WATTS WATER TECHNOLOGIES INC
Form 10-Q
May 14, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended April 4, 2010

or

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

For the transition period from to

Commission file number 001-11499

WATTS WATER TECHNOLOGIES, INC.

(Exact Name of Registrant as Specified in Its Charter)

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

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

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

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

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

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

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

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

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

Class	**Outstanding at May 7, 2010**
Class A Common Stock, $0.10 par value	29,601,475
Class B Common Stock, $0.10 par value	7,173,880

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Amounts in millions, except share information)

(Unaudited)

	April 4, 2010	December 31, 2009
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	**$ 252.7**	$ 258.2
Short-term investment securities	**6.3**	6.5
Trade accounts receivable, less allowance for doubtful accounts of $9.6 million in 2010 and $7.5 million in 2009	**196.2**	181.3
Inventories, net:		
Raw materials	**102.7**	88.0
Work in process	**24.2**	36.5
Finished goods	**137.7**	142.2
Total Inventories	**264.6**	266.7
Prepaid expenses and other assets	**23.6**	22.1
Deferred income taxes	**36.1**	35.4
Assets held for sale	**11.2**	11.3
Assets of discontinued operations	**12.1**	23.1
Total Current Assets	**802.8**	804.6
PROPERTY, PLANT AND EQUIPMENT:		
Property, plant and equipment, at cost	**442.5**	454.9
Accumulated depreciation	**(243.0)**	(248.4)
Property, plant and equipment, net	**199.5**	206.5
OTHER ASSETS:		
Goodwill	**414.0**	425.1
Intangible assets, net	**143.6**	151.2
Deferred income taxes	**3.0**	3.0
Other, net	**8.4**	8.8
TOTAL ASSETS	**$ 1,571.3**	$ 1,599.2
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	**$ 105.3**	$ 102.3
Accrued expenses and other liabilities	**110.8**	105.9
Accrued compensation and benefits	**36.7**	45.9
Current portion of long-term debt	**50.9**	50.9
Liabilities of discontinued operations	**6.2**	9.8
Total Current Liabilities	**309.9**	314.8

LONG-TERM DEBT, NET OF CURRENT PORTION		**303.6**		304.0
DEFERRED INCOME TAXES		**40.2**		43.0
OTHER NONCURRENT LIABILITIES		**54.5**		57.8
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, 29,601,475 shares in 2010 and 29,506,523 shares in 2009		**3.0**		3.0
Class B Common Stock, $0.10 par value; 25,000,000 shares authorized; 10 votes per share; issued and outstanding, 7,173,880 shares in 2010 and 7,193,880 shares at 2009		**0.7**		0.7
Additional paid-in capital		**397.4**		393.7
Retained earnings		**455.1**		452.1
Accumulated other comprehensive income		**6.9**		30.1
Total Stockholders Equity		**863.1**		879.6
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$	**1,571.3**	$	1,599.2

See accompanying notes to consolidated financial statements.

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WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(Amounts in millions, except per share information)

(Unaudited)

	First Quarter Ended	
	April 4, 2010	**March 29, 2009**
Net sales	$ **319.3**	$ 290.7
Cost of goods sold	**201.7**	193.7
GROSS PROFIT	**117.6**	97.0
Selling, general & administrative expenses	**88.3**	80.0
Restructuring and other charges	**3.3**	1.5
OPERATING INCOME	**26.0**	15.5
Other (income) expense:		
Interest income	**(0.2)**	(0.2)
Interest expense	**5.2**	5.6
Other income, net	**(0.2)**	(0.5)
Total other expense	**4.8**	4.9
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	**21.2**	10.6
Provision for income taxes	**9.0**	6.5
INCOME FROM CONTINUING OPERATIONS	**12.2**	4.1
Loss from discontinued operations, net of taxes	**(4.1)**	(0.7)
NET INCOME	**$ 8.1**	$ 3.4
BASIC EPS		
Income (loss) per share:		
Continuing operations	**$ 0.33**	$ 0.11
Discontinued operations	**(0.11)**	(0.02)
NET INCOME	**$ 0.22**	$ 0.09
Weighted average number of shares	**37.1**	36.9
DILUTED EPS		
Income (loss) per share:		
Continuing operations	**$ 0.33**	$ 0.11
Discontinued operations	**(0.11)**	(0.02)
NET INCOME	**$ 0.22**	$ 0.09
Weighted average number of shares	**37.3**	37.0
Dividends per share	**$ 0.11**	$ 0.11

See accompanying notes to consolidated financial statements.

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WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in millions)

(Unaudited)

	First Quarter Ended	
	April 4, 2010	**March 29, 2009**
OPERATING ACTIVITIES		
Net income	**$ 8.1**	$ 3.4
Less: Loss from discontinued operations, net of taxes	**(4.1)**	(0.7)
Net income from continuing operations	**12.2**	4.1
Adjustments to reconcile income from continuing operations to net cash provided by continuing operating activities:		
Depreciation	**8.2**	7.6
Amortization	**3.4**	3.2
Stock-based compensation	**1.2**	1.3
Deferred income taxes	**(2.3)**	(2.0)
Other	**0.1**	0.1
Changes in operating assets and liabilities, net of effects from business acquisitions and divestures:		
Accounts receivable	**(19.2)**	9.5
Inventories	**(2.9)**	18.1
Prepaid expenses and other assets	**(1.2)**	(3.4)
Accounts payable, accrued expenses and other liabilities	**5.2**	(20.5)
Net cash provided by continuing operations	**4.7**	18.0
INVESTING ACTIVITIES		
Additions to property, plant and equipment	**(6.8)**	(4.2)
Proceeds from the sale of property, plant and equipment	**0.2**	0.2
Proceeds from the sale of securities	**0.3**	
Other, net		1.1
Business acquisitions, net of cash acquired	**(0.5)**	(0.3)
Net cash used in investing activities	**(6.8)**	(3.2)
FINANCING ACTIVITIES		
Proceeds from long-term debt		0.3
Payments of long-term debt	**(0.2)**	(3.8)
Payment of capital leases	**(0.4)**	(0.3)
Proceeds from share transactions under employee stock plans		0.1
Tax benefit of stock awards exercised	**(0.5)**	(0.4)
Dividends	**(4.2)**	(4.1)
Net cash used in financing activities	**(5.3)**	(8.2)
Effect of exchange rate changes on cash and cash equivalents	**(1.4)**	(0.8)
Net cash used in operating activities of discontinued operations	**(1.8)**	(1.2)
Net cash provided by investing activities of discontinued operations	**5.1**	
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**(5.5)**	4.6
Cash and cash equivalents at beginning of year	**258.2**	165.6
CASH AND CASH EQUIVALENTS AT END OF PERIOD	**$ 252.7**	$ 170.2
NON-CASH INVESTING AND FINANCING ACTIVI TIES		
Issuance of stock under management stock purchase plan	**$ 2.1**	$ 1.5

CASH PAID FOR:				
Interest	**$**	**0.4**	$	0.6
Income Taxes	**$**	**6.7**	$	5.0

See accompanying notes to consolidated financial statements.

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WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included in the Watts Water Technologies, Inc. (the Company) Consolidated Balance Sheet as of April 4, 2010, the Consolidated Statements of Operations for the first quarter ended April 4, 2010 and the first quarter ended March 29, 2009, and the Consolidated Statements of Cash Flows for the first quarter ended April 4, 2010 and the first quarter ended March 29, 2009.

The balance sheet at December 31, 2009 has been derived from the audited consolidated financial statements at that date. The accounting policies followed by the Company are described in the Company s Annual Report on Form 10-K for the year ended December 31, 2009. The financial statements included in this report should be read in conjunction with the consolidated financial statements and notes included in the Annual Report on Form 10-K for the year ended December 31, 2009. Operating results for the interim period presented are not necessarily indicative of the results to be expected for the year ending December 31, 2010.

The Company operates on a 52-week fiscal year ending on December 31st. Any first quarter data contained in this Quarterly Report on Form 10-Q generally reflects the results of operations for a 13-week period. There were four additional working days in the first quarter ended April 4, 2010 than there were in the first quarter ended March 29, 2009.

Certain amounts in the year December 31, 2009 have been reclassified to permit comparison with the 2010 presentation. These reclassifications had no effect on reported results of operations or stockholders equity.

2. Accounting Policies

Estimates

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

Impairment of Goodwill and Long-Lived Assets

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

	North America	Europe	China	Total
		(in millions)		
Gross balance at January 1, 2010	**$ 210.4**	**$ 228.8**	**$ 7.9**	**$ 447.1**
Accumulated impairment losses	**(22.0)**			**(22.0)**
Net goodwill at January 1, 2010	**188.4**	**228.8**	**7.9**	**425.1**
Effect of change in exchange rates used for translation	**0.3**	**(11.4)**		**(11.1)**
Gross balance at April 4, 2010	**$ 210.7**	**$ 217.4**	**$ 7.9**	**$ 436.0**
Accumulated impairment losses	**(22.0)**			**(22.0)**
Net goodwill at April 4, 2010	**$ 188.7**	**$ 217.4**	**$ 7.9**	**$ 414.0**

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.

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

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Intangible assets include the following:

	April 4, 2010	
	Gross Carrying Amount	Accumulated Amortization
	(in millions)	
Patents	$ 17.1	$ (8.8)
Customer relationships	106.1	(34.4)
Technology	15.2	(4.5)
Other	8.2	(5.6)
Total amortizable intangibles	146.6	(53.3)
Intangible assets not subject to amortization	50.3	
Total	$ 196.9	$ (53.3)

Aggregate amortization expense for amortized intangible assets for the first quarters of 2010 and 2009 was $3.4 million and $3.2 million, respectively. Additionally, future amortization expense on amortizable intangible assets approximates $9.9 million for the remainder of 2010, $12.7 million for 2011, $10.3 million for 2012, $9.9 million for 2013 and $9.7 million for 2014. 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 9.8 years. Patents, customer relationships, technology and other amortizable intangibles have weighted-average remaining lives of 7.9 years, 8.1 years, 14.9 years and 45.4 years, respectively. Intangible assets not subject to amortization are comprised of trademarks.

Stock-Based Compensation

The Company maintains three stock incentive plans under which key employees and non-employee members of the Company s Board of Directors 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 2004 Stock Incentive Plan, is currently available for the grant of new equity awards. Stock options granted under prior plans became exercisable over a five-year period at the rate of 20% per year and expire ten years after the date of grant. 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% and 50% of the fair market value of the Class A Common Stock on the date of grant, respectively. The Company s current practice is to grant all options at fair market value on the grant date. The Company did not issue any options in the first quarter of 2010 or 2009.

The Company also grants shares of restricted stock to key employees and non-employee members of the Company s Board of Directors under the 2004 Stock Incentive Plan, which vest either immediately or over a three-year period at the rate of one-third per year. The restricted stock awards are amortized to expense on a straight-line basis over the vesting period. The Company did not issue any restricted stock in the first quarter of 2010 and issued 1,706 shares of restricted stock under the 2004 Stock Incentive Plan in the first quarter of 2009.

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 annually over a three-year period from the grant date. An aggregate of 2,000,000 shares of Class A Common Stock may be issued under the Management Stock Purchase Plan. The Company granted 158,473 RSUs and 150,098 RSUs in the first quarters of 2010 and 2009, respectively.

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:

	2010	2009
Expected life (years)	**3.0**	3.0
Expected stock price volatility	**45.6%**	45.0%
Expected dividend yield	**1.5%**	2.2%
Risk-free interest rate	**1.5%**	1.4%

The above assumptions were used to determine the weighted average grant-date fair value of RSUs of $12.81 and $8.14 in 2010 and 2009, respectively.

A more detailed description of each of these stock and stock option plans can be found in Note 13 of Notes to Consolidated Financial Statements in the Company s Annual Report on Form 10-K for the year ended December 31, 2009.

Shipping and Handling

The Company s shipping costs included in selling, general and administrative expenses were $8.4 million and $7.4 million for the first quarters of 2010 and 2009, respectively.

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Research and Development

Research and development costs included in selling, general and administrative expenses were $5.2 million and $4.4 million for the first quarters of 2010 and 2009, respectively.

Taxes, Other than Income Taxes

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

Income Taxes

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

New Accounting Standards

In October 2009, the Financial Accounting Standards Board (FASB) issued an accounting standard update to improve disclosures related to fair value measurements. This update requires new disclosures when significant transfers in and out of the various fair value levels occur. This update requires a reconciliation for fair value measurements using significant unobservable inputs (level 3) be prepared on a gross basis, separately presenting information about purchases, sales, issuance and settlements. In addition, this update amends current disclosure requirements for postretirement benefit plan assets. This update is effective for interim and annual periods beginning after December 15, 2009, except for disclosures regarding level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. Adoption of this standard did not have a material impact on the Company s consolidated financial statements.

3. Discontinued Operations

In September 2009, the Company s Board of Directors approved the sale of its investment in Watts Valve (Changsha) Co., Ltd. (CWV). CWV is a manufacturer of large diameter hydraulic-actuated butterfly valves for thermo-power and hydro-power plants, water distribution projects and water works projects in China. Management determined that CWV s business no longer fit strategically with the Company. The Company

completed the sale of CWV in January 2010. See Note 10 for further information related to CWV.

During 2009, the Company evaluated the classification of the assets and liabilities of CWV and concluded that the net assets qualified as discontinued operations. The Company evaluated the fair value (less cost to sell) of the net assets of CWV and recorded an estimated pre-tax non-cash loss of approximately $8.5 million in the third quarter of 2009, based on the final agreement with the buyer. The Company concluded that the future cash flows associated with CWV would be completely eliminated from the continuing operations of the Company. As such, the Company classified CWV s result of operations and the loss from the disposition as discontinued operations for all periods presented.

In May 2009, the Company liquidated its TEAM Precision Pipework, Ltd. (TEAM) business, located in Ammanford, U.K. TEAM custom designed and manufactured manipulated pipe and hose tubing assemblies and served the heating, ventilation and air conditioning and automotive markets in Western Europe. Management determined the business no longer fit strategically with the Company and that a sale of TEAM was not feasible. On May 22, 2009, the Company appointed an administrator for TEAM under the United Kingdom Insolvency Act of 1986. During the administration process, the administrator had sole control over, and responsibility for, TEAM s operations, assets and liabilities. The Company deconsolidated TEAM when the administrator obtained control of TEAM. The deconsolidation resulted in the recognition of a $18.0 million pre-tax non-cash loss in the second quarter of 2009. The Company evaluated the operations of TEAM and determined that it would not have a continuing involvement in TEAM s operations and cash flows. As a result of the loss of control, TEAM s cash flows and operations were eliminated from the continuing operations of the Company. As such, the Company classified TEAM s results of operations and the loss from deconsolidation as discontinued operations for all periods presented.

Discontinued operating expense for 2010 includes an estimated reserve in connection with the United States Foreign Corrupt Practices Act (FCPA) investigation at CWV (see Note 12), legal costs associated with the FCPA investigation and a loss on sale of CWV. The discontinued operating expense for 2009 are related to the operations of TEAM and CWV and legal costs associated with the now concluded James Jones Litigation. See Note 15 of the Company s Annual Report on Form 10-K for the year ended December 31, 2009, for a detailed description of the James Jones Litigation.

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Condensed operating statements for discontinued operations are summarized below:

	First Quarter Ended	
	April 4, 2010	March 29, 2009
	(in millions)	
Operating loss TEAM	$	$ (0.4)
Operating loss CWV		(0.4)
Loss on sale CWV	**(0.1)**	
Costs and expenses FCPA investigation (CWV)	**(5.6)**	
Costs and expenses - Municipal Water Group		(0.1)
Loss before income taxes	**(5.7)**	(0.9)
Income tax benefit	**1.6**	0.2
Loss from discontinued operations, net of taxes	**$ (4.1)**	$ (0.7)

Revenues reported in discontinued operations are as follows:

	First Quarter Ended	
	April 4, 2010	March 29, 2009
	(in millions)	
Revenues CWV	**$**	$ 2.8
Revenues TEAM		1.5
Total revenues discontinued operations	**$**	$ 4.3

The carrying amounts of major classes of assets and liabilities associated with discontinued operations are as follows:

	April 4, 2010	December 31, 2009
	(in millions)	
Accounts receivable	**$**	$ 4.2
Inventories		4.2
Prepaid expenses and other assets	**1.1**	2.3
Property, plant & equipment, net		1.3
Deferred income taxes	**1.5**	1.8
Intangible assets		1.5
Income taxes receivable	**9.5**	7.8
Assets of discontinued operations	**$ 12.1**	$ 23.1
Accounts payable	**$**	$ 2.1
Accrued expenses and other liabilities	**6.2**	7.2
Deferred taxes payable		0.5
Liabilities of discontinued operations	**$ 6.2**	$ 9.8

4. Financial Instruments and Derivatives Instruments

The Company measures certain financial assets and liabilities at fair value on a recurring basis, including auction rate securities, foreign currency derivatives, deferred compensation plan assets and related liability, and metal derivatives. The fair value of these certain financial assets and liabilities was determined using the following inputs at April 4, 2010:

			Fair Value Measurements at Reporting Date Using:					
		Total		Quoted Prices in Active Markets for Identical Assets (Level 1)		Significant Other Observable Inputs (Level 2)		Significant Unobservable Inputs (Level 3)
				(in millions)				
Assets								
Trading securities (1)	$	6.3	$		$		$	6.3
Plan asset for deferred compensation(2)		3.2		3.2				
Total assets	$	9.5	$	3.2	$		$	6.3
Liabilities								
Foreign currency derivatives (3)	$	0.7	$		$	0.7	$	
Plan liability for deferred compensation(4)		3.2		3.2				
Total liabilities	$	3.9	$	3.2	$	0.7	$	

(1) Included in short-term investment securities on the Company s consolidated balance sheet.

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

(3) Included in accrued expenses and other liabilities on the Company s consolidated balance sheet.

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(4) 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 measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the period December 31, 2009 to April 4, 2010.

	Balance December 31, 2009	Purchases, sales, settlements, net	Total realized and unrealized gains (losses) included in: Earnings	Comprehensive income	Balance April 4, 2010
			(in millions)		
Trading securities	$ 6.5	$ (0.2)	$	$	$ 6.3

Trading securities comprise illiquid auction rate securities (ARS) and rights issued by UBS, AG (UBS). The Company holds a variety of interest bearing ARS including $4.5 million in municipal bonds and $0.7 million in student loans at April 4, 2010. The Company elected to participate in a settlement offer from UBS for all of the outstanding ARS investments. Under the terms of the settlement offer, the Company was issued rights by UBS entitling the holder to require UBS to purchase the underlying ARS at par value during the period from June 30, 2010, through July 2, 2012. The rights, valued at $1.1 million at April 4, 2010, also entitle UBS to purchase or sell the ARS at any time from the settlement date, in which case UBS would be required to pay par value for the ARS.

While the Company continues to earn interest on its ARS investments, these investments are not currently trading and therefore do not currently have a readily determinable market value.

The Company used a discounted cash flow model to determine the estimated fair value of its investment in ARS and investments in UBS rights as of April 4, 2010. The assumptions used in preparing the discounted cash flow model include estimates for interest rates, credit quality of the ARS issuer, timing and amount of cash flows, government guarantees related to student loans and the expected holding periods of the ARS. Based on this assessment of fair value, the Company did not record any fair value adjustments in the first quarter of 2010. The Company recorded a credit of approximately $0.4 million to other (income) expense in the consolidated statement of operations for its investment in ARS in the first quarter of 2009. The Company performed a valuation of the ARS with the rights from UBS. The Company determined the value of the rights based upon the difference between the ARS without the rights and the ARS with the rights.   Based on this assessment of fair value, the Company did not record any fair value adjustments in the first quarter of 2010. The Company recorded a charge of approximately $0.6 million to other (income) expense in the first quarter of 2009.

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

The Company used financial instruments 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 uses this strategy for the purchases between Canada and the U.S., for purchases between the Euro zone and the U.S., and for purchases between the Euro zone and the United Kingdom. The average volume of contracts can vary but generally approximates $9 to $12 million in open contracts at the end of any given quarter. At April 4, 2010, the Company had contracts for notional amounts aggregating approximately $9.0 million to buy various currencies. 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 operations. During the quarters ended April 4, 2010 and March 29, 2009, the Company recorded unrealized gains of $0.2 million and $0.4 million, respectively, on foreign currency derivatives contracts. 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.

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 4.87% senior notes due 2010, 5.47% senior notes due 2013 and 5.85% senior notes due 2016 is based on a discounted cash flow model using like industrial companies, the Company s credit metrics, the Company s size, as well as,

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current market demand. 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:

		April 4, 2010		December 31, 2009
		(in millions)		
Carrying amount	**$**	**354.5**	$	354.9
Estimated fair value	**$**	**364.7**	$	360.9

5. Restructuring and Other Charges

The Company s Board of Directors approves all major restructuring programs that involve the discontinuance of product lines or the shut down of 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. The Company also includes as part of other charges expense associated with asset impairments. See Note 4 of the Company s Annual Report on Form 10-K for the year ended December 31, 2009, for a detailed description of the 2009 and 2010 actions. A summary of the pre- tax cost by restructuring program is as follows:

		First Quarter Ended April 4, 2010
		(in millions)
2009 Actions	$	0.8
2010 Actions		2.9
Other Actions		0.1
Total	$	3.8

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

		First Quarter Ended April 4, 2010
		(in millions)
North America	$	0.5
Europe		3.0
China		0.3
Total	$	3.8

The first quarter charges for 2010 of $3.8 million consist of approximately $2.0 million related to involuntary termination benefits, $0.7 million for accelerated depreciation for manufacturing operations, which was charged to cost of sales, and $0.2 million for other costs all associated with the 2010 actions. Additionally, the Company recorded $0.3 million related to involuntary termination benefits and $0.5 million for relocation

expenses associated with the 2009 actions. The remaining costs related to involuntary termination benefits which were not part of a previously announced restructuring plan.

The Company recorded a tax charge approximating $1.5 million in the quarter ended April 4, 2010 for taxes on the expected repatriation of prior earnings of a Chinese subsidiary which is in the process of being sold.

The following table summarizes the total estimated pre-tax charges expected, incurred and remaining cost for the footprint consolidation-restructuring program initiated in 2009 by the Company s reportable segments:

Reportable Segment	**Total Expected Costs**	**Incurred through April 4, 2009**	**Remaining Costs at April 4, 2010**
		(in millions)	
North America	$ 2.7	$ 1.3	$ 1.4
China	9.0	8.8	0.2
Total	$ 11.7	$ 10.1	$ 1.6

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Details of the Company s 2009 footprint consolidation-restructuring program for the first quarter of 2010 are as follows:

	Severance		Asset write-downs		Facility exit and other		Total
			(in millions)				
Balance at December 31, 2009	$	$		$		$	
Net pre-tax restructuring charges	**0.3**				**0.5**		**0.8**
Utilization	**(0.3)**				**(0.5)**		**(0.8)**
Balance at April 4, 2010	$	$		$		$	

The following table summarizes expected, incurred and remaining costs for 2009 restructuring actions by type:

		Severance		Asset write-downs		Facility exit and other		Total
				(in millions)				
Expected costs	$	3.2	$	5.2	$	3.3	$	11.7
Costs incurred 2009		1.8		7.4		0.1		9.3
Costs incurred quarter ended April 4, 2010		0.3				0.5		0.8
Balance at April 4, 2010	$	1.1	$	(2.2)	$	2.7	$	1.6

The following table summarizes the total estimated pre-tax charges expected, incurred and remaining cost for the 2010 footprint consolidation-restructuring program by the Company s reportable segments:

Reportable Segment		Total Expected Costs		Incurred through April 4, 2010		Remaining Costs at April 4, 2010
				(in millions)		
Europe	$	12.5	$	7.5	$	5.0

Details of the Company s 2010 footprint consolidation-restructuring program for the first quarter of 2010 are as follows:

		Severance		Asset write-downs		Facility exit and other		Total
				(in millions)				
Balance at December 31, 2009	$	**4.2**	**$**		**$**		**$**	**4.2**
Net pre-tax restructuring charges		**2.0**		**0.7**		**0.2**		**2.9**
Utilization and foreign currency		**(0.3)**		**(0.7)**		**(0.2)**		**(1.2)**
Balance at April 4, 2010	$	**5.9**	**$**		**$**		**$**	**5.9**

The following table summarizes expected, incurred and remaining cost for 2010 restructuring actions by type:

	Severance	Asset write-downs	Facility exit and other	Total
		(in millions)		
Expected costs	$ 7.5	$ 1.6	$ 3.4	$ 12.5
Costs incurred 2009	4.2		0.4	4.6
Costs incurred quarter ended April 4, 2010	2.0	0.7	0.2	2.9
Remaining costs at April 4, 2010	$ 1.3	$ 0.9	$ 2.8	$ 5.0

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6. Earnings per Share

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

	For the First Quarter Ended April 4, 2010				
	Income (loss) (Numerator)		Shares (Denominator)	Per Share Amount	
	(amounts in millions, except per share amounts)				
Basic EPS					
Income (loss) per share:					
Continuing operations	$	**12.2**	**37.1**	$	**0.33**
Discontinued operations		**(4.1)**			**(0.11)**
Net income	$	**8.1**		$	**0.22**
Effect of dilutive securities					
Common stock equivalents			**0.2**		
Diluted EPS					
Income (loss) per share:					
Continuing operations	$	**12.2**		$	**0.33**
Discontinued operations		**(4.1)**			**(0.11)**
Net income	$	**8.1**	**37.3**	$	**0.22**

Options to purchase 0.7 million shares of Class A Common Stock were outstanding during the first quarter of 2010 but were not included in the computation of diluted EPS because to do so would be anti-dilutive.

	For the First Quarter Ended March 29, 2009				
	Income (Numerator)		Shares (Denominator)	Per Share Amount	
	(amounts in millions, except per share amounts)				
Basic EPS					
Income (loss) per share:					
Continuing operations	$	4.1	36.9	$	0.11
Discontinued operations		(0.7)			(0.02)
Net income	$	3.4		$	0.9
Effect of dilutive securities					
Common stock equivalents			0.1		
Diluted EPS					
Income (loss) per share:					
Continuing operations	$	4.1		$	0.11
Discontinued operations		(0.7)			(0.02)
Net income	$	3.4	37.0	$	0.09

Options to purchase 0.8 million shares of Class A Common Stock were outstanding during the first quarter of 2009 but were not included in the computation of diluted EPS because to do so would be anti-dilutive.

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7. Segment Information

The Company operates in three geographic segments: North America, Europe, and China. Each of these segments is managed separately and has separate financial results that are reviewed by the Company s chief operating decision-maker. All intercompany sales transactions have been eliminated. Sales by region are based upon location of the entity recording the sale. The accounting policies for each segment are the same as those described in the summary of significant accounting policies.

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

	First Quarter Ended			
		April 4, 2010		March 29, 2009
	(in millions)			
Net Sales				
North America	**$**	**198.5**	$	177.5
Europe		**116.5**		108.2
China		**4.3**		5.0
Consolidated net sales	**$**	**319.3**	$	290.7
Operating income (loss)				
North America	**$**	**27.6**	$	14.5
Europe		**10.6**		9.9
China		**(1.1)**		(0.2)
Subtotal reportable segments		**37.1**		24.2
Corporate (*)		**(11.1)**		(8.7)
Consolidated operating income		**26.0**		15.5
Interest income		**0.2**		0.2
Interest expense		**(5.2)**		(5.6)
Other		**0.2**		0.5
Income from continuing operations before income taxes	**$**	**21.2**	$	10.6
Identifiable Assets				
North America	**$**	**799.9**	$	790.2
Europe		**666.1**		675.9
China		**93.2**		96.1
Discontinued operations		**12.1**		52.8
Consolidated identifiable assets	**$**	**1,571.3**	$	1,615.0
Long-Lived Assets				
North America	**$**	**81.6**	$	90.5
Europe		**101.9**		101.8
China		**16.0**		31.9
Consolidated long-lived assets	**$**	**199.5**	$	224.2
Capital Expenditures				
North America	**$**	**3.2**	$	1.7

Europe		**3.5**		2.3
China		**0.1**		0.2
Consolidated capital expenditures	**$**	**6.8**	$	4.2
Depreciation and Amortization				
North America	**$**	**4.3**	$	4.3
Europe		**6.8**		5.6
China		**0.5**		0.9
Consolidated depreciation and amortization	**$**	**11.6**	$	10.8

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* Corporate expenses are primarily for 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.

The above operating segments are presented on a basis consistent with the presentation included in the Company s December 31, 2009 consolidated financial statements included in its Annual Report on Form 10-K.

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The North American segment includes U.S. net sales of $181.1 million and $164.4 million for the first quarters of 2010 and 2009, respectively. The North American segment also includes U.S. long-lived assets of $75.3 million and $84.5 million at April 4, 2010 and March 29, 2009, respectively.

Intersegment sales for the first quarter of 2010 for North America, Europe and China were $1.0 million, $2.1 million and $24.5 million, respectively. Intersegment sales for the first quarter of 2009 for North America, Europe and China were $1.1 million, $1.9 million and $26.3 million, respectively.

8. Accumulated Other Comprehensive Income (Loss)

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

		Foreign Currency Translation		Pension Adjustment (in millions)		Accumulated Other Comprehensive Income (Loss)
Balance December 31, 2009	**$**	**51.6**	**$**	**(21.5)**	**$**	**30.1**
Change in period		**(23.8)**		**0.6**		**(23.2)**
Balance April 4, 2010	**$**	**27.8**	**$**	**(20.9)**	**$**	**6.9**
Balance December 31, 2008	$	25.4	$	(25.2)	$	0.2
Change in period		(13.2)		0.8		(12.4)
Balance March 29, 2009	$	12.2	$	(24.4)	$	(12.2)

Accumulated other comprehensive income (loss) in the consolidated balance sheets as of April 4, 2010 and March 29, 2009 consists primarily of cumulative translation adjustments and pension related prior service costs and net actuarial loss. The Company s total comprehensive income was as follows:

	First Quarter Ended (in millions)			
		April 4, 2010		March 29, 2009
Net income	**$**	**8.1**	$	3.4
Foreign currency translation and pension adjustments		**(23.2)**		(12.4)
Total comprehensive loss	**$**	**(15.1)**	$	(9.0)

9. Debt

The Company s revolving credit facility provides for multi-currency unsecured borrowings and stand-by letters of credit of up to $350.0 million and expires in April 2011. Borrowings outstanding under the revolving credit facility 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 of 0.625%, which is determined by reference to the Company s consolidated leverage ratio, or (ii) in the case of base rate loans and swing line loans, the higher of (a) the federal funds rate plus 0.5% and (b) the rate of interest in effect for such day as announced by Bank of America, N.A. as its prime rateThe revolving credit facility includes operational and financial covenants customary for facilities of this type, including, among others, restrictions on additional indebtedness, liens and investments and maintenance of certain leverage ratios. As of April 4, 2010, the Company was in compliance with all covenants related to the revolving credit facility, had $315.3 million of unused credit under the revolving credit facility and $34.7 million of stand-by letters of credit outstanding on its revolving credit facility. Due primarily to the consolidated leverage ratio, the Company could borrow approximately $127.0 million, as of April 4, 2010, under the existing facility, excluding the stand-by-letters of credit, before it would violate a covenant. The Company is currently negotiating a new revolving credit facility with its relationship banks and expects to have an agreement finalized before the end of the second quarter of 2010.

The Company is a party to several note agreements as further detailed in Note 11 of Notes to Consolidated Financial Statements of the Annual Report on Form 10-K for the year ended December 31, 2009. These note agreements require the Company to maintain a fixed charge coverage ratio of consolidated EBITDA plus consolidated rent expense during the period to consolidated fixed charges. Consolidated fixed charges are the sum of consolidated interest expense for the period and consolidated rent expense. As of April 4, 2010, the Company was in compliance with all the covenants.

The Company has $50.0 million in senior unsecured notes maturing on May 17, 2010 and expects to use available cash to repay these existing notes. See Note 12 for discussion of a new debt agreement.

10. Contingencies and Environmental Remediation

As disclosed in Part I, Item 1, Product Liability, Environmental and Other Litigation Matters of the Company s Annual Report on Form 10-K for the year ended December 31, 2009, the Company is a party to certain litigation, have conducted an investigation regarding information that employees of CWV made payments to employees of state-owned agencies and whether such payments may violate the Foreign Corrupt Practices Act, and the Company is engaged in certain environmental remediation. There have been no

material developments with respect to its contingencies and environmental remediation proceedings during the first quarter ended April 4, 2010 except as discussed in Note 12 regarding the FCPA investigation.

11. Employee Benefit Plans

The Company sponsors funded and unfunded defined benefit pension plans covering 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.

The components of net periodic benefit cost are as follows:

	First Quarter Ended	
	April 4, 2010	**March 29, 2009**
	(in millions)	
Service cost benefits earned	**$ 1.1**	$ 1.1
Interest costs on benefits obligation	**1.4**	1.3
Expected return on assets	**(1.5)**	(1.0)
Prior service costs and net actuarial loss amortization	**0.7**	0.8
Net periodic benefit cost	**$ 1.7**	$ 2.2

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

	First Quarter Ended	
	April 4, 2010	**March 29, 2009**
	(in millions)	
Employer contributions	**$ 2.6**	$ 1.6

The Company expects to contribute approximately $7.5 million for the remainder of 2010.

12. Subsequent Events

On May 5, 2010, the Company entered into an agreement with various investors to issue senior unsecured notes totaling $75.0 million at 5.05%, with principal due in 10 years. The Company expects the transaction to close in June 2010.

On May 4, 2010, the Company declared a quarterly dividend of eleven cents ($0.11) per share on each outstanding share of Class A Common Stock and Class B Common Stock.

On April 16, 2010 the Company completed the acquisition of Blue Ridge Atlantic Enterprises (BRAE) in a share purchase transaction for approximately $0.5 million plus an earn-out agreement with a maximum potential payment of $4.8 million three years from the purchase date. BRAE is a leading provider of engineered rain water harvesting solutions and addresses the commercial, industrial and residential markets. BRAE s rain water harvesting systems are an integral part of the Green movement to conserve water and can contribute up to 30% of Leadership in Energy and Environmental Design (LEED) points available for Green buildings. BRAE had annual revenues of approximately $2.0 million in 2009. The BRAE acquisition expands the Company s portfolio of drain products.

In March 2010, in connection 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 its equity ownership and remaining assets of TWVC. The sale is expected to be finalized before the end of 2010, subject to receiving all applicable government approvals. The Company expects to receive net proceeds of $5.9 million from the sale.

As previously disclosed in prior periodic reports on Form 10-K and Form 10-Q, the Company conducted an investigation into payments made by employees of CWV to individuals associated with state-owned agencies that may violate the FCPA. The Company voluntarily disclosed this matter to the Securities and Exchange Commission (SEC) and the Department of Justice (DOJ). The Company had engaged in negotiations with the staff of the SEC and DOJ to resolve potential violations of the FCPA relating to these payments. Those negotiations have reached a stage at which the Company was able to estimate a probable pre-tax charge in connection with these matters of approximately $5.3 million, which amount includes estimated disgorgement of profits and interest. This has been reflected in the Company s results for the first quarter ended April 4, 2010. The Company has recorded this charge, net of tax, in discontinued operations as these potential violations pertained to CWV, which had been classified as discontinued operations in 2009. There is currently no definitive agreement with the SEC staff or DOJ for the resolution of this matter, including with respect to any disgorgement of profits or interest payment, and any agreement will be subject to the approval by the Commissioners of the SEC and senior DOJ personnel. Therefore, there can be no assurance that the Company s negotiations with the SEC staff and DOJ will result in a final resolution, and the amount of the loss upon final disposition of these matters may exceed the Company s current estimate.

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Item 2. Management s Discussion And Analysis Of Financial Condition And Results Of Operations

Overview

The following discussion and analysis are provided to increase understanding of, and should be read in conjunction with, the accompanying unaudited consolidated financial statements and notes. In this quarterly report on Form 10-Q, references to the Company, Watts, we, us or ou refer to Watts Water Technologies, Inc. and its consolidated subsidiaries.

We operate on a 52-week fiscal year ending on December 31. Any first quarter ended data contained in this Quarterly Report on Form 10-Q reflects the results of operations for the applicable 13-week period ended. There were four additional working days in the first quarter ended April 4, 2010 than there were in the first quarter ended March 29, 2009.

We are a leading supplier of products for use in the water quality, water safety, water flow control and water conservation markets in both North America and Europe with a presence in Asia. For over 135 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:

- water quality products, including backflow preventers and check valves for preventing reverse flow within water lines and fire protection systems and point-of-use and point-of-entry water filtration and reverse osmosis systems for both commercial and residential applications;
- a wide range of water pressure regulators for both commercial and residential applications;
- drainage products for industrial, commercial, marine and residential applications;
- water supply products for commercial and residential applications;
- temperature and pressure relief valves for water heaters, boilers and associated systems;
- thermostatic mixing valves for tempering water in commercial and residential applications;

- systems for under-floor radiant applications and hydraulic pump groups for gas boiler manufacturers and renewable energy applications, including solar and heat pump control packages; and

- flexible stainless steel connectors for natural and liquid propane gas in commercial food service and residential applications.

Our business is reported in three geographic segments: North America, Europe and China. We distribute our products through three primary distribution channels: wholesale, do-it-yourself (DIY) and original equipment manufacturers (OEMs). Interest rates have an indirect effect on the demand for our products due to the effect such rates have on the number of new residential and commercial construction starts and remodeling projects. All three of these activities have an impact on our levels of sales and earnings. An additional factor that has had an effect on our sales and operating income is fluctuation in foreign currencies, as a portion of our sales and certain portions of our costs, assets and liabilities are denominated in currencies other than the U.S. dollar.

During the first quarter of 2010, organic sales increased by 6.7% over the first quarter of 2009, partially due to the additional four working days in the first quarter of 2010 mentioned previously and partially due to increased per day sales volume. This was our first organic sales increase since the third quarter of 2008. Sales into the North American wholesale and retail markets increased organically by 9.2% and 13.5%, respectively, and wholesale sales in Europe increased organically by approximately 3%. We believe key drivers of the increase in sales is the upturn in the repair and remodeling markets in both the U.S. and Europe, some minor restocking in the retail channels, new product introductions and improvements in the residential home building market. The comparative sales volume increase drove better plant absorption in many of our facilities and, along with productivity initiatives through Lean and Six Sigma principles, drove improved incremental gross margin and operating margin performance as compared to the first quarter of 2009. Foreign currency movements, mainly related to the strengthening of the euro and Canadian dollar against the U.S. dollar, positively impacted our first quarter diluted earnings by $0.02 as compared to the first quarter of 2009. The U.S. commercial marketplace continues to be weak and we do not foresee a pickup in this end market during 2010.

We believe that the factors relating to our future growth include the demand for clean water around the world, regulatory requirements relating to the quality and conservation of water, continued enforcement of plumbing and building codes, our ability to grow organically in select attractive market segments, the successful completion of selective acquisitions, both in our core markets as well as in new complementary markets, and a healthy economic environment. We have completed 33 acquisitions since divesting our industrial and oil and gas business in 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 residential and commercial construction 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 barrier to entry for competitors. We believe there is a demand among consumers for products to ensure water quality, which creates growth opportunities for our products.

We require substantial amounts of raw materials to produce our products, including bronze, brass, cast iron, steel and plastic, and substantially all of the raw materials we require are purchased from outside sources. The commodity markets, particularly copper, have experienced tremendous volatility over the past several years. Bronze and brass are copper-based alloys. The spot price of copper during the first quarter of 2010 increased approximately 7.3% from December 31, 2009. We typically carry several months of inventory on-hand primarily due to the significant extent of our international sourcing.

Historically, we have faced a risk relating to our ability to deal effectively with increases in raw material costs. 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, purchasing forward commitments for raw materials, when available, implementing cost reduction programs and passing increases in costs on to our customers.

Another risk we face in all areas of our business is competition. We consider brand preference, engineering specifications, code requirements, price, technological expertise, delivery times and breadth of product offerings to be the primary competitive factors. As mentioned previously, 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 barrier to entry for competitors. We are committed to maintaining our capital equipment at a level consistent with current technologies, and thus we expect to spend approximately $31.0 million in 2010.

In 2009, our Board of Directors approved the sale of our Watts Valve (Changsha) Co., Ltd. (CWV) subsidiary. We also liquidated our TEAM Precision Pipework, Ltd. (TEAM) subsidiary through an administration process under the United Kingdom law, as more fully described in Note 3 of Notes to Consolidated Financial Statements. We classified have CWV s and TEAM s results of operations and any related losses as discontinued operations for all periods presented in this report.

Recent Developments

On May 5, 2010, we entered into an agreement with various investors to issue senior unsecured notes totaling $75.0 million at 5.05%, with principal due in 10 years. We expect the transaction to close in June 2010.

On May 4, 2010, we declared a quarterly dividend of eleven cents ($0.11) per share on each outstanding share of Class A Common Stock and Class B Common Stock.

On April 16, 2010, we completed the acquisition of Blue Ridge Atlantic Enterprises (BRAE) in a share purchase transaction for approximately $0.5 million plus an earn-out agreement with a maximum potential payment of $4.8 million three years from the purchase date. BRAE is a leading provider of engineered rain water harvesting solutions and addresses the commercial, industrial and residential markets. BRAE s rain water harvesting systems are an integral part of the Green movement to conserve water and can contribute up to 30% of Leadership in Energy and Environmental Design (LEED) points available for Green buildings. BRAE had annual revenues of approximately $2.0 million in 2009. The BRAE acquisition expands our portfolio of drain products.

In March 2010, in connection with our manufacturing footprint consolidation, we closed the operations of Tianjin Watts Valve Company LTD. (TWVC) and relocated its manufacturing to other facilities. On April 12, 2010, we signed a definitive equity transfer agreement with a third party to sell our equity ownership and remaining assets of TWVC. The sale is expected to be finalized before the end of 2010, subject to receiving all applicable government approvals. We expect to receive net proceeds of approximately $5.9 million from the sale.

We completed the sale of CWV in January 2010. As previously disclosed in prior periodic reports on Form 10-K and Form 10-Q, we conducted an investigation into payments made by employees of CWV to individuals associated with state-owned agencies that may violate the United States Foreign Corrupt Practices Act (FCPA). We voluntarily disclosed this matter to the Securities and Exchange Commission (SEC) and the Department of Justice (DOJ). We have engaged in negotiations with the staff of the SEC and DOJ to resolve potential violations of the FCPA relating to these payments. Those negotiations have reached a stage at which we were able to estimate a probable pre-tax charge in connection with these matters of approximately $5.3 million, which amount includes estimated disgorgement of profits and interest. This has been reflected in our results for the first quarter ended April 4, 2010. We have recorded this charge, net of tax, in discontinued operations as these potential violations pertained to CWV, which had been classified as discontinued operations in 2009. There is currently no definitive agreement with the SEC staff or DOJ for the resolution of this matter, including with respect to any disgorgement of profits or interest payment, and any agreement will be subject to the approval by the Commissioners of the SEC and senior DOJ personnel. Therefore, there can be no assurance that our negotiations with the SEC staff and DOJ will result in a final resolution, and the amount of the loss upon final disposition of these matters may exceed our current estimate.

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Results of Operations

First Quarter Ended April 4, 2010 Compared to First Quarter Ended March 29, 2009

Net Sales. Our business is reported in three geographic segments: North America, Europe and China. Our net sales in each of these segments for each of the first quarters of 2010 and 2009 were as follows:

	First Quarter Ended April 4, 2010		First Quarter Ended March 29, 2009			
	Net Sales	% Sales	Net Sales	% Sales	Change	% Change to Consolidated Net Sales
	(dollars in millions)					
North America	$ **198.5**	**62.2%**	$ 177.5	61.1%	$ 21.0	7.2%
Europe	**116.5**	**36.5**	108.2	37.2	8.3	2.8
China	**4.3**	**1.3**	5.0	1.7	(0.7)	(0.2)
Total	$ **319.3**	**100%**	$ 290.7	100%	$ 28.6	9.8%

The increase (decrease) in net sales in each of the three geographic segments is attributable to the following:

					Change As a % of Consolidated Net Sales				Change As a % of Segment Net Sales		
	North America	Europe	China	Total	North America	Europe	China	Total	North America	Europe	China
	(dollars in millions)										
Organic	$ 18.2	$ 2.1	$ (0.7)	$ 19.6	6.2%	0.7%	(0.2)%	6.7%	10.3%	1.9%	(14.0)%
Foreign exchange	2.8	6.2		9.0	1.0	2.1		3.1	1.5	5.8	
Total	$ 21.0	$ 8.3	$ (0.7)	$ 28.6	7.2%	2.8%	(0.2)%	9.8%	11.8%	7.7%	(14.0)%

There were four additional working days in the first quarter ended April 4, 2010 than there were in the first quarter ended March 29, 2009.

Organic sales into the North American wholesale market in the first quarter of 2010 increased by 9.2% compared to the first quarter of 2009. This increase was primarily due to increased unit sales of our plumbing and heating, backflow and gas connector product lines. Organic sales into the North American DIY market in the first quarter of 2010 increased 13.5% compared to the first quarter of 2009, primarily from increased product volume associated with repair and remodeling activity, new product introductions and from customer restocking partially offset by price concessions.

Organic net sales increased in Europe primarily due to increased sales into the European wholesale market, which increased by 3.0%. The wholesale market increase was driven by a stronger repair and remodeling market place and due to high export sales. Overall, our sales into the European OEM and DIY markets remained relatively flat compared to the first quarter of 2009.

Organic net sales declined in China primarily due to decreased sales in the Chinese export markets.

The increases in net sales due to foreign exchange in Europe and North America were primarily due to the appreciation of the euro and the Canadian dollar, respectively, against the U.S. dollar. We cannot predict whether these currencies will continue to 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.

Gross Profit. Gross profit and gross profit as a percent of net sales (gross margin) for the first quarters of 2010 and 2009 were as follows:

	First Quarter Ended	
	April 4, 2010	**March 29, 2009**
	(dollars in millions)	
Gross profit	**$ 117.6**	$ 97.0
Gross margin	**36.8%**	33.3%

Gross margin increased 3.5 percentage points in the first quarter of 2010 compared to the first quarter of 2009. Gross profit included a charge of $0.7 million in 2010 for accelerated depreciation related to production facilities in France that are part of our restructuring program. Both North America and Europe improved gross margins were primarily attributable to increased sales volumes, better absorption at the factories, better product mix and productivity gains from cost savings initiatives partially offset by increased raw materials costs and some decreased selling prices. Our China segment s gross margin decreased as a result ofabsorption issues and aggressive pricing from competitors for domestic Chinese sales.

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Selling, General and Administrative Expenses. Selling, General and Administrative, or SG&A, expenses for the first quarter of 2010 increased $8.3 million, or 10.4%, compared to the first quarter of 2009. The increase in SG&A expenses was attributable to the following:

		(in millions)	% Change
Organic	$	6.2	7.8%
Foreign exchange		2.1	2.6
Total	$	8.3	10.4%

The organic increase in SG&A expenses was primarily due to increased legal and personnel related costs and increased variable selling expenses due to higher sales volumes. The increase in SG&A expenses from foreign exchange was primarily due to the appreciation of the euro against the U.S. dollar. Total SG&A expenses, as a percentage of sales, were 27.7% in the first quarter of 2010 compared to 27.5% in the first quarter of 2009.

Restructuring and Other Charges. In the first quarter of 2010, we recorded a charge of $3.3 million primarily for severance and other costs incurred as part of our previously announced restructuring programs, as compared to $1.5 million for the first quarter of 2009. For a more detailed description of our current restructuring plans see Note 5 of Notes to Consolidated Financial Statements.

Operating Income. Operating income (loss) by geographic segment for the first quarters of 2010 and 2009 was as follows:

	First Quarter Ended						% Change to Consolidated Operating Income
		April 4, 2010		March 29, 2009		Change	
	(dollars in millions)						
North America	**$**	**27.6**	$	14.5	$	13.1	84.5%
Europe		**10.6**					