks with significant experience using such derivative instruments. The impact of market risk on the fair value and cash flows of the Company s derivative instruments is monitored and the Company restricts the use of derivative financial instruments to hedging activities. The Company does not enter into contracts for trading purposes nor does the Company enter into any contracts for speculative purposes. The use of derivative instruments is approved by senior management under written guidelines.

The Company has exposure to a number of foreign currency rates, including the Canadian dollar, the euro, the Chinese yuan and the British pound. To manage this risk, the Company generally uses a layering methodology whereby at the end of any quarter, the Company has generally entered into forward exchange contracts which hedge approximately 50% of the projected intercompany purchase transactions for the next twelve months. The Company presently does not have any open forward exchange contracts.

Fair Value

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

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The fair value of the Company s 5.85% senior notes due 2016 and 5.05% senior notes due 2020 is based on quoted market prices of similar notes (level 2). The fair value of the Company s borrowings outstanding under the Credit Agreement and the Company s variable rate debt approximates its carrying value. The carrying amount and the estimated fair market value of the Company s long-term debt, including the current portion, are as follows:

	March 29, 2015	December 31, 2014
	(in millions)	
Carrying amount	**$ 578.9**	$ 579.7
Estimated fair value	**$ 597.2**	$ 599.3

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5. Restructuring and Other Charges, Net

The Company s Board of Directors approves all major restructuring programs that involve the discontinuance of significant product lines or the shutdown of significant facilities. From time to time, the Company takes additional restructuring actions, including involuntary terminations that are not part of a major program. The Company accounts for these costs in the period that the individual employees are notified or the liability is incurred. These costs are included in restructuring and other charges in the Company s consolidated statements of operations.

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

	First Quarter Ended			
	March 29, 2015		March 30, 2014	
	(in millions)			
Restructuring costs:				
2015 Actions	**$**	**1.3**	$	
2013 Actions		**0.5**		0.4
Other Actions		**0.2**		3.8
Total restructuring and other charges, net	**$**	**2.0**	$	4.2

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

	First Quarter Ended			
	March 29, 2015		March 30, 2014	
	(in millions)			
Americas	$	**1.3**	$	1.9
EMEA		**0.8**		1.5
Corporate		**(0.1)**		0.8
Total	**$**	**2.0**	$	4.2

2015 Actions

On February 17, 2015, the Board of Directors of the Company approved the initial phase of a restructuring program relating to the transformation of the Company s Americas and Asia-Pacific businesses, which primarily involves product line rationalization efforts relating to low margin, non-core products. The Company expects to ultimately eliminate between $175 million to $200 million of the combined Americas and Asia-Pacific net sales primarily within the Company s do-it-yourself (DIY) distribution channel (the program). Assuming that the Company would wind-down the affected product lines, the program was initially expected to include a pre-tax charge to earnings of approximately $40 million to $50 million, of which $25 million to $30 million was expected to consist of non-cash charges. Recently, the Company received interest from prospective buyers, which may allow the Company to exit these product lines at a reduced cost. While it is still too early to determine the final method of disposition, the Company has revised the low end of the range of expected pre-tax charges to $27 million, of which $17 million consists of non-cash charges, to reflect the possibility that the product lines may be sold. As of March 29, 2015, the assets have not been classified as Held for Sale as not all of the required criteria had been met.

In connection with the preparation of the financial statements, during the fourth quarter and year ended December 31, 2014, the Company recorded a $15.2 million pre-tax charge relating to the program consisting of goodwill impairment of $12.9 million, an indefinite-lived intangible asset impairment of $0.5 million, and other transformation and deployment costs of $1.8 million recorded in SG&A. The goodwill impairment charge was based on a quantitative assessment of the Asia-Pacific reporting unit goodwill performed as a result of it being more likely than not that the Asia-Pacific reporting unit s third party and intersegment net sales would be significantly reduced as a result of the program.

During the first quarter ended March 29, 2015, the Company recorded a $1.3 million pre-tax restructuring charge and liability relating to facility site clean-up costs at one of the affected locations in the Americas and other transformation and deployment costs in SG&A of $1.5 million.

Additional costs expected to be incurred relating to the program include costs of severance benefits of $1.6 million to $10 million, facility decommissioning, clean-up and other related exit costs of $1.7 million to $2.7 million, accelerated depreciation and amortization of long-lived assets of $1 million to $10 million, and other transformation and deployment costs including inventory charges, consulting fees, and other associated costs of $4.7 million to $9.3 million. The total net after-tax charge for this program is

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expected to be $22 million to $40 million, inclusive of the Asia-Pacific charges that are expected to have no tax benefit. The remaining costs are expected to be incurred in 2015.

2013 Actions

On July 30, 2013, the Board of Directors authorized a restructuring program with respect to the Company s EMEA segment to reduce its European manufacturing footprint, improve organizational and operational efficiency and better align costs with expected revenues in response to changing market conditions. Total pre-tax costs for the program were $8.4 million and were incurred from the third quarter of 2013 to the first quarter of 2015. The total charges for this program included costs for severance benefits, relocation, site clean-up, professional fees and certain asset write-downs. The total net after-tax charge for the restructuring program was approximately $5.9 million. The net after-tax charges incurred in the first quarter of 2015 and 2014 were $0.4 million and $0.3 million, respectively.

Details of the Company s 2013 European footprint program reserve, which for the first quarter ended March 29, 2015 relates only to severance, is as follows:

		First Quarter Ended March 29, 2015 (in millions)
Balance at December 31, 2014	$	1.5
Net pre-tax restructuring charges		**0.2**
Utilization and foreign currency impact		**(1.2)**
Balance at March 29, 2015	**$**	**0.5**

The following table summarizes total expected, incurred and remaining pre-tax costs for 2013 European footprint program actions by type, and all attributable to the EMEA reportable segment:

		Severance		Legal and consultancy		Asset write-downs (in millions)		Facility exit and other		Total
Expected costs	$	7.5	$	0.2	$	0.2	$	0.5	$	8.4
Costs incurred 2013		(4.1)								(4.1)
Costs incurred 2014		(3.2)		(0.2)		(0.2)		(0.2)		(3.8)
Costs incurred first quarter 2015		**(0.2)**						**(0.3)**		**(0.5)**
Remaining costs at March 29, 2015	**$**		**$**		**$**		**$**		**$**	

Other Actions

The Company also periodically initiates other actions which are not part of a major program. Total Other Actions pre-tax restructuring expense was $0.2 million and $3.8 million for the first quarters of 2015 and 2014, respectively.

In the fourth quarter of 2014, management initiated certain restructuring actions and strategic initiatives with respect to the Company s EMEA segment in response to the ongoing economic challenges in Europe and additional product rationalization. The restructuring actions primarily include expected severance benefits and limited costs relating to asset write offs, professional fees and relocation. The total pre-tax charge for these restructuring initiatives is expected to be approximately $9.9 million, of which approximately $7.2 million of pre-tax charges were incurred as of the first quarter of 2015 for the program to date. The remaining expected costs relate to severance, asset write-offs and relocation costs and are expected to be completed by the end of the fourth quarter of fiscal 2016. The restructuring reserve for these actions as of March 29, 2015 relates to the severance recorded in the prior year.

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

	Severance	Legal and consultancy	Asset write-downs (in millions)	Facility exit and other	Total
Expected costs	$ 8.8	$ 0.2	$ 0.8	$ 0.1	$ 9.9
Costs incurred 2014	(6.9)				(6.9)
Costs incurred first quarter 2015		**(0.2)**	**(0.1)**		**(0.3)**
Remaining costs at March 29, 2015	**$ 1.9**	**$**	**$ 0.7**	**$ 0.1**	**$ 2.7**

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In 2014, the Company initiated restructuring activities in the Americas and Corporate to reduce costs through reductions-in-force. Total pre-tax restructuring expense of $2.7 million was incurred in the first quarter of 2014 relating to these initiatives. A final adjustment reducing restructuring expense by $0.1 million was recorded in the first quarter of 2015. There are no remaining expected costs associated with these activities.

6. Earnings per Share

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

	For the First Quarter Ended March 29, 2015			For the First Quarter Ended March 30, 2014		
	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)	Per Share Amount
	(amounts in millions, except per share amounts)					
Basic EPS:						
Net income	**$ 11.6**	**35.1**	**$ 0.33**	$ 14.1	35.4	$ 0.40
Effect of dilutive securities:						
Common stock equivalents		**0.1**			0.1	
Diluted EPS:						
Net income	**$ 11.6**	**35.2**	**$ 0.33**	$ 14.1	35.5	$ 0.40

Options to purchase 0.3 million shares of Class A common stock were outstanding during the first quarters of 2015 and 2014, respectively, but were not included in the computation of diluted EPS because to do so would be anti-dilutive.

On April 30, 2013, the Company s Board of Directors authorized the repurchase of up to $90 million of the Company s Class A common stock from time to time on the open market or in privately negotiated transactions. In connection with this repurchase program, the Company entered into a Rule 10b5-1 plan, which permits shares to be repurchased when the Company might otherwise be precluded from doing so under insider trading laws. The repurchase program may be suspended or discontinued at any time, subject to the terms of the Rule 10b5-1 plan with respect to the repurchase program. During the first quarter ended March 29, 2015, the Company repurchased approximately 164,000 shares of Class A common stock at a cost of approximately $9.4 million. As of March 29, 2015, there was approximately $18 million remaining authorized for share repurchase under this program.

7. Segment Information

The Company operates in three geographic segments: Americas, EMEA, and Asia-Pacific. AERCO is included in the Americas segment results for the first quarter ended March 29, 2015. Each of these segments is managed separately and has separate financial results that are reviewed by the Company s chief operating decision-maker. All intercompany sales transactions have been eliminated. Sales by region are based upon location of the entity recording the sale. The accounting policies for each segment are the same as those described in the summary of significant accounting policies.

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

	First Quarter Ended March 29, 2015	March 30, 2014
	(in millions)	
Net sales		
Americas	**$ 237.4**	$ 219.1
EMEA	**109.0**	139.1
Asia-Pacific	**9.8**	7.0
Consolidated net sales	**$ 356.2**	$ 365.2
Operating income (loss)		
Americas	**$ 24.2**	$ 22.6
EMEA	**5.4**	8.9
Asia-Pacific	**1.5**	0.9
Subtotal reportable segments	**31.1**	32.4
Corporate (*)	**(8.3)**	(6.6)
Consolidated operating income	**22.8**	25.8
Interest income	**0.2**	0.1
Interest expense	**(5.9)**	(4.9)
Other income (expense), net	**0.2**	(0.4)
Income from continuing operations before income taxes	**$ 17.3**	$ 20.6
Capital expenditures		
Americas	**$ 4.1**	$ 2.2
EMEA	**1.2**	2.5
Asia-Pacific	**0.3**	0.3
Consolidated capital expenditures	**$ 5.6**	$ 5.0
Depreciation and amortization		
Americas	**$ 7.0**	$ 4.9
EMEA	**5.4**	6.6
Asia-Pacific	**0.6**	0.4
Consolidated depreciation and amortization	**$ 13.0**	$ 11.9
Identifiable assets (at end of period)		
Americas	**$ 1,060.2**	$ 767.9
EMEA	**714.8**	875.9
Asia-Pacific	**84.9**	71.4
Consolidated identifiable assets	**$ 1,859.9**	$ 1,715.2
Property, plant and equipment, net (at end of period)		
Americas	**$ 90.1**	$ 84.5
EMEA	**86.6**	117.7
Asia-Pacific	**12.8**	13.8
Consolidated property, plant and equipment, net	**$ 189.5**	$ 216.0

* Corporate expenses are primarily for administrative compensation expense, internal controls costs, professional fees, including corporate-related legal and audit expenses, shareholder services and benefit administration costs.

The above operating segments are presented on a basis consistent with the presentation included in the Company s December 31, 2014 consolidated financial statements included in its Annual Report on Form 10-K. The EMEA segment was significantly impacted by foreign currency translation in the first quarter of 2015 compared to the first quarter of 2014.

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The U.S. property, plant and equipment of the Company s Americas segment was $86.3 million and $80.0 million at March 29, 2015 and March 30, 2014, respectively. The following includes U.S. net sales of the Company s Americas segment:

	First Quarter Ended	
	March 29, 2015	March 30, 2014
	(in millions)	
U.S. net sales	**$ 221.4**	$ 201.6

The following includes intersegment sales for Americas, EMEA and Asia-Pacific:

	First Quarter Ended	
	March 29, 2015	March 30, 2014
	(in millions)	
Intersegment Sales		
Americas	**$ 1.8**	$ 1.2
EMEA	**2.7**	3.6
Asia-Pacific	**30.5**	39.0
Intersegment sales	**$ 35.0**	$ 43.8

8. Accumulated Other Comprehensive (Loss) Income

Accumulated other comprehensive (loss) income consists of the following:

	Foreign Currency Translation	Pension Adjustment	Accumulated Other Comprehensive Income (Loss)
		(in millions)	
Balance December 31, 2014	**$ (53.0)**	**$ (36.1)**	**$ (89.1)**
Change in period	**(65.1)**	**0.2**	**(64.9)**
Balance March 29, 2015	**$ (118.1)**	**$ (35.9)**	**$ (154.0)**
Balance December 31, 2013	$ 37.9	$ (25.9)	$ 12.0
Change in period	(4.3)	0.2	(4.1)
Balance March 30, 2014	$ 33.6	$ (25.7)	$ 7.9

9. Debt

On February 18, 2014, the Company terminated its prior credit agreement and entered into a new Credit Agreement (the Credit Agreement) among the Company, certain subsidiaries of the Company who become borrowers under the Credit Agreement, JPMorgan Chase Bank, N.A., as Administrative Agent, Swing Line Lender and Letter of Credit Issuer, and the other lenders referred to therein. The Credit Agreement provides for a $500 million, five-year, senior unsecured revolving credit facility which may be increased by an additional $500 million under certain circumstances and subject to the terms of the Credit Agreement. The Credit Agreement has a sublimit of up to $100 million in letters of credit. The Credit Agreement matures on February 18, 2019.

Borrowings outstanding under the Credit Agreement bear interest at a fluctuating rate per annum equal to an applicable percentage equal to (1) in the case of Eurocurrency rate loans, the British Bankers Association LIBOR rate plus an applicable percentage, ranging from 0.975% to 1.45%, determined by reference to the Company s consolidated leverage ratio, or (2) in the case of base rate loans and swing line loans, the highest of (a) the federal funds rate plus 0.5%, (b) the rate of interest in effect for such day as announced by JPMorgan Chase Bank, N.A. as its prime rate, and (c) the British Bankers Association LIBOR rate plus 1.0%, plus an applicable percentage, ranging from 0.00% to 0.45%, determined by reference to the Company s consolidated leverage ratio. In addition to paying interest under the Credit Agreement, the Company is also required to pay certain fees in connection with the credit facility, including, but not limited to, an unused facility fee and letter of credit fees. Under the Credit Agreement, the Company is required to satisfy and maintain specified financial ratios and other financial condition tests. The Company may repay loans outstanding under the Credit Agreement from time to time without premium or penalty, other than customary breakage costs, if any, and subject to the terms of the Credit Agreement. As of March 29, 2015, the Company was in compliance with all covenants related to the Credit Agreement and had $200.1 million of unused and available credit under the Credit Agreement and $24.9 million of stand-by letters of credit outstanding on the Credit Agreement. The Company had $275 million of borrowings outstanding under the Credit Agreement at March 29, 2015.

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The Company is a party to several note agreements as further detailed in Note 10 of Notes to Consolidated Financial Statements of the Annual Report on Form 10-K for the year ended December 31, 2014. These note agreements require the Company to maintain a fixed charge coverage ratio of consolidated EBITDA plus consolidated rent expense during the period to consolidated fixed charges. Consolidated fixed charges are the sum of consolidated interest expense for the period and consolidated rent expense. As of March 29, 2015, the Company was in compliance with all covenants regarding these note agreements.

10. Contingencies and Environmental Remediation

Accrual and Disclosure Policy

The Company is a defendant in numerous legal matters arising from its ordinary course of operations, including those involving product liability, environmental matters and commercial disputes.

The Company reviews its lawsuits and other legal proceedings on an ongoing basis and follows appropriate accounting guidance when making accrual and disclosure decisions. The Company establishes accruals for matters when the Company assesses that it is probable that a loss has been incurred and the amount of the loss can be reasonably estimated. The Company s assessment of whether a loss is probable is based on its assessment of the ultimate outcome of the matter following all appeals.

Under the FASB-issued ASC 450 Contingencies , an event is reasonably possible if the chance of the future event or events occurring is more than remote but less than likely and an event is remote if the chance of the future event or events occurring is slight . Thus, references to the upper end of the range of reasonably possible loss for cases in which the Company is able to estimate a range of reasonably possible loss mean the upper end of the range of loss for cases for which the Company believes the risk of loss is more than slight.

There may continue to be exposure to loss in excess of any amount accrued. When it is possible to estimate the reasonably possible loss or range of loss above the amount accrued for the matters disclosed, that estimate is aggregated and disclosed. The Company records legal costs associated with its legal contingencies as incurred, except for legal costs associated with product liability claims which are included in the actuarial estimates used in determining the product liability accrual.