

WATTS WATER TECHNOLOGIES INC  
Form 10-K  
February 27, 2014

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[TABLE OF CONTENTS](#)

# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

## FORM 10-K

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

For the fiscal year ended December 31, 2013

Or

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

Commission file number 001-11499

## WATTS WATER TECHNOLOGIES, INC.

(Exact name of registrant as specified in its charter)

**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**

Securities registered pursuant to Section 12(b) of the Act:

| <b>Title of Each Class</b>                       | <b>Name of Each Exchange on Which Registered</b> |
|--|--|
| Class A common stock, par value \$0.10 per share | New York Stock Exchange                          |

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ý No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes o No ý

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 ý No o

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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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

As of June 28, 2013, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was approximately \$1,293,553,373 based on the closing sale price as reported on the New York Stock Exchange.

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 January 31, 2014 |
|--|---------------------------------|
| Class A common stock, \$0.10 par value per share | 28,734,210 shares               |
| Class B common stock, \$0.10 par value per share | 6,489,290 shares                |

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Proxy Statement for its Annual Meeting of Stockholders to be held on May 14, 2014, are incorporated by reference into Part III of this Annual Report on Form 10-K.

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**PART I**

**Item 1. BUSINESS.**

*This Annual Report on Form 10-K contains statements that are not historical facts and are considered forward-looking within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements contain projections of our future results of operations or our financial position or state other forward-looking information. In some cases you can identify these forward-looking statements by words such as "anticipate," "believe," "could," "estimate," "expect," "intend," "may," "should," and "would" or similar words. You should not rely on forward looking statements because they involve known and unknown risks, uncertainties and other factors, some of which are beyond our control. These risks, uncertainties and other factors may cause our actual results, performance or achievements to differ materially from the anticipated future results, performance or achievements expressed or implied by the forward looking statements. Some of the factors that might cause these differences are described under Item 1A "Risk Factors." You should carefully review all of these factors, and you should be aware that there may be other factors that could cause these differences. These forward-looking statements were based on information, plans and estimates at the date of this report, and, except as required by law, we undertake no obligation to update any forward-looking statements to reflect changes in underlying assumptions or factors, new information, future events or other changes.*

In this Annual Report on Form 10-K, references to "the Company," "Watts Water," "we," "us" or "our" refer to Watts Water Technologies, Inc. and its consolidated subsidiaries.

**Overview**

Watts Regulator Co. was founded by Joseph E. Watts in 1874 in Lawrence, Massachusetts. Watts Regulator Co. started as a small machine shop supplying parts to the New England textile mills of the 19th century and grew into a global manufacturer of products and systems focused on the control, conservation and quality of water and the comfort and safety of the people using it. Watts Water Technologies, Inc. was incorporated in Delaware in 1985 and became the parent company of Watts Regulator Co.

Our strategy is to be the leading provider of water quality, water conservation, water safety and water flow control products for the residential and commercial markets in the Americas and EMEA (Europe, Middle East and Africa) and to expand our presence in Asia Pacific. Our primary objective is to grow earnings by increasing sales within existing markets, expanding into new markets, leveraging our distribution channels and customer base, making selected acquisitions, reducing manufacturing costs and advocating for the development and enforcement of industry standards.

We intend to continue to expand organically by introducing products in existing markets, by enhancing our preferred brands, by developing new complementary products, by promoting plumbing code development to drive sales of safety and water quality products and by continually improving merchandising in both the do-it-yourself (DIY) and wholesale distribution channels. We continually target selected new product and geographic markets based on growth potential, including our ability to leverage our existing distribution channels. Additionally, we continually leverage our distribution channels through the introduction of new products, as well as the integration of products of our acquired companies.

We intend to continue to generate incremental growth by targeting selected acquisitions, both in our core markets as well as new complementary markets. We have completed 36 acquisitions since 1999. Our acquisition strategy focuses on businesses that manufacture preferred brand name products that address our themes of water quality, water conservation, water safety, water flow control and comfort and related complementary markets. We target businesses that will provide us with one or more of the following: an entry into new markets, an increase in shelf space with existing customers, strong brand names, a new or improved technology or an expansion of the breadth of our product offerings.

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We are committed to reducing our manufacturing and operating costs through a combination of manufacturing in lower-cost countries, using Lean and Six Sigma to drive continuous improvement across all key processes, and consolidating our diverse manufacturing operations in Americas, EMEA and Asia Pacific. We have a number of manufacturing facilities in lower-cost regions such as Mexico, China, Bulgaria and Tunisia. In recent years, we have announced several global restructuring plans to reduce our manufacturing footprint in order to reduce our costs and to realize additional operating efficiencies.

Our products are sold to wholesale distributors and dealers, major DIY chains and original equipment manufacturers (OEMs). Most of our sales are for products that have been approved under regulatory standards incorporated into state and municipal plumbing, heating, building and fire protection codes in North America and Europe. We have consistently advocated for the development and enforcement of plumbing codes and are committed to providing products to meet these standards, particularly for safety and control valve products.

Additionally, a majority of our manufacturing facilities are ISO 9000, 9001 or 9002 certified by the International Organization for Standardization.

Our business is reported in three geographic segments: Americas, EMEA and Asia Pacific. Our Americas segment was formerly referred to as North America and our Asia Pacific segment was formerly referred to as Asia. We changed the description of our North America segment to the Americas to reflect the broadening of our focus to include Latin America and we changed the description of our Asia segment to Asia Pacific to reflect the broadening of our focus in that region to include Asian countries outside of China as well as Australia and New Zealand. The contributions of each segment to net sales, operating income and the presentation of certain other financial information by segment are reported in Note 16 of the Notes to Consolidated Financial Statements and in "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere in this report.

### *Products*

We have a broad range of products in terms of design distinction, size and configuration. We classify our many products into four universal product lines. These product lines are:

**Residential & commercial flow control products** includes products typically sold into plumbing and hot water applications such as backflow preventers, water pressure regulators, temperature and pressure relief valves, and thermostatic mixing valves. In 2013, 2012 and 2011, residential & commercial flow control products accounted for approximately 61%, 61% and 60%, respectively, of our total sales.

**HVAC & gas products** includes hydronic and electric heating systems for under-floor radiant applications, hydronic pump groups for boiler manufacturers and alternative energy control packages, and flexible stainless steel connectors for natural and liquid propane gas in commercial food service and residential applications. In 2013, 2012 and 2011, HVAC & gas products accounted for approximately 24%, 24% and 25%, respectively, of our total sales. HVAC is an acronym for heating, ventilation and air conditioning.

**Drains & water re-use products** includes drainage products and engineered rain water harvesting solutions for commercial, industrial, marine and residential applications. Drains & water re-use products accounted for approximately 10% of our total sales in each of 2013, 2012 and 2011.

**Water quality products** includes point-of-use and point-of-entry water filtration, conditioning and scale prevention systems for both commercial and residential applications. Water quality products accounted for approximately 5% of our total sales in each of 2013, 2012 and 2011.

***Customers and Markets***

We sell our products to plumbing, heating and mechanical wholesale distributors, major DIY chains and OEMs.

*Wholesalers.* Approximately 64% of our sales in 2013, and 63% of our sales in each of 2012 and 2011, were to wholesale distributors for commercial and residential applications. We rely on commissioned manufacturers' representatives, some of which maintain a consigned inventory of our products, to market our product lines. Additionally, various water quality products are sold to independent dealers throughout the Americas.

*DIY Chains.* Approximately 13% of our sales in each of 2013, 2012 and 2011 were to DIY chains. Our DIY chains demand less technical products, but are highly receptive to innovative designs and new product ideas.

*OEMs.* Approximately 23% of our sales in 2013, and 24% of our sales in each of 2012 and 2011, were to OEMs. In the Americas, our typical OEM customers are water heater manufacturers and equipment and water systems manufacturers needing flow control devices and other products. Our sales to OEMs in EMEA are primarily to boiler manufacturers and radiant system manufacturers. Our sales to OEMs in Asia Pacific are primarily to boiler, water heaters and bath manufacturers including manufacturers of faucet and shower products.

In 2013, 2012 and 2011, no customer accounted for more than 10% of our total net sales. Our top ten customers accounted for approximately \$321.7 million, or 22%, of our total net sales in 2013; \$309.3 million, or 22%, of our total net sales in 2012; and \$290.4 million, or 21%, of our total net sales in 2011. Thousands of other customers constituted the balance of our net sales in each of those years.

***Marketing and Sales***

For product sales, we rely primarily on commissioned manufacturers' representatives, some of which maintain a consigned inventory of our products. These representatives sell primarily to plumbing and heating wholesalers or service DIY stores in the Americas. We also sell products for the residential construction and home repair and remodeling industries through DIY plumbing retailers, national catalog distribution companies, hardware stores, building material outlets and retail home center chains and through plumbing and heating wholesalers. In addition, we sell products directly to wholesalers, OEMs and private label accounts primarily in EMEA and to a lesser extent in the Americas.

***Manufacturing***

We have integrated and automated manufacturing capabilities, including a lead free foundry and a traditional brass and bronze foundry, machining, plastic extrusion and injection molding and assembly operations. Our foundry operations include metal pouring systems, automatic core making, brass forging and brass and bronze die-castings. Our machining operations feature computer-controlled machine tools, high-speed chucking machines with robotics and automatic screw machines for machining bronze, brass and steel components. We have invested in recent years to expand our manufacturing capabilities to ensure the availability of the most efficient and productive equipment. In response to the U.S. federal Reduction of Lead in Drinking Water Act, we committed approximately \$18.3 million in capital spending (\$9.8 million in 2013 and \$8.5 million spent in 2012) for a new foundry and machinery in the U.S. to produce lead free products. The foundry cost and related equipment were commissioned during the second quarter of 2013. We are committed to maintaining our manufacturing equipment at a level consistent with current technology in order to maintain high levels of quality and manufacturing efficiencies.

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Capital expenditures and depreciation for each of the last three years were as follows:

|                      | Years Ended<br>December 31, |         |         |
|----------------------|-----------------------------|---------|---------|
|                      | 2013                        | 2012    | 2011    |
|                      | (in millions)               |         |         |
| Capital expenditures | \$ 27.7                     | \$ 30.5 | \$ 22.5 |
| Depreciation         | \$ 34.2                     | \$ 33.1 | \$ 32.1 |

### *Raw Materials*

We require substantial amounts of raw materials to produce our products, including bronze, brass, cast iron, stainless steel, steel, plastic, and components used in products, and substantially all of the raw materials we require are purchased from outside sources. The commodity markets have experienced tremendous volatility over the past several years, particularly with respect to copper. During 2011, spot copper prices increased to historic highs early in the year, and then trended downward in the second half of 2011. In 2012, increases in the first quarter and third quarter were offset by more moderate pricing in the second quarter and fourth quarter. In 2013, spot copper prices in the first quarter trended higher, with prices declining to a consistent level through the remainder of the year. Bronze and brass are copper-based alloys. The fact that we source internationally a significant amount of raw materials means that several months of raw materials and work in process are moving through our business at any point in time. We are not able to predict whether commodity costs, including copper, will significantly increase or decrease in the future. If commodity costs increase in the future and we are not able to reduce or eliminate the effect of the cost increases by reducing production costs or implementing price increases, our profit margins could decrease. If commodity costs were to decline, we may experience pressures from customers to reduce our selling prices. The timing of any price reductions and decreases in commodity costs may not align. As a result, our margins could be affected.

With limited exceptions, we have multiple suppliers for our commodities and other raw materials. We believe our relationships with our key suppliers are good and that an interruption in supply from any one supplier would not materially affect our ability to meet our immediate demands while another supplier is qualified. We regularly review our suppliers to evaluate their strengths. If a supplier is unable to meet our demands, we believe that in most cases our inventory of raw materials will allow for sufficient time to identify and obtain the necessary commodities and other raw materials from an alternate source. We believe that the nature of the commodities and other raw materials used in our business are such that multiple sources are generally available in the market.

### *Code Compliance*

Products representing a majority of our sales are subject to regulatory standards and code enforcement, which typically require that these products meet stringent performance criteria. Standards are established by such industry test and certification organizations as the American Society of Mechanical Engineers (A.S.M.E.), the Canadian Standards Association (C.S.A.), the American Society of Sanitary Engineers (A.S.S.E.), the University of Southern California Foundation for Cross-Connection Control (USC FCC), the International Association of Plumbing and Mechanical Officials (I.A.P.M.O.), Factory Mutual (F.M.), the National Sanitation Foundation (N.S.F.) and Underwriters Laboratory (U.L.). Many of these standards are incorporated into state and municipal plumbing and heating, building and fire protection codes.

National regulatory standards in Europe vary by country. The major standards and/or guidelines that our products must meet are AFNOR (France), DVGW (Germany), UNI/ICIN (Italy), KIWA (Netherlands), SVGW (Switzerland), SITAC (Sweden) and WRAS (United Kingdom). Further, there are local regulatory standards requiring compliance as well.

Together with our commissioned manufacturers' representatives, we have consistently advocated for the development and enforcement of plumbing codes. We maintain stringent quality control and testing

procedures at each of our manufacturing facilities in order to manufacture products that comply with code requirements. We believe that product-testing capability and investment in plant and equipment is needed to manufacture products that comply with code requirements. Additionally, a majority of our manufacturing facilities are ISO 9000, 9001 or 9002 certified by the International Organization for Standardization.

### ***New Product Development and Engineering***

We maintain our own product development staff, design teams, and testing laboratories in Americas, EMEA and Asia Pacific that work to enhance our existing products and develop new products. We maintain sophisticated product development and testing laboratories. Research and development costs included in selling, general, and administrative expense amounted to \$21.5 million, \$20.4 million and \$20.5 million for the years ended December 31, 2013, 2012 and 2011, respectively.

Between 2010 and 2012, California, Louisiana, Maryland and Vermont implemented laws that require all pipes, pipe and plumbing fittings and plumbing fixtures sold in those states that convey or dispense water for human consumption to contain no more than 0.25% lead content, which is generally referred to as lead free. On January 4, 2011, the federal government enacted a similar law that took effect nationwide in January 2014. We have invested considerable resources over the past several years to develop lead free versions of our plumbing products to comply with the new laws, and we successfully introduced our lead free product offerings in California, Louisiana, Maryland and Vermont. In response to the nationwide lead free law, we committed approximately \$18.3 million in capital spending over the last two years for a new foundry and machinery in the U.S. to meet expected lead free demand for our products sold in the U.S. Construction of the new foundry was completed and the new facility was commissioned during the second quarter of 2013.

Complying with these new requirements on a nationwide basis is a challenge for us. The new requirements may cause our material costs to increase as suppliers of alternative lead free metals are currently limited and lead free alloy substitutes are more expensive than the original leaded alloys. We may not succeed in passing through these cost increases to our customers. Our new lead free foundry has been operating since June 2013. As expected, we experienced some technical challenges in our new manufacturing process involved with the lead free alloys. But as of year-end, while our new foundry was not running at full capacity, production volumes were ramping up and down time has been minimized. The majority of our customers have converted to lead free products by year-end and, and we currently have been able to maintain our gross margin percentages, despite the higher cost of the new alloys.

### ***Competition***

The domestic and international markets for water quality, water conservation, water safety and water flow control devices are intensely competitive and require us to compete against some companies possessing greater financial, marketing and other resources than ours. Due to the breadth of our product offerings, the number and identities of our competitors vary by product line and market. We consider quality, brand preference, delivery times, engineering specifications, plumbing code requirements, price, technological expertise and breadth of product offerings to be the primary competitive factors. We believe that new product development and product engineering are also important to success in the water industry and that our position in the industry is attributable in part to our ability to develop new and innovative products quickly and to adapt and enhance existing products. We continue to develop new and innovative products to enhance our market position and are continuing to implement manufacturing and design programs to reduce costs. We cannot be certain that our efforts to develop new products will be successful or that our customers will accept our new products. Although we own certain patents and trademarks that we consider to be of importance, we do not believe that our business and competitiveness as a whole are dependent on any one of our patents or trademarks or on patent or trademark protection generally.

**Backlog**

Backlog was approximately \$84.4 million at February 7, 2014 and approximately \$84.5 million at February 8, 2013. We do not believe that our backlog at any point in time is indicative of future operating results and we expect our entire current backlog to be converted to sales in 2014.

**Employees**

As of December 31, 2013, we employed approximately 5,900 people worldwide. With the exception of our tekmar subsidiary in Canada, none of our employees in North America or Asia are covered by collective bargaining agreements. In some European countries, our employees are subject to traditional national collective bargaining agreements. We believe that our employee relations are good.

**Available Information**

We maintain a website with the address [www.wattswater.com](http://www.wattswater.com). The information contained on our website is not included as a part of, or incorporated by reference into, this Annual Report on Form 10-K. Other than an investor's own internet access charges, we make available free of charge through our website our Annual Report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, and amendments to these reports, as soon as reasonably practicable after we have electronically filed such material with, or furnished such material to, the Securities and Exchange Commission (SEC).

**Executive Officers and Directors**

Set forth below in alphabetical order are the names of our executive officers and directors, their respective ages and positions with our Company and a brief summary of their business experience for at least the past five years:

| <b>Executive Officers</b>     | <b>Age</b> | <b>Position</b>  |
|-------------------------------|------------|--|
| Dean P. Freeman               | 50         | Chief Executive Officer, President, and Chief Financial Officer            |
| Kenneth R. Lepage             | 43         | General Counsel, Executive Vice President of Human Resources and Secretary |
| Elie Melhem                   | 50         | President, Asia Pacific  |
| Mario Sanchez                 | 57         | President and Group Managing Director, EMEA                                |
| A. Suellen Torregrosa         | 51         | President, Americas  |
| <b>Non-Employee Directors</b> |            |  |
| Robert L. Ayers(2)(3)         | 68         | Director   |
| Bernard Baert(1)(3)           | 64         | Director   |
| Kenneth F. Burnes(1)(3)       | 71         | Director   |
| Richard J. Cathcart(2)(3)     | 69         | Director   |
| W. Craig Kissel(2)(3)         | 63         | Director   |
| John K. McGillicuddy(1)(3)    | 70         | Chairman of the Board and Director   |
| Joseph T. Noonan              | 32         | Director   |
| Merilee Raines(1)(3)          | 58         | Director   |

- (1) Member of the Audit Committee
- (2) Member of the Compensation Committee
- (3) Member of the Nominating and Corporate Governance Committee

*Dean P. Freeman* was appointed interim Chief Executive Officer and President of our Company in January 2014. Mr. Freeman originally joined our Company in October 2012 and was appointed Executive Vice President and Chief Financial Officer in November 2012. Mr. Freeman previously served as Senior Vice President of Finance and Treasurer of Flowserve Corporation from October 2009 to October 2011. Also while at Flowserve, Mr. Freeman served as Vice President, Finance and Chief



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Financial Officer of the Flowserve Pump Division from 2006 to October 2009. Flowserve is a leading global provider of fluid motion and control products and services, producing engineered and industrial pumps, seals and valves as well as a range of related flow management services. Prior to Flowserve, Mr. Freeman served as Chief Financial Officer, Europe for The Stanley Works Corporation. Mr. Freeman also served in financial executive and management roles of progressive responsibility with United Technologies Corporation and SPX Corporation.

*Kenneth R. Lepage* was appointed General Counsel and Secretary of the Company in August 2008 and Executive Vice President of Human Resources in December 2009. Mr. Lepage originally joined our Company in September 2003 as Assistant General Counsel and Assistant Secretary. Prior to joining our Company, he was a junior partner at the law firm of Hale and Dorr LLP (now Wilmer Cutler Pickering Hale and Dorr LLP).

*Elie Melhem* joined our Company in July 2011 as President, Asia Pacific. Mr. Melhem was previously the Managing Director of China for Ariston Thermo Group, a global manufacturer of heating and hot water products, from 2008 to July 2011. Prior to joining Ariston, Mr. Melhem spent eleven years with ITT Industries in China where he held several management positions, including serving as President of ITT's Residential and Commercial Water Group in China and President of ITT's Water Technology Group in Asia.

*Mario Sanchez* was appointed President and Group Managing Director, EMEA in June 2013. Mr. Sanchez originally joined our Company in January 2012 as Vice President of Plumbing and Heating, EMEA. Mr. Sanchez previously served as Vice President of Global Manufacturing for Johnson Controls, Inc. from September 2008 to January 2012. Johnson Controls is a global diversified technology and industrial company providing products, services and solutions to optimize energy and operational efficiencies of buildings; lead-acid automotive batteries and advanced batteries for hybrid and electric vehicles; and interior systems for automobiles. Before joining Johnson Controls, Mr. Sanchez served as Vice President of Global Operations for Tyco International, Ltd. from December 2006 to August 2008. Tyco is a global provider of fire protection and security products and services. Prior to Tyco, Mr. Sanchez held several global management positions with Ingersoll-Rand plc.

*A. Suellen Torregrosa* joined our Company in August 2013 as President, Americas. Ms. Torregrosa previously served as President of Milton Roy Company from November 2011 to June 2013. Milton Roy Company is a global manufacturer of controlled volume (metering) pumps and related equipment. Ms. Torregrosa was appointed President of Milton Roy Company when it was owned by United Technologies Corporation and continued to serve as President through its sale to a private equity group in December 2012. Ms. Torregrosa worked for several business units of United Technologies Corporation from 1990 until the sale of Milton Roy Company in December 2012, including as Vice President and General Manager, Americas of Milton Roy Company from 2006 until November 2011, General Manager, Dynamic Controls of Hamilton Sundstrand Company from 2002 to 2006, and in several management roles of progressive responsibility for Falk Corporation from 1990 to 2002. United Technologies Corporation is a diversified provider of high technology products and services to the building and aerospace industries.

*Robert L. Ayers* has served as a director of our Company since October 2006. He 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. Mr. Ayers joined ITT Industries in 1998 as President of ITT Industries' Industrial Pump Group. Before joining ITT Industries, he was President of Sulzer Industrial USA and Chief Executive Officer of Sulzer Bingham, a pump manufacturer. Mr. Ayers served as a director of T-3 Energy Services, Inc. from August 2007 to January 2011.

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*Bernard Baert* was elected as a member of our Board of Directors in August 2011. Mr. Baert has served as Senior Vice President and President, Europe and International of PolyOne Corporation since January 2010. Mr. Baert served as Senior Vice President and General Manager, Color and Engineered Materials Europe and China for PolyOne Corporation from 2006 to December 2009 and as Vice President and General Manager, Color and Engineered Materials Europe and China from 2000 to 2006. From 1995 to September 2000, Mr. Baert was General Manager, Color Europe for M.A. Hanna Company, the predecessor to PolyOne Corporation. PolyOne Corporation is a worldwide provider of specialty polymer materials, services and solutions. Prior to joining M.A. Hanna, Mr. Baert was General Manager, Europe for Hexcel Corporation and spent 17 years with Owens Corning where he served as a plant manager and held various positions in the areas of cost control and production.

*Kennett F. Burnes* became a director of our Company in February 2009. Mr. Burnes is the retired Chairman, President and Chief Executive Officer of Cabot Corporation, a global specialty chemicals company. He was Chairman from 2001 to March 2008, President from 1995 to January 2008 and Chief Executive Officer from 2001 to January 2008. Prior to joining Cabot Corporation in 1987, Mr. Burnes was a partner at the Boston-based law firm of Choate, Hall & Stewart, where he specialized in corporate and business law for nearly 20 years. He is a director of State Street Corporation, a member of the Dana Farber Cancer Institute's Board of Trustees and a board member of the New England Conservatory. Mr. Burnes is also Chairman of the Board of Trustees of the Schepens Eye Research Institute.

*Richard J. Cathcart* has served as a director of our Company since October 2007. He was Vice Chairman and a member of the Board of Directors of Pentair, Inc. from February 2005 until his retirement in September 2007. Pentair is a diversified manufacturing company consisting of two operating segments: Water Technologies and Technical Products. He was appointed President and Chief Operating Officer of Pentair's Water Technologies Group in January 2001 and served in that capacity until his appointment as Vice Chairman in February 2005. He began his career at Pentair in March 1995 as Executive Vice President, Corporate Development, where he identified water as a strategic area of growth. In February 1996, he was named Executive Vice President and President of Pentair's Water Technologies Group. Prior to joining Pentair, he held several management and business development positions during his 20-year career with Honeywell International Inc. He is a director of Fluidra S.A.

*W. Craig Kissel* was elected as a member of our Board of Directors in November 2011. Mr. Kissel previously was employed by Trane Inc. (formerly known as American Standard Companies Inc.) from 1980 until his retirement in September 2008. During his time at Trane, Mr. Kissel served as President of Trane Commercial Systems from 2004 to June, 2008, President of WABCO Vehicle Control Systems from 1998 to 2003, President of Trane's North American Unitary Products Group from 1994 to 1997, Vice President of Marketing of Trane's North American Unitary Products Group from 1992 to 1994 and held various other management positions at Trane from 1980 to 1991. Trane is a leading worldwide supplier of air conditioning and heating systems, and WABCO is a leading worldwide supplier of commercial vehicle control systems. From 2001 to 2008, Mr. Kissel served as Chairman of Trane's Corporate Ethics and Integrity Council, which was responsible for developing the company's ethical business standards. Mr. Kissel also served in the U.S. Navy from 1973 to 1978. Mr. Kissel has served as a director of Chicago Bridge & Iron Company since May 2009. Chicago Bridge & Iron Company engineers and constructs some of the world's largest energy infrastructure projects.

*John K. McGillicuddy* has served as a director of our Company since 2003. He was employed by KPMG LLP, a public accounting firm, from 1965 until his retirement in 2000. He was elected into the Partnership at KPMG LLP in June 1975 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. He is a director of Brooks Automation, Inc. and Cabot Corporation.

*Joseph T. Noonan* was elected as a member of our Board of Directors in May 2013. Mr. Noonan has served as Chief Executive Officer of Homespun Design, Inc. since November 2013. Homespun

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Design is a start-up phase online retailer of American-made furniture and design founded by Mr. Noonan. Mr. Noonan previously worked as an independent digital strategy consultant from November 2012 to November 2013. Mr. Noonan was employed by Wayfair LLC from April 2008 to November 2012. During his time at Wayfair, Mr. Noonan served as Senior Director of Wayfair International from June 2011 to November 2012, Director of Category Management and Merchandising from February 2009 to June 2011 and Manager of Wayfair's Business-to-Business Division from April 2008 to February 2009. Wayfair is an online retailer of home furnishings, décor and home improvement products. Prior to joining Wayfair, Mr. Noonan worked as a venture capitalist at Polaris Partners and as an investment banker at Cowen & Company.

*Merilee Raines* has served as a director of our Company since February 2011. Ms. Raines served as Chief Financial Officer of IDEXX Laboratories, Inc. from October 2003 until her retirement in May 2013. Prior to becoming Chief Financial Officer, Ms. Raines held several management positions with IDEXX Laboratories, including Corporate Vice President of Finance, Vice President and Treasurer of Finance, Director of Finance, and Controller. IDEXX Laboratories develops, manufactures and distributes diagnostic and information technology-based products and services for companion animals, livestock, poultry, water quality and food safety, and human point-of-care diagnostics. Ms. Raines is a director of Aratana Therapeutics, Inc.

### ***Product Liability, Environmental and Other Litigation Matters***

We are subject to a variety of potential liabilities connected with our business operations, including potential liabilities and expenses associated with possible product defects or failures and compliance with environmental laws. We maintain product liability and other insurance coverage, which we believe to be generally in accordance with industry practices. Nonetheless, such insurance coverage may not be adequate to protect us fully against substantial damage claims.

### ***Contingencies***

*Trabakoolas et al., v. Watts Water Technologies, Inc., et al.,*

On December 12, 2013, we reached an agreement in principle to settle all claims. The total settlement amount is \$23.0 million, of which we are expected to be responsible for \$14 million after insurance proceeds of \$9 million. The settlement was subject to review by the Court at a preliminary approval hearing held on February 12, 2014. The Court granted preliminary approval on February 14, 2014. The settlement is subject to final court approval after a fairness hearing, currently scheduled for July 16, 2014. Accordingly, there can be no assurance that the proposed settlement will be approved in its current form. If the settlement is not approved, the Company intends to continue to vigorously contest the allegations in this case.

### ***Environmental Remediation***

We have been named as a potentially responsible party with respect to a limited number of identified contaminated sites. The levels of contamination vary significantly from site to site as do the related levels of remediation efforts. Environmental liabilities are recorded based on the most probable cost, if known, or on the estimated minimum cost of remediation. Accruals are not discounted to their present value, unless the amount and timing of expenditures are fixed and reliably determinable. We accrue estimated environmental liabilities based on assumptions, which are subject to a number of factors and uncertainties. Circumstances that can affect the reliability and precision of these estimates include identification of additional sites, environmental regulations, level of clean-up required, technologies available, number and financial condition of other contributors to remediation and the time period over which remediation may occur. We recognize changes in estimates as new remediation requirements are defined or as new information becomes available.

*Asbestos Litigation*

We are defending approximately 44 lawsuits in different jurisdictions, alleging injury or death as a result of exposure to asbestos. The complaints in these cases typically name a large number of defendants and do not identify any particular Watts Water products as a source of asbestos exposure. To date, we have obtained a dismissal in every case before it has reached trial because discovery has failed to yield evidence of substantial exposure to any Watts Water products.

*Other Litigation*

Other lawsuits and proceedings or claims, arising from the ordinary course of operations, are also pending or threatened against us.

**Item 1A. RISK FACTORS.**

***Economic cycles, particularly those involving reduced levels of commercial and residential starts and remodeling, may have adverse effects on our revenues and operating results.***

We have experienced and expect to continue to experience fluctuations in revenues and operating results due to economic and business cycles. The businesses of most of our customers, particularly plumbing and heating wholesalers and home improvement retailers, are cyclical. Therefore, the level of our business activity has been cyclical, fluctuating with economic cycles. An economic downturn may also affect the financial stability of our customers, which could affect their ability to pay amounts owed to their vendors, including us. We also believe our level of business activity is influenced by commercial and residential starts and renovation and remodeling, which are, in turn, heavily influenced by interest rates, consumer debt levels, changes in disposable income, employment growth and consumer confidence. Credit market conditions may prevent commercial and residential builders or developers from obtaining the necessary capital to continue existing projects or to start new projects. This may result in the delay or cancellation of orders from our customers or potential customers and may adversely affect our revenues and our ability to manage inventory levels, collect customer receivables and maintain profitability. Further, the Euro Zone has been in recession since 2011 triggered by sovereign debt concerns and general economic malaise. If economic conditions worsen in the future or if economic recovery were to dissipate, our revenues and profits could decrease or trigger additional goodwill, indefinite-lived intangible assets, or long-lived asset impairments and could have a material effect on our financial condition and results of operations.

***We face intense competition and, if we are not able to respond to competition in our markets, our revenues may decrease.***

Competitive pressures in our markets could adversely affect our competitive position, leading to a possible loss of market share or a decrease in prices, either of which could result in decreased revenues and profits. We encounter intense competition in all areas of our business. Additionally, we believe our customers are attempting to reduce the number of vendors from which they purchase in order to reduce the size and diversity of their inventories and their transaction costs. To remain competitive, we will need to invest continually in manufacturing, product development, marketing, customer service and support and our distribution networks. We may not have sufficient resources to continue to make such investments and we may be unable to maintain our competitive position. In addition, we anticipate that we may have to reduce the prices of some of our products to stay competitive, potentially resulting in a reduction in the profit margin for, and inventory valuation of, these products. Some of our competitors are based in foreign countries and have cost structures and prices in foreign currencies. Accordingly, currency fluctuations could cause our U.S. dollar costed products to be less competitive than our competitors' products which are priced in other currencies.

***Changes in the costs of raw materials could reduce our profit margins. Reductions or interruptions in the supply of components or finished goods from international sources could adversely affect our ability to meet our customer delivery commitments.***

We require substantial amounts of raw materials, including bronze, brass, cast iron, steel and plastic, and substantially all of the raw materials we require are purchased from outside sources. The costs of raw materials may be subject to change due to, among other things, interruptions in production by suppliers and changes in exchange rates and worldwide price and demand levels. We typically do not enter into long-term supply agreements. Our inability to obtain supplies of raw materials for our products at favorable costs could have a material adverse effect on our business, financial condition or results of operations by decreasing our profit margins. The commodity markets have experienced tremendous volatility over the past several years, particularly copper. Should commodity costs increase substantially, we may not be able to recover such costs, through selling price increases to our customers or other product cost reductions, which would have a negative effect on our financial results. If commodity costs decline, we may experience pressure from customers to reduce our selling prices.

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Additionally, we continue to purchase increased levels of components and finished goods from international sources. In limited cases, these components or finished goods are single-sourced. The availability of components and finished goods from international sources could be adversely impacted by, among other things, interruptions in production by suppliers, suppliers' allocations to other purchasers and new laws or regulations.

***Government regulations could limit or delay our ability to market or sell our products and could affect raw material sourcing and/or increase our costs.***

Effective January 4, 2014, the *Reduction of Lead in Drinking Water Act* reduced the permissible weighted average lead content in faucets, fittings and valves used in potable water applications from 8% to 0.25% throughout the United States. The new law is consistent with laws previously in effect in California, Maryland, Louisiana and Vermont. Prior to 2013, we had introduced lead free products for sale in California, Maryland, Louisiana and Vermont, and we offer a large selection of lead free compliant valves and fittings. Complying with these new requirements throughout the United States poses a significant challenge for us. The nationwide requirements have caused our material costs to increase as suppliers of alternative lead free metals are currently limited and lead free alloy substitutes are more expensive than the original leaded alloys. We may not succeed in passing through all these cost increases to our customers. We have and may continue to experience technical challenges in our new lead free manufacturing operations to produce more lead free products. In addition, we could have difficulty providing sufficient quantities of our lead free compliant products to meet nationwide demand. These requirements could have a material effect on our financial condition and results of operation.

Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act) requires the SEC to establish new disclosure and reporting requirements regarding specified minerals originating in the Democratic Republic of the Congo or an adjoining country that are necessary to the functionality or production of products manufactured by companies required to file reports with the SEC. The final rules implementing these requirements, as released in 2012 by the SEC, could affect sourcing at competitive prices and availability in sufficient quantities of minerals used in the manufacture of our products. In addition, because our supply chain is complex, we may face commercial challenges if we are unable to verify sufficiently the origins for all metals used in our products through the due diligence procedures that we implement and otherwise may become obliged to disclose publicly those efforts with regard to conflict minerals. Moreover, we may encounter challenges to satisfy those customers who require that all of the components of our products be certified as conflict free, which could place us at a competitive disadvantage if we are unable to do so.

***Implementation of our acquisition strategy may not be successful, which could affect our ability to increase our revenues or our profitability.***

One of our strategies is to increase our revenues and profitability and expand our business through acquisitions that will provide us with complementary products and increase market share for our existing product lines. We cannot be certain that we will be able to identify, acquire or profitably manage additional companies or successfully integrate such additional companies without substantial costs, delays or other problems. Also, companies acquired recently and in the future may not achieve revenues, profitability or cash flows that justify our investment in them. We have faced increasing competition for acquisition candidates, which has resulted in significant increases in the purchase prices of many acquisition candidates. This competition, and the resulting purchase price increases, may limit the number of acquisition opportunities available to us, possibly leading to a decrease in the rate of growth of our revenues and profitability. In addition, acquisitions may involve a number of risks, including, but not limited to:

inadequate internal controls over financial reporting and our ability to bring such controls into compliance with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002 in a timely manner;

adverse short-term effects on our reported operating results;

diversion of management's attention;

investigations of, or challenges to, acquisitions by competition authorities;

loss of key personnel at acquired companies;

unanticipated management or operational problems or legal liabilities; and

potential goodwill, indefinite-lived intangible assets, or long-lived asset impairment charges.

***We are subject to risks related to product defects, which could result in product recalls and could subject us to warranty claims in excess of our warranty provisions or which are greater than anticipated due to the unenforceability of liability limitations.***

We maintain strict quality controls and procedures, including the testing of raw materials and safety testing of selected finished products. However, we cannot be certain that our testing will reveal latent defects in our products or the materials from which they are made, which may not become apparent until after the products have been sold into the market. We also cannot be certain that our suppliers will always eliminate latent defects in products we purchase from them. Accordingly, there is a risk that product defects will occur, which could require a product recall. Product recalls can be expensive to implement and, if a product recall occurs during the product's warranty period, we may be required to replace the defective product. In addition, a product recall may damage our relationship with our customers and we may lose market share with our customers. Our insurance policies may not cover the costs of a product recall.

Our standard warranties contain limits on damages and exclusions of liability for consequential damages and for misuse, improper installation, alteration, accident or mishandling while in the possession of someone other than us. We may incur additional operating expenses if our warranty provision does not reflect the actual cost of resolving issues related to defects in our products. If these additional expenses are significant, it could adversely affect our business, financial condition and results of operations.

***We face risks from product liability and other lawsuits, which may adversely affect our business.***

We have been and expect to continue to be subject to various product liability claims or other lawsuits, including, among others, that our products include inadequate or improper instructions for use or installation, or inadequate warnings concerning the effects of the failure of our products. If we do not have adequate insurance or contractual indemnification, damages from these claims would have to be paid from our assets and could have a material adverse effect on our results of operations, liquidity and financial condition. Like other manufacturers and distributors of products designed to control and regulate fluids and gases, we face an inherent risk of exposure to product liability claims and other lawsuits in the event that the use of our products results in personal injury, property damage or business interruption to our customers. We cannot be certain that our products will be completely free from defect. In addition, in certain cases, we rely on third-party manufacturers for our products or components of our products. We cannot be certain that our insurance coverage will continue to be available to us at a reasonable cost, or, if available, will be adequate to cover any such liabilities. For more information, see "Item 1. Business Product Liability, Environmental and Other Litigation Matters."

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### *Economic and other risks associated with international sales and operations could adversely affect our business and future operating results.*

Since we sell and manufacture our products worldwide, our business is subject to risks associated with doing business internationally. Our business and future operating results could be harmed by a variety of factors, including:

unexpected geo-political events in foreign countries in which we operate, which could adversely affect manufacturing and our ability to fulfill customer orders;

our inability to comply with anti-corruption laws and regulations of the U.S. government and various international jurisdictions, such as the U.S. Foreign Corrupt Practices Act and the United Kingdom's Bribery Act of 2010;

trade protection measures and import or export licensing requirements, which could increase our costs of doing business internationally;

potentially negative consequences from changes in tax laws, which could have an adverse impact on our profits;

difficulty in staffing and managing widespread operations, which could reduce our productivity;

costs of compliance with differing labor regulations, especially in connection with restructuring our overseas operations;

laws of some foreign countries, which may not protect our intellectual property rights to the same extent as the laws of the United States;

unexpected changes in regulatory requirements, which may be costly and require time to implement; and

foreign exchange rate fluctuations, which could also materially affect our reported results. A portion of our sales and certain portions of our costs, assets and liabilities are denominated in currencies other than U.S. dollars, and the percentage of our revenues denominated in a particular currency may not match the percentage of our expenses denominated in that currency. Approximately 46.5% of our sales during the year ended December 31, 2013 were from sales outside of the U.S. compared to 47.6% for the year ended December 31, 2012. We cannot predict whether currencies such as the Euro, Canadian dollar or Chinese yuan will appreciate or depreciate against the U.S. dollar in future periods or whether future foreign exchange rate fluctuations will have a positive or negative impact on our reported results.

### *Our ability to achieve savings through our restructuring plans may be adversely affected by local regulations or factors beyond the control of management.*

We have implemented a number of restructuring plans, which include steps that we believe are necessary to reduce operating costs and increase efficiencies throughout our manufacturing, sales and distribution footprint. Factors beyond the control of management may affect the timing and therefore affect when the savings will be achieved under the plans. Further, if we are not successful in completing the restructuring projects in the time frames contemplated or if additional issues arise during the projects that add costs or disrupt customer service, then our operating results could be negatively affected.

### *Future operating results could be negatively affected by the resolution of various uncertain tax positions and by potential changes to tax incentives.*

In the ordinary course of our business, there are many transactions and calculations where the ultimate tax determination is uncertain. Significant judgment is required in determining our worldwide provision for income taxes. We periodically assess our exposures related to our worldwide provision for income taxes and believe that we have appropriately accrued taxes for contingencies. Any reduction of





these contingent liabilities or additional assessment would increase or decrease income, respectively, in the period such determination was made. Our income tax filings are regularly under audit by tax authorities and the final determination of tax audits could be materially different than that which is reflected in historical income tax provisions and accruals. As issues arise during tax audits we adjust our tax accrual accordingly. Additionally, we benefit from certain tax incentives offered by various jurisdictions. If we are unable to meet the requirements of such incentives, our inability to use these benefits could have a material negative effect on future earnings.

***We are currently a decentralized company, which presents certain risks.***

We are currently a decentralized company, which sometimes places significant control and decision-making powers in the hands of local management. This presents various risks such as the risk of being slower to identify or react to problems affecting a key business. Additionally, we are implementing in a phased approach a company-wide initiative to selectively standardize and upgrade our enterprise resource planning (ERP) systems. This initiative could be more challenging and costly to implement because divergent legacy systems currently exist. Further, if the ERP updates are not successful, we could incur substantial business interruption, including our ability to perform routine business transactions, which could have a material adverse effect on our financial results.

***Our business and financial performance may be adversely affected by information technology and other business disruptions.***

Our business may be impacted by disruptions, including information technology attacks or failures, threats to physical security, as well as damaging weather or other acts of nature, pandemics or other public health crises. Cybersecurity attacks, in particular, are evolving and include, but are not limited to, malicious software, attempts to gain unauthorized access to data, and other electronic security breaches that could lead to disruptions in systems, unauthorized release of confidential or otherwise protected information and corruption of data. We have experienced cybersecurity attacks and may continue to experience them going forward, potentially with more frequency. Given the unpredictability of the timing, nature and scope of such disruptions, we could potentially be subject to production downtimes, operational delays, other detrimental impacts on our operations or ability to provide products to our customers, the compromising of confidential or otherwise protected information, misappropriation, destruction or corruption of data, security breaches, other manipulation or improper use of our systems or networks, financial losses from remedial actions, loss of business or potential liability, and/or damage to our reputation, any of which could have a material adverse effect on our competitive position, results of operations, cash flows or financial condition.

***The requirements to evaluate goodwill, indefinite-lived intangible assets and long-lived assets for impairment may result in a write-off of all or a portion of our recorded amounts, which would negatively affect our operating results and financial condition.***

As of December 31, 2013, our balance sheet included goodwill, indefinite-lived intangible assets, amortizable intangible assets and property, plant and equipment of \$514.8 million, \$41.9 million, \$199.0 million, and \$219.9 million, respectively. In lieu of amortization, we are required to perform an annual impairment review of both goodwill and indefinite-lived intangible assets. In performing our annual reviews in 2013, 2012 and 2011, we recognized non-cash pre-tax charges of approximately \$0.7 million, \$0.4 million and \$1.4 million, respectively, as impairments of the indefinite-lived intangible assets. In 2013, 2012 and 2011, we recognized pre-tax non-cash goodwill impairment charges of \$0.3 million, \$1.0 million and \$1.2 million, respectively, related to our Blue Ridge Atlantic Enterprises, Inc. (BRAE) reporting unit within our Americas segment. We are also required to perform an impairment review of our long-lived assets if indicators of impairment exist. In 2013 and 2012, we recognized a pre-tax non-cash charge of \$1.3 million and \$1.6 million, respectively, to write down long-term assets. In 2011, we recognized pre-tax non-cash long-lived asset impairment charges of \$14.8 million related to our Watts Insulation GmbH (Austroflex) operations within our EMEA

segment. We completed the sale of Austroflex on August 1, 2013, and Austroflex's results of operations have been presented as discontinued operations for all periods presented. There can be no assurances that future goodwill, indefinite-lived intangible assets or other long-lived asset impairments will not occur. We perform our annual test for indications of goodwill and indefinite-lived intangible assets impairment in the fourth quarter of our fiscal year or sooner if indicators of impairment exist.

***The loss or financial instability of major customers could have an adverse effect on our results of operations.***

In 2013, our top ten customers accounted for approximately 22% of our total net sales with no one customer accounting for more than 10% of our total net sales. Our customers generally are not obligated to purchase any minimum volume of products from us and are able to terminate their relationships with us at any time. In addition, increases in the prices of our products could result in a reduction in orders from our customers. A significant reduction in orders from, or change in terms of contracts with, any significant customers could have a material adverse effect on our future results of operations. Furthermore, some of our major customers are facing financial challenges due to market declines and heavy debt levels; should these challenges become acute, our results could be materially adversely affected due to reduced orders and/or payment delays or defaults.

***Certain indebtedness may limit our ability to pay dividends, incur additional debt and make acquisitions and other investments.***

Our revolving credit facility and other senior indebtedness contain operational and financial covenants that restrict our ability to make distributions to stockholders, incur additional debt and make acquisitions and other investments unless we satisfy certain financial tests and comply with various financial ratios. If we do not maintain compliance with these covenants, our creditors could declare a default under our revolving credit facility or senior notes and our indebtedness could be declared immediately due and payable. Our ability to comply with the provisions of our indebtedness may be affected by changes in economic or business conditions beyond our control. Further, one of our strategies is to increase our revenues and profitability and expand our business through acquisitions. We may require capital in excess of our available cash and the unused portion of our revolving credit facility to make large acquisitions, which we would generally obtain from access to the credit markets. There can be no assurance that if a large acquisition is identified that we would have access to sufficient capital to complete such acquisition. Should we require additional debt financing above our existing credit limit, we cannot be assured such financing would be available to us or available to us on reasonable economic terms.

***One of our stockholders can exercise substantial influence over our Company.***

Our Class B common stock entitles its holders to ten votes for each share and our Class A common stock entitles its holders to one vote per share. As of January 31, 2014, Timothy P. Horne beneficially owned approximately 18.4% of our outstanding shares of Class A common stock (assuming conversion of all shares of Class B common stock beneficially owned by Mr. Horne into Class A common stock) and approximately 99.2% of our outstanding shares of Class B common stock, which represents approximately 68.8% of the total outstanding voting power. As long as Mr. Horne controls shares representing at least a majority of the total voting power of our outstanding stock, Mr. Horne will be able to unilaterally determine the outcome of most stockholder votes, and other stockholders will not be able to affect the outcome of any such votes.

***Conversion and sale of a significant number of shares of our Class B common stock could adversely affect the market price of our Class A common stock.***

As of January 31, 2014, there were outstanding 28,734,210 shares of our Class A common stock and 6,489,290 shares of our Class B common stock. Shares of our Class B common stock may be converted into Class A common stock at any time on a one for one basis. Under the terms of a registration rights agreement with respect to outstanding shares of our Class B common stock, the

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holders of our Class B common stock have rights with respect to the registration of the underlying Class A common stock. Under these registration rights, the holders of Class B common stock may require, on up to two occasions that we register their shares for public resale. If we are eligible to use Form S-3 or a similar short-form registration statement, the holders of Class B common stock may require that we register their shares for public resale up to two times per year. If we elect to register any shares of Class A common stock for any public offering, the holders of Class B common stock are entitled to include shares of Class A common stock into which such shares of Class B common stock may be converted in such registration. However, we may reduce the number of shares proposed to be registered in view of market conditions. We will pay all expenses in connection with any registration, other than underwriting discounts and commissions. If all of the available registered shares are sold into the public market the trading price of our Class A common stock could decline.

**Item 1B. UNRESOLVED STAFF COMMENTS.**

None.

**Item 2. PROPERTIES.**

As of December 31, 2013, we maintained 31 principal manufacturing, warehouse and distribution centers worldwide, including our corporate headquarters located in North Andover, Massachusetts. Additionally, we maintain numerous sales offices and other smaller manufacturing facilities and warehouses. The principal properties in each of our three geographic segments and their location, principal use and ownership status are set forth below:

**Americas:**

| Location               | Principal Use              | Owned/Leased |
|------------------------|----------------------------|--------------|
| North Andover, MA      | Corporate Headquarters     | Owned        |
| Burlington, ON, Canada | Distribution Center        | Owned        |
| Chesnee, SC            | Manufacturing              | Owned        |
| Export, PA             | Manufacturing              | Owned        |
| Franklin, NH           | Manufacturing/Distribution | Owned        |
| Kansas City, KS        | Manufacturing              | Owned        |
| St. Pauls, NC          | Manufacturing              | Owned        |
| San Antonio, TX        | Warehouse/Distribution     | Owned        |
| Spindale, NC           | Distribution Center        | Owned        |
| Kansas City, MO        | Manufacturing/Distribution | Leased       |
| Peoria, AZ             | Manufacturing/Distribution | Leased       |
| Reno, NV               | Distribution Center        | Leased       |
| Springfield, MO        | Manufacturing/Distribution | Leased       |
| Vernon, BC, Canada     | Manufacturing/Distribution | Leased       |
| Woodland, CA           | Manufacturing              | Leased       |

**Europe, Middle East and Africa:**

| Location               | Principal Use                   | Owned/Leased |
|------------------------|---------------------------------|--------------|
| Eerbeek, Netherlands   | EMEA Headquarters/Manufacturing | Owned        |
| Biassono, Italy        | Manufacturing/Distribution      | Owned        |
| Hautvillers, France    | Manufacturing                   | Owned        |
| Landau, Germany        | Manufacturing/Distribution      | Owned        |
| Mery, France           | Manufacturing                   | Owned        |
| Plovdiv, Bulgaria      | Manufacturing                   | Owned        |
| Vildbjerg, Denmark     | Manufacturing/Distribution      | Owned        |
| Virey-le-Grand, France | Manufacturing/Distribution      | Owned        |
| Gardolo, Italy         | Manufacturing                   | Leased       |
| Monastir, Tunisia      | Manufacturing                   | Leased       |
| Rosières, France       | Manufacturing/Distribution      | Leased       |
| Sorgues, France        | Distribution Center             | Leased       |

**Asia Pacific:**

| Location                       | Principal Use             | Owned/Leased |
|--------------------------------|---------------------------|--------------|
| Shanghai, China                | Asia Pacific Headquarters | Leased       |
| Ningbo, Beilun District, China | Distribution Center       | Leased       |
| Ningbo, Beilun, China          | Manufacturing             | Owned        |
| Taizhou, Yuhuan, China         | Manufacturing             | Owned        |

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Certain of our facilities are subject to mortgages and collateral assignments under loan agreements with long-term lenders. In general, we believe that our properties, including machinery, tools and equipment, are in good condition, well maintained and adequate and suitable for their intended uses.

### **Item 3. LEGAL PROCEEDINGS.**

We are from time to time involved in various legal and administrative proceedings. See Item 1. "Business Product Liability, Environmental and Other Litigation Matters," and Note 14 of the Notes to Consolidated Financial Statements, both of which are incorporated herein by reference.

### **Item 4. MINE SAFETY DISCLOSURES.**

Not applicable.

**PART II****Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.**

The following table sets forth the high and low sales prices of our Class A common stock on the New York Stock Exchange during 2013 and 2012 and cash dividends paid per share.

|                | 2013     |          |          | 2012     |          |          |
|----------------|----------|----------|----------|----------|----------|----------|
|                | High     | Low      | Dividend | High     | Low      | Dividend |
| First Quarter  | \$ 50.04 | \$ 42.63 | \$ 0.11  | \$ 42.38 | \$ 34.97 | \$ 0.11  |
| Second Quarter | 48.32    | 43.12    | 0.13     | 41.59    | 31.61    | 0.11     |
| Third Quarter  | 58.18    | 45.73    | 0.13     | 40.29    | 30.88    | 0.11     |
| Fourth Quarter | 62.66    | 52.33    | 0.13     | 43.39    | 36.45    | 0.11     |

There is no established public trading market for our Class B common stock, which is held by members of the Horne family. The principal holders of such stock are subject to restrictions on transfer with respect to their shares. Each share of our Class B common stock (10 votes per share) is convertible into one share of Class A common stock (1 vote per share).

On February 18, 2014, we declared a quarterly dividend of thirteen cents (\$0.13) per share on each outstanding share of Class A common stock and Class B common stock.

Aggregate common stock dividend payments in 2013 were \$17.7 million, which consisted of \$14.4 million and \$3.3 million for Class A shares and Class B shares, respectively. Aggregate common stock dividend payments in 2012 were \$16.0 million, which consisted of \$13.0 million and \$3.0 million for Class A shares and Class B shares, respectively. While we presently intend to continue to pay comparable cash dividends, the payment of future cash dividends depends upon the Board of Directors' assessment of our earnings, financial condition, capital requirements and other factors.

The number of record holders of our Class A common stock as of January 31, 2014 was 199. The number of record holders of our Class B common stock as of January 31, 2014 was 8.

We satisfy the minimum withholding tax obligation due upon the vesting of shares of restricted stock and the conversion of restricted stock units into shares of Class A common stock by automatically withholding from the shares being issued a number of shares with an aggregate fair market value on the date of such vesting or conversion that would satisfy the withholding amount due.

The following table includes information with respect to shares of our Class A common stock withheld to satisfy withholding tax obligations during the quarter ended December 31, 2013.

| Period                                | Issuer Purchases of Equity Securities           |  |   |   |
|---------------------------------------|---|--|---|---|
|                                       | (a) Total Number of Shares (or Units) Purchased | (b) Average Price Paid per Share (or Unit) | (c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs | (d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs |
| September 30, 2013 - October 27, 2013 |   |  |   |   |
| October 28, 2013 - November 24, 2013  |   |  |   |   |
| November 25, 2013 - December 31, 2013 | 1,383   | \$ 58.16                                   |   |   |
| Total                                 | 1,383   | \$ 58.16                                   |   |   |





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The following table includes information with respect to repurchases of our Class A common stock during the three-month period ended December 31, 2013 under our stock repurchase program.

| Period                                   | Issuer Purchases of Equity Securities                          |   |   |  |
|--|--|---|---|--|
|  | (a) Total<br>Number of<br>Shares (or<br>Units)<br>Purchased(1) | (b) Average<br>Price Paid<br>per Share<br>(or Unit) | (c) Total Number<br>of<br>Shares (or Units)<br>Purchased as<br>Part of<br>Publicly<br>Announced<br>Plans or<br>Programs | (d) Maximum Number<br>(or<br>Approximate Dollar<br>Value) of Shares (or<br>Units) that May Yet<br>Be<br>Purchased Under the<br>Plans or Programs |
| September 30, 2013 - October 27,<br>2013 | 17,631   | \$ 55.22  | 17,631  | \$ 69,036,487  |
| October 28, 2013 - November 24,<br>2013  | 18,445   | \$ 58.15  | 18,445  | \$ 67,963,822  |
| November 25, 2013 -<br>December 31, 2013 | 16,050   | \$ 59.33  | 16,050  | \$ 67,011,512  |
| <b>Total</b>                             | <b>52,126</b>  | <b>\$ 57.53</b>                                     | <b>52,126</b>   | <b>\$ 67,011,512</b>   |

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(1)

On April 30, 2013, the Board of Directors authorized a stock repurchase program of up to \$90 million of the Company's Class A common stock to be purchased from time to time on the open market or in privately negotiated transactions. The timing and number of any shares repurchased will be determined by the Company's management based on its evaluation of market conditions. During the quarter ended December 31, 2013, we repurchased approximately \$3.0 million of common stock.

**Performance Graph**

Set forth below is a line graph comparing the cumulative total shareholder return on our Class A common stock for the last five years with the cumulative return of companies on the Standard & Poor's 500 Stock Index and the Russell 2000 Index. We chose the Russell 2000 Index because it represents companies with a market capitalization similar to that of Watts Water. The graph assumes that the value of the investment in our Class A common stock and each index was \$100 at December 31, 2008 and that all dividends were reinvested.

**COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN\*  
Among Watts Water Technologies, Inc., the S&P 500 Index  
and the Russell 2000 Index**

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\*

\$100 invested on 12/31/08 in stock or index, including reinvestment of dividends. Fiscal year ending December 31.

**Cumulative Total Return**

|                               | 12/31/08 | 12/31/09 | 12/31/10 | 12/31/11 | 12/31/12 | 12/31/13 |
|-------------------------------|----------|----------|----------|----------|----------|----------|
| Watts Water Technologies, Inc | 100.00   | 126.13   | 151.37   | 143.42   | 182.38   | 265.05   |
| S & P 500                     | 100.00   | 126.46   | 145.51   | 148.59   | 172.37   | 228.19   |
| Russell 2000                  | 100.00   | 127.17   | 161.32   | 154.59   | 179.86   | 249.69   |

*The above Performance Graph and related information shall not be deemed "soliciting material" or to be "filed" with the Securities and Exchange Commission, nor shall such information be incorporated by reference into any future filing under the Securities Act of 1933 or Securities Exchange Act of 1934, each as amended, except to the extent that we specifically incorporate it by reference into such filing.*

**Item 6. SELECTED FINANCIAL DATA.**

The selected financial data set forth below should be read in conjunction with our consolidated financial statements, related Notes thereto and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included herein.

**FIVE-YEAR FINANCIAL SUMMARY**

(Amounts in millions, except per share and cash dividend information)

|   | Year Ended<br>12/31/13(1)(6) | Year Ended<br>12/31/12(2)(6) | Year Ended<br>12/31/11(3)(6) | Year Ended<br>12/31/10(4)(6) | Year Ended<br>12/31/09(5)(6) |
|---|------------------------------|------------------------------|------------------------------|------------------------------|------------------------------|
| <b>Statement of operations data:</b>            |                              |                              |                              |                              |                              |
| Net sales                                       | \$ 1,473.5                   | \$ 1,427.4                   | \$ 1,407.4                   | \$ 1,264.0                   | \$ 1,225.9                   |
| Net income from continuing operations           | 60.9                         | 70.4                         | 77.2                         | 64.1                         | 41.0                         |
| Loss from discontinued operations, net of taxes | (2.3)                        | (2.0)                        | (10.8)                       | (5.3)                        | (23.6)                       |
| Net income                                      | 58.6                         | 68.4                         | 66.4                         | 58.8                         | 17.4                         |
| <b>DILUTED EPS</b>                              |                              |                              |                              |                              |                              |
| Income (loss) per share:                        |                              |                              |                              |                              |                              |
| Continuing operations                           | 1.71                         | 1.95                         | 2.06                         | 1.71                         | 1.10                         |
| Discontinued operations                         | (0.07)                       | (0.05)                       | (0.28)                       | (0.14)                       | (0.63)                       |
| NET INCOME                                      | 1.65                         | 1.90                         | 1.78                         | 1.57                         | 0.47                         |
| Cash dividends declared per common share        | \$ 0.50                      | \$ 0.44                      | \$ 0.44                      | \$ 0.44                      | \$ 0.44                      |
| <b>Balance sheet data (at year end):</b>        |                              |                              |                              |                              |                              |
| Total assets                                    | \$ 1,740.2                   | \$ 1,709.0                   | \$ 1,694.0                   | \$ 1,646.1                   | \$ 1,599.2                   |
| Long-term debt, net of current portion          | 305.5                        | 307.5                        | 397.4                        | 378.0                        | 304.0                        |

- (1) For the year ended December 31, 2013, net income from continuing operations includes the following net pre-tax costs: legal costs of \$15.3 million, restructuring charges of \$8.7 million, goodwill and other long-lived asset impairment of \$2.3 million (of which \$1.1 million is recorded in cost of goods sold), EMEA transformation deployment costs of \$1.2 million, earn-out adjustments of \$0.9 million, acceleration of executive share based compensation expense of \$0.9 million and an adjustment to the disposal of the business related to the sale of Tianjin Watts Valve Company Ltd. (TWVC) of \$0.6 million. The net after-tax cost of these items was \$18.3 million.
- (2) For the year ended December 31, 2012, net income from continuing operations includes the following net pre-tax costs: restructuring charges of \$5.2 million, goodwill and other long-lived asset impairment of \$3.4 million, net legal and customs costs of \$2.5 million, an adjustment to the gain on sale of TWVC of \$1.6 million, retention charges related to our former Chief Financial Officer of \$1.6 million, and a charge of \$0.4 million for costs related to the 2012 acquisition of tekmar, offset by a pre-tax gain for an earn-out adjustment of \$1.0 million. Additionally, net income includes tax benefits totaling \$0.7 million, primarily related to a tax law change in Italy. The net after-tax cost of these items was \$8.1 million.
- (3) For the year ended December 31, 2011, net income from continuing operations includes the following net pre-tax costs: restructuring charges of \$10.0 million, goodwill and other long-lived asset impairment charges of \$2.6 million, pension curtailment charges of \$1.5 million, separation costs related to our former Chief Executive Officer of \$6.3 million, and costs related to our acquisition of Danfoss Socla S.A.S (Socla) in France of \$5.8 million offset by pre-tax gains of \$1.2 million for an earn-out adjustment, \$7.7 million related to the sale of TWVC in China and \$1.1 million from legal settlements. Additionally, net income includes a tax benefit of \$4.2 million relating to the sale of TWVC offset by a \$1.1 million tax charge in EMEA related to our France restructuring. The net after-tax cost of these items was \$5.7 million. Included in loss from

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discontinued operations is goodwill and other long-lived asset impairment charges of \$14.8 million related to Austroflex, see (6).

- (4) For the year ended December 31, 2010, net income from continuing operations includes the following net pre-tax costs: restructuring charges of \$14.1 million, intangible impairment charges of \$1.4 million, and costs related to acquisitions and other items of \$7.1 million offset by pre-tax gains of \$4.5 million primarily for product liability and workers compensation accrual adjustments. Additionally, net income includes a tax benefit of \$4.3 million related to the release of a valuation allowance in EMEA offset by a tax charge of \$1.5 million relating to the repatriation of earnings recognized upon our decision to dispose of a China subsidiary. The net after-tax cost of these items was \$10.3 million.
- (5) For the year ended December 31, 2009, net income includes the following net pre-tax costs: restructuring charges of \$18.9 million and intangible impairment charges of \$3.3 million, offset by pre-tax gains on the sale of Tianjin Tangu Watts Valve Co. Ltd. (TWT) in China of \$1.1 million, favorable product liability and workers compensation accrual adjustments of \$4.9 million and legal settlements of \$1.5 million. Additionally, net income includes a tax charge of \$3.9 million relating to previously realized tax benefits, which were expected to be recaptured as a result of our decision to restructure our operations in China. The net after-tax cost of these items was \$16.7 million.
- (6) In August 2013, we disposed of the stock of Austroflex. Results from operations and a loss on disposal are recorded in discontinued operations for 2013, 2012, 2011 and 2010. In December 2012, we disposed of the stock of Flomatic Corporation. Results from operations and a loss on disposal are recorded in discontinued operations for 2012 and 2011. In January 2010, we disposed of our investment in CWV. Results from operation and estimated loss on disposal are included net of tax for CWV in discontinued operations for 2010 and 2009. In May 2009, the Company liquidated its TEAM Precision Pipework, Ltd. (TEAM) business. Results from operation and loss on disposal are included net of tax from the deconsolidation of TEAM in discontinued operations for 2011, 2010 and 2009. In September 1996, we divested our Municipal Water Group of businesses, which included Henry Pratt, James Jones Company and Edward Barber and Company Ltd. Costs and expenses related to the Municipal Water Group, for 2011, 2010 and 2009 relate to legal and settlement costs associated with the James Jones Litigation and other miscellaneous costs. Discontinued operating loss for 2011 and 2010 include an estimated settlement reserve adjustment in connection with the FCPA investigation at CWV (see Note 3) and in 2010 and 2009, includes legal costs associated with the FCPA investigation.

**Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.**

**Overview**

We are a leading supplier of products for use in the water quality, water safety, water flow control and water conservation markets in both the Americas and EMEA with a growing presence in Asia Pacific. For over 139 years, we have designed and manufactured products that promote the comfort and safety of people and the quality and conservation of water used in commercial and residential applications. We earn revenue and income almost exclusively from the sale of our products. Our principal product lines include:

**Residential & commercial flow control products** includes products typically sold into plumbing and hot water applications such as backflow preventers, water pressure regulators, temperature and pressure relief valves, and thermostatic mixing valves.

**HVAC & gas products** includes hydronic and electric heating systems for under-floor radiant applications, hydronic pump groups for boiler manufacturers and alternative energy control packages, and flexible stainless steel connectors for natural and liquid propane gas in commercial food service and residential applications. HVAC is an acronym for heating, ventilation and air conditioning.

**Drains & water re-use products** includes drainage products and engineered rain water harvesting solutions for commercial, industrial, marine and residential applications.

**Water quality products** includes point-of-use and point-of-entry water filtration, conditioning and scale prevention systems for both commercial and residential applications.

Our business is reported in three geographic segments: Americas, EMEA and Asia Pacific. We distribute our products through three primary distribution channels: wholesale, do-it-yourself (DIY) and original equipment manufacturers (OEMs).

We believe that the factors relating to our future growth include our ability to continue to make selective acquisitions, both in our core markets as well as in new complementary markets; regulatory requirements relating to the quality and conservation of water and the safe use of water; increased demand for clean water; continued enforcement of plumbing and building codes; and a healthy economic environment. We have completed 36 acquisitions since 1999. Our acquisition strategy focuses on businesses that manufacture preferred brand name products that address our themes of water quality, water conservation, water safety and water flow control and related complementary markets. We target businesses that will provide us with one or more of the following: an entry into new markets, an increase in shelf space with existing customers, a new or improved technology or an expansion of the breadth of our water quality, water conservation, water safety and water flow control products for the commercial, industrial and residential markets.

Products representing a majority of our sales are subject to regulatory standards and code enforcement, which typically require that these products meet stringent performance criteria. Together with our commissioned manufacturers' representatives, we have consistently advocated for the development and enforcement of such plumbing codes. We are focused on maintaining stringent quality control and testing procedures at each of our manufacturing facilities in order to manufacture products in compliance with code requirements and take advantage of the resulting demand for compliant products. We believe that the product development, product testing capability and investment in plant and equipment needed to manufacture products in compliance with code requirements, represent a competitive advantage for us.

Our performance in 2013 varied, driven by different economic and business dynamics within each region in which we participate. In the Americas, we saw sequential growth during 2013 as the U.S. residential new construction marketplace continued to recover and the repair and replace end market remained strong. Although we experienced minimal growth in the new commercial construction market,

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there have been recent positive macroeconomic signs that a recovery is forthcoming. In EMEA, a weak pan European economy negatively impacted our sales. Certain parts of Europe, such as Italy France and Germany, remained affected by the general economic downturn. However, we were able to partially mitigate the effect of the sales volume reduction with productivity initiatives and cost reduction initiatives. Our EMEA segment continued to expand its sales into Eastern Europe during the year. In Asia Pacific, we had solid growth as we expanded our sales and marketing efforts.

Overall, sales grew organically by 2.1% as compared to 2012. Organic sales growth excludes the impacts of acquisitions, divestitures and foreign exchange from year-over-year comparisons. We believe this provides investors with a more complete understanding of underlying sales trends by providing sales growth on a consistent basis. Compared to 2012, organic sales in Americas and Asia Pacific grew by 5.5% and 20.5%, respectively, but were offset by a reduction in EMEA organic sales of 3.6%.

Operationally, in the U.S. we continued our focus around our transition to lead free production. In 2013 and 2012, we committed an aggregate of approximately \$18.3 million in capital spending for a new foundry and machinery in the U.S. to meet expected lead free demand for our products sold in the U.S. Construction of the new foundry was completed during the second quarter of 2013. We incurred \$5.8 million in transition costs in 2013 relating to inefficiencies experienced as part of the lead free conversion project, including furnace repairs, excess scrap and consulting costs related to the new foundry. The impact of commodity costs during 2013 was minimal, especially with our most important raw material, copper. We saw copper spot prices in the first quarter trending higher, with prices declining to a consistent level through the remainder of the year. Pricing, in turn, was fairly stable, although we experienced some pricing pressures in certain geographies and in certain product lines in the Americas, especially in the DIY channel. In EMEA, we were able to selectively increase pricing for certain products. However, we believe the economic uncertainty in Europe may continue affecting how we and our competitors are pricing in end markets.

We continually review our business and implement restructuring plans as needed. The restructuring program for EMEA that we announced in July 2013 is proceeding in accordance with our expectations. Please see Note 4 of the Notes to Consolidated Financial Statements for a more detailed explanation of our restructuring activities.

In the fourth quarter of 2013, we began a program that we refer to as the European transformation. This program is designed to refocus our European operations from being country specific to a pan European business unit operating strategy. Under this initiative, we intend to (1) develop better sales capabilities through improved product management and enhanced product cross-selling efforts, (2) drive more efficient European sourcing and logistics, and (3) enhance our focus on emerging market opportunities. We plan to align our legal and tax structure in accordance with our business structure and take advantage of favorable tax rates where possible. We expect this project to be ongoing through 2016. We anticipate total non-recurring external deployment costs of \$12.2 million, with approximately \$9.0 million anticipated to be spent in 2014. We incurred approximately \$1.2 million in the fourth quarter of 2013 in deployment costs. Total annual savings are forecasted at \$18.0 million by 2018, with approximately \$3.5 million and \$10.0 million in annual savings expected in 2014 and 2015, respectively. We expect that we will need to add approximately \$4.0 million of infrastructure costs per annum to our current operational base by 2018 to maintain the program, of which approximately \$3.5 million will be added in 2014.

### **Acquisitions and Disposals**

On August 1, 2013, the Company completed the sale of all of the outstanding shares of an indirectly wholly-owned subsidiary, Austroflex, receiving net cash proceeds of \$7.9 million. Austroflex is an Austrian-based manufacturer of pre-insulated flexible pipe systems for district heating, solar applications and under-floor radiant heating systems. Austroflex did not meet performance expectations since its purchase in 2010. The loss after tax on disposal of the business was approximately \$2.2 million. Further, during the year ended December 31, 2011, the Company wrote down Austroflex's long-lived

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assets by \$14.8 million. The Company will not have a substantial continuing involvement in Austroflex's operations and cash flows, therefore Austroflex's results of operations have been presented as discontinued operations and all comparative periods presented have been adjusted in the consolidated financial statements to reflect Austroflex's results as discontinued operations. Please see Note 3 of the Notes to Consolidated Financial Statements for additional information regarding operating results of Austroflex.

On December 21, 2012, we disposed of the outstanding shares of Flomatic Corporation (Flomatic), to a third party in an all cash transaction. Flomatic was acquired as part of the Danfoss Socla S.A.S. (Socla) acquisition in April 2011. Flomatic specializes in manufacturing various valves for the well water industry, a product line not core to our business. The operating results of Flomatic have been classified in discontinued operations for 2012 and 2011. A net loss on disposal of approximately \$3.8 million was charged to discontinued operations in 2012.

On January 31, 2012, we completed the acquisition of tekmar Control Systems (tekmar) in a share purchase transaction. A designer and manufacturer of control systems used in heating, ventilation, and air conditioning applications; tekmar is expected to enhance our hydronic systems product offerings in the U.S. and Canada. The initial purchase price paid was CAD \$18.0 million, with an earn-out based on future earnings levels being achieved. The initial purchase price paid was equal to approximately \$17.8 million based on the exchange rate of Canadian dollar to U.S. dollars as of January 31, 2012. In 2012, a contingent liability of \$5.1 million was recognized as the estimate of the acquisition date fair value of the earn-out. A portion of the contingent consideration was paid out during 2013, in the amount of \$1.2 million, based on performance metrics achieved in 2012. The contingent liability was increased by \$1.0 million during the year ended 2013 based on performance metrics achieved or expected to be achieved. The total purchase price will not exceed CAD \$26.2 million.

### Recent Developments

On January 9, 2014, David J. Coghlan resigned from his positions as Chief Executive Officer, President and Director of the Company and our Board of Directors appointed Dean P. Freeman, our Executive Vice President and Chief Financial Officer, to serve as interim Chief Executive Officer and President of the Company. The Company's Board of Directors has initiated a search for the Company's next Chief Executive Officer and President

On February 18, 2014, we declared a quarterly dividend of thirteen cents (\$0.13) per share on each outstanding share of Class A common stock and Class B common stock.

On February 18, 2014, we entered into a new Credit Agreement (the "New Credit Agreement") among the Company, certain of our subsidiaries who become borrowers under the New 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 New 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 New Credit Agreement. The New Credit Agreement has a sublimit of up to \$100 million in letters of credit. We expect to use any borrowings under the New Credit Agreement for general corporate purposes, acquisitions and the repayment of existing debt.

In connection with the execution and delivery of the New Credit Agreement, all outstanding amounts owing under our prior Credit Agreement (the "Prior Credit Agreement"), dated as of June 18, 2010, among the Company, certain subsidiaries of the Company as borrowers, Bank of America, N.A., as Administrative Agent, Swing Line Lender and Letter of Credit Issuer, and the other lenders referred to therein, were repaid in full and the Prior Credit Agreement was terminated.

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## Results of Operations

### Year Ended December 31, 2013 Compared to Year Ended December 31, 2012

*Net Sales.* Our business is reported in three geographic segments: Americas, EMEA and Asia Pacific. Our net sales in each of these segments for the years ended December 31, 2013 and 2012 were as follows:

|                       | Year Ended<br>December 31, 2013 |               | Year Ended<br>December 31, 2012 |               | Change         | % Change<br>to<br>Consolidated<br>Net Sales |
|-----------------------|---------------------------------|---------------|---------------------------------|---------------|----------------|---|
|                       | Net Sales                       | % Sales       | Net Sales                       | % Sales       |                |   |
| (Dollars in millions) |                                 |               |                                 |               |                |   |
| Americas              | \$ 878.5                        | 59.6%         | \$ 835.0                        | 58.5%         | \$ 43.5        | 3.0%  |
| EMEA                  | 562.2                           | 38.2          | 565.6                           | 39.6          | (3.4)          | (0.2)                                       |
| Asia Pacific          | 32.8                            | 2.2           | 26.8                            | 1.9           | 6.0            | 0.4   |
| <b>Total</b>          | <b>\$ 1,473.5</b>               | <b>100.0%</b> | <b>\$ 1,427.4</b>               | <b>100.0%</b> | <b>\$ 46.1</b> | <b>3.2%</b>                                 |

The change in net sales was attributable to the following:

|                       | Change as a %<br>of Consolidated Net Sales |                 |                 |                | Change as a %<br>of Segment Net Sales |               |                 |             |             |               |              |
|-----------------------|--|-----------------|-----------------|----------------|---------------------------------------|---------------|-----------------|-------------|-------------|---------------|--------------|
|                       | Americas                                   | EMEA            | Asia<br>Pacific | Total          | Americas                              | EMEA          | Asia<br>Pacific | Total       |             |               |              |
| (Dollars in millions) |  |                 |                 |                |                                       |               |                 |             |             |               |              |
| Organic               | \$ 45.6                                    | \$ (20.5)       | \$ 5.5          | \$ 30.6        | 3.1%                                  | (1.4)%        | 0.4%            | 2.1%        | 5.4%        | (3.6)%        | 20.5%        |
| Foreign<br>exchange   | (2.8)                                      | 17.1            | 0.5             | 14.8           | (0.2)                                 | 1.2           |                 | 1.0         | (0.3)       | 3.0           | 1.9          |
| Acquisitions          | 0.7  |                 |                 | 0.7            | 0.1                                   |               |                 | 0.1         | 0.1         |               |              |
| <b>Total</b>          | <b>\$ 43.5</b>                             | <b>\$ (3.4)</b> | <b>\$ 6.0</b>   | <b>\$ 46.1</b> | <b>3.0%</b>                           | <b>(0.2)%</b> | <b>0.4%</b>     | <b>3.2%</b> | <b>5.2%</b> | <b>(0.6)%</b> | <b>22.4%</b> |

Organic net sales in 2013 in the Americas wholesale market increased by \$37.0 million, or 6.3%, compared to 2012 mainly from increased sales in residential and commercial flow product lines and from our customers continuing to transition to lead free products. Organic sales into the Americas DIY market in 2013 increased \$4.8 million, or 2.7%, compared to 2012, primarily due to increased product sales of \$1.9 million in residential and commercial flow control products and \$1.2 million in water quality products. Unit sales increases were substantially offset by competitive pricing in the DIY market.

Organic net sales in the EMEA wholesale market decreased by \$10.7 million, or 3.7%, compared to 2012 primarily due to the economic market conditions in France and Germany. Organic net sales into the EMEA OEM market decreased by \$6.0 million, or 2.3%, as compared to 2012 primarily due to a slower HVAC market in Germany and fewer large project sales in the drains business, offset by increased sales in the electronics business.

The net increase in sales due to foreign exchange was primarily due to the appreciation of the euro against the U.S. dollar. We cannot predict whether these currencies will appreciate or depreciate against the U.S. dollar in future periods or whether future foreign exchange rate fluctuations will have a positive or negative impact on our net sales.

Acquired net sales growth in Americas was due to tekmar.





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*Gross Profit.* Gross profit and gross profit as a percent of net sales (gross margin) for 2013 and 2012 were as follows:

|              | Year Ended<br>December 31, |          |
|--------------|----------------------------|----------|
|              | 2013                       | 2012     |
|              | (Dollars in millions)      |          |
| Gross profit | \$ 526.5                   | \$ 513.5 |
| Gross margin | 35.7%                      | 36.0%    |

In Americas, gross margin decreased primarily due to inefficiencies related to our lead free transition program and retail pricing pressure offset partially by product mix and volume growth. EMEA gross margin increased slightly as compared to 2012, primarily due to production efficiencies driven from ongoing restructuring programs offsetting lower overhead absorption related to reduced manufacturing volumes.

*Selling, General and Administrative Expenses.* Selling, general and administrative expenses, or SG&A expenses, for 2013 increased \$24.7 million, or 6.5%, compared to 2012. The increase in SG&A expenses was attributable to the following:

|                  | (in millions) | % Change |
|------------------|---------------|----------|
| Organic          | \$ 20.8       | 5.5%     |
| Foreign exchange | 3.6           | 0.9      |
| Acquisitions     | 0.3           | 0.1      |
| <br>Total        | <br>\$ 24.7   | <br>6.5% |

The net organic increase in SG&A is primarily attributable to increased legal costs of \$12.5 million, increased product liability cost of \$4.5 million, increased freight and commission costs of \$4.1 million associated with increased sales, and increased personnel costs of \$2.2 million, offset by lower depreciation and amortization of \$1.6 million and lower advertising costs of \$1.3 million. Incremental legal costs include the impact of an agreement in principle to settle all claims in the *Trabakoolas et al., v. Watts Water Technologies, Inc., et al.*, matter pending in the United States District Court for the Northern District of California. The net settlement charged to operations amounted to \$13.6 million in 2013. Refer to Note 14 of the Notes to Consolidated Financial Statements in this Annual Report on Form 10-K for more detail. Increased product liability cost of \$4.5 million in the Americas is based on a third-party actuarial analysis that incorporated higher reported claims in 2013 offset to some extent by the impact of the *Trabakoolas* settlement. Increased personnel costs primarily relate to investments in new positions and increased stock incentive plan costs.

The increase in SG&A expenses from foreign exchange was primarily due to the appreciation of the Euro against the U.S. dollar. Acquired SG&A expenses related to the *tekmar* acquisition. Total SG&A expense, as a percentage of sales, was 27.5% in 2013 and 26.7% in 2012.

*Restructuring and Other Charges.* In 2013, we recorded a net charge of \$8.7 million primarily for severance and other costs incurred as part of our previously announced restructuring programs, as compared to \$4.2 million for 2012. For a more detailed description of our current restructuring plans, see Note 4 of Notes to Consolidated Financial Statements in this Annual Report on Form 10-K.

*(Gain On) Adjustment to Disposal of Business.* In 2011, we booked a net gain of approximately \$7.7 million relating primarily to the recognition of currency translation adjustments resulting from the sale of TWVC. In 2012 and 2013, we recorded adjustments to decrease the gain on disposal by \$1.6 million and increase the gain on disposal by \$0.6 million, respectively.

*Goodwill and Other Long-Lived Asset Impairment Charges.* In 2013, we recorded asset impairment charges of \$1.2 million, primarily relating to a \$0.3 million goodwill impairment charge for BRAE, and

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trade name impairment charges of \$0.3 million and \$0.4 million for the Americas and EMEA, respectively. The goodwill impairment was based on historical results being below our expectations and a reduction in the expected future cash flows to be generated by BRAE. See the results of operations discussion for the year ended December 31, 2012 compared to the year ended December 31, 2011, for details of the 2012 goodwill and other long-lived asset impairment charges. See also Note 2 of Notes to Consolidated Financial Statements in this Annual Report on Form 10-K, for additional information regarding these impairments.

*Operating Income.* Operating income by geographic segment for 2013 and 2012 was as follows:

|                       | Year Ended        |                   | Change           | % Change to Consolidated Operating Income |
|-----------------------|-------------------|-------------------|------------------|---|
|                       | December 31, 2013 | December 31, 2012 |                  |   |
| (Dollars in millions) |                   |                   |                  |   |
| Americas              | \$ 90.4           | \$ 96.5           | \$ (6.1)         | (4.9)%                                    |
| EMEA                  | 46.9              | 52.5              | (5.6)            | (4.6)                                     |
| Asia Pacific          | 9.7               | 6.5               | 3.2              | 2.6                                       |
| Corporate             | (35.5)            | (32.2)            | (3.3)            | (2.7)                                     |
| <b>Total</b>          | <b>\$ 111.5</b>   | <b>\$ 123.3</b>   | <b>\$ (11.8)</b> | <b>(9.6)%</b>                             |

The change in operating income was attributable to the following:

|   | Change as a % of Consolidated Operating Income |                 |                    |                 |                  | Change as a % of Segment Operating Income |               |                    |               |               |               |                |                    |              |
|---|--|-----------------|--------------------|-----------------|------------------|---|---------------|--------------------|---------------|---------------|---------------|----------------|--------------------|--------------|
|   | Americas                                       |                 | Asia Pacific Corp. |                 | Total            | Americas                                  |               | Asia Pacific Corp. |               | Total         | Americas      |                | Asia Pacific Corp. |              |
| (Dollars in millions)                       |  |                 |                    |                 |                  |   |               |                    |               |               |               |                |                    |              |
| Organic                                     | \$ (7.3)                                       | \$ (2.4)        | \$ 0.9             | \$ (3.3)        | \$ (12.1)        | (5.9)%                                    | (2.0)%        | 0.7%               | (2.7)%        | (9.9)%        | (7.5)%        | (4.6)%         | 13.9%              | 10.2%        |
| Foreign exchange                            | (0.6)  | 1.8             | 0.1                | 1.3             | (0.5)            | 1.5                                       | 0.1           | 1.1                | (0.6)         | 3.4           | 1.5           |                |                    |              |
| Acquisitions                                | 0.1  |                 |                    | 0.1             | 0.1              |   |               | 0.1                | 0.1           |               |               |                |                    |              |
| Restructuring, impairment charges and other | 1.7  | (5.0)           | 2.2                | (1.1)           | 1.4              | (4.1)                                     | 1.8           | (0.9)              | 1.7           | (9.5)         | 33.8          |                |                    |              |
| <b>Total</b>                                | <b>\$ (6.1)</b>                                | <b>\$ (5.6)</b> | <b>\$ 3.2</b>      | <b>\$ (3.3)</b> | <b>\$ (11.8)</b> | <b>(4.9)%</b>                             | <b>(4.6)%</b> | <b>2.6%</b>        | <b>(2.7)%</b> | <b>(9.6)%</b> | <b>(6.3)%</b> | <b>(10.7)%</b> | <b>49.2%</b>       | <b>10.2%</b> |

The decrease in consolidated organic operating income was due primarily to an increase in SG&A expenses, as previously discussed. Acquired operating income relates to the tekmar acquisition.

The increase in restructuring, impairment charges and other from 2013 to 2012 is primarily driven by the EMEA restructuring programs, as previously discussed.

The net increase in operating income from foreign exchange was primarily due to the appreciation of the euro against the U.S. dollar. We cannot predict whether the euro will appreciate or depreciate against the U.S. dollar in future periods or whether future foreign exchange rate fluctuations will have a positive or negative impact on our operating income.

*Interest Expense.* Interest expense decreased \$3.1 million, or 12.6%, in 2013 compared to 2012, primarily due to the retirement in mid-May 2013 of \$75 million in unsecured senior notes and to a lower balance outstanding on our stand-by letters of credit. See Note 10 of Notes to Consolidated Financial Statements in this Annual Report on Form 10-K, for additional information regarding financing arrangements.

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*Other Expense (Income), Net.* Other expense (income), net increased \$3.6 million in 2013 compared to 2012, primarily due to a foreign currency transaction losses in the Americas, EMEA and Asia Pacific as a result of the appreciation of the Chinese yuan and the euro against the U.S. dollar and appreciation of the U.S. dollar against the Canadian dollar in 2013. In addition, a favorable customs settlement recorded in 2012 did not repeat in 2013.





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Organic net sales in 2012 into the Americas wholesale market increased by \$4.0 million, or 0.6%, compared to 2011. Minimal increases were noted in our four major product categories ranging from 0.2% in water quality products to 2.0% in HVAC and gas products. Organic sales into the Americas DIY market in 2012 increased \$11.2 million, or 6.9%, compared to 2011, primarily due to increased product sales of \$8.5 million in residential and commercial flow control products and \$2.1 million in water quality products.

Organic net sales in the EMEA wholesale market were essentially flat compared to 2011. Wholesale sales increased \$5.7 million due to stronger plumbing and valves sales into the Middle East and Eastern Europe, and increased drain sales on a pan European basis by \$1.0 million. However, those gains were offset by wholesale sales reductions of \$3.5 million in Italy and \$2.1 million in France, both due to a poor overall economy, and a reduction of pre-insulated pipe products sales of \$2.1 million. Organic sales into the OEM market in 2012 decreased by \$6.0 million compared to 2011. The decline was primarily due to decreased sales in the Nordic region of \$6.2 million from lower demands by heating pump and electrical heating manufacturers, lower sales in France and Italy of \$3.5 million and \$1.4 million, respectively, due to the economic slowdown. Declines were offset by increased sales of \$8.4 million related to our drains product line.

The net decrease in sales due to foreign exchange was primarily due to the depreciation of the Euro and the Canadian dollar against the U.S. dollar. We cannot predict whether these currencies will appreciate or depreciate against the U.S. dollar in future periods or whether future foreign exchange rate fluctuations will have a positive or negative impact on our net sales.

Acquired net sales in EMEA and Asia Pacific related to the Socla acquisition and in the Americas were due to tekmar.

*Gross Profit.* Gross profit and gross profit as a percent of net sales (gross margin) for 2012 and 2011 were as follows:

|              | <b>Year Ended<br/>December 31,</b> |             |
|--------------|------------------------------------|-------------|
|              | <b>2012</b>                        | <b>2011</b> |
|              | <b>(Dollars in millions)</b>       |             |
| Gross profit | \$ 513.5                           | \$ 508.4    |
| Gross margin | 36.0%                              | 36.1%       |

Consolidated gross margin was fairly stable in 2012 compared to 2011, but varied by geography. In Americas, gross margin declined due to non-commodity cost increases as well as manufacturing inefficiencies driven by pre-production costs and outsourcing costs caused by certain U.S. plants transitioning to lead free production. Americas gross margin was also affected by product mix as DIY sales grew faster than wholesale sales and there were selective price concessions to meet market competition. Americas gross margin increased during the second half of 2012 as lead free related costs abated. EMEA gross margin increased as compared to 2011, partially due to acquisition accounting charges of \$4.7 million made in 2011 in connection with the Socla acquisition and partially due to better product mix and improved pricing in 2012.

*Selling, General and Administrative Expenses.* Selling, general and administrative expenses, or SG&A expenses, for 2012 increased \$9.5 million, or 2.6%, compared to 2011. The increase in SG&A expenses was attributable to the following:

|                  | <b>(in millions)</b> | <b>% Change</b> |
|------------------|----------------------|-----------------|
| Organic          | \$ 3.3               | 0.9%            |
| Foreign exchange | (10.1)               | (2.7)           |
| Acquisitions     | 16.3                 | 4.4             |
| <b>Total</b>     | <b>\$ 9.5</b>        | <b>2.6%</b>     |

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The net organic increase in SG&A is primarily attributable to increases in professional services of \$6.4 million, insurance costs of \$4.4 million and variable selling and sales related costs of \$2.8 million, offset by lower personnel related costs of \$7.7 million, lower depreciation and amortization of \$0.9 million, and a \$1.7 million reduction in other expenses. Professional service costs increased due to higher legal fees and legal settlement costs, and IT and tax related projects undertaken in 2012. Insurance costs increased due to higher product liability charges in the Americas. Personnel costs were reduced in 2012 primarily due to the separation costs incurred in 2011 for the former Chief Executive Officer and lower retirement costs in 2012 related to the 2011 pension freeze.

The decrease in SG&A expenses from foreign exchange was primarily due to the depreciation of the euro against the U.S. dollar. Acquired SG&A expenses related to the Socla and tekmar acquisitions. Total SG&A expense, as a percentage of sales, was 26.7% in 2012 and 26.4% in 2011.

*Restructuring and Other Charges.* In 2012, we recorded a net charge of \$4.2 million primarily for severance and other costs incurred as part of our previously announced restructuring programs, as compared to \$8.8 million for 2011. For a more detailed description of our current restructuring plans, see Note 4 of Notes to Consolidated Financial Statements in this Annual Report on Form 10-K.

*Goodwill and Other Long-Lived Asset Impairment Charges.* In 2012, we recorded asset impairment charges of \$3.4 million, including \$1.7 million for impairment charges on long-lived assets in the Americas that were ultimately sold during 2012, a \$1.0 million goodwill impairment charge for BRAE, a \$0.4 million impairment charge for an Americas trade name and \$0.3 million for asset write-downs in Europe. The goodwill impairment was based on historical results being below our expectations and a reduction in the expected future cash flows to be generated by BRAE. See Note 2 of Notes to Consolidated Financial Statements in this Annual Report on Form 10-K, for additional information regarding these impairments.

*(Gain On) Adjustment to Disposal of Business.* In 2011, we booked a net gain of approximately \$7.7 million relating primarily to the recognition of currency translation adjustments resulting from the sale of TWVC. In 2012, we recorded an adjustment of \$1.6 million to decrease the gain.

*Operating Income.* Operating income by geographic segment for 2012 and 2011 was as follows:

|                       | Year Ended        |                   | Change           | % Change to Consolidated Operating Income |
|-----------------------|-------------------|-------------------|------------------|---|
|                       | December 31, 2012 | December 31, 2011 |                  |   |
| (Dollars in millions) |                   |                   |                  |   |
| Americas              | \$ 96.5           | \$ 111.6          | \$ (15.1)        | (11.3)%                                   |
| EMEA                  | 52.5              | 45.5              | 7.0              | 5.2                                       |
| Asia Pacific          | 6.5               | 12.2              | (5.7)            | (4.2)                                     |
| Corporate             | (32.2)            | (35.8)            | 3.6              | 2.7                                       |
| <b>Total</b>          | <b>\$ 123.3</b>   | <b>\$ 133.5</b>   | <b>\$ (10.2)</b> | <b>(7.6)%</b>                             |

The change in operating income was attributable to the following:

|   | Asia      |        |         |        | Change as a % of Consolidated Operating Income |         |         |       | Change as a % of Segment Operating Income |        |         |       |        |         |
|---|-----------|--------|---------|--------|--|---------|---------|-------|---|--------|---------|-------|--------|---------|
|   | Americas  | EMEA   | Pacific | Corp.  | Americas                                       | EMEA    | Pacific | Corp. | Americas                                  | EMEA   | Pacific | Corp. |        |         |
| (Dollars in millions)                       |           |        |         |        |  |         |         |       |   |        |         |       |        |         |
| Organic                                     | \$ (14.4) | \$ 2.6 | \$ 3.4  | \$ 3.6 | \$ (4.8)                                       | (10.8)% | 2.0%    | 2.5%  | 2.7%                                      | (3.6)% | (12.9)% | 5.7%  | 27.9%  | (10.1)% |
| Foreign exchange                            | (0.2)     | (4.4)  | 0.1     |        | (4.5)  | (0.2)   | (3.3)   | 0.1   |   | (3.4)  | (0.2)   | (9.6) | 0.8    |         |
| Acquisitions                                | 1.5       | 3.5    |         |        | 5.0  | 1.2     | 2.6     |       |   | 3.8    | 1.3     | 7.7   |        |         |
| Restructuring, impairment charges and other | (2.0)     | 5.3    | (9.2)   |        | (5.9)  | (1.5)   | 3.9     | (6.8) |   | (4.4)  | (1.7)   | 11.6  | (75.4) |         |



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|       |           |        |          |        |           |         |      |        |      |        |         |       |         |         |
|-------|-----------|--------|----------|--------|-----------|---------|------|--------|------|--------|---------|-------|---------|---------|
| Total | \$ (15.1) | \$ 7.0 | \$ (5.7) | \$ 3.6 | \$ (10.2) | (11.3)% | 5.2% | (4.2)% | 2.7% | (7.6)% | (13.5)% | 15.4% | (46.7)% | (10.1)% |
|-------|-----------|--------|----------|--------|-----------|---------|------|--------|------|--------|---------|-------|---------|---------|

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The decrease in consolidated organic operating income was due primarily to a reduction in gross margin in Americas, for reasons previously discussed. Their impact was offset partially by a reduction in acquisition costs in EMEA related to the 2011 Socla acquisition. Acquired operating income relates to the Socla and tekmar acquisitions.

The increase in restructuring, impairment charges and other from 2011 to 2012 is primarily driven by the gain on disposal of business recorded in 2011 which did not repeat in 2012, as previously discussed, offset primarily by decreased restructuring costs.

The net decrease in operating income from foreign exchange was primarily due to the depreciation of the euro against the U.S. dollar. We cannot predict whether the euro will appreciate or depreciate against the U.S. dollar in future periods or whether future foreign exchange rate fluctuations will have a positive or negative impact on our operating income.

*Interest Expense.* Interest expense decreased \$1.2 million, or 4.7%, in 2012 compared to 2011, primarily due to a decrease in the amounts outstanding under our revolving credit facility that was used to partially finance the Socla acquisition in 2011. See Note 10 of Notes to Consolidated Financial Statements in this Annual Report on Form 10-K, for additional information regarding financing arrangements.

*Other Expense (Income), Net.* Other expense (income), net decreased \$1.6 million in 2012 compared to 2011, primarily due to a reduction in foreign currency transaction losses and a favorable customs settlement in Asia Pacific in 2012.

*Income Taxes.* Our effective rate for continuing operations increased to 29.7% in 2012 from 28.5% in 2011. The primary cause of the lower rate in 2011 was the tax benefit realized in connection with the disposition of our TWVC facility in China. This was partially offset by the release of a tax reserve in 2012 following the completion of a European tax audit.

*Net Income From Continuing Operations.* Net income from continuing operations for 2012 was \$70.4 million, or \$1.95 per common share, compared to \$77.2 million, or \$2.06 per common share, for 2011. Results for 2012 include net after-tax charges of \$8.1 million, or \$0.22 per common share, including restructuring and other net charges of \$0.07, goodwill and other long-lived asset impairments of \$0.07, a charge to adjust the TWVC gain of \$0.04, retention costs for our former Chief Financial Officer of \$0.03, net legal/customs settlement charges of \$0.02, and other net credits of \$0.01, primarily related to a favorable tax adjustment due to a change in 2012 in Italian tax rules.

Results for 2011 include net after-tax charges of \$5.7 million or \$0.16 per common share, including restructuring and other charge of \$0.18, acquisition and due diligence costs of \$0.12, a charge related to our former Chief Executive Officer's separation agreement of \$0.11, goodwill and asset impairment charges of \$0.05, a pension curtailment loss of \$0.02, offset by a gain on the disposal of TWVC of \$0.30 and other net gains of \$0.02 primarily related to earnout and legal adjustments.

The depreciation of the euro and Canadian dollar against the U.S. dollar in 2012 resulted in a negative impact on our operations of \$0.09 per common share compared to 2011. We cannot predict whether the euro, Canadian dollar or Chinese yuan will appreciate or depreciate against the U.S. dollar in future periods or whether future foreign exchange rate fluctuations will have a positive or negative impact on our net income.

*Loss From Discontinued Operations.* Loss from discontinued operations in 2012 of \$2.0 million, or (\$0.05) per common share, was related to the operations and disposal of Flomatic and Austroflex. Loss from discontinued operations in 2011 of \$10.8 million, or (\$0.28) per common share, was primarily related to the operating loss of Austroflex. See Note 3 of Notes to Consolidated Financial Statements.

*Liquidity and Capital Resources*

*2013 Cash Flows*

In 2013, we generated \$118.3 million of cash from operating activities as compared to \$130.3 million in 2012. The decrease was primarily due to lower net income and cash used to fund a lead free inventory increase in the Americas. We generated approximately \$92.1 million of free cash flow (a non-GAAP financial measure, which we reconcile below, defined as net cash provided by continuing operating activities minus capital expenditures plus proceeds from sale of assets), compared to free cash flow of \$103.0 million in 2012. Free cash flow as a percentage of net income from continuing operations was 151.2% in 2013 as compared to 146.3% in 2012.

In 2013, we used \$24.1 million of net cash for investing activities, including \$27.7 million of cash for capital equipment, offset partially by the proceeds from the sale of buildings and equipment of \$1.5 million. We anticipate investing approximately \$27.0 million in capital equipment in 2014 to improve our manufacturing capabilities.

In 2013, we used \$109.5 million of net cash from financing activities. Our most significant cash outlays included the repayment of the \$75.0 million of unsecured senior notes that matured on May 15, 2013, payments to repurchase approximately 454,000 shares of Class A common stock at a cost of approximately \$23.0 million and payment of dividends of \$17.7 million, offset by proceeds of \$11.9 million from option exercises under the employee stock plans.

On June 18, 2010, we entered into a credit agreement (the Prior Credit Agreement) among the Company, certain subsidiaries of the Company who become borrowers under the Prior Credit Agreement, Bank of America, N.A., as Administrative Agent, swing line lender and letter of credit issuer, and the other lenders referred to therein. The Prior Credit Agreement provided for a \$300.0 million, five-year, senior unsecured revolving credit facility which could have been increased by an additional \$150.0 million under certain circumstances and subject to the terms of the Prior Credit Agreement. The Prior Credit Agreement had a sublimit of up to \$75.0 million in letters of credit.

Borrowings outstanding under the Prior Credit Agreement bore interest at a fluctuating rate per annum equal to (1) in the case of Eurocurrency rate loans, the British Bankers Association LIBOR rate plus an applicable percentage, ranging from 1.70% to 2.30%, determined by reference to our consolidated leverage ratio plus, in the case of certain lenders, a mandatory cost calculated in accordance with the terms of the Prior Credit Agreement, 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 Bank of America, N.A. as its "prime rate," and (c) the British Bankers Association LIBOR rate plus 1.0%, plus an applicable percentage, ranging from 0.70% to 1.30%, determined by reference to our consolidated leverage ratio. In addition to paying interest under the Prior Credit Agreement, we were also required to pay certain fees in connection with the credit facility, including, but not limited to, a facility fee and letter of credit fees.

On February 18, 2014, we entered into a new Credit Agreement (the New 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 New 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 New Credit Agreement. The New Credit Agreement has a sublimit of up to \$100 million in letters of credit. In connection with our entering into the New Credit Agreement, we terminated the Prior Credit Agreement.

Borrowings outstanding under the New 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 plus, in the case of certain

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lenders, a mandatory cost calculated in accordance with the terms of the New Credit Agreement, 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 New Credit Agreement, we are 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.

The New Credit Agreement matures on February 18, 2019, subject to extension under certain circumstances and subject to the terms of the New Credit Agreement. We may repay loans outstanding under the New Credit Agreement from time to time without premium or penalty, other than customary breakage costs, if any, and subject to the terms of the New Credit Agreement.

As of December 31, 2013, we held \$267.9 million in cash and cash equivalents. Our ability to fund operations from cash and cash equivalents could be limited by market liquidity as well as possible tax implications of moving proceeds across jurisdictions. Of this amount, approximately \$214.4 million of cash and cash equivalents were held by foreign subsidiaries. Our U.S. operations currently generate sufficient cash flows to meet our domestic obligations. We also have the ability to borrow funds at reasonable interest rates and utilize the committed funds under our New Credit Agreement. However, if amounts held by foreign subsidiaries were needed to fund operations in the United States, we could be required to accrue and pay taxes to repatriate these funds. Such charges may include a federal tax of up to 35.0% on dividends received in the U.S., potential state income taxes and an additional withholding tax payable to foreign jurisdictions of up to 10.0%. However, our intent is to permanently reinvest undistributed earnings of foreign subsidiaries and we do not have any current plans to repatriate them to fund operations in the United States.

### *Covenant compliance*

Under the Prior Credit Agreement, we were required to satisfy and maintain specified financial ratios and other financial condition tests as of December 31, 2013. The financial ratios included a consolidated interest coverage ratio based on consolidated earnings before income taxes, interest expense, depreciation, and amortization (Consolidated EBITDA) to consolidated interest expense, as defined in the Prior Credit Agreement. Our Prior Credit Agreement defined Consolidated EBITDA to exclude unusual or non-recurring charges and gains. We were also required to maintain a consolidated leverage ratio of consolidated funded debt to Consolidated EBITDA. Consolidated funded debt, as defined in the Credit Agreement, included all long and short-term debt, capital lease obligations and any trade letters of credit that are outstanding. Finally, we were required to maintain a consolidated net worth that exceeds a minimum net worth calculation. Consolidated net worth was defined as the total stockholders' equity as reported adjusted for any cumulative translation adjustments and goodwill impairments.

As of December 31, 2013, our actual financial ratios calculated in accordance with our Prior Credit Agreement compared to the required levels under the Prior Credit Agreement were as follows:

|                                | <b>Actual Ratio</b> | <b>Required Level</b>         |
|--------------------------------|---------------------|-------------------------------|
|                                |                     | Minimum level                 |
| Interest Charge Coverage Ratio | 7.43 to 1.00        | 3.50 to 1.00<br>Maximum level |
| Leverage Ratio                 | 0.62 to 1.00        | 3.25 to 1.00<br>Minimum level |
| Consolidated Net Worth         | \$986.1 million     | \$812.5 million               |

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As of December 31, 2013, we were in compliance with all covenants related to the Prior Credit Agreement and had \$276.4 million of unused and available credit under the Prior Credit Agreement and \$23.6 million of stand-by letters of credit outstanding under the Prior Credit Agreement. There were no borrowings outstanding under the Prior Credit Agreement at December 31, 2013.

The New Credit Agreement retains the interest charge coverage ratio and leverage ratio financial covenants, but the consolidated net worth covenant has been eliminated. The required levels for the interest charge coverage ratio and leverage ratio financial covenants remain consistent with the required levels under the Prior Credit Agreement.

We have several senior note agreements as further detailed in Note 10 of Notes to Consolidated Financial Statements. These senior note agreements require us 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 December 31, 2013, our actual fixed charge coverage ratio calculated in accordance with our senior note agreements compared to the required ratio therein was as follows:

|                             | <b>Actual Ratio</b> | <b>Required Level</b> |
|-----------------------------|---------------------|-----------------------|
|                             |                     | <b>Minimum level</b>  |
| Fixed Charge Coverage Ratio | 4.99 to 1.00        | 2.00 to 1.00          |

In addition to financial ratios, the Prior Credit Agreement, New Credit Agreement and senior note agreements contain affirmative and negative covenants that include limitations on disposition or sale of assets, prohibitions on assuming or incurring any liens on assets with limited exceptions and limitations on making investments other than those permitted by the agreements.

We used \$0.1 million of net cash from operating activities of discontinued operations in 2013 related to Austroflex. We generated \$7.9 million of net cash from investing activities of discontinued operations resulting from proceeds received upon the disposal of Austroflex in August 2013.

Working capital (defined as current assets less current liabilities) as of December 31, 2013 was \$530.2 million compared to \$454.9 million as of December 31, 2012. The increase was primarily due the retirement in mid-May 2013 of \$75.0 million of unsecured senior notes. The ratio of current assets to current liabilities was 2.6 to 1 as of December 31, 2013 compared to 2.2 to 1 as of December 31, 2012, increased primarily by the retirement of the senior notes previously mentioned and also by the buildup of inventory as of December 31, 2013 in preparation for the lead free transition.

### *2012 Cash Flows*

In 2012, we generated \$130.3 million of cash from operating activities as compared to \$126.1 million in 2011. We generated approximately \$103.0 million of free cash flow (a non-GAAP financial measure, which we reconcile below, defined as net cash provided by continuing operating activities minus capital expenditures plus proceeds from sale of assets), compared to free cash flow of \$104.4 million in 2011. Free cash flow as a percentage of net income from continuing operations was 146.3% in 2012 as compared to 135.2% in 2011.

In 2012, we used \$42.9 million of net cash for investing activities, including \$17.5 million for the purchase of tekmar and \$30.5 million of cash for capital equipment, offset partially by the proceeds from the sale of buildings and equipment of \$3.2 million.

In 2012, we used \$80.7 million of net cash from financing activities. Our most significant cash outlays included \$65.8 million for the repurchase of two million shares of Class A common stock and \$16.0 million to fund dividend payments. Repayments of long-term debt related to amounts borrowed under the Prior Credit Agreement in 2012 for operating purposes and repayments related to 2011 borrowings for the purchase of Socla.

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We generated \$3.2 million of net cash from operating activities of discontinued operations in 2012 related to a legal settlement regarding the disposal of a former Chinese subsidiary and from operating activities of discontinued operations related to Austroflex. We generated \$8.3 million of net cash from investing activities of discontinued operations resulting primarily from proceeds received upon the disposal of Flomatic in December 2012.

### 2011 Cash Flows

In 2011, we generated \$126.1 million of cash from operating activities. We generated approximately \$104.4 million of free cash flow (a non-GAAP financial measure, which we reconcile below, defined as net cash provided by continuing operating activities minus capital expenditures plus proceeds from sale of assets). Free cash flow as a percentage of net income from continuing operations was 135.2% in 2011.

In 2011, we used \$188.1 million of net cash from investing activities primarily for the purchase of Socla and for capital equipment.

In 2011, we used \$23.9 million of net cash from financing activities. Borrowings and repayments primarily related to funds borrowed under the Prior Credit Agreement for the purchase of Socla and then partially repaid. Other cash outflows included \$27.2 million used to repurchase one million shares of Class A common stock during 2011 and for \$16.3 million of dividend payments.

### Non-GAAP Financial Measures

We believe free cash flow to be an appropriate supplemental measure of our operating performance because it provides investors with a measure of our ability to generate cash, to repay debt and to fund acquisitions. Other companies may define free cash flow differently. Free cash flow does not represent cash generated from operating activities in accordance with GAAP. Therefore it should not be considered an alternative to net cash provided by operations as an indication of our performance. Free cash flow should also not be considered an alternative to net cash provided by operations as defined by GAAP. The cash conversion rate of free cash flow to net income from continuing operations is also a measure of our performance in cash flow generation.

A reconciliation of net cash provided by continuing operations to free cash flow and calculation of our cash conversion rate is provided below:

|   | Years Ended December 31, |              |              |
|---|--------------------------|--------------|--------------|
|   | 2013                     | 2012         | 2011         |
|   | (in millions)            |              |              |
| Net cash provided by continuing operations  | \$ 118.3                 | \$ 130.3     | \$ 126.1     |
| Less: additions to property, plant, and equipment                                   | (27.7)                   | (30.5)       | (22.5)       |
| Plus: proceeds from the sale of property, plant, and equipment                      | 1.5                      | 3.2          | 0.8          |
| <br>Free cash flow  | <br>\$ 92.1              | <br>\$ 103.0 | <br>\$ 104.4 |
| <br>Net income from continuing operations as reported                               | <br>\$ 60.9              | <br>\$ 70.4  | <br>\$ 77.2  |
| <br>Cash conversion rate of free cash flow to net income from continuing operations | <br>151.2%               | <br>146.3%   | <br>135.2%   |

Our net debt to capitalization ratio, a non-GAAP financial measure used by management, decreased to 3.8% for 2013 from 10.8% for 2012. The decrease in net debt to capitalization ratio is due to a reduction in net debt and incremental net income recorded during the period. Management believes this to be an appropriate supplemental measure because it helps investors understand our ability to meet our financing needs and as a basis to evaluate our financial structure. Our computation may not be comparable to other companies that may define net debt to capitalization differently.



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A reconciliation of long-term debt (including current portion) to net debt and our net debt to capitalization ratio is provided below:

|  | December 31,  |              |
|--|---------------|--------------|
|  | 2013          | 2012         |
|  | (in millions) |              |
| Current portion of long-term debt            | \$ 2.2        | \$ 77.1      |
| Plus: long-term debt, net of current portion | 305.5         | 307.5        |
| Less: cash and cash equivalents              | (267.9)       | (271.3)      |
| <br>Net debt                                 | <br>\$ 39.8   | <br>\$ 113.3 |

A reconciliation of capitalization is provided below:

|                            | December 31,   |                |
|----------------------------|----------------|----------------|
|                            | 2013           | 2012           |
|                            | (in millions)  |                |
| Net debt                   | \$ 39.8        | \$ 113.3       |
| Total stockholders' equity | 1,002.1        | 939.5          |
| <br>Capitalization         | <br>\$ 1,041.9 | <br>\$ 1,052.8 |

|                                  |      |       |
|----------------------------------|------|-------|
| Net debt to capitalization ratio | 3.8% | 10.8% |
|----------------------------------|------|-------|

### Contractual Obligations

Our contractual obligations as of December 31, 2013 are presented in the following table:

| Contractual Obligations                                     | Total        | Payments Due by Period |              |             |                      |
|---|--------------|------------------------|--------------|-------------|----------------------|
|   |              | Less than<br>1 year    | 1-3 years    | 4-5 years   | More than<br>5 years |
|   |              | (in millions)          |              |             |                      |
| Long-term debt obligations, including current maturities(a) | \$ 307.7     | \$ 2.2                 | \$ 228.8     | \$ 1.7      | \$ 75.0              |
| Operating lease obligations                                 | 28.6         | 9.1                    | 9.9          | 3.2         | 6.4                  |
| Capital lease obligations(a)                                | 9.5          | 1.4                    | 2.7          | 2.7         | 2.7                  |
| Pension contributions                                       | 17.2         | 1.2                    | 2.6          | 2.9         | 10.5                 |
| Interest  | 61.6         | 17.9                   | 28.1         | 7.9         | 7.7                  |
| Earnout payments(a)   | 4.4          | 2.2                    | 2.2          |             |                      |
| Other(b)  | 30.2         | 26.3                   | 3.1          | 0.3         | 0.5                  |
| <br>Total   | <br>\$ 459.2 | <br>\$ 60.3            | <br>\$ 277.4 | <br>\$ 18.7 | <br>\$ 102.8         |



- (a) as recognized in the consolidated balance sheet
- (b) the majority relates to commodity and capital commitments at December 31, 2013

We maintain letters of credit that guarantee our performance or payment to third parties in accordance with specified terms and conditions. Amounts outstanding were approximately \$23.6 million as of December 31, 2013 and \$34.8 million as of December 31, 2012, respectively. Our letters of credit are primarily associated with insurance coverage and, to a lesser extent, foreign purchases and generally expire within one year of issuance. These instruments may exist or expire without being drawn down; therefore they do not necessarily represent future cash flow obligations.

### **Off-Balance Sheet Arrangements**

Except for operating lease commitments, we have no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

### **Application of Critical Accounting Policies and Key Estimates**

The preparation of our consolidated financial statements in accordance with U.S. GAAP requires management to make judgments, assumptions and estimates that affect the amounts reported. A critical accounting estimate is an assumption about highly uncertain matters and could have a material effect on the consolidated financial statements if another, also reasonable, amount were used, or, a change in the estimate is reasonably likely from period to period. We base our assumptions on historical experience and on other estimates that we believe are reasonable under the circumstances. Actual results could differ significantly from these estimates. There were no changes in our accounting policies or significant changes in our accounting estimates during 2013. In 2011, we changed the amortization period of pension gains and losses as discussed below under the caption "Pension benefits".

We periodically discuss the development, selection and disclosure of the estimates with our Audit Committee. Management believes the following critical accounting policies reflect its more significant estimates and assumptions.

#### *Revenue recognition*

We recognize revenue when all of the following criteria are met: (1) we have entered into a binding agreement, (2) the product has shipped and title has passed, (3) the sales price to the customer is fixed or is determinable and (4) collectability is reasonably assured. We recognize revenue based upon a determination that all criteria for revenue recognition have been met, which, based on the majority of our shipping terms, is considered to have occurred upon shipment of the finished product. Some shipping terms require the goods to be received by the customer before title passes. In those instances, revenues are not recognized until the customer has received the goods. We record estimated reductions to revenue for customer returns and allowances and for customer programs. Provisions for returns and allowances are made at the time of sale, derived from historical trends and form a portion of the allowance for doubtful accounts. Customer programs, which are primarily annual volume incentive plans, allow customers to earn credit for attaining agreed upon purchase targets from us. We record estimated reductions to revenue, made at the time of sale, for customer programs based on estimated purchase targets.

#### *Allowance for doubtful accounts*

The allowance for doubtful accounts is established to represent our best estimate of the net realizable value of the outstanding accounts receivable. The development of our allowance for doubtful accounts varies by region but in general is based on a review of past due amounts, historical write-off experience, as well as aging trends affecting specific accounts and general operational factors affecting all accounts. In addition, factors are developed in certain regions utilizing historical trends of sales and returns and allowances and cash discount activities to derive a reserve for returns and allowances and cash discounts.

We uniformly consider current economic trends and changes in customer payment terms when evaluating the adequacy of the allowance for doubtful accounts. We also aggressively monitor the creditworthiness of our largest customers, and periodically review customer credit limits to reduce risk. If circumstances relating to specific customers change or unanticipated changes occur in the general business environment, our estimates of the recoverability of receivables could be further adjusted.

*Inventory valuation*

Inventories are stated at the lower of cost or market with costs determined primarily on a first-in first-out basis. We utilize both specific product identification and historical product demand as the basis for determining our excess or obsolete inventory reserve. We identify all inventories that exceed a range of one to four years in sales. This is determined by comparing the current inventory balance against unit sales for the trailing twelve months. New products added to inventory within the past twelve months are excluded from this analysis. A portion of our products contain recoverable materials, therefore the excess and obsolete reserve is established net of any recoverable amounts. Changes in market conditions, lower-than-expected customer demand or changes in technology or features could result in additional obsolete inventory that is not saleable and could require additional inventory reserve provisions.

In certain countries, additional inventory reserves are maintained for potential shrinkage experienced in the manufacturing process. The reserve is established based on the prior year's inventory losses adjusted for any change in the gross inventory balance.

*Goodwill and other intangibles*

We have made numerous acquisitions over the years which included the recognition of a significant amount of goodwill. Goodwill is tested for impairment annually or more frequently if an event or circumstance indicates that an impairment loss may have been incurred. Application of the goodwill impairment test requires judgment, including the identification of reporting units, assignment of assets and liabilities to reporting units, and determination of the fair value of each reporting unit. We estimate the fair value of our reporting units using an income approach based on the present value of estimated future cash flows, and when appropriate, guideline public company and guideline transaction market approaches.

Accounting guidance allows us to review goodwill for impairment utilizing either qualitative or quantitative analyses. We have the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events and circumstances, we determine it is more likely than not that the fair value of a reporting unit is greater than its carrying amount, then performing the two-step (quantitative) impairment test is unnecessary.

We first identify those reporting units that we believe could pass a qualitative assessment to determine whether further impairment testing is necessary. For each reporting unit identified, our qualitative analysis includes:

- 1) A review of the most recent fair value calculation to identify the extent of the cushion between fair value and carrying amount, to determine if a substantial cushion existed.
- 2) A review of events and circumstances that have occurred since the most recent fair value calculation to determine if those events or circumstances would have affected our previous fair value assessment. Items identified and reviewed include macroeconomic conditions, industry and market changes, cost factor changes, events that affect the reporting unit, financial performance against expectations and the reporting unit's performance relative to peers.

We then compile this information and make our assessment of whether it is more likely than not that the fair value of the reporting unit is less than its carrying amount. If we determine it is not more likely than not, then no further quantitative analysis is required. We have eight reporting units in continuing operations, one of which, Water Quality, has no goodwill. In 2013, we performed a qualitative analysis for the Residential and Commercial, Blücher, Drains and Water Re-use, Dormont and Asia Pacific reporting units. As a result of our qualitative analyses, we determined that the fair values of the reporting units were greater than the carrying amounts.

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The second analysis for goodwill impairment involves a quantitative two-step process. In 2013, we performed a quantitative impairment analysis for the EMEA reporting unit and BRAE, including an impairment analysis during the second quarter for the EMEA reporting unit due to results below expectations. The EMEA reporting unit represents the EMEA geographic segment excluding the Blücher reporting unit. The first step of the impairment test requires a comparison of the fair value of each of our reporting units to the respective carrying value. If the carrying value of a reporting unit is less than its fair value, no indication of impairment exists and a second step is not performed. If the carrying amount of a reporting unit is higher than its fair value, there is an indication that impairment may exist and a second step must be performed. In the second step, the impairment is computed by comparing the implied fair value of the reporting unit's goodwill with the carrying amount of the goodwill. If the carrying amount of the reporting unit's goodwill is greater than the implied fair value of its goodwill, an impairment loss must be recognized for the excess and charged to operations.

Inherent in our development of the fair value of the reporting unit are the assumptions and estimates used in the income and market approaches. The discounted cash flow method (income approach) calculates the present value of future cash flows projections based on assumptions and estimates derived from a review of our operating results, business plans, expected growth rates, cost of capital and tax rates. We also make certain assumptions about future economic conditions and other market data. We develop our assumptions based on our historical results including sales growth, operating profits, working capital levels and tax rates. The market approaches calculate estimated fair values based on valuation multiples derived from stock prices and enterprise values of publicly traded companies that are comparable to our Company (guideline public company method) and based on valuation multiples derived from actual transactions for comparable public and private companies (guideline transaction method).

We believe that the discounted cash flow model is sensitive to the selected discount rate and the market approaches are sensitive to valuation multiples used. We use third-party valuation specialists to help develop the appropriate discount rate and valuation multiples. We use standard valuation practices to arrive at a weighted average cost of capital based on the market and guideline public companies. The higher the discount rate, the lower the discounted cash flows. While we believe that our estimate of future cash flows and market approach valuations are reasonable, different assumptions could significantly affect our valuations and result in impairments in the future.

During the fourth quarter of 2013, third quarter of 2012 and the fourth quarter of 2011, we recognized a pre-tax non-cash goodwill impairment charge of \$0.3 million, \$1.0 million and \$1.2 million, respectively, related to our BRAE reporting unit within our Americas segment. As of December 31, 2013, the goodwill for BRAE had been fully impaired. The charges were taken as a result of reduced expectations regarding the reporting unit.

As of our October 27, 2013 testing date, we had approximately \$516.4 million of goodwill on our balance sheet. Our impairment testing indicated that the fair values of the reporting units exceeded the carrying values, thereby resulting in no impairment. The results of the EMEA reporting unit's quantitative impairment analysis are summarized in the table below:

|                       | <b>Goodwill balance at<br/>October 27, 2013</b> | <b>Book value of equity of<br/>reporting unit at<br/>October 27, 2013</b> | <b>Estimated fair value<br/>(implied<br/>value of equity) at<br/>October 27, 2013</b> |
|-----------------------|---|---|---|
|                       | (in millions)                                   |   |   |
| <b>Reporting unit</b> |   |   |   |
| EMEA                  | € 161.6   | € 341.8   | € 400.0   |

The underlying analyses supporting our fair value assessment are related to our comparable companies' historical and projected results, current transaction values and our outlook of our business' long-term performance, which included key assumptions as to the appropriate revenue and EBITDA multiples, discount rate and long-term growth rate. In connection with our October 27, 2013 impairment test, we utilized a discount rate of 10.5%, growth rates beyond our planning periods

ranging from 0% to 5% and long-term terminal growth rate of 3%. Future increases in discount rates due to changing interest rates or a declining economic environment and different market multiples could impact our assumptions and the value of our reporting unit.

Intangible assets such as trademarks and trade names are generally recorded in connection with a business acquisition. Values assigned to intangible assets are determined by an independent valuation firm based on our estimates and judgments regarding expectations of the success and life cycle of products and technology acquired. During 2013, 2012 and 2011, we recognized non-cash pre-tax charges of approximately \$0.7 million, \$0.4 million and \$1.4 million, respectively, as an impairment of certain of our indefinite-lived intangible assets. In addition, during 2011, we recognized non-cash pretax charges of \$13.5 million as an impairment of certain amortizable intangible assets in our EMEA segment. The Company determined that the prospects for Austroflex, part of our EMEA segment, were lower than originally estimated due to current operating profits below forecast and tempered future growth expectations. Accordingly, the Company performed a fair value assessment and, as a result, wrote down the long-lived assets by \$14.8 million, or approximately 78%, including customer relationships of \$12.1 million, trade names of \$1.4 million, and property, plant and equipment of \$1.3 million. Fair value was based on discounted cash flows using market participant assumptions and utilized an estimated weighted average cost of capital. We subsequently completed the sale of Austroflex on August 1, 2013 and Austroflex's results of operations have been presented as discontinued operations for all periods presented.

Revised accounting guidance issued in 2012 allows us to perform a qualitative impairment assessment of indefinite-lived intangible assets consistent with the goodwill guidance noted previously. For our 2013 impairment assessment, we performed quantitative assessments for all indefinite-lived intangible assets. The methodology we employed was the relief from royalty method, a subset of the income approach. That impairment review occurred as of October 27, 2013.

#### *Product liability and workers' compensation costs*

Because of retention requirements associated with our insurance policies, we are generally self-insured for potential product liability claims and for workers' compensation costs associated with workplace accidents. We are subject to a variety of potential liabilities in connection with product liability cases and we maintain product liability and other insurance coverage, which we believe to be generally in accordance with industry practices. For product liability cases in the U.S., management establishes its product liability accrual by utilizing third-party actuarial valuations which incorporates historical trend factors and our specific claims experience derived from loss reports provided by third-party administrators. In other countries, we maintain insurance coverage with relatively high deductible payments, as product liability claims tend to be smaller than those experienced in the U.S. Changes in the nature of claims or the actual settlement amounts could affect the adequacy of this estimate and require changes to the provisions. Because the liability is an estimate, the ultimate liability may be more or less than reported.

Workers' compensation liabilities in the U.S. are recognized for claims incurred (including claims incurred but not reported) and for changes in the status of individual case reserves. At the time a workers' compensation claim is filed, a liability is estimated to settle the claim. The liability for workers' compensation claims is determined based on management's estimates of the nature and severity of the claims and based on analysis provided by third-party administrators and by various state statutes and reserve requirements. We have developed our own trend factors based on our specific claims experience, discounted based on risk-free interest rates. We employ third-party actuarial valuations to help us estimate our workers' compensation accrual. In other countries where workers' compensation costs are applicable, we maintain insurance coverage with limited deductible payments. Because the liability is an estimate, the ultimate liability may be more or less than reported and is subject to changes in discount rates.

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We determine the trend factors for product liability and workers' compensation liabilities based on consultation with outside actuaries.

We maintain excess liability insurance with outside insurance carriers to minimize our risks related to catastrophic claims in excess of all self-insured positions. Any material change in the aforementioned factors could have an adverse impact on our operating results.

### *Legal contingencies*

We are a defendant in numerous legal matters including those involving environmental law and product liability as discussed in more detail in Part I, Item 1. "Business Product Liability, Environmental and Other Litigation Matters." As required by GAAP, we determine whether an estimated loss from a loss contingency should be accrued by assessing whether a loss is deemed probable and the loss amount can be reasonably estimated, net of any applicable insurance proceeds. When it is possible to estimate reasonably possible loss or range of loss above the amount accrued, that estimate is aggregated and disclosed. Estimates of potential outcomes of these contingencies are developed in consultation with outside counsel. While this assessment is based upon all available information, litigation is inherently uncertain and the actual liability to fully resolve litigation cannot be predicted with any assurance of accuracy. In the event of an unfavorable outcome in one or more legal matters, the ultimate liability may be in excess of amounts currently accrued, if any, and may be material to our operating results or cash flows for a particular quarterly or annual period. However, based on information currently known to us, management believes that the ultimate outcome of all legal contingencies, as they are resolved over time, is not likely to have a material adverse effect on our financial condition, though the outcome could be material to our operating results for any particular period depending, in part, upon the operating results for such period.

### *Pension benefits*

We account for our pension plans in accordance with GAAP, which involves recording a liability or asset based on the projected benefit obligation and the fair value of plan assets. Assumptions are made regarding the valuation of benefit obligations and the performance of plan assets. The primary assumptions are as follows:

**Weighted average discount rate** this rate is used to estimate the current value of future benefits. This rate is adjusted based on movement in long-term interest rates.

**Expected long-term rate of return on assets** this rate is used to estimate future growth in investments and investment earnings. The expected return is based upon a combination of historical market performance and anticipated future returns for a portfolio reflecting the mix of equity, debt and other investments indicative of our plan assets.

We determine these assumptions based on consultation with outside actuaries and investment advisors. Any variance in these assumptions could have a significant impact on future recognized pension costs, assets and liabilities.

On October 31, 2011, our Board of Directors voted to cease accruals effective December 31, 2011 under both the Pension Plan and Supplemental Employees Retirement Plan. We recorded a curtailment charge of approximately \$1.5 million in the fourth quarter of 2011 in connection with this action. Effective November 1, 2011, we began amortizing the unamortized gains and losses over the remaining life expectancy of the participants instead of our former policy of average remaining service period.

### *Income taxes*

We estimate and use our expected annual effective income tax rates to accrue income taxes. Effective tax rates are determined based on budgeted earnings before taxes, including our best estimate of permanent items that will affect the effective rate for the year. Management periodically reviews

these rates with outside tax advisors and changes are made if material variances from expectations are identified.

We recognize deferred taxes for the expected future consequences of events that have been reflected in the consolidated financial statements. Deferred tax assets and liabilities are determined based on differences between the book values and tax bases of particular assets and liabilities, using tax rates in effect for the years in which the differences are expected to reverse. A valuation allowance is provided to offset any net deferred tax assets if, based upon the available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized. We consider estimated future taxable income and ongoing prudent tax planning strategies in assessing the need for a valuation allowance.

#### ***New Accounting Standards***

In July 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2013-11, "Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists" which is intended to eliminate the diversity in practice in the presentation of unrecognized tax benefits in those instances. ASU 2013-11 is effective for fiscal years and interim periods beginning after December 15, 2013, with early adoption permitted. The adoption of this guidance is not expected to have a material impact on the Company's financial statements.

In March 2013, the FASB issued ASU No. 2013-05, "Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity." This ASU is intended to eliminate diversity in practice on the release of cumulative translation adjustment into net income when a parent either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest. In addition, the amendments in this ASU resolve the diversity in practice for the treatment of business combinations achieved in stages (sometimes also referred to as step acquisitions) involving a foreign entity. The provisions of this ASU are effective for interim and annual periods beginning after December 15, 2013, with early adoption permitted, and must be applied prospectively. The Company early adopted the ASU in 2013. The adoption of this guidance has not had a material impact on the Company's financial statements.

In February 2013, the FASB issued ASU 2013-02, "Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income" which requires additional disclosures about amounts reclassified out of Other Comprehensive Income (OCI) by component, either on the face of the income statement or as a separate footnote to the financial statements. ASU 2013-02 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2012. The adoption of this guidance has not had a material impact on the Company's financial statements.

#### **Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

We use derivative financial instruments primarily to reduce exposure to adverse fluctuations in foreign exchange rates, interest rates and costs of certain raw materials used in the manufacturing process. We do not enter into derivative financial instruments for trading purposes. As a matter of policy, all derivative positions are used to reduce risk by hedging underlying economic exposure. The derivatives we use are instruments with liquid markets. See Note 15 of Notes to the Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2013.

Our consolidated earnings, which are reported in United States dollars, are subject to translation risks due to changes in foreign currency exchange rates. This risk is concentrated in the exchange rate between the U.S. dollar and the euro; the U.S. dollar and the Canadian dollar; and the U.S. dollar and the Chinese yuan.

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Our foreign subsidiaries transact most business, including certain intercompany transactions, in foreign currencies. Such transactions are principally purchases or sales of materials and are denominated in European currencies or the U.S. or Canadian dollar. We use foreign currency forward exchange contracts to manage the risk related to intercompany purchases that occur during the course of a year and certain open foreign currency denominated commitments to sell products to third parties. For 2013, we recorded a \$0.1 million loss in other income associated with the change in the fair value of such contracts.

We have historically had a low exposure on the cost of our debt to changes in interest rates. Information about our long-term debt including principal amounts and related interest rates appears in Note 10 of Notes to the Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2013.

We purchase significant amounts of bronze ingot, brass rod, cast iron, steel and plastic, which are utilized in manufacturing our many product lines. Our operating results can be adversely affected by changes in commodity prices if we are unable to pass on related price increases to our customers. We manage this risk by monitoring related market prices, working with our suppliers to achieve the maximum level of stability in their costs and related pricing, seeking alternative supply sources when necessary and passing increases in commodity costs to our customers, to the maximum extent possible, when they occur.

### **Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.**

The financial statements listed in section (a) (1) of "Part IV, Item 15. Exhibits and Financial Statement Schedules" of this annual report are incorporated herein by reference.

### **Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.**

None.

### **Item 9A. CONTROLS AND PROCEDURES.**

As required by Rule 13a-15(b) under the Securities Exchange Act of 1934, as amended, or Exchange Act, as of the end of the period covered by this report, we carried out an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures. In designing and evaluating our disclosure controls and procedures, we recognize that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and our management necessarily applies its judgment in evaluating and implementing possible controls and procedures. The effectiveness of our disclosure controls and procedures is also necessarily limited by the staff and other resources available to us and the geographic diversity of our operations. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective, in that they provide reasonable assurance that information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act are accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

There was no change in our internal control over financial reporting that occurred during the quarter ended December 31, 2013, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. In connection with these rules, we will continue to review and document our disclosure controls and procedures, including our internal control over financial reporting, and may from time to time make changes aimed at enhancing their effectiveness and to ensure that our systems evolve with our business.



**Management's Annual Report on Internal Control Over Financial Reporting**

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934. The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. The Company's internal control over financial reporting includes those policies and procedures that:

- (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and
- (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management, including our Chief Executive Officer and Chief Financial Officer, assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2013. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control Integrated Framework (1992).

Based on our assessment and those criteria, management believes that the Company maintained effective internal control over financial reporting as of December 31, 2013.

The independent registered public accounting firm that audited the Company's consolidated financial statements included elsewhere in this Annual Report on Form 10-K has issued an audit report on the Company's internal control over financial reporting. That report appears immediately following this report.

**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders  
Watts Water Technologies, Inc.:

We have audited Watts Water Technologies, Inc.'s internal control over financial reporting as of December 31, 2013, based on criteria established in *Internal Control Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Watts Water Technologies, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying *Management's Annual Report on Internal Control Over Financial Reporting*. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Watts Water Technologies, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on criteria established in *Internal Control Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Watts Water Technologies, Inc. and subsidiaries as of December 31, 2013 and 2012, and the related consolidated statements of operations, comprehensive income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2013, and our report dated February 27, 2014 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Boston, Massachusetts  
February 27, 2014

**Item 9B. OTHER INFORMATION.**

None.

**PART III**

**Item 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.**

Information with respect to the executive officers of the Company is set forth in Part I, Item 1 of this Report under the caption "Executive Officers and Directors" and is incorporated herein by reference. The information provided under the captions "Information as to Nominees for Director," "Corporate Governance," and "Section 16(a) Beneficial Ownership Reporting Compliance" in our definitive Proxy Statement for our 2014 Annual Meeting of Stockholders to be held on May 14, 2014 is incorporated herein by reference.

We have adopted a Code of Business Conduct applicable to all officers, employees and Board members. The Code of Business Conduct is posted in the Investor Relations section of our website, [www.wattswater.com](http://www.wattswater.com). We will provide you with a print copy of our Code of Business Conduct free of charge on written request to Kenneth R. Lepage, Secretary, Watts Water Technologies, Inc., 815 Chestnut Street, North Andover, MA 01845. Any amendments to, or waivers of, the Code of Business Conduct 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.

**Item 11. EXECUTIVE COMPENSATION.**

The information provided under the captions "Director Compensation," "Corporate Governance," "Compensation Discussion and Analysis," "Executive Compensation," "Compensation Committee Interlocks and Insider Participation," and "Compensation Committee Report" in our definitive Proxy Statement for our 2014 Annual Meeting of Stockholders to be held on May 14, 2014 is incorporated herein by reference.

The "Compensation Committee Report" contained in our Proxy Statement shall not be deemed "soliciting material" or "filed" with the Securities and Exchange Commission or otherwise subject to the liabilities of Section 18 of the Securities Exchange Act of 1934, nor shall it be deemed incorporated by reference in any filings under the Securities Act of 1933 or the Exchange Act, except to the extent we specifically request that such information be treated as soliciting material or specifically incorporate such information by reference into a document filed under the Securities Act or Exchange Act.

**Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.**

The information appearing under the caption "Principal Stockholders" in our definitive Proxy Statement for our 2014 Annual Meeting of Stockholders to be held on May 14, 2014 is incorporated herein by reference.

***Securities Authorized for Issuance Under Equity Compensation Plans***

The following table provides information as of December 31, 2013, about the shares of Class A common stock that may be issued upon the exercise of stock options issued under the Company's Second Amended and Restated 2004 Stock Incentive Plan, and the settlement of restricted stock units granted under our Management Stock Purchase Plan as well as the number of shares remaining for

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future issuance under our Second Amended and Restated 2004 Stock Incentive Plan and Management Stock Purchase Plan.

| <b>Equity Compensation Plan Information</b>                |   |   |  |
|--|---|---|--|
| <b>Plan Category</b>                                       | <b>Number of securities to be issued upon exercise of outstanding options, warrants and rights</b><br>(a) | <b>Weighted-average exercise price of outstanding options, warrants and rights</b><br>(b) | <b>Number of securities remaining available for future issuance under equity compensation plan (excluding securities reflected in column (a))</b><br>(c) |
| Equity compensation plans approved by security holders     | 1,171,893(1) \$   | 40.18   | 2,547,429(2)   |
| Equity compensation plans not approved by security holders | None  | None  | None   |
| <b>Total</b>   | <b>1,171,893(1) \$</b>  | <b>40.18</b>  | <b>2,547,429(2)</b>  |

- (1) Represents 1,029,067 outstanding options and 10,956 deferred restricted stock awards under the Second Amended and Restated 2004 Stock Incentive Plan, and 131,870 outstanding restricted stock units under the Management Stock Purchase Plan.
- (2) Includes 1,650,400 shares available for future issuance under the Second Amended and Restated 2004 Stock Incentive Plan, and 897,029 shares available for future issuance under the Management Stock Purchase Plan.

**Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE.**

The information provided under the captions "Corporate Governance" and "Certain Relationships and Related Transactions" in our definitive Proxy Statement for our 2014 Annual Meeting of Stockholders to be held on May 14, 2014 is incorporated herein by reference.

**Item 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.**

The information provided under the caption "Ratification of Independent Registered Public Accounting Firm" in our definitive Proxy Statement for our 2014 Annual Meeting of Stockholders to be held on May 14, 2014 is incorporated herein by reference.

**PART IV**

**Item 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.**

***(a)(1) Financial Statements***

The following financial statements are included in a separate section of this Report commencing on the page numbers specified below:

|   |           |
|---|-----------|
| <u>Report of Independent Registered Public Accounting Firm</u>  | <u>55</u> |
| <u>Consolidated Statements of Operations for the years ended December 31, 2013, 2012 and 2011</u>           | <u>56</u> |
| <u>Consolidated Statements of Comprehensive Income for the years ended December 31, 2013, 2012 and 2011</u> | <u>57</u> |
| <u>Consolidated Balance Sheets as of December 31, 2013 and 2012</u>   | <u>58</u> |
| <u>Consolidated Statements of Stockholders' Equity for the years ended December 31, 2013, 2012 and 2011</u> | <u>59</u> |
| <u>Consolidated Statements of Cash Flows for the years ended December 31, 2013, 2012 and 2011</u>           | <u>60</u> |
| <u>Notes to Consolidated Financial Statements</u>   | <u>61</u> |

***(a)(2) Schedules***

|   |            |
|---|------------|
| <u>Schedule II Valuation and Qualifying Accounts for the years ended December 31, 2013, 2012 and 2011</u> | <u>101</u> |
|---|------------|

All other required schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission are included in the Notes to the Consolidated Financial Statements.

***(a)(3) Exhibits***

The exhibits listed in the Exhibit Index immediately preceding the exhibits are filed as part of this Annual Report on Form 10-K.

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**WATTS WATER TECHNOLOGIES, INC.**

By:                                 /s/ DEAN P. FREEMAN

Dean P. Freeman  
*Chief Executive Officer, President and  
 Chief Financial Officer*

DATED: February 27, 2014

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| <b>Signature</b>   | <b>Title</b>   | <b>Date</b>       |
|--|--|-------------------|
| <u>                                /s/ DEAN P. FREEMAN</u><br>Dean P. Freeman          | Chief Executive Officer, President and Chief Financial Officer (Principal Executive Officer and Principal Financial Officer) | February 27, 2014 |
| <u>                                /s/ KENNETH S. KOROTKIN</u><br>Kenneth S. Korotikin | Chief Accounting Officer<br>(Principal Accounting Officer)   | February 27, 2014 |
| <u>                                /s/ ROBERT L. AYERS</u><br>Robert L. Ayers          | Director   | February 27, 2014 |
| <u>                                /s/ BERNARD BAERT</u><br>Bernard Baert              | Director   | February 27, 2014 |
| <u>                                /s/ KENNETT F. BURNES</u><br>Kennett F. Burnes      | Director   | February 27, 2014 |
| <u>                                /s/ RICHARD J. CATHCART</u><br>Richard J. Cathcart  | Director   | February 27, 2014 |
| <u>                                /s/ W. CRAIG KISSEL</u><br>W. Craig Kissel          | Director   | February 27, 2014 |

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| Signature   | Title                 | Date              |
|---|-----------------------|-------------------|
| <hr/> <b>/s/ JOHN K. MCGILlicuddy</b><br>John K. McGillicuddy | Chairman of the Board | February 27, 2014 |
| <hr/> <b>/s/ JOSEPH T. NOONAN</b><br>Joseph T. Noonan         | Director              | February 27, 2014 |
| <hr/> <b>/s/ MERILEE RAINES</b><br>Merilee Raines             | Director              | February 27, 2014 |

**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders  
Watts Water Technologies, Inc.:

We have audited the accompanying consolidated balance sheets of Watts Water Technologies, Inc. and subsidiaries as of December 31, 2013 and 2012, and the related consolidated statements of operations, comprehensive income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2013. In connection with our audits of the consolidated financial statements, we also have audited the financial statement Schedule II Valuation and Qualifying Accounts. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Watts Water Technologies, Inc. and subsidiaries as of December 31, 2013 and 2012, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2013, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Watts Water Technologies, Inc.'s internal control over financial reporting as of December 31, 2013, based on criteria established in *Internal Control Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 27, 2014 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP

Boston, Massachusetts  
February 27, 2014



## Watts Water Technologies, Inc. and Subsidiaries

## Consolidated Statements of Operations

(Amounts in millions, except per share information)

|  | Years Ended December 31, |            |            |
|--|--------------------------|------------|------------|
|  | 2013                     | 2012       | 2011       |
| Net sales  | \$ 1,473.5               | \$ 1,427.4 | \$ 1,407.4 |
| Cost of goods sold   | 947.0                    | 913.9      | 899.0      |
| <b>GROSS PROFIT</b>  | <b>526.5</b>             | 513.5      | 508.4      |
| Selling, general and administrative expenses                 | 405.7                    | 381.0      | 371.5      |
| Restructuring and other charges, net                         | 8.7                      | 4.2        | 8.8        |
| (Gain on) adjustment to disposal of business                 | (0.6)                    | 1.6        | (7.7)      |
| Goodwill and other long-lived asset impairment charges       | 1.2                      | 3.4        | 2.3        |
| <b>OPERATING INCOME</b>                                      | <b>111.5</b>             | 123.3      | 133.5      |
| Other (income) expense:                                      |                          |            |            |
| Interest income  | (0.6)                    | (0.7)      | (1.0)      |
| Interest expense   | 21.5                     | 24.6       | 25.8       |
| Other expense (income), net                                  | 2.8                      | (0.8)      | 0.8        |
| <b>Total other expense</b>                                   | <b>23.7</b>              | 23.1       | 25.6       |
| <b>INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES</b> | <b>87.8</b>              | 100.2      | 107.9      |
| Provision for income taxes                                   | 26.9                     | 29.8       | 30.7       |
| <b>NET INCOME FROM CONTINUING OPERATIONS</b>                 | <b>60.9</b>              | 70.4       | 77.2       |
| Loss from discontinued operations, net of taxes              | (2.3)                    | (2.0)      | (10.8)     |
| <b>NET INCOME</b>  | <b>\$ 58.6</b>           | \$ 68.4    | \$ 66.4    |
| <b>Basic EPS</b>   |                          |            |            |
| Income (loss) per share:                                     |                          |            |            |
| Continuing operations  | \$ 1.72                  | \$ 1.96    | \$ 2.07    |
| Discontinued operations                                      | (0.06)                   | (0.06)     | (0.29)     |
| <b>NET INCOME</b>  | <b>\$ 1.65</b>           | \$ 1.90    | \$ 1.78    |

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|                                   |             |      |      |
|-----------------------------------|-------------|------|------|
| Weighted average number of shares | <b>35.5</b> | 36.0 | 37.3 |
|-----------------------------------|-------------|------|------|

**Diluted EPS**

Income (loss) per share:

|                         |                |         |         |
|-------------------------|----------------|---------|---------|
| Continuing operations   | \$ <b>1.71</b> | \$ 1.95 | \$ 2.06 |
| Discontinued operations | <b>(0.07)</b>  | (0.05)  | (0.28)  |

|                   |                |         |         |
|-------------------|----------------|---------|---------|
| <b>NET INCOME</b> | <b>\$ 1.65</b> | \$ 1.90 | \$ 1.78 |
|-------------------|----------------|---------|---------|

|                                   |             |      |      |
|-----------------------------------|-------------|------|------|
| Weighted average number of shares | <b>35.6</b> | 36.1 | 37.5 |
|-----------------------------------|-------------|------|------|

|                     |                |         |         |
|---------------------|----------------|---------|---------|
| Dividends per share | \$ <b>0.50</b> | \$ 0.44 | \$ 0.44 |
|---------------------|----------------|---------|---------|

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

## Watts Water Technologies, Inc. and Subsidiaries

## Consolidated Statements of Comprehensive Income

(Amounts in millions)

|  | Years Ended December 31, |         |         |
|--|--------------------------|---------|---------|
|  | 2013                     | 2012    | 2011    |
| Net income   | \$ 58.6                  | \$ 68.4 | \$ 66.4 |
| Other comprehensive income (loss):   |                          |         |         |
| Foreign currency translation adjustments   | 23.5                     | 14.3    | (16.4)  |
| Foreign currency adjustment for sale of foreign entity   |                          |         | (8.6)   |
| Defined benefit pension plans, net of tax:   |                          |         |         |
| Net loss, net of tax benefits of \$0.8, \$4.1, and \$2.7 in 2013, 2012 and 2011, respectively  | (1.3)                    | (6.5)   | (4.2)   |
| Amortization of prior service cost included in net periodic pension cost, net of tax expense of \$0.1 in 2011  |                          |         | 0.2     |
| Amortization of net losses included in net periodic pension cost, net of tax expense of \$0.4, \$0.2, and \$1.0 in 2013, 2012 and 2011, respectively | 0.6                      | 0.4     | 1.7     |
| Reduction in obligation related to pension curtailment, net of tax expense of \$5.4 in 2011  |                          |         | 8.6     |
| Defined benefit pension plans, net of tax  | (0.7)                    | (6.1)   | 6.3     |
| Other comprehensive income (loss)  | 22.8                     | 8.2     | (18.7)  |
| Comprehensive income   | \$ 81.4                  | \$ 76.6 | \$ 47.7 |

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

## Watts Water Technologies, Inc. and Subsidiaries

## Consolidated Balance Sheets

(Amounts in millions, except share information)

|   | December 31,      |                   |
|---|-------------------|-------------------|
|   | 2013              | 2012              |
| <b>ASSETS</b>   |                   |                   |
| CURRENT ASSETS:   |                   |                   |
| Cash and cash equivalents   | \$ 267.9          | \$ 271.3          |
| Short-term investment securities  |                   | 2.1               |
| Trade accounts receivable, less allowance for doubtful accounts of \$9.7 in 2013 and \$9.5 in 2012  | 212.9             | 206.2             |
| Inventories, net  | 310.2             | 288.0             |
| Prepaid expenses and other assets   | 35.0              | 22.5              |
| Deferred income taxes   | 29.8              | 21.5              |
| Assets held for sale  | 1.3               |                   |
| Assets of discontinued operations   |                   | 11.7              |
| <b>Total Current Assets</b>   | <b>857.1</b>      | <b>823.3</b>      |
| PROPERTY, PLANT AND EQUIPMENT, NET  | 219.9             | 221.7             |
| OTHER ASSETS:   |                   |                   |
| Goodwill  | 514.8             | 504.0             |
| Intangible assets, net  | 132.4             | 145.4             |
| Deferred income taxes   | 3.8               | 4.8               |
| Other, net  | 12.2              | 9.8               |
| <b>TOTAL ASSETS</b>   | <b>\$ 1,740.2</b> | <b>\$ 1,709.0</b> |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                   |                   |
| CURRENT LIABILITIES:  |                   |                   |
| Accounts payable  | \$ 145.6          | \$ 131.3          |
| Accrued expenses and other liabilities  | 135.2             | 116.6             |
| Accrued compensation and benefits   | 43.9              | 41.9              |
| Current portion of long-term debt   | 2.2               | 77.1              |
| Liabilities of discontinued operations  |                   | 1.5               |
| <b>Total Current Liabilities</b>  | <b>326.9</b>      | <b>368.4</b>      |
| LONG-TERM DEBT, NET OF CURRENT PORTION  | 305.5             | 307.5             |
| DEFERRED INCOME TAXES   | 45.9              | 44.9              |
| OTHER NONCURRENT LIABILITIES  | 59.8              | 48.7              |
| 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, 28,824,779 shares in 2013 and 28,673,639 shares in 2012 | 2.9               | 2.9               |
| Class B common stock, \$0.10 par value; 25,000,000 shares authorized; 10 votes per share; issued and outstanding, 6,489,290 shares in 2013 and 6,588,680 shares in 2012 | 0.6               | 0.6               |
| Additional paid-in capital  | 473.5             | 448.7             |
| Retained earnings   | 513.1             | 498.1             |

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|   |            |            |
|---|------------|------------|
| Accumulated other comprehensive income (loss) | 12.0       | (10.8)     |
| Total Stockholders' Equity                    | 1,002.1    | 939.5      |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY    | \$ 1,740.2 | \$ 1,709.0 |

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

## Watts Water Technologies, Inc. and Subsidiaries

## Consolidated Statements of Stockholders' Equity

(Amounts in millions, except share information)

|  | Class A<br>Common Stock |               | Class B<br>Common Stock |               | Additional<br>Paid-In<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Total<br>Stockholders'<br>Equity |
|--|-------------------------|---------------|-------------------------|---------------|----------------------------------|----------------------|---|----------------------------------|
|  | Shares                  | Amount        | Shares                  | Amount        |                                  |                      |   |                                  |
| Balance at December 31, 2010   | 30,102,677              | \$ 3.0        | 6,953,680               | \$ 0.7        | \$ 405.2                         | \$ 492.9             | \$ (0.3)  | \$ 901.5                         |
| Comprehensive income (loss)  |                         |               |                         |               |                                  | 66.4                 | (18.7)  | 47.7                             |
| Shares of Class A common stock issued upon the exercise of stock options | 247,870                 |               |                         |               | 5.4                              |                      |   | 5.4                              |
| Stock-based compensation   |                         |               |                         |               | 8.3                              |                      |   | 8.3                              |
| Stock repurchase   | (1,000,000)             | (0.1)         |                         |               |                                  | (27.1)               |   | (27.2)                           |
| Issuance of shares of restricted Class A common stock                    | 79,438                  |               |                         |               |                                  | (0.5)                |   | (0.5)                            |
| Net change in restricted stock units                                     | 41,429                  |               |                         |               | 1.2                              | (0.3)                |   | 0.9                              |
| Common stock dividends   |                         |               |                         |               |                                  | (16.3)               |   | (16.3)                           |
| <b>Balance at December 31, 2011</b>                                      | <b>29,471,414</b>       | <b>\$ 2.9</b> | <b>6,953,680</b>        | <b>\$ 0.7</b> | <b>\$ 420.1</b>                  | <b>\$ 515.1</b>      | <b>\$ (19.0)</b>  | <b>\$ 919.8</b>                  |
| Comprehensive income   |                         |               |                         |               |                                  | 68.4                 | 8.2   | 76.6                             |
| Shares of Class B common stock converted to Class A common stock         | 365,000                 | 0.1           | (365,000)               | (0.1)         |                                  |                      |   |                                  |
| Shares of Class A common stock issued upon the exercise of stock options | 589,798                 | 0.1           |                         |               | 17.7                             |                      |   | 17.8                             |
| Stock-based compensation   |                         |               |                         |               | 6.6                              |                      |   | 6.6                              |
| Stock repurchase   | (2,000,000)             | (0.2)         |                         |               |                                  | (65.6)               |   | (65.8)                           |
| Issuance of net shares of restricted Class A common stock                | 141,767                 |               |                         |               |                                  | (0.8)                |   | (0.8)                            |
| Net change in restricted stock units                                     | 105,660                 |               |                         |               | 4.3                              | (3.0)                |   | 1.3                              |
| Common stock dividends   |                         |               |                         |               |                                  | (16.0)               |   | (16.0)                           |
| <b>Balance at December 31, 2012</b>                                      | <b>28,673,639</b>       | <b>\$ 2.9</b> | <b>6,588,680</b>        | <b>\$ 0.6</b> | <b>\$ 448.7</b>                  | <b>\$ 498.1</b>      | <b>\$ (10.8)</b>  | <b>\$ 939.5</b>                  |
| <b>Comprehensive income</b>  |                         |               |                         |               |                                  | <b>58.6</b>          | <b>22.8</b>   | <b>81.4</b>                      |
| Shares of Class B common stock converted to Class A common stock         | 99,390                  |               | (99,390)                |               |                                  |                      |   |                                  |
| Shares of Class A common stock issued upon the exercise of stock options | 361,094                 |               |                         |               | 11.9                             |                      |   | 11.9                             |
| Stock-based compensation   |                         |               |                         |               | 9.6                              |                      |   | 9.6                              |
| Stock repurchase   | (453,880)               |               |                         |               |                                  | (23.0)               |   | (23.0)                           |
| Issuance of net shares of restricted Class A common stock                | 75,592                  |               |                         |               |                                  | (1.6)                |   | (1.6)                            |
| Net change in restricted stock units                                     | 68,944                  |               |                         |               | 3.3                              | (1.3)                |   | 2.0                              |
| Common stock dividends   |                         |               |                         |               |                                  | (17.7)               |   | (17.7)                           |
| <b>Balance at December 31, 2013</b>                                      | <b>28,824,779</b>       | <b>\$ 2.9</b> | <b>6,489,290</b>        | <b>\$ 0.6</b> | <b>\$ 473.5</b>                  | <b>\$ 513.1</b>      | <b>\$ 12.0</b>  | <b>\$ 1,002.1</b>                |

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



## Watts Water Technologies, Inc. and Subsidiaries

## Consolidated Statements of Cash Flows

(Amounts in millions)

|   | Years Ended December 31, |         |         |
|---|--------------------------|---------|---------|
|   | 2013                     | 2012    | 2011    |
| <b>OPERATING ACTIVITIES</b>   |                          |         |         |
| Net income  | \$ 58.6                  | \$ 68.4 | \$ 66.4 |
| Loss from discontinued operations, net of taxes   | (2.3)                    | (2.0)   | (10.8)  |
| Net income from continuing operations.  | 60.9                     | 70.4    | 77.2    |
| Adjustments to reconcile income from continuing operations to net cash provided by continuing operating activities: |                          |         |         |
| Depreciation  | 34.2                     | 33.1    | 32.1    |
| Amortization of intangibles   | 14.7                     | 15.4    | 15.8    |
| (Gain) loss on disposal and impairment of goodwill, property, plant and equipment and other                         | 1.5                      | 4.1     | (9.8)   |
| Stock-based compensation  | 9.6                      | 6.6     | 8.3     |
| Deferred income taxes   | (6.8)                    |         | 3.7     |
| Changes in operating assets and liabilities, net of effects from business acquisitions and divestitures:            |                          |         |         |
| Accounts receivable   | (3.5)                    | 2.0     | 3.1     |
| Inventories   | (17.3)                   | (7.1)   | 3.1     |
| Prepaid expenses and other assets   | (14.5)                   | 1.1     | (8.9)   |
| Accounts payable, accrued expenses and other liabilities  | 39.5                     | 4.7     | 1.5     |
| Net cash provided by continuing operations  | 118.3                    | 130.3   | 126.1   |
| <b>INVESTING ACTIVITIES</b>   |                          |         |         |
| Additions to property, plant and equipment  | (27.7)                   | (30.5)  | (22.5)  |
| Proceeds from the sale of property, plant and equipment   | 1.5                      | 0.2     | 0.8     |
| Investments in securities   |                          | (2.1)   | (8.1)   |
| Proceeds from sale of asset held for sale   |                          | 3.0     |         |
| Proceeds from sale of securities  | 2.1                      | 4.1     | 8.1     |
| Purchase of intangible assets and other   |                          | (0.1)   | (0.9)   |
| Business acquisitions, net of cash acquired   |                          | (17.5)  | (165.5) |
| Net cash used in investing activities   | (24.1)                   | (42.9)  | (188.1) |
| <b>FINANCING ACTIVITIES</b>   |                          |         |         |
| Proceeds from long-term debt  |                          | 9.2     | 184.0   |
| Payments of long-term debt  | (77.2)                   | (23.9)  | (168.0) |
| Payment of capital leases and other   | (4.8)                    | (2.9)   | (2.6)   |
| Proceeds from share transactions under employee stock plans   | 11.9                     | 17.8    | 5.4     |
| Tax benefit of stock awards exercised   | 1.3                      | 0.9     | 0.8     |
| Payments to repurchase common stock   | (23.0)                   | (65.8)  | (27.2)  |
| Dividends   | (17.7)                   | (16.0)  | (16.3)  |
| Net cash used in financing activities   | (109.5)                  | (80.7)  | (23.9)  |
| Effect of exchange rate changes on cash and cash equivalents  | 4.1                      | 3.2     | 7.3     |



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|  |          |          |          |
|--|----------|----------|----------|
| Net cash (used in) provided by operating activities of discontinued operations | (0.1)    | 3.2      | (0.2)    |
| Net cash provided by (used in) investing activities of discontinued operations | 7.9      | 8.3      | (0.2)    |
| <br>   |          |          |          |
| (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS                               | (3.4)    | 21.4     | (79.0)   |
| <br>   |          |          |          |
| Cash and cash equivalents at beginning of year                                 | 271.3    | 249.9    | 328.9    |
| <br>   |          |          |          |
| CASH AND CASH EQUIVALENTS AT END OF YEAR                                       | \$ 267.9 | \$ 271.3 | \$ 249.9 |
| <br>   |          |          |          |
| <b>NON CASH INVESTING AND FINANCING ACTIVITIES</b>                             |          |          |          |
| Acquisition of businesses:   |          |          |          |
| Fair value of assets acquired  | \$       | \$ 25.2  | \$ 225.5 |
| Cash paid, net of cash acquired  |          | 17.5     | 165.5    |
| <br>   |          |          |          |
| Liabilities assumed  | \$       | \$ 7.7   | \$ 60.0  |
| <br>   |          |          |          |
| Acquisitions of fixed assets under financing agreement                         | \$ 3.7   | \$ 1.1   | \$ 4.3   |
| <br>   |          |          |          |
| Issuance of stock under management stock purchase plan                         | \$ 0.7   | \$ 0.5   | \$ 0.4   |
| <br>   |          |          |          |
| <b>CASH PAID FOR:</b>  |          |          |          |
| Interest   | \$ 21.5  | \$ 23.9  | \$ 24.7  |
| <br>   |          |          |          |
| Taxes  | \$ 32.7  | \$ 27.1  | \$ 35.5  |

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

**Watts Water Technologies, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements**

**(1) Description of Business**

Watts Water Technologies, Inc. (the Company), through its subsidiaries, designs, manufactures and sells an extensive line of water safety and flow control products primarily for the water quality, water conservation, water safety and water flow control markets located predominantly in the Americas and Europe, Middle East and Africa (EMEA) with a presence in Asia Pacific.

**(2) Accounting Policies**

*Principles of Consolidation*

The consolidated financial statements include the accounts of the Company and its majority and wholly owned subsidiaries. Upon consolidation, all significant intercompany accounts and transactions are eliminated.

*Cash Equivalents*

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.

*Investment Securities*

Investment securities at December 31, 2012 consisted of certificates of deposit with original maturities of greater than three months. The Company did not hold investment securities at December 31, 2013.

Trading securities are recorded at fair value. The Company determines the fair value by obtaining market value when available from quoted prices in active markets. In the absence of quoted prices, the Company uses other inputs to determine the fair value of the investments. All changes in the fair value as well as any realized gains and losses from the sale of the securities are recorded when incurred to the consolidated statements of operations as other income or expense.

*Allowance for Doubtful Accounts*

Allowance for doubtful accounts includes reserves for bad debts, sales returns and allowances and cash discounts. The Company analyzes the aging of accounts receivable, individual accounts receivable, historical bad debts, concentration of receivables by customer, customer credit worthiness, current economic trends, and changes in customer payment terms. The Company specifically analyzes individual accounts receivable and establishes specific reserves against financially troubled customers. In addition, factors are developed in certain regions utilizing historical trends of sales and returns and allowances and cash discount activities to derive a reserve for returns and allowances and cash discounts.

*Concentration of Credit*

The Company sells products to a diversified customer base and, therefore, has no significant concentrations of credit risk. In 2013 and 2012, no customer accounted for 10% or more of the Company's total sales.

## Watts Water Technologies, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

## (2) Accounting Policies (Continued)

*Inventories*

Inventories are stated at the lower of cost (using primarily the first-in, first-out method) or market. Market value is determined by replacement cost or net realizable value. Historical usage is used as the basis for determining the reserve for excess or obsolete inventories.

*Goodwill and Other Intangible Assets*

Goodwill is recorded when the consideration paid for acquisitions exceeds the fair value of net tangible and intangible assets acquired. Goodwill and other intangible assets with indefinite useful lives are not amortized, but rather are tested at least annually for impairment. The test for 2013 was performed as of October 27, 2013.

*Impairment of Goodwill and Long-Lived Assets*

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

|               | Year Ended December 31, 2013  |                                     |   |                                 |                               |  |                                 | Net<br>Goodwill<br>December 31,<br>2013 |
|---------------|-------------------------------|-------------------------------------|---|---------------------------------|-------------------------------|--|---------------------------------|---|
|               | Gross Balance                 |                                     |   | Balance<br>December 31,<br>2013 | Accumulated Impairment Losses |  | Balance<br>December 31,<br>2013 |   |
|               | Balance<br>January 1,<br>2013 | Acquired<br>During<br>the<br>Period | Foreign<br>Currency<br>Translation<br>and Other |                                 | Balance<br>January 1,<br>2013 | Impairment<br>Loss<br>During<br>the Period |                                 |   |
| (in millions) |                               |                                     |   |                                 |                               |  |                                 |   |
| Americas      | \$ 225.6                      | \$                                  | \$ (0.9)  | \$ 224.7                        | \$ (24.2)                     | \$ (0.3)                                   | \$ (24.5)                       | \$ 200.2                                |
| EMEA          | 289.7                         |                                     | 11.6  | 301.3                           |                               |  |                                 | 301.3                                   |
| Asia Pacific  | 12.9                          |                                     | 0.4   | 13.3                            |                               |  |                                 | 13.3                                    |
| Total         | \$ 528.2                      | \$                                  | \$ 11.1   | \$ 539.3                        | \$ (24.2)                     | \$ (0.3)                                   | \$ (24.5)                       | \$ 514.8                                |

|               | Year Ended December 31, 2012  |                                     |   |                                 |                               |  |                                 | Net<br>Goodwill<br>December 31,<br>2012 |
|---------------|-------------------------------|-------------------------------------|---|---------------------------------|-------------------------------|--|---------------------------------|---|
|               | Gross Balance                 |                                     |   | Balance<br>December 31,<br>2012 | Accumulated Impairment Losses |  | Balance<br>December 31,<br>2012 |   |
|               | Balance<br>January 1,<br>2012 | Acquired<br>During<br>the<br>Period | Foreign<br>Currency<br>Translation<br>and Other |                                 | Balance<br>January 1,<br>2012 | Impairment<br>Loss<br>During<br>the Period |                                 |   |
| (in millions) |                               |                                     |   |                                 |                               |  |                                 |   |
| Americas      | \$ 213.8                      | \$ 11.7                             | \$ 0.1  | \$ 225.6                        | \$ (23.2)                     | \$ (1.0)                                   | \$ (24.2)                       | \$ 201.4                                |
| EMEA          | 281.1                         |                                     | 8.6   | 289.7                           |                               |  |                                 | 289.7                                   |
| Asia Pacific  | 12.7                          |                                     | 0.2   | 12.9                            |                               |  |                                 | 12.9                                    |
| Total         | \$ 507.6                      | \$ 11.7                             | \$ 8.9  | \$ 528.2                        | \$ (23.2)                     | \$ (1.0)                                   | \$ (24.2)                       | \$ 504.0                                |

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

The Company determined that the future prospects for its Blue Ridge Atlantic Enterprises, Inc. (BRAE) reporting unit in the Americas were lower than originally estimated as future sales growth expectations had been reduced a number of times since the 2010 acquisition of BRAE. The Company recorded pre-tax goodwill impairment charges of \$0.3 million, \$1.0 million and \$1.2 million in 2013,

**Watts Water Technologies, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Continued)**

**(2) Accounting Policies (Continued)**

2012 and 2011, respectively, for that reporting unit. The BRAE goodwill balance was fully impaired in 2013. The goodwill impairment charges were offset by the reduction in anticipated earnout payments of equal amounts, with no remaining earnout liability as of December 31, 2013. The Company estimated the fair value of the reporting unit using the expected present value of future cash flows.

As of October 28, 2012, which was the previous annual impairment analysis date, the fair value of the EMEA reporting unit exceeded the carrying value by approximately 40%. The EMEA reporting unit represents the EMEA geographic segment excluding the Blücher reporting unit. During the six months ended June 30, 2013, operating results for the EMEA reporting unit had been hindered by the downturn in the economic environment in Europe and continued to fall below the expected operating results and growth rates used in the calculation of the present value of future cash flow projections, triggering the decision to update the impairment analysis. As a result of the fair value assessment, it was determined that the fair value of the EMEA reporting unit decreased from the prior year but continued to exceed its carrying value as of June 30, 2013. An updated fair value assessment was performed at the annual impairment date of October 27, 2013. The updated fair value assessment determined that the fair value of the EMEA reporting continued to exceed its carrying value by approximately 20% in 2013.

On January 31, 2012, the Company completed the acquisition of tekmar Control Systems (tekmar) in a share purchase transaction. The initial purchase price paid was CAD \$18.0 million, with post-closing adjustments related to working capital and an earnout based on the attainment of certain future earnings levels. The initial purchase price paid was equal to approximately \$17.8 million based on the exchange rate of Canadian dollar to U.S. dollar as of January 31, 2012. The total purchase price will not exceed CAD \$26.2 million. The Company accounted for the transaction as a business combination. In January 2013, the Company completed a purchase price allocation that resulted in the recognition of \$11.7 million in goodwill and \$10.1 million in intangible assets (see Note 5).

Indefinite-lived intangibles are tested for impairment at least annually or more frequently if events or circumstances, such as a change in business conditions, indicate that it is "more likely than not" that the intangible asset might be impaired. The Company performs its annual indefinite-lived intangibles impairment assessment in the fourth quarter of each year. For the 2013, 2012 and 2011 impairment assessments, the Company performed quantitative assessments for all indefinite-lived intangible assets. The methodology employed was the relief from royalty method, a subset of the income approach. Based on the results of the assessment the Company recognized non-cash pre-tax impairment charges in 2013, 2012 and 2011 of approximately \$0.7 million, \$0.4 million and \$1.4 million, respectively. The impairment charge of \$0.7 million in 2013 consists of a \$0.3 million impairment charge for a trade name in the Americas segment and a \$0.4 million impairment charge for two trade names in the EMEA segment. The gross carrying amount in the table below reflects the impairment charges.

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 is 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

## Watts Water Technologies, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

## (2) Accounting Policies (Continued)

companies for the related businesses 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:

|                                    | December 31,                |                             |                           |                             |                             |                           |
|------------------------------------|-----------------------------|-----------------------------|---------------------------|-----------------------------|-----------------------------|---------------------------|
|                                    | 2013                        |                             | 2012                      |                             |                             |                           |
|                                    | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net<br>Carrying<br>Amount | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net<br>Carrying<br>Amount |
|                                    | (in millions)               |                             |                           |                             |                             |                           |
| Patents                            | \$ 16.6                     | \$ (12.6)                   | \$ 4.0                    | \$ 16.5                     | \$ (11.7)                   | \$ 4.8                    |
| Customer relationships             | 133.0                       | (76.4)                      | 56.6                      | 131.4                       | (65.9)                      | 65.5                      |
| Technology                         | 26.9                        | (10.9)                      | 16.0                      | 27.4                        | (9.0)                       | 18.4                      |
| Trade names                        | 13.7                        | (3.0)                       | 10.7                      | 13.5                        | (1.8)                       | 11.7                      |
| Other                              | 8.8                         | (5.6)                       | 3.2                       | 8.7                         | (5.5)                       | 3.2                       |
| <br>                               |                             |                             |                           |                             |                             |                           |
| Total amortizable intangibles      | 199.0                       | (108.5)                     | 90.5                      | 197.5                       | (93.9)                      | 103.6                     |
| Indefinite-lived intangible assets | 41.9                        |                             | 41.9                      | 41.8                        |                             | 41.8                      |
| <br>                               |                             |                             |                           |                             |                             |                           |
| Total                              | \$ 240.9                    | \$ (108.5)                  | \$ 132.4                  | \$ 239.3                    | \$ (93.9)                   | \$ 145.4                  |

Aggregate amortization expense for amortized intangible assets for 2013, 2012 and 2011 was \$14.7 million, \$15.4 million and \$15.8 million, respectively. Additionally, future amortization expense on amortizable intangible assets is expected to be \$14.9 million for 2014, \$14.7 million for 2015, \$14.2 million for 2016, \$13.8 million for 2017, and \$10.0 million for 2018. Amortization expense is provided 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 8.4 years. Patents, customer relationships, technology, trade names and other amortizable intangibles have weighted-average remaining lives of 5.6 years, 5.6 years, 11.4 years, 10.9 years and 40.2 years, respectively. Indefinite-lived intangible assets primarily include trade names and trademarks.

*Property, Plant and Equipment*

Property, plant and equipment are recorded at cost. Depreciation is provided on a straight-line basis over the estimated useful lives of the assets, which range from 10 to 40 years for buildings and improvements and 3 to 15 years for machinery and equipment.

*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*

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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

## Watts Water Technologies, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

## (2) Accounting Policies (Continued)

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.

The Company recognizes tax benefits when the item in question meets the more-likely-than-not (greater than 50% likelihood of being sustained upon examination by the taxing authorities) threshold. During 2013, due to the completion of the federal audit, unrecognized tax benefits decreased by approximately \$3.7 million related to an adjustment to temporary differences that did not impact overall income tax expense.

As of December 31, 2013, the Company had gross unrecognized tax benefits of approximately \$0.8 million, approximately \$0.2 million of which, if recognized, would affect the effective tax rate. The difference between the amount of unrecognized tax benefits and the amount that would affect the effective tax rate consists of the federal tax benefit of state income tax items as well as a liability related to the 2011 acquisition of Danfoss Socla S.A.S (Socla) in France that will be recoverable under the terms of the acquisition agreement.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

|   | (in millions) |
|---|---------------|
| Balance at January 1, 2013                    | \$ 4.6        |
| Increases related to prior year tax positions | 0.1           |
| Decreases related to prior year tax positions | (0.2)         |
| Settlements                                   | (3.7)         |
| <br>  |               |
| Balance at December 31, 2013                  | \$ 0.8        |

In February 2013, the United States Internal Revenue Service concluded an audit of the Company's 2009, 2010 and 2011 tax years. The Company conducts business in a variety of locations throughout the world resulting in tax filings in numerous domestic and foreign jurisdictions. The Company is subject to tax examinations regularly as part of the normal course of business. The Company's major jurisdictions are the U.S., Canada, China, Netherlands, U.K., Germany, Italy and France. With few exceptions the Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations for years before 2007. The statute of limitations in our major jurisdictions is open in the U.S. for the year 2010 and later; in Canada for 2009 and later; and in the Netherlands for 2012 and later.

The Company accounts for interest and penalties related to uncertain tax positions as a component of income tax expense.

*Foreign Currency Translation*

The financial statements of subsidiaries located outside the United States generally are measured using the local currency as the functional currency. Balance sheet accounts, including goodwill, of foreign subsidiaries are translated into United States dollars at year-end exchange rates. Income and expense items are translated at weighted average exchange rates for each period. Net translation gains or losses are included in other comprehensive income, a separate component of stockholders' equity. The Company does not provide for U.S. income taxes on foreign currency translation adjustments since it does not provide for such taxes on undistributed earnings of foreign subsidiaries. Gains and losses from foreign currency transactions of these subsidiaries are included in net earnings.



**Watts Water Technologies, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Continued)**

**(2) Accounting Policies (Continued)**

*Stock-Based Compensation, Former Chief Executive Officer Separation Costs and Former Chief Financial Officer Retention Costs*

The Company records compensation expense in the financial statements for share-based awards based on the grant date fair value of those awards. Stock-based compensation expense includes an estimate for pre-vesting forfeitures and is recognized over the requisite service periods of the awards on a straight-line basis, which is generally commensurate with the vesting term. The benefits associated with tax deductions in excess of recognized compensation cost are reported as a financing cash flow.

At December 31, 2013, the Company had two stock-based compensation plans with total unrecognized compensation costs related to unvested stock-based compensation arrangements of approximately \$20.8 million and a total weighted average remaining term of 2.5 years. Included in the \$20.8 million of unrecognized compensation costs is \$4.5 million related to equity awards previously granted to David J. Coghlan, the Company's former Chief Executive Officer, which will not be recognized. Refer to Note 18 for details on Mr. Coghlan's resignation on January 9, 2014. For 2013, 2012 and 2011, the Company recognized compensation costs related to stock-based programs of approximately \$9.6 million, \$5.8 million and \$5.3 million, respectively, in selling, general and administrative expenses. The Company recorded approximately \$1.2 million of tax benefits during 2013 and \$0.7 million in 2012 and 2011 for the compensation expense relating to its stock options. For 2013, 2012 and 2011, the Company recorded approximately \$1.9 million, \$1.4 million and \$1.5 million, respectively, of tax benefit for its other stock-based plans. For 2013, 2012 and 2011, the recognition of total stock-based compensation expense impacted both basic and diluted net income per common share by \$0.14, \$0.10 and \$0.09, respectively.

On May 23, 2012, William C. McCartney resigned from his position as Chief Financial Officer of the Company. Pursuant to the retention agreement entered into with Mr. McCartney, the Company recorded a charge of \$1.5 million over the retention period, consisting of cash payments of \$0.7 million and a non-cash charge of \$0.8 million for the modification of stock options and restricted stock awards.

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

*Net Income Per Common Share*

Basic net income per common share is calculated by dividing net income by the weighted average number of common shares outstanding. The calculation of diluted income per share assumes the conversion of all dilutive securities (see Note 12).

## Watts Water Technologies, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

## (2) Accounting Policies (Continued)

Net income and number of shares used to compute net income per share, basic and assuming full dilution, are reconciled below:

|  | Years Ended December 31, |        |                        |               |        |                        |               |        |                        |
|--|--------------------------|--------|------------------------|---------------|--------|------------------------|---------------|--------|------------------------|
|  | 2013                     |        | 2012                   |               | 2011   |                        |               |        |                        |
|  | Net<br>Income            | Shares | Per<br>Share<br>Amount | Net<br>Income | Shares | Per<br>Share<br>Amount | Net<br>Income | Shares | Per<br>Share<br>Amount |
| (Amounts in millions, except per share information)      |                          |        |                        |               |        |                        |               |        |                        |
| Basic EPS  | \$ 58.6                  | 35.5   | \$ 1.65                | \$ 68.4       | 36.0   | \$ 1.90                | \$ 66.4       | 37.3   | \$ 1.78                |
| Dilutive securities, principally<br>common stock options |                          | 0.1    |                        |               | 0.1    |                        |               | 0.2    |                        |
| Diluted EPS  | \$ 58.6                  | 35.6   | \$ 1.65                | \$ 68.4       | 36.1   | \$ 1.90                | \$ 66.4       | 37.5   | \$ 1.78                |

The computation of diluted net income per share for the years ended December 31, 2013, 2012 and 2011 excludes the effect of the potential exercise of options to purchase approximately 0.2 million, 0.2 million and 0.7 million shares, respectively, because the exercise price of the option was greater than the average market price of the Class A common stock and the effect would have been anti-dilutive.

On April 30, 2013, the Board of Directors authorized the repurchase of up to \$90.0 million of the Company's Class A common stock from time to time on the open market or in privately negotiated transactions. The timing and number of any shares repurchased will be determined by the Company's management based on its evaluation of market conditions. Repurchases may also be made under a Rule 10b5-1 plan, which would permit 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 any Rule 10b5-1 plan the Company may enter into with respect to the repurchase program. During the year ended December 31, 2013, the Company repurchased approximately 454,000 shares of Class A common stock at a cost of approximately \$23.0 million.

On May 16, 2012, the Board of Directors authorized a stock repurchase program of up to two million shares of the Company's Class A common stock. The stock repurchase program was completed in July 2012, as the Company repurchased the entire two million shares of Class A common stock at a cost of approximately \$65.8 million.

On August 2, 2011, the Board of Directors authorized a stock repurchase program. Under the program, the Company was authorized to repurchase up to one million shares of our Class A common stock. During the three months ended October 2, 2011, the Company repurchased the entire one million shares at a cost of \$27.2 million.

*Financial Instruments*

In the normal course of business, the Company manages risks associated with commodity prices, foreign exchange rates and interest rates through a variety of strategies, including the use of hedging transactions, executed in accordance with the Company's policies. The Company's hedging transactions include, but are not limited to, the use of various derivative financial and commodity instruments. As a matter of policy, the Company does not use derivative instruments unless there is an underlying exposure. Any change in value of the derivative instruments would be substantially offset by an

**Watts Water Technologies, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Continued)**

**(2) Accounting Policies (Continued)**

opposite change in the value of the underlying hedged items. The Company does not use derivative instruments for trading or speculative purposes.

Derivative instruments may be designated and accounted for as either a hedge of a recognized asset or liability (fair value hedge) or a hedge of a forecasted transaction (cash flow hedge). For a fair value hedge, both the effective and ineffective portions of the change in fair value of the derivative instrument, along with an adjustment to the carrying amount of the hedged item for fair value changes attributable to the hedged risk, are recognized in earnings. For a cash flow hedge, changes in the fair value of the derivative instrument that are highly effective are deferred in accumulated other comprehensive income or loss until the underlying hedged item is recognized in earnings. There were no cash flow hedges as of December 31, 2013 or December 31, 2012.

If a fair value or cash flow hedge were to cease to qualify for hedge accounting or be terminated, it would continue to be carried on the balance sheet at fair value until settled, but hedge accounting would be discontinued prospectively. If a forecasted transaction were no longer probable of occurring, amounts previously deferred in accumulated other comprehensive income would be recognized immediately in earnings. On occasion, the Company may enter into a derivative instrument that does not qualify for hedge accounting because it is entered into to offset changes in the fair value of an underlying transaction which is required to be recognized in earnings (natural hedge). These instruments are reflected in the Consolidated Balance Sheets at fair value with changes in fair value recognized in earnings.

Foreign currency derivatives include forward foreign exchange contracts primarily for Canadian dollars. Metal derivatives include commodity swaps for copper.

Portions of the Company's outstanding debt are exposed to interest rate risks. The Company monitors its interest rate exposures on an ongoing basis to maximize the overall effectiveness of its interest rates.

*Fair Value Measurements*

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. An entity is required to maximize the use of observable inputs, where available, and minimize the use of unobservable inputs when measuring fair value.

The Company has certain financial assets and liabilities that are measured at fair value on a recurring basis and certain nonfinancial assets and liabilities that may be measured at fair value on a nonrecurring basis. The fair value disclosures of these assets and liabilities are based on a three-level hierarchy, which is defined as follows:

- Level 1** Quoted prices in active markets for identical assets or liabilities that the entity has the ability to access at the measurement date.
- Level 2** Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3** Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

**Watts Water Technologies, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Continued)**

**(2) Accounting Policies (Continued)**

Assets and liabilities subject to this hierarchy are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

*Shipping and Handling*

Shipping and handling costs included in selling, general and administrative expense amounted to \$38.4 million, \$37.0 million and \$36.9 million for the years ended December 31, 2013, 2012 and 2011, respectively.

*Research and Development*

Research and development costs included in selling, general, and administrative expense amounted to \$21.5 million, \$20.4 million and \$20.5 million for the years ended December 31, 2013, 2012 and 2011, respectively.

*Revenue Recognition*

The Company recognizes revenue when all of the following criteria have been met: the Company has entered into a binding agreement, the product has been shipped and title passes, the sales price to the customer is fixed or is determinable, and collectability is reasonably assured. Provisions for estimated returns and allowances are made at the time of sale, and are recorded as a reduction of sales and included in the allowance for doubtful accounts in the Consolidated Balance Sheets. The Company records provisions for sales incentives (primarily volume rebates), as an adjustment to net sales, at the time of sale based on estimated purchase targets.

*Basis of Presentation*

Certain amounts in the 2012 and 2011 consolidated financial statements have been reclassified to permit comparison with the 2013 presentation. These reclassifications had no effect on reported results of operations or stockholders' equity.

*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.

*New Accounting Standards*

In July 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2013-11, "Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists" which is intended to eliminate the diversity in practice in the presentation of unrecognized tax benefits in those instances. ASU 2013-11 is effective for fiscal years and interim periods beginning after December 15, 2013, with early adoption permitted. The adoption of this guidance is not expected to have a material impact on the Company's financial statements.

**Watts Water Technologies, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Continued)**

**(2) Accounting Policies (Continued)**

In March 2013, the FASB issued ASU No. 2013-05, "Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity." This ASU is intended to eliminate diversity in practice on the release of cumulative translation adjustment into net income when a parent either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest. In addition, the amendments in this ASU resolve the diversity in practice for the treatment of business combinations achieved in stages (sometimes also referred to as step acquisitions) involving a foreign entity. The provisions of this ASU are effective for interim and annual periods beginning after December 15, 2013, with early adoption permitted, and must be applied prospectively. The Company early adopted the ASU in 2013. The adoption of this guidance has not had a material impact on the Company's financial statements.

In February 2013, the FASB issued ASU 2013-02, "Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income" which requires additional disclosures about amounts reclassified out of OCI by component, either on the face of the income statement or as a separate footnote to the financial statements. ASU 2013-02 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2012. The adoption of this guidance has not had a material impact on the Company's financial statements.

**(3) Discontinued Operations**

On August 1, 2013, the Company completed the sale of all of the outstanding shares of an indirect wholly-owned subsidiary, Watts Insulation GmbH (Austroflex), receiving net cash proceeds of \$7.9 million. Austroflex is an Austrian-based manufacturer of pre-insulated flexible pipe systems for district heating, solar applications and under-floor radiant heating systems. Austroflex did not meet performance expectations since its purchase approximately three years ago on June 28, 2010. The loss after tax on disposal of the business was approximately \$2.2 million. Further, during the year ended December 31, 2011, the Company wrote down Austroflex's long-lived assets by \$14.8 million. The Company will not have a substantial continuing involvement in Austroflex's operations and cash flows, and therefore Austroflex's results of operations have been presented as discontinued operations for all periods presented.

On December 21, 2012, the Company completed the sale of all of the outstanding shares of its subsidiary, Flomatic Corporation (Flomatic). The sale excluded the backflow product line of Flomatic, which was retained by the Company. Flomatic Corporation, located in Glens Falls, New York, specializes in manufacturing and selling check valves, foot valves and automatic hydraulic control valves for the well water industry. The Company acquired Flomatic as part of its acquisition of Socla in April 2011. The Company determined that it would not have a substantial continuing involvement in Flomatic's operations and cash flows, and therefore Flomatic's results of operations have been presented as discontinued operations for all periods presented.

In the first quarter of 2010, the Company recorded an estimated reserve of \$5.3 million in discontinued operations in connection with its investigation of potential violations of the Foreign Corrupt Practices Act (FCPA) at Watts Valve (Changsha) Co., Ltd. (CWV), a former indirect wholly-owned subsidiary of the Company in China. On October 13, 2011, the Company entered into a settlement for \$3.8 million with the Securities and Exchange Commission to resolve allegations concerning potential violations of the FCPA at CWV. In connection with this matter, in 2012, the Company received a \$1.1 million payment from a service provider related to issues concerning a former divested operation.

## Watts Water Technologies, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

## (3) Discontinued Operations (Continued)

Condensed operating statements for discontinued operations are summarized below:

|   | Years Ended<br>December 31, |          |           |
|---|-----------------------------|----------|-----------|
|   | 2013                        | 2012     | 2011      |
|   | (in millions)               |          |           |
| Operating income FCPA matter (CWV)              | \$                          | \$ 1.1   | \$ 1.7    |
| Operating income Flomatic                       |                             | 1.3      | 0.4       |
| Loss on disposal Flomatic                       |                             | (3.8)    |           |
| Operating (loss) income Austroflex              | (0.2)                       | 0.2      | (16.9)    |
| Loss on disposal Austroflex                     | (2.2)                       |          |           |
| Other   |                             | 0.3      | 0.2       |
| Loss before income taxes                        | (2.4)                       | (0.9)    | (14.6)    |
| Income tax benefit (expense)                    | 0.1                         | (1.1)    | 3.8       |
| Loss from discontinued operations, net of taxes | \$ (2.3)                    | \$ (2.0) | \$ (10.8) |

The Company did not recognize a tax benefit on the loss on the disposal of the Flomatic and Austroflex shares, as the Company does not believe it is more likely than not that a tax benefit would be realized.

Revenues reported in discontinued operations are as follows:

|                     | Years Ended<br>December 31, |         |         |
|---------------------|-----------------------------|---------|---------|
|                     | 2013                        | 2012    | 2011    |
|                     | (in millions)               |         |         |
| Flomatic revenues   | \$                          | \$ 12.9 | \$ 8.5  |
| Austroflex revenues | 9.5                         | 18.2    | 20.7    |
| Total revenues      | \$ 9.5                      | \$ 31.1 | \$ 29.2 |

## (4) 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.

## 2013 Actions

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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 by approximately 10%, improve organizational and operational efficiency and better align costs with expected revenues in response to changing market conditions. The restructuring program is expected to include a pre-tax charge to earnings totaling approximately \$14.0 million, approximately \$10.0 million of which is expected to be recorded through fiscal 2014 and the remainder recorded during fiscal 2015. The total charge will include costs for severance benefits, relocation, site clean-up, professional fees and certain

**Watts Water Technologies, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Continued)**

**(4) Restructuring and Other Charges, Net (Continued)**

asset write-downs. The total net after-tax charge for the restructuring program is expected to be approximately \$10.0 million. The restructuring program is expected to be completed by the end of the fourth quarter of fiscal 2015. Certain aspects of the restructuring program are subject to further analysis and determinations by local management and consultation and negotiation with various workers' councils. The net after-tax charge incurred in fiscal 2013 was \$2.9 million.

*2011 Actions*

In April 2011, the Board approved an integration program in association with the acquisition of Socla. The program was designed to integrate certain operations and management structures of Socla with a total estimated pre-tax cost of \$6.4 million, with costs being incurred through 2012. The Company revised its forecast to \$4.2 million primarily to reflect reduced severance costs. The total net after-tax charge was \$2.8 million, with costs being fully incurred in 2012. As of December 31, 2013, the restructuring reserve was zero.

*2010 Actions*

On February 8, 2010, the Board approved a restructuring program with respect to the Company's operating facilities in France. The restructuring program included the consolidation of five facilities into two facilities. The program was originally expected to include pre-tax charges totaling approximately \$12.5 million, including costs for severance, relocation, site clean-up and certain asset write-downs. Prior to 2013, the Company revised its forecast to \$17.1 million primarily to reflect additional severance and legal costs. In 2013, the Company recorded additional severance costs of \$0.7 million for total costs of \$17.8 million. The 2010 restructuring program is substantially complete. As of December 31, 2013, the restructuring reserve was 2.3 million and related to severance costs.

On September 13, 2010, the Board approved a restructuring program with respect to certain of the Company's operating facilities in the United States. The restructuring program included the shutdown of two manufacturing facilities in North Carolina. Operations at these facilities have been consolidated into the Company's manufacturing facilities in New Hampshire, Missouri and other locations. The program originally included pre-tax charges totaling approximately \$4.9 million, including costs for severance, shutdown costs and equipment write-downs and pre-tax training and pre-production set-up costs of approximately \$2.0 million. The Company revised its forecast to \$2.5 million due to reduced shutdown costs. The total net after-tax charge for this restructuring program was approximately \$1.5 million. The restructuring program was completed in 2012.

*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 \$5.2 million, \$3.5 million and \$3.6 million in 2013, 2012 and 2011, respectively.

In 2013, the Company initiated restructuring activities with respect to the Company's operating facilities in EMEA, which included the relocation and closure of a manufacturing facility in Italy and other relocation initiatives in Europe. In 2012, the Company initiated restructuring activities in North America and Europe which continued into 2013. The restructuring activities in the Americas included the relocation of certain production activities, which included the closure of a manufacturing site, severance and shutdown costs in North America. The restructuring activities included costs for



## Watts Water Technologies, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

## (4) Restructuring and Other Charges, Net (Continued)

severance, fixed asset impairment and shut-down costs. Additional expected pre-tax costs through 2015 are \$0.4 million.

During 2011, the Company initiated several actions that were not part of a major program. In September 2011, the Company announced a plan of termination that would result in a reduction of approximately 10% of North American non-direct payroll costs. The Company recorded a charge of \$1.1 million for severance in connection with the plan during the year ended December 31, 2011. Also in 2011, the Company initiated restructuring activities with respect to the Company's operating facilities in Europe, which included the closure of a facility. The Europe restructuring activities included pre-tax costs of approximately \$4.0 million, including costs for severance and shut-down costs. All costs were incurred as of December 31, 2012.

During 2013, 2012 and 2011, the Company recorded a credit in restructuring and other charges, net related to the reduction in the contingent liability for the anticipated earnout payment in connection with the BRAE acquisition of \$0.2 million, \$1.0 million and \$1.2 million, respectively.

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

|  | Year Ended December 31, |        |        |
|--|-------------------------|--------|--------|
|  | 2013                    | 2012   | 2011   |
|  | (in millions)           |        |        |
| Restructuring costs:                                 |                         |        |        |
| 2010 Actions   | \$ 0.7                  | \$ 0.6 | \$ 3.3 |
| 2011 Actions   |                         | 1.1    | 3.1    |
| 2013 Actions   | 4.1                     |        |        |
| Other Actions  | 5.2                     | 3.5    | 3.6    |
| <br>   |                         |        |        |
| Total restructuring charges                          | 10.0                    | 5.2    | 10.0   |
| Adjustment related to contingent liability reduction | (0.2)                   | (1.0)  | (1.2)  |
| <br>   |                         |        |        |
| Less: amount included in cost of goods sold          | (1.1)                   |        |        |
| <br>   |                         |        |        |
| Total restructuring and other charges, net           | \$ 8.7                  | \$ 4.2 | \$ 8.8 |

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

|              | Years Ended<br>December 31, |        |         |
|--------------|-----------------------------|--------|---------|
|              | 2013                        | 2012   | 2011    |
|              | (in millions)               |        |         |
| Americas     | \$ 1.3                      | \$ 1.3 | \$ 1.2  |
| EMEA         | 8.7                         | 3.9    | 8.6     |
| Asia Pacific |                             |        | 0.2     |
| <br>         |                             |        |         |
| Total        | \$ 10.0                     | \$ 5.2 | \$ 10.0 |



## Watts Water Technologies, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

## (4) Restructuring and Other Charges, Net (Continued)

## 2013 Actions

Details of the Company's 2013 European footprint program reserve, which for the year ended December 31, 2013 only relates to severance, is as follows:

|   | Year Ended<br>December 31, 2013<br>(in millions) |            |
|---|--|------------|
| Balance at December 31, 2012            | \$   |            |
| Net pre-tax restructuring charges       |  | 4.1        |
| Utilization and foreign currency impact |  | (2.1)      |
| <b>Balance at December 31, 2013</b>     | <b>\$</b>  | <b>2.0</b> |

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 |            | Facility exit and other |            | Total         |
|---|---------------|------------|-----------------------|------------|-------------------|------------|-------------------------|------------|---------------|
|   | (in millions) |            |                       |            |                   |            |                         |            |               |
| Expected costs                              | \$            | 12.3       | \$                    | 1.3        | \$                | 0.2        | \$                      | 0.2        | \$ 14.0       |
| Costs incurred 2013                         |               | (4.1)      |                       |            |                   |            |                         |            | (4.1)         |
| <b>Remaining costs at December 31, 2013</b> | <b>\$</b>     | <b>8.2</b> | <b>\$</b>             | <b>1.3</b> | <b>\$</b>         | <b>0.2</b> | <b>\$</b>               | <b>0.2</b> | <b>\$ 9.9</b> |

## (5) Business Acquisitions and Disposition

## tekmar

On January 31, 2012, the Company completed the acquisition of tekmar in a share purchase transaction. A designer and manufacturer of control systems used in heating, ventilation, and air conditioning applications, tekmar enhances the Company's hydronic systems product offerings in the U.S. and Canada and is part of the Americas segment. The initial purchase price paid was CAD \$18.0 million, with an earn-out based on future earnings levels being achieved. The initial purchase price paid was equal to approximately \$17.8 million based on the exchange rate of Canadian dollar to U.S. dollars as of January 31, 2012. The total purchase price will not exceed CAD \$26.2 million. Sales for tekmar in 2011 approximated \$11.0 million. The Company accounted for the transaction as a business combination. The Company completed a purchase price allocation that resulted in the recognition of \$11.7 million in goodwill and \$10.1 million in intangible assets. Intangible assets consist primarily of acquired technology with an estimated life of 10 years, distributor relationships with an estimated life of 7 years, and a trade name with an estimated life of 20 years. The goodwill is not expected to be deductible for tax purposes. The results of tekmar are not material to the Company's consolidated financial statements. The results of operations for tekmar are included in the Company's Americas segment since acquisition date.

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In 2012, a contingent liability of \$5.1 million was recognized as the estimate of the acquisition date fair value of the contingent consideration. A portion of the contingent consideration was paid out during 2013, in the amount of \$1.2 million, based on performance metrics achieved in 2012. The contingent liability was increased by \$1.0 million during the year ended 2013 based on performance metrics achieved or expected to be achieved.

## Watts Water Technologies, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

## (5) Business Acquisitions and Disposition (Continued)

*Socla*

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

The Company accounted for the transaction as a business combination. The Company completed a purchase price allocation that resulted in the recognition of \$83.1 million in goodwill and \$39.9 million in intangible assets. Intangible assets consist primarily of customer relationships with estimated lives of 10 years and trade names with either 20 year lives or indefinite lives.

The consolidated statement of operations for the year ended December 31, 2011 includes the results of Socla since the acquisition date and includes \$94.8 million of revenues and \$1.6 million of operating income, which includes acquisition accounting charges of \$4.7 million and restructuring charges of \$2.7 million.

*TWVC*

In March 2010, in connection with the Company's manufacturing footprint consolidation, the Company closed the operations of Tianjin Watts Valve Company Ltd. (TWVC) and relocated its manufacturing to other facilities. On April 12, 2010, the Company signed a definitive equity transfer agreement with a third party to sell the Company's equity ownership and remaining assets of TWVC. The sale was finalized in the fourth quarter of 2011. The Company received net proceeds of approximately \$6.1 million from the sale and recorded a receivable for the remaining proceeds. The Company recognized a net pre-tax gain of \$7.7 million and an after-tax gain of approximately \$11.4 million relating mainly to the recognition of a cumulative translation adjustment and a tax benefit related to the reversal of a tax claw back in China. In 2012 and 2013, the Company recorded adjustments to decrease the gain on disposal by \$1.6 million and increase the gain on disposal by \$0.6 million, respectively.

## (6) Inventories, net

Inventories consist of the following:

|                 | December 31,  |          |
|-----------------|---------------|----------|
|                 | 2013          | 2012     |
|                 | (in millions) |          |
| Raw materials   | \$ 111.3      | \$ 110.8 |
| Work-in-process | 19.1          | 20.5     |
| Finished goods  | 179.8         | 156.7    |
|                 | \$ 310.2      | \$ 288.0 |

Raw materials, work-in-process and finished goods are net of valuation reserves of \$29.9 million and \$27.7 million as of December 31, 2013 and 2012, respectively. Finished goods of \$16.7 million and \$13.5 million as of December 31, 2013 and 2012, respectively, were consigned.

## Watts Water Technologies, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

**(7) Property, Plant and Equipment**

Property, plant and equipment consist of the following:

|                            | December 31,    |          |
|----------------------------|-----------------|----------|
|                            | 2013            | 2012     |
|                            | (in millions)   |          |
| Land                       | \$ 15.2         | \$ 15.8  |
| Buildings and improvements | 166.3           | 156.4    |
| Machinery and equipment    | 353.2           | 322.5    |
| Construction in progress   | 4.5             | 15.5     |
|                            | <b>539.2</b>    | 510.2    |
| Accumulated depreciation   | (319.3)         | (288.5)  |
|                            | <b>\$ 219.9</b> | \$ 221.7 |

**(8) Income Taxes**

The significant components of the Company's deferred income tax liabilities and assets are as follows:

|  | December 31,  |         |
|--|---------------|---------|
|  | 2013          | 2012    |
|  | (in millions) |         |
| Deferred income tax liabilities:               |               |         |
| Excess tax over book depreciation              | \$ 22.4       | \$ 23.7 |
| Intangibles                                    | 29.1          | 30.5    |
| Other  | 18.3          | 15.7    |
| Total deferred tax liabilities                 | <b>69.8</b>   | 69.9    |
| Deferred income tax assets:                    |               |         |
| Accrued expenses                               | 21.3          | 16.7    |
| Net operating loss carry-forward               | 10.9          | 5.4     |
| Inventory reserves                             | 12.3          | 8.6     |
| Pension accumulated other comprehensive income | 16.3          | 15.8    |
| Other  | 9.8           | 14.9    |
| Total deferred tax assets                      | <b>70.6</b>   | 61.4    |
| Less: valuation allowance                      | (13.1)        | (10.1)  |
| Net deferred tax assets                        | <b>57.5</b>   | 51.3    |

|                              |           |           |
|------------------------------|-----------|-----------|
| Net deferred tax liabilities | \$ (12.3) | \$ (18.6) |
|------------------------------|-----------|-----------|

## Watts Water Technologies, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

## (8) Income Taxes (Continued)

The provision for income taxes from continuing operations is based on the following pre-tax income:

|          | Years Ended December 31, |          |          |
|----------|--------------------------|----------|----------|
|          | 2013                     | 2012     | 2011     |
|          | (in millions)            |          |          |
| Domestic | \$ 21.6                  | \$ 27.3  | \$ 39.6  |
| Foreign  | 66.2                     | 72.9     | 68.3     |
|          | \$ 87.8                  | \$ 100.2 | \$ 107.9 |

The provision for income taxes from continuing operations consists of the following:

|                                 | Years Ended<br>December 31, |         |         |
|---------------------------------|-----------------------------|---------|---------|
|                                 | 2013                        | 2012    | 2011    |
|                                 | (in millions)               |         |         |
| Current tax expense:            |                             |         |         |
| Federal                         | \$ 12.8                     | \$ 5.0  | \$ 6.9  |
| Foreign                         | 19.7                        | 21.5    | 18.3    |
| State                           | 2.5                         | 1.3     | 1.8     |
|                                 | 35.0                        | 27.8    | 27.0    |
| Deferred tax expense (benefit): |                             |         |         |
| Federal                         | (5.0)                       | 4.4     | 5.5     |
| Foreign                         | (2.3)                       | (3.5)   | (3.0)   |
| State                           | (0.8)                       | 1.1     | 1.2     |
|                                 | (8.1)                       | 2.0     | 3.7     |
|                                 | \$ 26.9                     | \$ 29.8 | \$ 30.7 |

Actual income taxes reported from continuing operations are different than would have been computed by applying the federal statutory tax rate to income from continuing operations before income taxes. The reasons for this difference are as follows:

|  | Years Ended<br>December 31, |      |      |
|--|-----------------------------|------|------|
|  | 2013                        | 2012 | 2011 |



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|  | (in millions)  |                |                |
|--|----------------|----------------|----------------|
| Computed expected federal income expense       | \$ 30.8        | \$ 35.0        | \$ 37.8        |
| State income taxes, net of federal tax benefit | 1.0            | 1.5            | 1.9            |
| Foreign tax rate differential                  | (5.7)          | (7.4)          | (4.4)          |
| China tax clawback                             |                |                | (4.2)          |
| Other, net                                     | 0.8            | 0.7            | (0.4)          |
|  | <b>\$ 26.9</b> | <b>\$ 29.8</b> | <b>\$ 30.7</b> |

At December 31, 2013, the Company had foreign net operating loss carry forwards of \$43.5 million for income tax purposes before considering valuation allowances; \$32.0 million of the losses can be carried forward indefinitely and \$11.5 million expire in 2020. The net operating losses consist of

## Watts Water Technologies, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

**(8) Income Taxes (Continued)**

\$29.8 million related to Austrian operations, \$2.2 million to Italian operations, and \$11.5 million to Dutch operations.

At December 31, 2013 and December 31, 2012, the Company had valuation allowances of \$13.1 million and \$10.1 million, respectively. At December 31, 2013, \$6.1 million relates to U.S. capital losses and \$7.0 million relates to Austrian net operating losses. At December 31, 2012, the entire \$10.1 million related to U.S. capital losses. Management believes that the ability of the Company to use such losses within the applicable carry forward period does not rise to the level of the more likely than not threshold. The Company does not have a valuation allowance with respect to other deferred tax assets, as management believes that it is more likely than not that the Company will recover such deferred tax assets.

Changes enacted in income tax laws had no material effect on the Company in 2013, 2012 or 2011.

Undistributed earnings of the Company's foreign subsidiaries amounted to approximately \$397.2 million at December 31, 2013, \$329.7 million at December 31, 2012, and \$282.2 million at December 31, 2011. Those earnings are considered to be indefinitely reinvested and, accordingly, no provision for U.S. federal and state income taxes has been recorded thereon. Upon distribution of those earnings, in the form of dividends or otherwise, the Company will be subject to withholding taxes payable to the various foreign countries. Determination of the amount of U.S. income tax liability that would be incurred is not practicable because of the complexities associated with its hypothetical calculation; however, unrecognized foreign tax credits may be available to reduce some portion of any U.S. income tax liability. Withholding taxes of approximately \$11.3 million would be payable upon remittance of all previously unremitted earnings at December 31, 2013.

**(9) Accrued Expenses and Other Liabilities**

Accrued expenses and other liabilities consist of the following:

|   | December 31,    |                 |
|---|-----------------|-----------------|
|   | 2013            | 2012            |
|   | (in millions)   |                 |
| Commissions and sales incentives payable    | \$ 40.5         | \$ 40.6         |
| Product liability and workers' compensation | 33.5            | 31.4            |
| Other                                       | 56.6            | 42.5            |
| Income taxes payable                        | 4.6             | 2.1             |
|   | <b>\$ 135.2</b> | <b>\$ 116.6</b> |

## Watts Water Technologies, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

## (10) Financing Arrangements

Long-term debt consists of the following:

|   | December 31,    |                 |
|---|-----------------|-----------------|
|   | 2013            | 2012            |
|   | (in millions)   |                 |
| 5.85% notes due April 2016  | \$ 225.0        | \$ 225.0        |
| 5.47% notes due May 2013  |                 | 75.0            |
| 5.05% notes due June 2020   | 75.0            | 75.0            |
| Other consists primarily of European borrowings (at interest rates ranging from 5.0% to 6.0%) | 7.7             | 9.6             |
|   | <b>307.7</b>    | <b>384.6</b>    |
| Less Current Maturities   | 2.2             | 77.1            |
|   | <b>\$ 305.5</b> | <b>\$ 307.5</b> |

Principal payments during each of the next five years and thereafter are due as follows (in millions): 2014 \$2.2; 2015 \$2.3; 2016 \$226.5; 2017 \$1.7; 2018 \$0.0, and thereafter \$75.0.

The Company maintains letters of credit that guarantee its performance or payment to third parties in accordance with specified terms and conditions. Amounts outstanding were approximately \$23.6 million as of December 31, 2013 and \$34.8 million as of December 31, 2012. The Company's letters of credit are primarily associated with insurance coverage and, to a lesser extent, foreign purchases. The Company's letters of credit generally expire within one year of issuance and are drawn down against the revolving credit facility. These instruments may exist or expire without being drawn down. Therefore, they do not necessarily represent future cash flow obligations.

On June 18, 2010, the Company entered into a note purchase agreement with certain institutional investors (the 2010 Note Purchase Agreement). Pursuant to the 2010 Note Purchase Agreement, the Company issued senior notes of \$75.0 million in principal, due June 18, 2020. The Company will pay interest on the outstanding balance of the Notes at the rate of 5.05% per annum, payable semi-annually on June 18 and December 18 until the principal on the Notes shall become due and payable. The Company may, at its option, upon notice, and subject to the terms of the 2010 Note Purchase Agreement, prepay at any time all or part of the Notes in an amount not less than \$1 million by paying the principal amount plus a make-whole amount (which is dependent upon the yield of respective U.S. Treasury securities). The 2010 Note Purchase Agreement includes operational and financial covenants, with which the Company is required to comply, including, among others, maintenance of certain financial ratios and restrictions on additional indebtedness, liens and dispositions. As of December 31, 2013, the Company was in compliance with all covenants related to the 2010 Note Purchase Agreement.

On June 18, 2010, the Company entered into a credit agreement (the Prior Credit Agreement) among the Company, certain subsidiaries of the Company who become borrowers under the Prior Credit Agreement, Bank of America, N.A., as Administrative Agent, swing line lender and letter of credit issuer, and the other lenders referred to therein. The Prior Credit Agreement provided for a \$300 million, five-year, senior unsecured revolving credit facility which could have been increased by an additional \$150 million under certain circumstances and subject to the terms of the Prior Credit Agreement. The Prior Credit Agreement had a sublimit of up to \$75.0 million in letters of credit. Borrowings outstanding under the Prior Credit Agreement bore interest at a fluctuating rate per annum equal to (i) in the case of Eurocurrency rate loans, the British Bankers Association LIBOR rate

**Watts Water Technologies, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Continued)**

**(10) Financing Arrangements (Continued)**

plus an applicable percentage, ranging from 1.70% to 2.30%, determined by reference to the Company's consolidated leverage ratio plus, in the case of certain lenders, a mandatory cost calculated in accordance with the terms of the Prior Credit Agreement, or (ii) in the case of base rate loans and swing line loans, the highest of (a) the federal funds rate plus 0.5%, (b) the rate of interest in effect for such day as announced by Bank of America, N.A. as its "prime rate," and (c) the British Bankers Association LIBOR rate plus 1.0%, plus an applicable percentage, ranging from 0.70% to 1.30%, determined by reference to the Company's consolidated leverage ratio. In addition to paying interest under the Prior Credit Agreement, the Company was also required to pay certain fees in connection with the credit facility, including, but not limited to, a facility fee and letter of credit fees.

Under the Prior Credit Agreement, the Company was required to satisfy and maintain specified financial ratios and other financial condition tests. As of December 31, 2013, the Company was in compliance with all covenants related to the Prior Credit Agreement and had \$276.4 million of unused and available credit under the Prior Credit Agreement, \$23.6 million of stand-by letters of credit outstanding on the Prior Credit Agreement and no borrowings outstanding under the Prior Credit Agreement.

On February 18, 2014, the Company terminated the Prior Credit Agreement and entered into a new Credit Agreement (the New 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 New 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 New Credit Agreement. The New Credit Agreement has a sublimit of up to \$100 million in letters of credit. Borrowings outstanding under the New Credit Agreement bear interest at a fluctuating rate per annum equal to an applicable percentage equal to (i) 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 plus, in the case of certain lenders, a mandatory cost calculated in accordance with the terms of the New Credit Agreement, or (ii) in the case of base rate loans and swing line loans, the highest of (a) the federal funds rate plus 0.5%, (b) the rate of interest in effect for such day as announced by 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 New 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. The Credit Agreement matures on February 18, 2019, subject to extension under certain circumstances and subject to the terms of the New Credit Agreement. The Company may repay loans outstanding under the New Credit Agreement from time to time without premium or penalty, other than customary breakage costs, if any, and subject to the terms of the New Credit Agreement.

The New Credit Agreement imposes various restrictions on the Company and its subsidiaries, including restrictions pertaining to: (i) the incurrence of additional indebtedness, (ii) limitations on liens, (iii) making distributions, dividends and other payments, (iv) mergers, consolidations and acquisitions, (v) dispositions of assets, (vi) the maintenance of minimum consolidated net worth, certain consolidated leverage ratios and consolidated interest coverage ratios, (vii) transactions with affiliates, (viii) changes to governing documents, and (ix) changes in control.

**Watts Water Technologies, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Continued)**

**(10) Financing Arrangements (Continued)**

On April 27, 2006, the Company completed a private placement of \$225.0 million of 5.85% senior unsecured notes due April 2016 (the 2006 Note Purchase Agreement). The 2006 Note Purchase Agreement includes operational and financial covenants, with which the Company is required to comply, including, among others, maintenance of certain financial ratios and restrictions on additional indebtedness, liens and dispositions. Events of default under the 2006 Note Purchase Agreement include failure to comply with its financial and operational covenants, as well as bankruptcy and other insolvency events. The Company may, at its option, upon notice to the note holders, prepay at any time all or part of the Notes in an amount not less than \$1.0 million by paying the principal amount plus a make-whole amount, which is dependent upon the yield of respective U.S. Treasury securities. As of December 31, 2013, the Company was in compliance with all covenants related to the 2006 Note Purchase Agreement. The payment of interest on the senior unsecured notes is due semi-annually on April 30<sup>th</sup> and October 30<sup>th</sup> of each year.

On May 15, 2003, the Company completed a private placement of \$125.0 million of senior unsecured notes consisting of \$50.0 million principal amount of 4.87% senior notes due 2010 and \$75.0 million principal amount of 5.47% senior notes due May 2013. In May 2010, the Company repaid \$50.0 million in principal of 4.87% senior notes due upon maturity. The Company repaid the \$75.0 million of unsecured senior notes that matured on May 15, 2013 during the period ended June 30, 2013 with available cash.

**(11) Common Stock**

The Class A common stock and Class B common stock have equal dividend and liquidation rights. Each share of the Company's Class A common stock is entitled to one vote on all matters submitted to stockholders, and each share of Class B common stock is entitled to ten votes on all such matters. Shares of Class B common stock are convertible into shares of Class A common stock, on a one-to-one basis, at the option of the holder. As of December 31, 2013, the Company had reserved a total of 3,719,322 of Class A common stock for issuance under its stock-based compensation plans and 6,489,290 shares for conversion of Class B common stock to Class A common stock.

On April 30, 2013, the 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. The timing and number of any shares repurchased will be determined by the Company's management based on its evaluation of market conditions. Repurchases may also be made under a Rule 10b5-1 plan, which would permit 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 any Rule 10b5-1 plan the Company may enter into with respect to the repurchase program. During 2013, the Company repurchased approximately 454,000 shares of Class A common stock at a cost of approximately \$23.0 million.

On May 16, 2012, the Board of Directors authorized a stock repurchase program of up to two million shares of the Company's Class A common stock. The stock repurchase program was completed in July 2012, as the Company repurchased the entire two million shares of Class A common stock at a cost of approximately \$65.8 million.

On August 2, 2011 the Board of Directors authorized a stock repurchase program. Under the program, the Company was authorized to repurchase up to one million shares of our Class A common stock. During the three months ended October 2, 2011, the Company repurchased the entire one million shares at a cost of \$27.2 million.

**Watts Water Technologies, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Continued)**

**(12) Stock-Based Compensation**

As of December 31, 2013, the Company maintains two stock incentive plans under which key employees have been granted incentive stock options (ISOs) and nonqualified stock options (NSOs) to purchase the Company's Class A common stock. Only one plan, the Second Amended and Restated 2004 Stock Incentive Plan, is currently available for the grant of new stock options, which are currently being granted only to employees. Under the 2004 Stock Incentive Plan, options become exercisable over a four-year period at the rate of 25% per year and expire ten years after the grant date. ISOs and NSOs granted under the plans may have exercise 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. At December 31, 2013, 1,650,400 shares of Class A common stock were authorized for future grants of new equity awards under the Company's 2004 Stock Incentive Plan.

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 vest immediately, and employees restricted stock awards and deferred shares vest over a three-year period at the rate of one-third per year. The restricted stock awards and deferred shares are amortized to expense on a straight-line basis over the vesting period.

The Company also has a Management Stock Purchase Plan that allows for the granting of restricted stock units (RSUs) to 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 provides the key employee with the right to purchase a share of Class A common stock at 67% of the fair market value 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. At December 31, 2013, 897,029 shares of Class A common stock were authorized for future grants under the Company's Management Stock Purchase Plan.

*2004 Stock Incentive Plan*

At December 31, 2013, total unrecognized compensation cost related to the unvested stock options was approximately \$10.6 million with a total weighted average remaining term of 2.9 years. For 2013, 2012 and 2011, the Company recognized compensation cost of \$3.8 million, \$2.1 million and \$1.6 million, respectively, in selling, general and administrative expenses. The Company recognized additional stock compensation expense in 2012 of approximately \$0.6 million in connection with the modification of our former Chief Financial Officer's options related to his retention agreement. The Company recognized additional stock compensation expense in 2011 of approximately \$2.2 million in connection with the modification of the former Chief Executive Officer's options related to his separation agreement.

## Watts Water Technologies, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

## (12) Stock-Based Compensation (Continued)

The following is a summary of stock option activity and related information:

|                                  | Years Ended December 31, |                                 |                                  |         |                                 |         |                                 |
|----------------------------------|--------------------------|---------------------------------|----------------------------------|---------|---------------------------------|---------|---------------------------------|
|                                  | 2013                     |                                 | 2012                             |         | 2011                            |         |                                 |
|                                  | Options                  | Weighted Average Exercise Price | Weighted Average Intrinsic Value | Options | Weighted Average Exercise Price | Options | Weighted Average Exercise Price |
| (Options in thousands)           |                          |                                 |                                  |         |                                 |         |                                 |
| Outstanding at beginning of year | 1,064                    | \$ 33.37                        |                                  | 1,272   | \$ 30.43                        | 1,303   | \$ 29.00                        |
| Granted                          | 379                      | 54.78                           |                                  | 415     | 37.67                           | 295     | 29.39                           |
| Cancelled/Forfeitures            | (53)                     | 36.97                           |                                  | (33)    | 31.18                           | (78)    | 30.38                           |
| Exercised                        | (361)                    | 31.73                           |                                  | (590)   | 30.19                           | (248)   | 21.68                           |
| Outstanding at end of year       | 1,029                    | \$ 41.66                        | \$ 20.21                         | 1,064   | \$ 33.37                        | 1,272   | \$ 30.43                        |
| Exercisable at end of year       | 249                      | \$ 32.35                        | \$ 29.52                         | 360     | \$ 30.91                        | 745     | \$ 30.61                        |

As of December 31, 2013, the aggregate intrinsic value of exercisable options was approximately \$7.3 million, representing the total pre-tax intrinsic value, based on the Company's closing Class A common stock price of \$61.87 as of December 31, 2013, which would have been received by the option holders had all option holders exercised their options as of that date. The total intrinsic value of options exercised for 2013, 2012 and 2011 was approximately \$7.4 million, \$5.7 million and \$3.9 million, respectively.

Upon exercise of options, the Company issues shares of Class A common stock.

The following table summarizes information about options outstanding at December 31, 2013:

| Range of Exercise Prices | Options Outstanding |   |                                 | Options Exercisable |                                 |  |
|--------------------------|---------------------|---|---------------------------------|---------------------|---------------------------------|--|
|                          | Number Outstanding  | Weighted Average Remaining Contractual Life (years) | Weighted Average Exercise Price | Number Exercisable  | Weighted Average Exercise Price |  |
| (Options in thousands)   |                     |   |                                 |                     |                                 |  |
| \$26.34 - \$33.65        | 305                 | 3.97  | \$ 30.18                        | 174                 | \$ 30.16                        |  |
| \$35.20 - \$35.70        | 10                  | 3.80  | 35.35                           | 10                  | 35.35                           |  |
| \$37.41 - \$37.41        | 301                 | 6.05  | 37.41                           | 55                  | 37.41                           |  |
| \$40.17 - \$57.95        | 413                 | 7.93  | 53.40                           | 10                  | 40.17                           |  |
|                          | 1,029               | 6.17  | \$ 41.66                        | 249                 | \$ 32.35                        |  |

The fair value of each option granted under the 2004 Stock Incentive Plan is estimated on the date of grant, using the Black-Scholes-Merton Model, based on the following weighted average assumptions:

|                                 | Years Ended December 31, |       |       |
|---------------------------------|--------------------------|-------|-------|
|                                 | 2013                     | 2012  | 2011  |
| Expected life (years)           | <b>6.0</b>               | 6.0   | 6.0   |
| Expected stock price volatility | <b>40.3%</b>             | 41.2% | 40.9% |
| Expected dividend yield         | <b>1.0%</b>              | 1.2%  | 1.5%  |
| Risk-free interest rate         | <b>1.7%</b>              | 0.9%  | 1.6%  |

83



## Watts Water Technologies, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

## (12) Stock-Based Compensation (Continued)

The risk-free interest rate is based upon the U.S. Treasury yield curve at the time of grant for the respective expected life of the option. The expected life (estimated period of time outstanding) of options and volatility were calculated using historical data. The expected dividend yield of stock is the Company's best estimate of the expected future dividend yield. The Company applied an estimated forfeiture rate of 6.75% for 2013, 2012 and 2011, for its stock options. This rate was calculated based upon historical activity and is an estimate of granted shares not expected to vest. If actual forfeitures differ from the expected rates, the Company may be required to make additional adjustments to compensation expense in future periods.

The above assumptions were used to determine the weighted average grant-date fair value of stock options of \$20.30, \$13.49 and \$10.19 for the years ended December 31, 2013, 2012 and 2011, respectively.

The following is a summary of unvested restricted stock and deferred shares activity and related information:

|                               | Years Ended December 31, |   |        |   |        |   |
|-------------------------------|--------------------------|---|--------|---|--------|---|
|                               | 2013                     |   | 2012   |   | 2011   |   |
|                               | Shares                   | Weighted<br>Average<br>Grant Date<br>Fair Value | Shares | Weighted<br>Average<br>Grant Date<br>Fair Value | Shares | Weighted<br>Average<br>Grant Date<br>Fair Value |
| (Shares in thousands)         |                          |   |        |   |        |   |
| Unvested at beginning of year | 237                      | \$ 35.45  | 153    | \$ 30.33  | 162    | \$ 31.39  |
| Granted                       | 142                      | 54.80   | 170    | 37.62   | 115    | 29.51   |
| Cancelled/Forfeitures         | (16)                     | 37.44   | (8)    | 30.66   | (14)   | 31.12   |
| Vested                        | (103)                    | 35.25   | (78)   | 30.61   | (110)  | 30.94   |
| Unvested at end of year       | 260                      | \$ 45.58  | 237    | \$ 35.45  | 153    | \$ 30.33  |

The total fair value of shares vested during 2013, 2012 and 2011 was \$5.6 million, \$2.5 million and \$2.5 million, respectively. At December 31, 2013, total unrecognized compensation cost related to unvested restricted stock and deferred shares was approximately \$9.4 million with a total weighted average remaining term of 2.1 years. For 2013, 2012 and 2011, the Company recognized compensation costs of \$5.1 million, \$2.9 million and \$2.4 million, respectively, in selling, general and administrative expenses. The Company recognized additional stock compensation expense in 2012 of approximately \$0.2 million in connection with the modification of our former Chief Financial Officer's restricted stock awards related to his retention agreement. The Company recognized additional stock compensation expense in 2011 related to restricted stock of approximately \$0.8 million in connection with the modification of the former Chief Executive Officer's stock awards related to his separation agreement.

The Company applied an estimated forfeiture rate of 9.0% for 2013, 2012 and 2011, for restricted stock and deferred shares issued to key employees. The aggregate intrinsic value of restricted stock and deferred shares granted and outstanding approximated \$16.1 million representing the total pre-tax intrinsic value based on the Company's closing Class A common stock price of \$61.87 as of December 31, 2013.

*Management Stock Purchase Plan*

Total unrecognized compensation cost related to unvested RSUs was approximately \$0.8 million at December 31, 2013 with a total weighted average remaining term of 1.4 years. For 2013, 2012 and 2011

## Watts Water Technologies, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

## (12) Stock-Based Compensation (Continued)

the Company recognized compensation cost of \$0.7 million, \$0.8 million and \$1.3 million, respectively, in selling, general and administrative expenses. Dividends declared for RSUs, that are paid to individuals, that remain unpaid at December 31, 2013 total approximately \$0.1 million.

A summary of the Company's RSU activity and related information is shown in the following table:

|                                    | Years Ended December 31,                 |   |  |  |  |  |          |
|------------------------------------|--|---|--|--|--|--|----------|
|                                    | 2013                                     |   | 2012                                     |  | 2011                                     |  |          |
|                                    | Weighted<br>Average<br>Purchase<br>Price | Weighted<br>Average<br>Intrinsic<br>Value | Weighted<br>Average<br>Purchase<br>Price | Weighted<br>Average<br>Purchase<br>Price | Weighted<br>Average<br>Purchase<br>Price | Weighted<br>Average<br>Purchase<br>Price |          |
| RSUs                               |  |   | RSUs                                     |  | RSUs                                     |  |          |
| (RSU's in thousands)               |  |   |  |  |  |  |          |
| Outstanding at beginning of period | 196                                      | \$ 22.88                                  | 392                                      | \$ 18.74                                 | 361                                      | \$ 16.92                                 |          |
| Granted                            | 45                                       | 31.63                                     | 64                                       |  | 99                                       | 25.15                                    |          |
| Cancelled/Forfeitures              | (14)                                     | 28.35                                     | (110)                                    |  | (10)                                     | 20.92                                    |          |
| Settled                            | (95)                                     | 19.19                                     | (150)                                    |  | (58)                                     | 18.01                                    |          |
| Outstanding at end of period       | 132                                      | \$ 27.46                                  | \$ 34.41                                 | 196                                      | \$ 22.88                                 | 392                                      | \$ 18.74 |
| Vested at end of period            | 42                                       | \$ 25.30                                  | \$ 36.57                                 | 81                                       | \$ 20.36                                 | 157                                      | \$ 15.57 |

As of December 31, 2013, the aggregate intrinsic values of outstanding and vested RSUs were approximately \$4.5 million and \$1.5 million, respectively, representing the total pre-tax intrinsic value, based on the Company's closing Class A common stock price of \$61.87 as of December 31, 2013, which would have been received by the RSUs holders had all RSUs settled as of that date. The total intrinsic value of RSUs settled for 2013, 2012 and 2011 was approximately \$2.8 million, \$3.8 million and \$1.2 million, respectively. Upon settlement of RSUs, the Company issues shares of Class A common stock.

The following table summarizes information about RSUs outstanding at December 31, 2013:

| Range of Purchase Prices | RSUs Outstanding   |                                 | RSUs Vested   |                                 |
|--------------------------|--------------------|---------------------------------|---------------|---------------------------------|
|                          | Number Outstanding | Weighted Average Purchase Price | Number Vested | Weighted Average Purchase Price |
| (RSUs in thousands)      |                    |                                 |               |                                 |
| \$13.25 \$19.87          | 2                  | \$ 16.21                        | 2             | \$ 16.21                        |
| \$25.15 \$26.51          | 91                 | 25.88                           | 40            | 25.69                           |
| \$31.63 \$31.63          | 39                 | 31.63                           |               |                                 |
|                          | 132                | \$ 27.46                        | 42            | \$ 25.30                        |



## Watts Water Technologies, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

**(12) Stock-Based Compensation (Continued)**

The fair value of each share 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:

|                                 | Years Ended December 31, |       |       |
|---------------------------------|--------------------------|-------|-------|
|                                 | 2013                     | 2012  | 2011  |
| Expected life (years)           | 3.0                      | 3.0   | 3.0   |
| Expected stock price volatility | 34.1%                    | 38.3% | 44.9% |
| Expected dividend yield         | 0.9%                     | 1.1%  | 1.2%  |
| Risk-free interest rate         | 0.4%                     | 0.4%  | 1.2%  |

The risk-free interest rate is based upon the U.S. Treasury yield curve at the time of grant for the respective expected life of the RSUs. The expected life (estimated period of time outstanding) of RSUs and volatility were calculated using historical data. The expected dividend yield of stock is the Company's best estimate of the expected future dividend yield. The Company applied an estimated forfeiture rate of 6.3% for 2013, 2012 and 2011, for its RSUs. This rate was calculated based upon historical activity and an estimate of granted shares not expected to vest. If actual forfeitures differ from the expected rates, the Company may be required to make additional adjustments to compensation expense in future periods.

The above assumptions were used to determine the weighted average grant-date fair value of RSUs granted of \$18.05, \$15.68 and \$16.25 during 2013, 2012 and 2011, respectively.

The Company distributed dividends of \$0.50 per share for 2013, and \$0.44 per share for 2012 and 2011, respectively, on the Company's Class A common stock and Class B common stock.

**(13) Employee Benefit Plans**

The Company sponsors funded and unfunded non-contributing defined benefit pension plans that together cover substantially all of its domestic employees. Benefits are based primarily on years of service and employees' compensation. The funding policy of the Company for these plans is to contribute an annual amount that does not exceed the maximum amount that can be deducted for federal income tax purposes.

On October 31, 2011, the Company's Board of Directors voted to cease accruals effective December 31, 2011 under both the Company's Pension Plan and Supplemental Employees Retirement Plan. The Company recorded a curtailment charge of approximately \$1.5 million to write-off previously unrecognized prior service costs and reduced the projected benefit obligation by \$12.5 million. The Board of Directors also voted to enhance the Company's existing 401(k) Savings Plan.

## Watts Water Technologies, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

## (13) Employee Benefit Plans (Continued)

The funded status of the defined benefit plans and amounts recognized in the consolidated balance sheets are as follows:

|   | December 31,  |           |
|---|---------------|-----------|
|   | 2013          | 2012      |
|   | (in millions) |           |
| <b>Change in projected benefit obligation</b> |               |           |
| Balance at beginning of the year              | \$ 138.0      | \$ 121.2  |
| Service cost                                  | 0.5           | 0.6       |
| Administration costs paid                     | (0.8)         | (0.9)     |
| Interest cost                                 | 5.4           | 5.7       |
| Actuarial (gain) loss                         | (12.5)        | 15.6      |
| Benefits paid                                 | (4.3)         | (4.2)     |
| <br>  |               |           |
| Balance at end of year                        | \$ 126.3      | \$ 138.0  |
| <br>  |               |           |
| <b>Change in fair value of plan assets</b>    |               |           |
| Balance at beginning of the year              | \$ 115.8      | \$ 108.4  |
| Actual (loss) gain on assets                  | (7.7)         | 11.8      |
| Employer contributions                        | 0.7           | 0.7       |
| Administration costs paid                     | (0.8)         | (0.9)     |
| Benefits paid                                 | (4.3)         | (4.2)     |
| <br>  |               |           |
| Fair value of plan assets at end of the year  | \$ 103.7      | \$ 115.8  |
| <br>  |               |           |
| Funded status at end of year                  | \$ (22.6)     | \$ (22.2) |

Amounts recognized in the consolidated balance sheets are as follows:

|                        | December 31,  |           |
|------------------------|---------------|-----------|
|                        | 2013          | 2012      |
|                        | (in millions) |           |
| Current liabilities    | \$ (0.6)      | \$ (0.6)  |
| Noncurrent liabilities | (22.0)        | (21.6)    |
| <br>                   |               |           |
| Net amount recognized  | \$ (22.6)     | \$ (22.2) |

Amounts recognized in accumulated other comprehensive income consist of:

|                               | December 31,  |         |
|-------------------------------|---------------|---------|
|                               | 2013          | 2012    |
|                               | (in millions) |         |
| Net actuarial loss recognized | \$ 42.2       | \$ 41.2 |

## Watts Water Technologies, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

## (13) Employee Benefit Plans (Continued)

Information for pension plans with an accumulated benefit obligation in excess of plan assets are as follows:

|                                | December 31,  |          |
|--------------------------------|---------------|----------|
|                                | 2013          | 2012     |
|                                | (in millions) |          |
| Projected benefit obligation   | \$ 126.3      | \$ 138.0 |
| Accumulated benefit obligation | \$ 126.3      | \$ 138.0 |
| Fair value of plan assets      | \$ 103.7      | \$ 115.8 |

The components of net periodic benefit cost are as follows:

|                                       | Years Ended<br>December 31, |        |        |
|---------------------------------------|-----------------------------|--------|--------|
|                                       | 2013                        | 2012   | 2011   |
|                                       | (in millions)               |        |        |
| Service cost benefits earned          | \$ 0.5                      | \$ 0.6 | \$ 5.3 |
| Interest costs on benefits obligation | 5.4                         | 5.7    | 6.0    |
| Expected return on assets             | (6.8)                       | (6.9)  | (7.5)  |
| Prior service cost amortization       |                             |        | 0.3    |
| Net actuarial loss amortization       | 1.0                         | 0.6    | 2.7    |
| Curtailment charge                    |                             |        | 1.5    |
| Net periodic benefit cost             | \$ 0.1                      | \$     | \$ 8.3 |

For fiscal year 2014, the estimated net actuarial loss for the defined benefit pension plans that will be amortized from accumulated other comprehensive income into net periodic benefit cost is \$1.1 million.

Assumptions:

Weighted-average assumptions used to determine benefit obligations:

|               | December 31, |      |
|---------------|--------------|------|
|               | 2013         | 2012 |
| Discount rate | 4.9%         | 4.0% |

Weighted-average assumptions used to determine net periodic benefit costs:

|                                    | Years Ended December 31, |       |             |
|------------------------------------|--------------------------|-------|-------------|
|                                    | 2013                     | 2012  | 2011        |
| Discount rate                      | 4.0%                     | 4.8%  | 5.50%/4.70% |
| Long-term rate of return on assets | 6.0%                     | 6.50% | 7.75%       |

Discount rates are selected based upon rates of return at the measurement date utilizing a bond matching approach to match the expected benefit cash flows. In selecting the expected long-term rate of return on assets, the Company considers the average rate of earnings expected on the funds invested or to be invested to provide for the benefits of this plan. This includes considering the trust's asset allocation and the expected returns likely to be earned over the life of the plan. This basis is consistent





## Watts Water Technologies, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

## (13) Employee Benefit Plans (Continued)

with the prior year. The original 2011 discount rate of 5.5% was revised to 4.70% at October 31, 2011, the curtailment date of the plans.

*Plan assets*

The Company's written Retirement Plan Investment Policy sets forth the investment policy, objectives and constraints of the Watts Water Technologies, Inc. Pension Plan. This Retirement Plan Investment Policy, set forth by the Pension Plan Committee, defines general investment principles and directs investment management policy, addressing preservation of capital, risk aversion and adherence to investment discipline. Investment managers are to make a reasonable effort to control risk and are evaluated quarterly against commonly accepted benchmarks to ensure that the risk assumed is commensurate with the given investment style and objectives.

The portfolio is designed to achieve a balanced return of current income and modest growth of capital, while achieving returns in excess of the rate of inflation over the investment horizon in order to preserve purchasing power of Plan assets. All Plan assets are required to be invested in liquid securities. Derivative investments are not allowed.

Prohibited investments include, but are not limited to the following: futures contracts, private placements, options, limited partnerships, venture-capital investments, interest-only (IO), principal-only (PO), and residual tranche collateralized mortgage obligation (CMOs), and Watts Water Technologies, Inc. stock.

Prohibited transactions include, but are not limited to the following: short selling and margin transactions.

Allowable assets include: cash equivalents, fixed income securities, equity securities, mutual funds, and guaranteed investment contracts.

Specific guidelines regarding allocation of assets are followed using a liability driven investment (LDI) strategy. Under an LDI strategy, investments are made based on the expected cash flows required to fund the pension plan's liabilities. This cash flow matching technique requires a plan's asset allocation to be heavily weighted toward fixed income securities. The Company's current allocation target is 85% fixed income, 15% equities and other investments. With the plan curtailment, this allocation target may increase to 90% or more in fixed income in the future. Investment performance is monitored on a regular basis and investments are re-allocated to stay within specific guidelines. The securities of any one company or government agency should not exceed 10% of the total fund, and no more than 20% of the total fund should be invested in any one industry. Individual treasury securities may represent 50% of the total fund, while the total allocation to treasury bonds and notes may represent up to 100% of the Plan's aggregate bond position.

The weighted average asset allocations by asset category are as follows:

| Asset Category    | December 31, |        |
|-------------------|--------------|--------|
|                   | 2013         | 2012   |
| Equity securities | 9.4%         | 9.6%   |
| Debt securities   | 85.1         | 85.3   |
| Other             | 5.5          | 5.1    |
| Total             | 100.0%       | 100.0% |

## Watts Water Technologies, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

## (13) Employee Benefit Plans (Continued)

The following table presents the investments in the pension plan measured at fair value at December 31, 2013 and 2012:

|                                | December 31, 2013 |            |            |          | December 31, 2012 |            |            |          |
|--------------------------------|-------------------|------------|------------|----------|-------------------|------------|------------|----------|
|                                | Level<br>1        | Level<br>2 | Level<br>3 | Total    | Level<br>1        | Level<br>2 | Level<br>3 | Total    |
|                                | (in millions)     |            |            |          |                   |            |            |          |
| <b>Money market funds</b>      | \$ 2.0            | \$         | \$         | \$ 2.0   | \$ 1.2            | \$ 0.3     | \$         | \$ 1.5   |
| <b>Equity securities</b>       |                   |            |            |          |                   |            |            |          |
| U.S. equity securities(a)      | 7.6               |            |            | 7.6      | 8.3               |            |            | 8.3      |
| Non-U.S. equity securities(a)  | 1.3               |            |            | 1.3      | 1.4               |            |            | 1.4      |
| Other equity securities(b)     | 0.7               |            |            | 0.7      | 1.3               |            |            | 1.3      |
| <b>Debt securities</b>         |                   |            |            |          |                   |            |            |          |
| U.S. government                | 16.5              |            |            | 16.5     | 18.8              |            |            | 18.8     |
| U.S. and non-U.S. corporate(c) |                   | 70.9       |            | 70.9     |                   | 79.0       |            | 79.0     |
| <b>Other investments(d)</b>    | 4.7               |            |            | 4.7      | 4.4               | 1.1        |            | 5.5      |
| <b>Total investments</b>       | \$ 32.8           | \$ 70.9    | \$         | \$ 103.7 | \$ 35.4           | \$ 80.4    | \$         | \$ 115.8 |

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- (a) Includes investments in common stock from diverse industries
- (b) Includes investments in index and exchange-traded funds
- (c) Includes investment grade bonds from diverse industries
- (d) Includes investments in real estate investment funds, exchange-traded funds, commodity mutual funds and accrued interest

*Cash flows*

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

|                        | December 31,  |        |
|------------------------|---------------|--------|
|                        | 2013          | 2012   |
|                        | (in millions) |        |
| Employer Contributions | \$ 0.7        | \$ 0.7 |
| Benefit Payments       | \$ 4.3        | \$ 4.2 |

The Company expects to contribute approximately \$0.8 million in 2014.

Expected benefit payments to be paid by the pension plans are as follows:

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|  | (in millions) |
|--|---------------|
| During fiscal year ending December 31, 2014                            | \$ 5.2        |
| During fiscal year ending December 31, 2015                            | \$ 5.5        |
| During fiscal year ending December 31, 2016                            | \$ 5.8        |
| During fiscal year ending December 31, 2017                            | \$ 6.1        |
| During fiscal year ending December 31, 2018                            | \$ 6.4        |
| During fiscal years ending December 31, 2019 through December 31, 2023 | \$ 37.3       |

90

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**Watts Water Technologies, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Continued)**

**(13) Employee Benefit Plans (Continued)**

Additionally, all of the Company's domestic employees are eligible to participate in the Company's 401(k) savings plan. Effective January 1, 2012, the Company provides a base contribution of 2% of an employee's salary, regardless of whether the employee participates in the plan. Further, the Company matches the contribution of up to 100% of the first 4% of an employee's contribution. The Company's match contribution for the years ended December 31, 2013 and 2012 were \$4.2 million and \$4.0 million, respectively. During 2011, the Company matched a specified percentage of employee contributions, subject to certain limitations. The Company's match contributions for the year ended December 31, 2011 was \$0.5 million. Charges for EMEA pension plans approximated \$5.8 million, \$6.0 million and \$6.2 million for the years ended December 31, 2013, 2012 and 2011, respectively. These costs relate to plans administered by certain European subsidiaries, with benefits calculated according to government requirements and paid out to employees upon retirement or change of employment.

The Company entered into a Supplemental Compensation Agreement (the Agreement) with Timothy P. Horne on September 1, 1996. Per the Agreement, upon ceasing to be an employee of the Company, Mr. Horne must make himself available, as requested by the Board, to work a minimum of 300 but not more than 500 hours per year as a consultant in return for certain annual compensation as long as he is physically able to do so. Mr. Horne retired effective December 31, 2002, and therefore the Supplemental Compensation period began on January 1, 2003. If Mr. Horne complies with the consulting provisions of the agreement above, he shall receive supplemental compensation on an annual basis, subject to cost of living increases each year, in exchange for the services performed, as long as he is physically able to do so. The payment for consulting services provided by Mr. Horne will be expensed as incurred by the Company. During the years ended 2013, 2012 and 2011, Mr. Horne received payments of \$0.6 million, \$0.6 million and \$0.5 million, respectively. In the event of physical disability, Mr. Horne will continue to receive this payment annually. In accordance with Generally Accepted Accounting Principles (GAAP), the Company accrues for the future post-retirement disability benefits over the period from January 1, 2003, to the time in which Mr. Horne becomes physically unable to perform his consulting services (the period in which the disability benefits are earned). Mr. Horne is still active as a consultant in accordance with the terms of the Agreement.

**(14) 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, net of any applicable insurance proceeds. The Company does not establish accruals for such matters when the Company does not believe both 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

**Watts Water Technologies, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Continued)**

**(14) Contingencies and Environmental Remediation (Continued)**

end of the range of reasonable 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.

As of December 31, 2013, the Company estimates that the aggregate amount of reasonably possible loss in excess of the amount accrued for its legal contingencies is approximately \$11.2 million pre-tax. With respect to the estimate of reasonably possible loss, management has estimated the upper end of the range of reasonably possible loss based on (i) the amount of money damages claimed, where applicable, (ii) the allegations and factual development to date, (iii) available defenses based on the allegations, and/or (iv) other potentially liable parties. This estimate is based upon currently available information and is subject to significant judgment and a variety of assumptions, and known and unknown uncertainties. The matters underlying the estimate will change from time to time, and actual results may vary significantly from the current estimate. In the event of an unfavorable outcome in one or more of the matters described below, the ultimate liability may be in excess of amounts currently accrued, if any, and may be material to the Company's operating results or cash flows for a particular quarterly or annual period. However, based on information currently known to it, management believes that the ultimate outcome of all matters, as they are resolved over time, is not likely to have a material adverse effect on the financial condition of the Company, though the outcome could be material to the Company's operating results for any particular period depending, in part, upon the operating results for such period.

*Trabakoolas et al., v. Watts Water Technologies, Inc., et al.,*

On March 8, 2012, Watts Water Technologies, Inc., Watts Regulator Co., and Watts Plumbing Technologies Co., Ltd., among other companies, were named as defendants in a putative nationwide class action complaint filed in the U.S. District Court for the Northern District of California seeking to recover damages and other relief based on the alleged failure of toilet connectors. The complaint seeks among other items, damages in an unspecified amount, replacement costs, injunctive relief, and attorneys' fees and costs. No class certification hearing has been scheduled and the matter is currently in the discovery phase. On August 22, 2013, the Court stayed the action for 45 days, to allow the parties to explore the possibility of settlement. On October 8, 2013, this stay was extended until November 7, 2013, in order to allow the parties additional time to explore settlement. On November 7, 2013, the Court extended the stay until December 12, 2013, in order to allow the parties additional time to explore settlement.

On December 12, 2013, the Company reached an agreement in principle to settle all claims. The total settlement amount is \$23.0 million, of which the Company would be responsible for \$14.0 million after insurance proceeds of \$9.0 million. The settlement was subject to review by the Court at a preliminary approval hearing held on February 12, 2014. The Court granted preliminary approval on February 14, 2014. The settlement is subject to final court approval after a fairness hearing currently scheduled for July 16, 2014. Accordingly, there can be no assurance that the proposed settlement will be approved in its current form. If the settlement is not approved, the Company intends to continue to vigorously contest the allegations in this case.

**Watts Water Technologies, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Continued)**

**(14) Contingencies and Environmental Remediation (Continued)**

During the fourth quarter of 2013, the Company recorded a liability of \$22.6 million related to the Trabakoolas matter, of which \$12.7 million was included in current liabilities and \$9.9 million in other noncurrent liabilities. In addition, a \$9.0 million receivable was recorded in current assets related to insurance proceeds due under a separate settlement agreement if the class action settlement is approved.

*Product Liability*

The Company is subject to a variety of potential liabilities in connection with product liability cases. The Company maintains product liability and other insurance coverage, which the Company believes to be generally in accordance with industry practices. For product liability cases in the U.S., management establishes its product liability accrual, which includes legal costs associated with accrued claims, by utilizing third-party actuarial valuations which incorporate historical trend factors and the Company's specific claims experience derived from loss reports provided by third-party administrators. In other countries, the Company maintains insurance coverage with relatively high deductible payments, as product liability claims tend to be smaller than those experienced in the U.S. Changes in the nature of claims or the actual settlement amounts could affect the adequacy of this estimate and require changes to the provisions. Because the liability is an estimate, the ultimate liability may be more or less than reported.

*Foreign Corrupt Practices Act Settlement*

On October 13, 2011, the Company entered into a settlement with the SEC to resolve allegations concerning potential violations of the U.S. Foreign Corrupt Practices Act (FCPA) at Watts Valve Changsha Co., Ltd., (CWV), a former indirect wholly-owned subsidiary of Watts Water in China. Under the terms of the settlement, without admitting or denying the SEC's allegations, the Company consented to entry of an administrative cease-and-desist order under the books and records and internal controls provisions of the FCPA. The Company also agreed to pay to the SEC \$3.6 million in disgorgement and prejudgment interest, and \$0.2 million in penalties.

The amounts paid by us in connection with the settlement were fully accrued as of December 31, 2010. This settlement resolves all government investigations with respect to the Company concerning CWV's sales practices and potential FCPA violations.

*Environmental Remediation*

The Company has been named as a potentially responsible party with respect to a limited number of identified contaminated sites. The levels of contamination vary significantly from site to site as do the related levels of remediation efforts. Environmental liabilities are recorded based on the most probable cost, if known, or on the estimated minimum cost of remediation. Accruals are not discounted to their present value, unless the amount and timing of expenditures are fixed and reliably determinable. The Company accrues estimated environmental liabilities based on assumptions, which are subject to a number of factors and uncertainties. Circumstances that can affect the reliability and precision of these estimates include identification of additional sites, environmental regulations, level of clean-up required, technologies available, number and financial condition of other contributors to remediation and the time period over which remediation may occur. The Company recognizes changes in estimates as new remediation requirements are defined or as new information becomes available.

## Watts Water Technologies, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

**(14) Contingencies and Environmental Remediation (Continued)***Asbestos Litigation*

The Company is defending 44 lawsuits in different jurisdictions, alleging injury or death as a result of exposure to asbestos. The complaints in these cases typically name a large number of defendants and do not identify any particular Company products as a source of asbestos exposure. To date, the Company has obtained a dismissal in every case before it has reached trial because discovery has failed to yield evidence of substantial exposure to any Company products.

*Other Litigation*

Other lawsuits and proceedings or claims, arising from the ordinary course of operations, are also pending or threatened against the Company.

**(15) Financial Instruments***Fair Value*

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

The fair 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 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:

|                      | December 31,  |          |
|----------------------|---------------|----------|
|                      | 2013          | 2012     |
|                      | (in millions) |          |
| Carrying amount      | \$ 307.7      | \$ 384.6 |
| Estimated fair value | \$ 333.4      | \$ 420.8 |

*Financial Instruments*

The Company measures certain financial assets and liabilities at fair value on a recurring basis, including foreign currency derivatives, deferred compensation plan assets and related liability. There

## Watts Water Technologies, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

## (15) Financial Instruments (Continued)

are no cash flow hedges as of December 31, 2013. The fair value of these certain financial assets and liabilities were determined using the following inputs at December 31, 2013 and 2012:

|   | Fair Value Measurements at December 31, 2013 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)                               |   |  |   |   |
| <b>Assets</b>                               |   |  |   |   |
| Plan asset for deferred compensation(1)     | \$ 4.6  | \$ 4.6   | \$  | \$  |
| <b>Total assets</b>                         | <b>\$ 4.6</b>                                       | <b>\$ 4.6</b>  | <b>\$</b>                                     | <b>\$</b>                                 |
| <b>Liabilities</b>                          |   |  |   |   |
| Plan liability for deferred compensation(2) | \$ 4.6  | \$ 4.6   | \$  | \$  |
| Contingent consideration(2)                 | 4.4   |  |   | 4.4                                       |
| <b>Total liabilities</b>                    | <b>\$ 9.0</b>                                       | <b>\$ 4.6</b>  | <b>\$</b>                                     | <b>\$ 4.4</b>                             |

|   | Fair Value Measurements at December 31, 2012 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)                               |   |  |   |   |
| <b>Assets</b>                               |   |  |   |   |
| Plan asset for deferred compensation(1)     | \$ 4.2  | \$ 4.2   | \$  | \$  |
| <b>Total assets</b>                         | <b>\$ 4.2</b>                                       | <b>\$ 4.2</b>  | <b>\$</b>                                     | <b>\$</b>                                 |
| <b>Liabilities</b>                          |   |  |   |   |
| Plan liability for deferred compensation(2) | \$ 4.2  | \$ 4.2   | \$  | \$  |
| Contingent consideration(2)                 | 5.2   |  |   | 5.2                                       |



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|                   |        |    |     |    |        |
|-------------------|--------|----|-----|----|--------|
| Total liabilities | \$ 9.4 | \$ | 4.2 | \$ | \$ 5.2 |
|-------------------|--------|----|-----|----|--------|

- 
- (1) Included in other, net on the Company's consolidated balance sheet.
- (2) Included in other noncurrent liabilities on the Company's consolidated balance sheet.

The table below provides a summary of the changes in fair value of all financial assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the period December 31, 2012 to December 31, 2013.

|                          | Balance<br>December 31,<br>2012 | Purchases,<br>sales,<br>settlements,<br>net | Net<br>earnings<br>adjustments<br>(in millions) | Total realized and<br>unrealized (gains)<br>losses included in:<br>Comprehensive<br>income | Balance<br>December 31,<br>2013 |
|--------------------------|---------------------------------|---|---|--|---------------------------------|
| Contingent consideration | \$ 5.2                          | \$ (1.2)                                    | \$ 0.8  | \$ (0.4)   | \$ 4.4                          |

**Watts Water Technologies, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Continued)**

**(15) Financial Instruments (Continued)**

In 2010, a contingent liability of \$1.9 million was recognized as an estimate of the acquisition date fair value of the contingent consideration in the BRAE acquisition. This liability was classified as Level 3 under the fair value hierarchy as it was based on the weighted probability of achievement of a future performance metric as of the date of the acquisition, which was not observable in the market. During the year ended December 31, 2011 and the year ended December 31, 2012, the estimate of the fair value of the contingent consideration was reduced to \$1.1 million and subsequently to \$0.2 million, based on the revised probability of achievement of the future performance metric. During the year ended December 31, 2013, the remaining liability was reduced to zero.

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. Failure to meet the performance metrics would reduce this liability to zero; while complete achievement would increase this liability to the full remaining purchase price of \$8.2 million. A portion of the contingent consideration was paid out during 2013, in the amount of \$1.2 million, based on performance metrics achieved in 2012. The contingent liability was increased by \$1.0 million during the year ended 2013 based on performance metrics achieved to date.

Short-term investment securities as of December 31, 2012 consist of a certificate of deposit with a remaining maturity of greater than three months at the date of purchase, for which the carrying amount is a reasonable estimate of fair value.

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

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

The Company has exposure to a number of foreign currency rates, including the Canadian dollar, the euro, the Chinese yuan and the British pound. To manage this risk, the Company generally uses a layering methodology whereby at the end of any quarter, the Company has generally entered into forward exchange contracts which hedge approximately 50% of the projected intercompany purchase transactions for the next twelve months. The Company primarily uses this strategy for the purchases between Canada and the U.S. The average volume of contracts can vary but generally approximates \$1.0 to \$10.0 million in open contracts at the end of any given quarter. At December 31, 2013, the Company had contracts for notional amounts aggregating approximately \$1.0 million. The Company accounts for the forward exchange contracts as an economic hedge. Realized and unrealized gains and losses on the contracts are recognized in other (income) expense in the consolidated statement of

## Watts Water Technologies, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

## (15) Financial Instruments (Continued)

operations. These contracts do not subject the Company to significant market risk from exchange movement because they offset gains and losses on the related foreign currency denominated transactions. As of December 31, 2013 and 2012, the Company had no outstanding swaps.

The Company recorded income (loss) of approximately \$0.1 million, \$0.1 million and \$0.6 million in 2013, 2012 and 2011, respectively, to other expense (income), net in the consolidated statement of operations from the impact of derivative instruments.

*Leases*

The Company leases certain manufacturing facilities, sales offices, warehouses, and equipment. Generally, the leases carry renewal provisions and require the Company to pay maintenance costs. Future minimum lease payments under capital leases and non-cancelable operating leases as of December 31, 2013 are as follows:

|              | Capital Leases | Operating Leases |
|--------------|----------------|------------------|
|              | (in millions)  |                  |
| 2014         | \$ 1.6         | \$ 9.1           |
| 2015         | 1.6            | 6.3              |
| 2016         | 1.6            | 3.6              |
| 2017         | 1.5            | 2.2              |
| 2018         | 1.4            | 1.0              |
| Thereafter   | 2.8            | 6.4              |
| <b>Total</b> | <b>\$ 10.5</b> | <b>\$ 28.6</b>   |

Less amount representing interest (at rates ranging from 4.2% to 8.7%)

1.0

Present value of net minimum capital lease payments

9.5

Less current installments of obligations under capital leases

1.4

Obligations under capital leases, excluding current installments

\$ 8.1

Carrying amounts of assets under capital lease include:

|                         | December 31,  |         |
|-------------------------|---------------|---------|
|                         | 2013          | 2012    |
|                         | (in millions) |         |
| Buildings               | \$ 17.5       | \$ 16.8 |
| Machinery and equipment | 1.8           | 1.2     |

|                               |                |         |
|-------------------------------|----------------|---------|
|                               | <b>19.3</b>    | 18.0    |
| Less accumulated depreciation | <b>(5.1)</b>   | (3.9)   |
|                               | <b>\$ 14.2</b> | \$ 14.1 |

**(16) Segment Information**

The Company operates in three geographic segments: Americas, EMEA, and Asia Pacific. Each of these segments sells similar products, 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 (see Note 2).

## Watts Water Technologies, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

## (16) Segment Information (Continued)

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

|   | Years Ended December 31, |            |            |
|---|--------------------------|------------|------------|
|   | 2013                     | 2012       | 2011       |
|   | (in millions)            |            |            |
| Net Sales   |                          |            |            |
| Americas  | \$ 878.5                 | \$ 835.0   | \$ 810.9   |
| EMEA  | 562.2                    | 565.6      | 574.8      |
| Asia Pacific  | 32.8                     | 26.8       | 21.7       |
| Consolidated net sales                                | \$ 1,473.5               | \$ 1,427.4 | \$ 1,407.4 |
| Operating income (loss)                               |                          |            |            |
| Americas  | \$ 90.4                  | \$ 96.5    | \$ 111.6   |
| EMEA  | 46.9                     | 52.5       | 45.5       |
| Asia Pacific  | 9.7                      | 6.5        | 12.2       |
| Subtotal reportable segments                          | 147.0                    | 155.5      | 169.3      |
| Corporate(*)  | (35.5)                   | (32.2)     | (35.8)     |
| Consolidated operating income                         | 111.5                    | 123.3      | 133.5      |
| Interest income                                       | 0.6                      | 0.7        | 1.0        |
| Interest expense                                      | (21.5)                   | (24.6)     | (25.8)     |
| Other income (expense), net                           | (2.8)                    | 0.8        | (0.8)      |
| Income from continuing operations before income taxes | \$ 87.8                  | \$ 100.2   | \$ 107.9   |
| Identifiable assets (at end of period)                |                          |            |            |
| Americas  | \$ 787.9                 | \$ 810.9   | \$ 814.3   |
| EMEA  | 869.6                    | 802.1      | 759.8      |
| Asia Pacific  | 82.7                     | 84.3       | 92.5       |
| Discontinued operations                               |                          | 11.7       | 27.4       |
| Consolidated identifiable assets                      | \$ 1,740.2               | \$ 1,709.0 | \$ 1,694.0 |
| Property, plant and equipment, net (at end of period) |                          |            |            |
| Americas  | \$ 85.8                  | \$ 80.6    | \$ 74.8    |

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|              |              |       |       |
|--------------|--------------|-------|-------|
| EMEA         | <b>119.8</b> | 126.3 | 130.6 |
| Asia Pacific | <b>14.3</b>  | 14.8  | 15.0  |

|                                |                 |          |          |
|--------------------------------|-----------------|----------|----------|
| Consolidated long-lived assets | <b>\$ 219.9</b> | \$ 221.7 | \$ 220.4 |
|--------------------------------|-----------------|----------|----------|

Capital Expenditures

|              |                |         |        |
|--------------|----------------|---------|--------|
| Americas     | <b>\$ 18.0</b> | \$ 17.9 | \$ 8.3 |
| EMEA         | <b>8.5</b>     | 10.7    | 13.5   |
| Asia Pacific | <b>1.2</b>     | 1.9     | 0.7    |

|                                   |                |         |         |
|-----------------------------------|----------------|---------|---------|
| Consolidated capital expenditures | <b>\$ 27.7</b> | \$ 30.5 | \$ 22.5 |
|-----------------------------------|----------------|---------|---------|

Depreciation and Amortization

|              |                |         |         |
|--------------|----------------|---------|---------|
| Americas     | <b>\$ 20.5</b> | \$ 19.6 | \$ 18.7 |
| EMEA         | <b>26.0</b>    | 26.8    | 27.2    |
| Asia Pacific | <b>2.4</b>     | 2.1     | 2.0     |

|  |                |         |         |
|--|----------------|---------|---------|
| Consolidated depreciation and amortization | <b>\$ 48.9</b> | \$ 48.5 | \$ 47.9 |
|--|----------------|---------|---------|

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\*

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

## Watts Water Technologies, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

## (16) Segment Information (Continued)

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

|  | Years Ended December 31, |          |          |
|--|--------------------------|----------|----------|
|  | 2013                     | 2012     | 2011     |
|  | (in millions)            |          |          |
| U.S. net sales   | \$ 788.7                 | \$ 747.4 | \$ 732.9 |
| U.S. property, plant and equipment, net (at end of period) | \$ 81.1                  | \$ 75.1  | \$ 69.9  |

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

|                    | Years Ended December 31, |          |          |
|--------------------|--------------------------|----------|----------|
|                    | 2013                     | 2012     | 2011     |
|                    | (in millions)            |          |          |
| Intersegment Sales |                          |          |          |
| Americas           | \$ 5.4                   | \$ 5.3   | \$ 3.3   |
| EMEA               | 10.2                     | 10.9     | 8.4      |
| Asia Pacific       | 170.9                    | 139.0    | 132.9    |
| Intersegment sales | \$ 186.5                 | \$ 155.2 | \$ 144.6 |

The Company sells its products into various end markets around the world and groups net sales to third parties into four product categories. As a result of the EMEA transformation program, the Company reallocated revenues of approximately \$90.0 million and \$100.0 million in 2012 and 2011, respectively, from HVAC & gas to Residential & commercial flow control from what was previously reported. The reallocation is based on the alignment of certain subsidiaries within these product groupings. The adjustment to the disclosure has no effect on the consolidated financial statements. Net sales to third parties for the four product categories are as follows:

|                                       | Years Ended December 31, |            |            |
|---------------------------------------|--------------------------|------------|------------|
|                                       | 2013                     | 2012       | 2011       |
|                                       | (in millions)            |            |            |
| Net Sales                             |                          |            |            |
| Residential & commercial flow control | \$ 907.7                 | \$ 879.2   | \$ 854.9   |
| HVAC & gas                            | 348.8                    | 337.0      | 347.0      |
| Drains & water re-use                 | 140.0                    | 138.8      | 135.3      |
| Water quality                         | 77.0                     | 72.4       | 70.2       |
| Consolidated net sales                | \$ 1,473.5               | \$ 1,427.4 | \$ 1,407.4 |

## Watts Water Technologies, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

## (17) Quarterly Financial Information (unaudited)

|   | First<br>Quarter | Second<br>Quarter | Third<br>Quarter | Fourth<br>Quarter |
|---|------------------|-------------------|------------------|-------------------|
| (in millions, except per share information) |                  |                   |                  |                   |
| <b>Year ended December 31, 2013</b>         |                  |                   |                  |                   |
| Net sales                                   | \$ 358.9         | \$ 366.8          | \$ 371.8         | \$ 376.0          |
| Gross profit                                | 128.9            | 132.8             | 133.9            | 130.9             |
| Income from continuing operations           | 16.3             | 18.9              | 17.5             | 8.2               |
| Net income                                  | 16.1             | 18.9              | 15.4             | 8.2               |
| <b>Per common share:</b>                    |                  |                   |                  |                   |
| <b>Basic</b>                                |                  |                   |                  |                   |
| Income from continuing operations           | 0.46             | 0.53              | 0.49             | 0.23              |
| Net income                                  | 0.45             | 0.53              | 0.43             | 0.23              |
| <b>Diluted</b>                              |                  |                   |                  |                   |
| Income from continuing operations           | 0.46             | 0.53              | 0.49             | 0.23              |
| Net income                                  | 0.45             | 0.53              | 0.43             | 0.23              |
| Dividends per common share                  | 0.11             | 0.13              | 0.13             | 0.13              |
| <b>Year ended December 31, 2012</b>         |                  |                   |                  |                   |
| Net sales                                   | \$ 357.6         | \$ 362.5          | \$ 352.8         | \$ 354.5          |
| Gross profit                                | 127.8            | 129.4             | 127.7            | 128.6             |
| Income from continuing operations           | 15.7             | 18.2              | 18.3             | 18.2              |
| Net income                                  | 15.7             | 18.5              | 18.7             | 15.5              |
| <b>Per common share:</b>                    |                  |                   |                  |                   |
| <b>Basic</b>                                |                  |                   |                  |                   |
| Income from continuing operations           | 0.42             | 0.50              | 0.52             | 0.51              |
| Net income                                  | 0.42             | 0.51              | 0.53             | 0.44              |
| <b>Diluted</b>                              |                  |                   |                  |                   |
| Income from continuing operations           | 0.42             | 0.50              | 0.52             | 0.51              |
| Net income                                  | 0.42             | 0.51              | 0.53             | 0.44              |
| Dividends per common share                  | 0.11             | 0.11              | 0.11             | 0.11              |

In the fourth quarter of 2013, the Company recorded legal costs related to the agreement in principle to settle all claims in the Trabakoolas et al., v. Watts Water Technologies, Inc., et al., matter pending in the United States District Court for the Northern District of California. The net settlement expense recorded in income from continuing operations was \$13.6 million. Please see Note 14 for additional information. Also in the fourth quarter of 2013, the Company recorded customer rebate expense of approximately \$3.0 million that related to accrual adjustments for 2013.

## (18) Subsequent Events

On January 9, 2014, David J. Coghlan resigned from his positions as Chief Executive Officer, President and Director of the Company and our Board of Directors appointed Dean P. Freeman, our Executive Vice President and Chief Financial Officer, to serve as interim Chief Executive Officer and President of the Company. The Company's Board of Directors has initiated a search for the Company's next Chief Executive Officer and President.

On February 18, 2014, the Company declared a quarterly dividend of thirteen cents (\$0.13) per share on each outstanding share of Class A common stock and Class B common stock.



**Watts Water Technologies, Inc. and Subsidiaries**  
**Schedule II Valuation and Qualifying Accounts**  
(Amounts in millions)

For the Three Years Ended December 31:

|   | Balance At<br>Beginning of<br>Period | Additions<br>Charged<br>To<br>Expense | Additions<br>Charged To<br>Other<br>Accounts | Deductions | Balance At<br>End of<br>Period |
|---|--------------------------------------|---------------------------------------|--|------------|--------------------------------|
| <b>Year Ended December 31, 2011</b>         |                                      |                                       |  |            |                                |
| Allowance for doubtful accounts             | \$ 8.7                               | 1.1                                   | 0.3  | (1.2)      | \$ 8.9                         |
| Reserve for excess and obsolete inventories | \$ 23.5                              | 6.1                                   | 1.3  | (4.9)      | \$ 26.0                        |
| <b>Year Ended December 31, 2012</b>         |                                      |                                       |  |            |                                |
| Allowance for doubtful accounts             | \$ 8.9                               | 1.2                                   | 1.0  | (1.6)      | \$ 9.5                         |
| Reserve for excess and obsolete inventories | \$ 26.0                              | 6.6                                   | 0.4  | (6.2)      | \$ 26.8                        |
| <b>Year Ended December 31, 2013</b>         |                                      |                                       |  |            |                                |
| Allowance for doubtful accounts             | \$ 9.5                               | 1.2                                   | 0.2  | (1.2)      | \$ 9.7                         |
| Reserve for excess and obsolete inventories | \$ 26.8                              | 8.1                                   | 0.3  | (7.3)      | \$ 27.9                        |

101

## EXHIBIT INDEX

| Exhibit No. | Description   |
|-------------|---|
| 3.1         | Restated Certificate of Incorporation, as amended(14)   |
| 3.2         | Amended and Restated By-Laws(1)   |
| 9.1         | The Amended and Restated George B. Horne Voting Trust Agreement 1997 dated as of September 14, 1999(15)   |
| 10.1*       | Supplemental Compensation Agreement effective as of September 1, 1996 between the Registrant and Timothy P. Horne (9), Amendment No. 1, dated July 25, 2000 (16), and Amendment No. 2 dated October 23, 2002(3)   |
| 10.2*       | Form of Indemnification Agreement between the Registrant and certain directors and officers of the Registrant(6)  |
| 10.3*       | Watts Water Technologies, Inc. Pension Plan (amended and restated effective as of January 1, 2006) and First Amendment (17), Second Amendment, Third Amendment, Fourth Amendment, Fifth Amendment and Sixth Amendment(11)                                     |
| 10.4        | Registration Rights Agreement dated July 25, 1986(5)  |
| 10.5*       | Watts Water Technologies, Inc. Executive Incentive Bonus Plan(8)  |
| 10.6        | Amended and Restated Stock Restriction Agreement dated October 30, 1991 (2), and Amendment dated August 26, 1997(12)  |
| 10.7*       | Compromise Agreement among Watts UK Limited, Watts Industries Europe B.V., Watts Water Technologies, Inc. and John Dennis Cawte(10)   |
| 10.8*       | Watts Water Technologies, Inc. Management Stock Purchase Plan Amended and Restated as of July 30, 2013(10)  |
| 10.9*       | Watts Water Technologies, Inc. Second Amended and Restated 2004 Stock Incentive Plan(8)   |
| 10.10*      | Non-Employee Director Compensation Arrangements(7)  |
| 10.11*      | Watts Water Technologies, Inc. Supplemental Employees Retirement Plan as Amended and Restated Effective May 4, 2004, First Amendment and Second Amendment (17), Third Amendment and Fourth Amendment(11)  |
| 10.12*      | Form of Non-Qualified Stock Option Agreement under the Watts Water Technologies, Inc. Second Amended and Restated 2004 Stock Incentive Plan(10)   |
| 10.13*      | Form of Restricted Stock Award Agreement for Employees under the Watts Water Technologies, Inc. Second Amended and Restated 2004 Stock Incentive Plan(10)   |
| 10.14*      | Form of Deferred Stock Award Agreement under the Watts Water Technologies, Inc. Second Amended and Restated 2004 Stock Incentive Plan(10)   |
| 10.15       | Note Purchase Agreement, dated as of April 27, 2006, between the Registrant and the Purchasers named in Schedule A thereto relating to the Registrant's \$225,000,000 5.85% Senior Notes due April 30, 2016(4)  |
| 10.16       | Form of 5.85% Senior Note due April 30, 2016(4)   |
| 10.17       | Subsidiary Guaranty, dated as of April 27, 2006, in connection with the Registrant's 5.85% Senior Notes due April 30, 2016 executed by the subsidiary guarantors party thereto, including the form of Joinder to Subsidiary Guaranty(4)                       |
| 10.18       | Credit Agreement, dated as of February 18, 2014, among the Registrant, certain subsidiaries of the Registrant as Borrowers, JPMorgan Chase Bank N.A., as Administrative Agent, Swing Line Lender and L/C Issuer and the other lenders referred to therein(19) |
| 10.19       | Guaranty, dated as of February 18, 2014, by the Registrant and the Subsidiaries of the Registrant set forth therein, in favor of JPMorgan Chase Bank N.A. and other lenders referred to therein(19)   |
| 10.18       | Note Purchase Agreement, dated as of June 18, 2010, between the Registrant and Purchasers named in Schedule A thereto relating to the Registrant's \$75,000,000 5.05% Senior Notes due June 18, 2020(18)  |
| 10.19       | Form of 5.05% Senior Note due June 18, 2020(18)   |

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| Exhibit No. | Description  |
|-------------|--|
| 10.20       | Form of Subsidiary Guaranty in connection with the Registrants 5.05% Senior Notes due June 18, 2020, including the form of Joinder to Subsidiary Guaranty(18)                |
| 10.21       | Retention Agreement dated as of June 14, 2012 between the Registrant and William C. McCartney(20)  |
| 11          | Statement Regarding Computation of Earnings per Common Share(13)   |
| 21          | Subsidiaries   |
| 23          | Consent of KPMG LLP, Independent Registered Public Accounting Firm   |
| 31          | Certification of Principal Executive Officer and Principal Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended |
| 32          | Certification of Principal Executive Officer and Principal Financial Officer Pursuant to 18 U.S.C. Section 1350  |
| 101.INS**   | XBRL Instance Document.  |
| 101.SCH**   | XBRL Taxonomy Extension Schema Document.   |
| 101.CAL**   | XBRL Taxonomy Extension Calculation Linkbase Document.   |
| 101.DEF**   | XBRL Taxonomy Extension Definition Linkbase Document   |
| 101.LAB**   | XBRL Taxonomy Extension Label Linkbase Document.   |
| 101.PRE**   | XBRL Taxonomy Extension Presentation Linkbase Document.  |

- 
- (1) Incorporated by reference to the Registrant's Current Report on Form 8-K dated April 29, 2013 (File No. 001-11499).
  - (2) Incorporated by reference to the Registrant's Current Report on Form 8-K dated November 14, 1991 (File No. 001-11499).
  - (3) Incorporated by reference to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2002 (File No. 001-11499).
  - (4) Incorporated by reference to the Registrant's Current Report on Form 8-K dated April 27, 2006 (File No. 001-11499).
  - (5) Incorporated by reference to the Registrant's Form S-1 (No. 33-6515) as part of the Second Amendment to such Form S-1 dated August 21, 1986.
  - (6) Incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 29, 2013 (File No. 001-11499).
  - (7) Incorporated by reference to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2012 (File No. 001-11499).
  - (8) Incorporated by reference to the Registrant's Current Report on Form 8-K dated May 15, 2013 (File No. 001-11499).
  - (9) Incorporated by reference to the Registrant's Annual Report on Form 10-K for year ended June 30, 1996 (File No. 001-11499).
  - (10) Incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2013 (File No. 001-11499).
  - (11) Incorporated by reference to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2011 (File No. 001-11499).
  - (12) Incorporated by reference to the Registrant's Annual Report on Form 10-K for year ended June 30, 1997 (File No. 001-11499).
  - (13)

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Incorporated by reference to notes to Consolidated Financial Statements, Note 2 of this Report.

- (14) Incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarter ended July 3, 2005 (File No. 001-11499).

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- (15) Incorporated by reference to the Registrant's Annual Report on Form 10-K for year ended June 30, 1999 (File No. 001-11499).
- (16) Incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for quarter ended September 30, 2000 (File No. 001-11499).
- (17) Incorporated by reference to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2007 (File No. 001-11499).
- (18) Incorporated by reference to the Registrant's Current Report on Form 8-K dated June 18, 2010 (File No. 001-11499).
- (19) Incorporated by reference to the Registrant's Current Report on Form 8-K dated February 24, 2014 (File No. 001-11499).
- (20) Incorporated by reference to the Registrant's Current Report on Form 8-K dated June 14, 2012 (File No. 001-11499).

\*  
Management contract or compensatory plan or arrangement.

\*\*  
Attached as Exhibit 101 to this report are the following formatted in XBRL (Extensible Business Reporting Language):  
(i) Consolidated Statements of Operations for the Years Ended December 31, 2013, 2012 and 2011, (ii) Consolidated Statements of Comprehensive Income for the Years Ended December 31, 2013, 2012 and 2011, (iii) Consolidated Balance Sheets at December 31, 2013 and December 31, 2012, (iv) Consolidated Statements of Stockholders' Equity for the Years Ended December 31, 2013, 2012 and 2011, (v) Consolidated Statements of Cash Flows for the Years Ended December 31, 2013, 2012 and 2011, and (vi) Notes to Consolidated Financial Statements.