

WATTS WATER TECHNOLOGIES INC
Form 10-Q
May 09, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2013

or

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

For the transition period from to

Commission file number 001-11499

WATTS WATER TECHNOLOGIES, INC.

(Exact Name of Registrant as Specified in Its Charter)

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Delaware
(State or Other Jurisdiction of Incorporation or
Organization)

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

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

01845
(Zip Code)

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

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

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

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

Class	Outstanding at May 6, 2013
Class A Common Stock, \$0.10 par value	28,762,203
Class B Common Stock, \$0.10 par value	6,588,680

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WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Amounts in millions, except share information)

(Unaudited)

	March 31, 2013	December 31, 2012
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 251.0	\$ 271.8
Short-term investment securities	2.1	2.1
Trade accounts receivable, less allowance for doubtful accounts of \$10.4 million at March 31, 2013 and \$9.7 million at December 31, 2012	218.5	207.1
Inventories, net:		
Raw materials	104.9	111.7
Work in process	21.7	20.5
Finished goods	173.1	158.5
Total Inventories	299.7	290.7
Prepaid expenses and other assets	27.8	22.7
Deferred income taxes	23.3	21.6
Total Current Assets	822.4	816.0
PROPERTY, PLANT AND EQUIPMENT:		
Property, plant and equipment, at cost	514.9	515.0
Accumulated depreciation	(292.7)	(291.4)
Property, plant and equipment, net	222.2	223.6
OTHER ASSETS:		
Goodwill	499.5	508.2
Intangible assets, net	140.5	146.6
Deferred income taxes	3.9	4.8
Other, net	9.6	9.8
TOTAL ASSETS	\$ 1,698.1	\$ 1,709.0
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$ 134.1	\$ 131.6
Accrued expenses and other liabilities	114.1	116.8
Accrued compensation and benefits	40.1	42.5
Current portion of long-term debt	77.0	77.1
Total Current Liabilities	365.3	368.0
LONG-TERM DEBT, NET OF CURRENT PORTION	306.8	307.5
DEFERRED INCOME TAXES	44.5	45.2
OTHER NONCURRENT LIABILITIES	45.5	48.8

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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 28,761,901 shares at March 31, 2013 and 28,673,639 shares at December 31, 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, 6,588,680 shares at March 31, 2013 and at December 31, 2012	0.6	0.6
Additional paid-in capital	453.8	448.7
Retained earnings	509.2	498.1
Accumulated other comprehensive loss	(30.5)	(10.8)
Total Stockholders Equity	936.0	939.5
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	\$ 1,698.1	\$ 1,709.0

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	
	March 31, 2013	April 1, 2012
Net sales	\$ 362.1	\$ 361.2
Cost of goods sold	232.6	232.7
GROSS PROFIT	129.5	128.5
Selling, general and administrative expenses	99.0	100.2
Restructuring and other charges, net	2.2	1.7
OPERATING INCOME	28.3	26.6
Other (income) expense:		
Interest income	(0.1)	(0.2)
Interest expense	6.0	6.2
Other income, net		(0.9)
Total other expense	5.9	5.1
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	22.4	21.5
Provision for income taxes	6.3	6.0
NET INCOME FROM CONTINUING OPERATIONS	16.1	15.5
Income from discontinued operations, net of taxes		0.2
NET INCOME	\$ 16.1	\$ 15.7
BASIC EPS		
Net income per share:		
Continuing operations	\$ 0.45	\$ 0.42
Discontinued operations		
NET INCOME	\$ 0.45	\$ 0.42
Weighted average number of shares	35.5	36.9
DILUTED EPS		
Net income per share:		
Continuing operations	\$ 0.45	\$ 0.42
Discontinued operations		
NET INCOME	\$ 0.45	\$ 0.42
Weighted average number of shares	35.6	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 COMPREHENSIVE INCOME (LOSS)

(Amounts in millions)

(Unaudited)

	First Quarter Ended	
	March 31, 2013	April 1, 2012
Net income	\$ 16.1	\$ 15.7
Other comprehensive income (loss), net of tax:		
Foreign currency translation adjustments	(19.9)	16.5
Defined benefit pension plans:		
Amortization of net losses included in net periodic pension cost	0.2	0.2
Defined benefit pension plans	0.2	0.2
Other comprehensive income (loss), net of tax	(19.7)	16.7
Comprehensive income (loss)	\$ (3.6)	\$ 32.4

See accompanying notes to consolidated financial statements.

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WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in millions)

(Unaudited)

	First Quarter Ended	
	March 31, 2013	April 1, 2012
OPERATING ACTIVITIES		
Net income	\$ 16.1	\$ 15.7
Less: Income from discontinued operations, net of taxes		0.2
Net income from continuing operations	16.1	15.5
Adjustments to reconcile net income from continuing operations to net cash provided by (used in) continuing operating activities:		
Depreciation	8.7	8.3
Amortization of intangibles	3.7	4.2
Stock-based compensation	1.6	1.1
Deferred income tax (benefit)	(0.6)	2.9
Loss on disposal and impairment of property, plant and equipment and other	(0.1)	0.4
Changes in operating assets and liabilities, net of effects from business acquisitions and divestitures:		
Accounts receivable	(14.8)	(14.3)
Inventories	(12.2)	(5.1)
Prepaid expenses and other assets	(5.2)	(15.6)
Accounts payable, accrued expenses and other liabilities	0.1	5.6
Net cash provided by (used in) continuing operations	(2.7)	3.0
INVESTING ACTIVITIES		
Additions to property, plant and equipment	(11.0)	(4.9)
Proceeds from the sale of property, plant and equipment		0.3
Business acquisitions, net of cash acquired		(17.6)
Net cash used in investing activities	(11.0)	(22.2)
FINANCING ACTIVITIES		
Payments of long-term debt	(0.5)	(4.4)
Payment of capital leases and other	(1.3)	(0.2)
Proceeds from share transactions under employee stock plans	1.4	6.0
Tax benefit of stock awards exercised	0.5	0.4
Dividends	(3.9)	(4.2)
Net cash used in financing activities	(3.8)	(2.4)
Effect of exchange rate changes on cash and cash equivalents	(3.3)	1.6
Net cash provided in operating activities of discontinued operations		0.2
DECREASE IN CASH AND CASH EQUIVALENTS	(20.8)	(19.8)
Cash and cash equivalents at beginning of year	271.8	250.6
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 251.0	\$ 230.8
NON-CASH INVESTING AND FINANCING ACTIVITIES		
Acquisition of businesses:		
Fair value of assets acquired	\$	\$ 27.7
Cash paid, net of cash acquired		17.6
Liabilities assumed	\$	\$ 10.1
Issuance of stock under management stock purchase plan	\$ 0.4	\$ 0.4

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CASH PAID FOR:

Interest	\$	0.6	\$	0.8
Income taxes	\$	10.0	\$	5.4

See accompanying notes to consolidated financial statements.

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WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included in the Watts Water Technologies, Inc. (the Company) Consolidated Balance Sheet as of March 31, 2013, the Consolidated Statements of Operations for the first quarter ended March 31, 2013 and April 1, 2012, the Consolidated Statements of Comprehensive Income (Loss) for the first quarter ended March 31, 2013 and April 1, 2012, and the Consolidated Statements of Cash Flows for the first quarter ended March 31, 2013 and April 1, 2012.

The consolidated balance sheet at December 31, 2012 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, 2012. 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, 2012. Operating results for the interim periods presented are not necessarily indicative of the results to be expected for the year ending December 31, 2013.

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

2. Accounting Policies

Estimates

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

Goodwill and Long-Lived Assets

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

	March 31, 2013							Net Goodwill March 31, 2013
	Balance January 1, 2013	Gross Balance		Balance March 31, 2013	Accumulated Impairment Losses		Balance March 31, 2013	
		Acquired During the Period	Foreign Currency Translation and Other		Impairment Loss During the Period	Balance March 31, 2013		
	(in millions)							
North America	\$ 225.6	\$	\$ (0.3)	\$ 225.3	\$ (24.2)	\$	\$ (24.2)	\$ 201.1
Europe, Middle East and Africa (EMEA)	293.9		(8.4)	285.5				285.5
Asia	12.9			12.9				12.9
Total	\$ 532.4	\$	\$ (8.7)	\$ 523.7	\$ (24.2)	\$	\$ (24.2)	\$ 499.5

	April 1, 2012							Net Goodwill April 1, 2012
	Balance January 1, 2012	Gross Balance		Balance April 1, 2012	Accumulated Impairment Losses		Balance April 1, 2012	
		Acquired During the Period	Foreign Currency Translation and Other		Impairment Loss During the Period	Balance April 1, 2012		
	(in millions)							
North America	\$ 213.8	\$ 13.1	\$ 0.1	\$ 227.0	\$ (23.2)	\$	\$ (23.2)	\$ 203.8
EMEA	285.3		7.6	292.9				292.9
Asia	12.7		0.1	12.8				12.8
Total	\$ 511.8	\$ 13.1	\$ 7.8	\$ 532.7	\$ (23.2)	\$	\$ (23.2)	\$ 509.5

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.

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

Intangible assets include the following:

	March 31, 2013			December 31, 2012		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
	(in millions)					
Patents	\$ 16.4	\$ (11.9)	\$ 4.5	\$ 16.5	\$ (11.7)	\$ 4.8
Customer relationships	133.1	(71.4)	61.7	134.3	(68.7)	65.6
Technology	28.3	(9.8)	18.5	28.5	(9.3)	19.2
Trade Names	13.7	(2.2)	11.5	13.9	(1.9)	12.0
Other	8.7	(5.6)	3.1	8.7	(5.5)	3.2
Total amortizable intangibles	200.2	(100.9)	99.3	201.9	(97.1)	104.8
Indefinite-lived intangible assets	41.2		41.2	41.8		41.8
Total	\$ 241.4	\$ (100.9)	\$ 140.5	\$ 243.7	\$ (97.1)	\$ 146.6

Aggregate amortization expense for amortizable intangible assets for the first quarters of 2013 and 2012 was \$3.7 million and \$4.2 million. Additionally, future amortization expense for the next five years on amortizable intangible assets is expected to be approximately \$11.1 million for the remainder of 2013, \$14.8 million for 2014, \$14.5 million for 2015, \$14.0 million for 2016 and \$13.6 million for 2017. Amortization expense is recorded on a straight-line basis over the estimated useful lives of the intangible assets. The weighted-average remaining life of total amortizable intangible assets is 9.0 years. Patents, customer relationships, technology, trade names and other amortizable intangibles have weighted-average remaining lives of 6.2 years, 6.3 years, 11.7 years, 11.3 years and 41.4 years, respectively. Indefinite-lived intangible assets primarily include trademarks and trade names.

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 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% 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 issued 2,000 stock options during the first quarter of 2013.

The Company has also granted shares of restricted stock 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 vest 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 issued 667 shares of restricted stock under the 2004 Stock Incentive Plan in the first quarter of 2013.

The Company also has a Management Stock Purchase Plan that allows for the purchase of restricted stock units (RSUs) by key employees. On an annual basis, key employees may elect to receive a portion of their annual incentive compensation in RSUs instead of cash. Each RSU represents one share of Class A Common Stock and is purchased by the employee at 67% of the fair market value of the Company's Class A Common Stock on the date of grant. RSUs vest annually over a three-year period from the grant date and receipt of the shares underlying RSUs is deferred for a minimum of three years or such greater number of years as is chosen by the employee. An aggregate of 2,000,000 shares of Class A Common Stock may be issued under the Management Stock Purchase Plan. The Company granted 44,777 RSUs and 63,739 RSUs in the first quarters of 2013 and 2012, respectively.

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