

WATTS WATER TECHNOLOGIES INC

Form 10-Q

May 08, 2018

[Table of Contents](#)

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 April 1, 2018

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, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

(Do not check if a smaller reporting company)

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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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 April 29 , 2018 |
|--|--------------------------------|
| Class A Common Stock, \$0.10 par value | 27,819,548                     |
| Class B Common Stock, \$0.10 par value | 6,329,290                      |

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Table of Contents

WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

INDEX

|   |    |
|---|----|
| <u>Part I. Financial Information</u>  | 3  |
| <u>Item 1. Financial Statements</u>   | 3  |
| <u>Consolidated Balance Sheets at April 1, 2018 and December 31, 2017 (unaudited)</u>   | 3  |
| <u>Consolidated Statements of Operations for the First Quarters ended April 1, 2018 and April 2, 2017 (unaudited)</u>           | 4  |
| <u>Consolidated Statements of Comprehensive Income for the First Quarters ended April 1, 2018 and April 2, 2017 (unaudited)</u> | 5  |
| <u>Consolidated Statements of Cash Flows for the First Quarters ended April 1, 2018 and April 2, 2017 (unaudited)</u>           | 6  |
| <u>Notes to Consolidated Financial Statements (unaudited)</u>   | 7  |
| <u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>                            | 21 |
| <u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>   | 27 |
| <u>Item 4. Controls and Procedures</u>  | 27 |
| <u>Part II. Other Information</u>   | 29 |
| <u>Item 1. Legal Proceedings</u>  | 29 |
| <u>Item 1A. Risk Factors</u>  | 29 |
| <u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>  | 29 |
| <u>Item 6. Exhibits</u>   | 30 |
| <u>Signatures</u>   | 31 |



Table of Contents

## 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 1,<br>2018  | December 31,<br>2017 |
|--|-------------------|----------------------|
| <b>ASSETS</b>  |                   |                      |
| <b>CURRENT ASSETS:</b>   |                   |                      |
| Cash and cash equivalents  | \$ 184.7          | \$ 280.2             |
| Trade accounts receivable, less allowance for doubtful accounts of \$15.4 million at April 1, 2018 and \$14.3 million at December 31, 2017 | 233.1             | 216.1                |
| Inventories, net   |                   |                      |
| Raw materials  | 92.1              | 81.8                 |
| Work in process  | 19.8              | 17.5                 |
| Finished goods   | 169.9             | 159.8                |
| Total Inventories  | 281.8             | 259.1                |
| Prepaid expenses and other current assets  | 29.5              | 26.7                 |
| Assets held for sale   | 1.5               | 1.5                  |
| Total Current Assets   | 730.6             | 783.6                |
| <b>PROPERTY, PLANT AND EQUIPMENT</b>   |                   |                      |
| Property, plant and equipment, at cost   | 538.9             | 525.8                |
| Accumulated depreciation   | (337.8)           | (327.3)              |
| Property, plant and equipment, net   | 201.1             | 198.5                |
| <b>OTHER ASSETS:</b>   |                   |                      |
| Goodwill   | 554.2             | 550.5                |
| Intangible assets, net   | 180.9             | 185.2                |
| Deferred income taxes  | 2.6               | 1.6                  |
| Other, net   | 19.1              | 17.1                 |
| <b>TOTAL ASSETS</b>  | <b>\$ 1,688.5</b> | <b>\$ 1,736.5</b>    |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                   |                      |
| <b>CURRENT LIABILITIES:</b>  |                   |                      |
| Accounts payable   | \$ 113.1          | \$ 123.8             |
| Accrued expenses and other liabilities   | 122.3             | 125.8                |
| Accrued compensation and benefits  | 47.1              | 55.3                 |
| Current portion of long-term debt  | 22.5              | 22.5                 |
| Total Current Liabilities  | 305.0             | 327.4                |

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|   |            |            |
|---|------------|------------|
| LONG-TERM DEBT, NET OF CURRENT PORTION  | 424.1      | 474.6      |
| DEFERRED INCOME TAXES   | 53.7       | 55.2       |
| OTHER NONCURRENT LIABILITIES  | 49.9       | 50.3       |
| 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, 27,852,496 shares at April 1, 2018 and 27,724,192 shares at December 31, 2017 | 2.8        | 2.8        |
| Class B common stock, \$0.10 par value; 25,000,000 shares authorized; 10 votes per share; issued and outstanding, 6,329,290 shares at April 1, 2018 and 6,379,290 shares at December 31, 2017 | 0.6        | 0.6        |
| Additional paid-in capital  | 555.4      | 551.8      |
| Retained earnings   | 383.6      | 372.9      |
| Accumulated other comprehensive loss  | (86.6)     | (99.1)     |
| Total Stockholders' Equity  | 855.8      | 829.0      |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY  | \$ 1,688.5 | \$ 1,736.5 |

See accompanying notes to consolidated financial statements.

Table of Contents

## WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS

(Amounts in millions, except per share information)

(Unaudited)

|  | First Quarter Ended |                  |
|--|---------------------|------------------|
|  | April 1,<br>2018    | April 2,<br>2017 |
| Net sales                                    | \$ 378.5            | \$ 347.2         |
| Cost of goods sold                           | 221.8               | 203.4            |
| <b>GROSS PROFIT</b>                          | 156.7               | 143.8            |
| Selling, general and administrative expenses | 112.8               | 107.6            |
| Restructuring                                | —                   | 0.5              |
| <b>OPERATING INCOME</b>                      | 43.9                | 35.7             |
| Other (income) expense:                      |                     |                  |
| Interest income                              | (0.4)               | (0.2)            |
| Interest expense                             | 4.3                 | 4.8              |
| Other expense, net                           | 0.7                 | 0.3              |
| Total other expense                          | 4.6                 | 4.9              |
| <b>INCOME BEFORE INCOME TAXES</b>            | 39.3                | 30.8             |
| Provision for income taxes                   | 11.1                | 9.1              |
| <b>NET INCOME</b>                            | \$ 28.2             | \$ 21.7          |
| Basic EPS                                    |                     |                  |
| <b>NET INCOME PER SHARE</b>                  | \$ 0.82             | \$ 0.63          |
| Weighted average number of shares            | 34.3                | 34.4             |
| Diluted EPS                                  |                     |                  |
| <b>NET INCOME PER SHARE</b>                  | \$ 0.82             | \$ 0.63          |
| Weighted average number of shares            | 34.4                | 34.5             |
| Dividends declared per share                 | \$ 0.19             | \$ 0.18          |

See accompanying notes to consolidated financial statements.



Table of Contents

WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Amounts in millions)

(Unaudited)

|  | First Quarter Ended |                  |
|--|---------------------|------------------|
|  | April 1,<br>2018    | April 2,<br>2017 |
| Net income                               | \$ 28.2             | \$ 21.7          |
| Other comprehensive income, net of tax:  |                     |                  |
| Foreign currency translation adjustments | 9.7                 | 7.9              |
| Cash flow hedges                         | 2.8                 | 0.1              |
| Other comprehensive income               | 12.5                | 8.0              |
| Comprehensive income                     | \$ 40.7             | \$ 29.7          |

See accompanying notes to consolidated financial statements.

Table of Contents

## WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in millions)

(Unaudited)

|  | First Quarter Ended |                  |
|--|---------------------|------------------|
|  | April 1,<br>2018    | April 2,<br>2017 |
| <b>OPERATING ACTIVITIES</b>  |                     |                  |
| Net income   | \$ 28.2             | \$ 21.7          |
| Adjustments to reconcile net income to net cash used in operating activities:                            |                     |                  |
| Depreciation   | 7.1                 | 6.6              |
| Amortization of intangibles  | 5.6                 | 5.5              |
| Loss on disposal and impairment of intangibles, property, plant and equipment and other                  | —                   | 0.4              |
| Stock-based compensation   | 2.7                 | 2.9              |
| Deferred income tax  | (4.4)               | 5.3              |
| Changes in operating assets and liabilities, net of effects from business acquisitions and divestitures: |                     |                  |
| Accounts receivable  | (13.9)              | (12.5)           |
| Inventories  | (19.7)              | (14.3)           |
| Prepaid expenses and other assets  | (1.6)               | (2.7)            |
| Accounts payable, accrued expenses and other liabilities   | (30.1)              | (22.0)           |
| Net cash used in operating activities  | (26.1)              | (9.1)            |
| <b>INVESTING ACTIVITIES</b>  |                     |                  |
| Additions to property, plant and equipment   | (7.3)               | (5.8)            |
| Net proceeds from the sale of assets, and other  | —                   | 1.9              |
| Business acquisitions, net of cash acquired and other  | (1.5)               | 0.1              |
| Net cash used in investing activities  | (8.8)               | (3.8)            |
| <b>FINANCING ACTIVITIES</b>  |                     |                  |
| Proceeds from long-term borrowings   | 20.0                | 10.0             |
| Payments of long-term debt   | (70.6)              | (38.9)           |
| Payment of capital leases and other  | (0.4)               | (3.3)            |
| Proceeds from share transactions under employee stock plans  | —                   | 0.3              |
| Payments to repurchase common stock  | (6.2)               | (4.4)            |
| Dividends  | (6.7)               | (6.2)            |
| Net cash used in financing activities  | (63.9)              | (42.5)           |
| Effect of exchange rate changes on cash and cash equivalents   | 3.3                 | 4.0              |
| <b>DECREASE IN CASH AND CASH EQUIVALENTS</b>   | <b>(95.5)</b>       | <b>(51.4)</b>    |
| Cash and cash equivalents at beginning of year   | 280.2               | 338.4            |
| <b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>  | <b>\$ 184.7</b>     | <b>\$ 287.0</b>  |
| <b>NON CASH INVESTING AND FINANCING ACTIVITIES</b>   |                     |                  |
| Acquisition of businesses:   |                     |                  |
| Fair value of assets acquired  | \$ 0.7              | \$ —             |

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|  |          |        |
|--|----------|--------|
| Cash paid, net of cash acquired                        | 1.3      | —      |
| Liabilities assumed                                    | \$ (0.6) | \$ —   |
| Issuance of stock under management stock purchase plan | \$ 1.1   | \$ 0.9 |
| <b>CASH PAID FOR:</b>                                  |          |        |
| Interest   | \$ 4.0   | \$ 4.0 |
| Income taxes   | \$ 7.0   | \$ 5.0 |

See accompanying notes to consolidated financial statements.

Table of Contents

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 1, 2018, the Consolidated Statements of Operations for the first quarters ended April 1, 2018 and April 2, 2017, the Consolidated Statements of Comprehensive Income for the first quarters ended April 1, 2018 and April 2, 2017, and the Consolidated Statements of Cash Flows for the first quarters ended April 1, 2018 and April 2, 2017.

The consolidated balance sheet at December 31, 2017 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, 2017. 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, 2017. Operating results for the interim periods presented are not necessarily indicative of the results to be expected for the year ending December 31, 2018.

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

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.

2. Accounting Policies

The significant accounting policies used in preparation of these consolidated financial statements for the three months ended April 1, 2018 are consistent with those discussed in Note 2 of the Notes to Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2017, with the exception of the Company's change in its Revenue Recognition accounting policy resulting from the adoption of ASC 606 described herein.

## Revenue Recognition

On January 1, 2018, the Company adopted the accounting standard ASC 606, Revenue from Contracts with Customers and all the related amendments ("new revenue standard" or "ASU 2014-09") to all contracts using the modified retrospective method. The adoption of ASU 2014-09 was not material to the Company and as such, there was no cumulative effect upon the January 1, 2018 adoption date. As the impact of the new revenue standard is not material to the Company, there is no pro-forma disclosure presented as of and for the quarter ended April 1, 2018. The Company expects the impact of the adoption of the new standard to be immaterial to the Company's financial statements on an ongoing basis.

The Company recognizes revenue under the core principle to depict the transfer of control to the Company's customers in an amount reflecting the consideration the Company expects to be entitled. In order to achieve that core principle, the Company applies the following five step approach: (1) identify the contract with a customer, (2) identify the performance obligations in the contract, (3) determine the transaction price, (4) allocate the transaction price to the performance obligations in the contract, and (5) recognize revenue when a performance obligation is satisfied.

The Company's revenue for product sales is recognized on a point in time model, at the point control transfers to the customer, which is generally when products are shipped from the Company's manufacturing or distribution facilities or

## Table of Contents

when delivered to the customer's named location. Sales tax, value-added tax, or other taxes collected concurrent with revenue producing activities are excluded from revenue. Freight costs billed to customers for shipping and handling activities are included in revenue with the related cost included in selling, general and administrative expenses. See Note 3 for further disclosures and detail regarding revenue recognition.

### Other Recently Adopted Accounting Standards

In February 2018, the FASB issued ASU 2018-02 "Income Statement-Reporting Comprehensive Income." ASU 2018-02 provides guidance on the reclassification of certain tax effects from the Tax Cuts and Jobs Act from accumulated other comprehensive income. Current generally accepted accounting principles requires deferred tax liabilities and deferred tax assets to be adjusted for the effect of a change in tax laws or tax rates, with that effect included in income from operations in the period of enactment. This included the income tax effects of items in accumulated other comprehensive income. This guidance allows a reclassification from accumulated other comprehensive income to retained earnings for the tax effects on items in accumulated other comprehensive income related to the change in tax rates from the Tax Cuts and Jobs Act. This standard is effective for all entities for fiscal years beginning after December 15, 2018, including interim periods within that reporting period. Early adoption of this standard is permitted. The Company adopted this standard in the first quarter of 2018, and it did not have a material impact on the Company's financial statements.

In October 2016, the FASB issued ASU 2016-16 "Intra-Entity Transfers of Assets Other than Inventory." ASU 2016-16 provides guidance on the timing of recognition of tax consequences of an intra-entity transfer of an asset other than inventory. The Company adopted the provision of this ASU during the first quarter of 2018, using the modified retrospective approach through a cumulative-effect adjustment to retained earnings as of the beginning of the quarter.

The adoption of this guidance did not have a material impact on the Company's financial statements.

### Accounting Standards Updates

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)." ASU 2016-02 requires a lessee to recognize in the statement of financial position a liability to make lease payments and a right-of-use asset representing the right to use the underlying asset for the lease term for both finance and operating leases. ASU 2016-02 is effective for financial statements issued for annual periods beginning after December 15, 2018 and all interim periods thereafter. Early adoption is permitted for all entities. The Company plans to adopt this standard effective January 1, 2019, using the modified retrospective approach. The Company has begun evaluating the new lease standard, including the review and implementation of the necessary changes to its existing processes and systems that will be required to implement this new standard. The Company has a variety of categories of lease arrangements, including real estate, automobiles, manufacturing equipment, facility equipment, office equipment and certain service arrangements. The Company is currently reviewing its leasing arrangements in order to evaluate the impact of this standard on the Company's financial statements. The Company does not expect a significant change in its leasing activity between now and

adoption. The Company is unable to quantify the impact of adoption at this time, however the Company expects the primary impact to its consolidated financial position upon adoption will be the recognition, on a discounted basis, of its minimum commitments under non-cancelable operating leases on its consolidated balance sheets resulting in the recording of right-of-use assets and lease obligations. The Company currently does not expect ASC 842 to have a material effect on either its consolidated statement of operations or consolidated statement of cash flow.

#### Shipping and Handling

Shipping and handling costs included in selling, general and administrative expenses amounted to \$13.2 million and \$12.8 million for the first quarters of 2018 and 2017, respectively.

#### Research and Development

Research and development costs included in selling, general and administrative expenses amounted to \$8.5 million and \$7.1 million for the first quarters of 2018 and 2017, respectively.

Table of Contents

## 3. Revenue Recognition

The Company is a leading supplier of products that manage and conserve the flow of fluids and energy into, through and out of buildings in the residential and commercial markets of the Americas, Europe, and Asia Pacific, Middle East, and Africa (“APMEA”). For over 140 years, the Company has designed and produced valve systems that safeguard and regulate water systems, energy efficient heating and hydronic systems, drainage systems and water filtration technology that helps purify and conserve water.

The Company distributes products through four primary distribution channels: wholesale, original equipment manufacturers (OEMs), specialty, and do-it-yourself (DIY). The Company operates in three geographic segments: Americas, Europe, and APMEA. Each of these segments sells similar products, which are comprised of the following principal product lines:

- 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 commercial high efficiency boilers, water heaters and heating solutions, hydronic and electric heating systems for under floor radiant applications, custom heat and hot water solutions, 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.
- Drainage & 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.

The following table disaggregates our revenue for each reportable segment, by distribution channel and principal product line. The Company believes that disaggregating revenue into these categories achieves the disclosure objective to depict how the nature, amount, and cash flows are affected by economic factors:

| Distribution Channel | For the period ended April 1, 2018<br>(in millions) |          |         |              |
|----------------------|---|----------|---------|--------------|
|                      | Americas  | Europe   | APMEA   | Consolidated |
| Wholesale            | \$ 136.6  | \$ 82.7  | \$ 13.9 | \$ 233.2     |
| OEM                  | 19.1  | 39.5     | 0.5     | 59.1         |
| Specialty            | 67.6  | —        | —       | 67.6         |
| DIY                  | 17.8  | 0.8      | —       | 18.6         |
| Total revenues       | \$ 241.1  | \$ 123.0 | \$ 14.4 | \$ 378.5     |



|                                       |          |          |         |          |
|---------------------------------------|----------|----------|---------|----------|
| Principal Product Line                |          |          |         |          |
| Residential & Commercial Flow Control | \$ 139.9 | \$ 47.2  | \$ 9.5  | \$ 196.6 |
| HVAC and Gas Products                 | 62.5     | 53.9     | 4.3     | 120.7    |
| Drainage and Water Re-use Products    | 16.5     | 21.6     | 0.3     | 38.4     |
| Water Quality Products                | 22.2     | 0.3      | 0.3     | 22.8     |
| Total revenues                        | \$ 241.1 | \$ 123.0 | \$ 14.4 | \$ 378.5 |

The Company considers customer purchase orders, which in some cases are governed by master sales agreements, to represent the contract with a customer. The Company's contracts with customers are generally for products only and typically do not include other performance obligations such as professional services, extended warranties, or other material rights. In situations where sales are to a distributor, the Company has concluded that its contracts are with the distributor as the Company holds a contract bearing enforceable rights and obligations only with the distributor. As part of its consideration of the contract, the Company evaluates certain factors including the customer's ability to pay (or credit risk). For each contract, the Company considers the promise to transfer products, each of which is distinct, to be the identified performance obligations. In determining the transaction price, the Company evaluates whether the price is subject to refund or adjustment to determine the net consideration to which the Company expects to be entitled. As the Company's standard payment terms are less than one year, the Company has elected the practical expedient under

Table of Contents

ASC 606-10-32-18 to not assess whether a contract has a significant financing component. The Company allocates the transaction price to each distinct product based on their relative standalone selling price. The product price as specified on the purchase order is considered the standalone selling price as it is an observable input which depicts the price as if sold to a similar customer in similar circumstances. Revenue is recognized when control of the product is transferred to the customer (i.e., when the Company's performance obligation is satisfied), which typically occurs at shipment from the Company's manufacturing site or distribution center, or delivery to the customer's named location. In certain circumstances, revenue from shipments to retail customers is recognized only when the product is consumed by the customer, as based on the terms of the arrangement, transfer of control is not satisfied until that point in time. In determining whether control has transferred, the Company considers if there is a present right to payment, physical possession and legal title, along with risks and rewards of ownership having transferred to the customer. In certain circumstances, the Company manufactures customized product without alternative use for its customers. However, as these arrangements do not entitle the Company a right to payment of cost plus a profit for work completed, the Company has concluded that revenue recognition at the point in time control transfers is appropriate and not over time recognition.

At times, the Company receives orders for products to be delivered over multiple dates that may extend across reporting periods. The Company invoices for each delivery upon shipment and recognizes revenues for each distinct product delivered, assuming transfer of control has occurred. As scheduled delivery dates are within one year, under the optional exemption provided by ASC 606-10-50-14 revenues allocated to future shipments of partially completed contracts are not disclosed.

The Company generally provides an assurance warranty that its products will substantially conform to the published specification. The Company's liability is limited to either a credit equal to the purchase price or replacement of the defective part. Returns under warranty have historically been immaterial. The Company does not consider activities related to such warranty, if any, to be a separate performance obligation. For certain of its products, the Company will separately sell extended warranty and service policies to its customers. The Company considers the sale of the extended warranty a separate performance obligation. These policies typically are for periods ranging from one to three years. Payments received are deferred and recognized over the policy period. For all periods presented, the revenue recognized and the revenue deferred for under these policies is not material to the consolidated financial statements.

The timing of revenue recognition, billings and cash collections from the Company's contracts with customers can vary based on the payment terms and conditions in the customer contracts. In some cases, customers will partially prepay for their goods; in other cases, after appropriate credit evaluations, payment is due in arrears. In addition, there are constraints which cause variability in the ultimate consideration to be recognized. These constraints typically include early payment discounts, volume rebates, rights of return, cooperative advertising, and market development funds. The Company includes these constraints in the estimated transaction price when there is a basis to reasonably estimate the amount of variable consideration. These estimates are based on historical experience, anticipated future performance and the Company's best judgment at the time. When the timing of the Company's recognition of revenue is different from the timing of payments made by the customer, the Company recognizes either a contract asset (performance precedes contractual due date) or a contract liability (customer payment precedes performance). Contracts with payment in arrears are recognized as receivables. The opening and closing balances of the Company's contract assets and contract liabilities are as follows:

|                           | Contract<br>Assets | Contract<br>Liabilities<br>- Current<br>(in<br>millions) | Contract<br>Liabilities -<br>Noncurrent |
|---------------------------|--------------------|--|---|
| Opening - January 1, 2018 | \$ 0.6             | \$ 11.3  | \$ 2.1                                  |
| Closing - April 1, 2018   | 1.7                | 11.5   | 2.4                                     |
| Increase                  | \$ 1.1             | \$ 0.2   | \$ 0.3                                  |

The amount of revenue recognized in the period that was included in the opening contract liability was \$2.9 million. This revenue consists primarily of revenue recognized for shipments of product which had been prepaid as well as the amortization of extended warranty and service policy revenue. The Company did not recognize any material revenue from obligations satisfied in prior periods. The change in Contract Liabilities is not material for the first quarter of 2018. There were no impairment losses related to Contract Assets for the quarter ended April 1, 2018.

The Company incurs costs to obtain and fulfill a contract; however, the Company has elected the practical expedient under ASC 340-40-24-4 to recognize all incremental costs to obtain a contract as an expense when incurred if the amortization period is one year or less. The Company has elected to treat shipping and handling activities performed

Table of Contents

after the customer has obtained control of the related goods as a fulfillment cost and the related cost is accrued for in conjunction with the recording of revenue for the goods.

4. Income Taxes

The 2017 Tax Cuts and Jobs Act (“2017 Tax Act”) was enacted on December 22, 2017 and has resulted in significant changes to the U.S. corporate income tax system. These changes include (1) lowering the U.S. corporate income tax rate from 35% to 21%, (2) implementing a base erosion and anti-abuse tax, (3) generally eliminating U.S. federal income taxes on dividends from foreign subsidiaries, (4) a new provision designed to tax global intangible low-taxed income (“GILTI”) of foreign subsidiaries, which allows for the possibility of utilizing foreign tax credits to offset the tax liability (subject to limitations), (5) a lower effective U.S. tax rate on certain revenues from sources outside the U.S., and (6) a one-time mandatory deemed repatriation tax (“Toll Tax”) on foreign subsidiaries’ previously untaxed accumulated foreign earnings.

In the period ended December 31, 2017, the Company recorded a provisional tax expense of \$25.1 million related to the 2017 Tax Act, which included a \$23.3 million charge for the Toll Tax. For the quarter ended April 1, 2018, the Company has not recorded any additional provisional expense or benefit related to the 2017 Tax Act.

In December 2017, the SEC staff issued Staff Accounting Bulletin No. 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act (SAB 118), which allows companies to record provisional amounts during a measurement period not to extend beyond one year of the enactment date. These provisional amounts may be impacted by further analysis and future clarification and guidance regarding available tax accounting methods and elections, earnings and profits computations, foreign tax credit computations, and state tax conformity to federal tax changes. When the Company refines these provisional amounts, any adjustments will be recorded in the period completed. The final analysis may be different from the Company’s current provisional amounts, which could materially affect the Company’s tax obligations and effective tax rate in the period or periods in which the adjustments are made.

As of April 1, 2018, the amounts recorded for the 2017 Tax Act remain provisional for the Toll Tax, the remeasurement of deferred taxes, and gross foreign tax credit carryforwards and related valuation allowances to offset foreign tax credit carryforwards. Further, the Company has not yet determined its policy election with respect to whether to record deferred taxes for basis differences expected to reverse as a result of the GILTI provisions in future periods or use the period cost method.

Due to the complexity of the new GILTI tax rules, the Company has included an estimate of the current GILTI impact in the Company’s tax provision for 2018. The Company’s GILTI estimate may be revised in future periods as we obtain additional data, and as the IRS issues new guidance on implementing the law changes.

## 5. Goodwill &amp; Intangibles

The Company operates in three geographic segments: Americas, Europe, and APMEA. The changes in the carrying amount of goodwill by geographic segment are as follows:

|          | April 1, 2018<br>Gross Balance                 |  |   |                             | Accumulated Impairment Losses |   |                             | Net Goodwill     |
|----------|--|--|---|-----------------------------|-------------------------------|---|-----------------------------|------------------|
|          | Balance<br>January 1,<br>2018<br>(in millions) | Acquired<br>During<br>the<br>Period<br>(1) | Foreign<br>Currency<br>Translation<br>and Other | Balance<br>April 1,<br>2018 | Balance<br>January 1,<br>2018 | Impairment<br>Loss During<br>the Period<br>2018 | Balance<br>April 1,<br>2018 | April 1,<br>2018 |
| Americas | \$ 437.4                                       | 0.4  | (0.3)   | 437.5                       | \$ (24.5)                     | —   | (24.5)                      | 413.0            |
| Europe   | 249.3  | —  | 3.2   | 252.5                       | (129.7)                       | —   | (129.7)                     | 122.8            |
| APMEA    | 30.9   | —  | 0.4   | 31.3                        | (12.9)                        | —   | (12.9)                      | 18.4             |
| Total    | \$ 717.6                                       | 0.4  | 3.3   | 721.3                       | \$ (167.1)                    | —   | (167.1)                     | 554.2            |

Table of Contents

|          | December 31, 2017                                    |                                     |   | Balance<br>December 31,<br>2017 | Accumulated Impairment Losses |   | Net Goodwill<br>December 31,<br>2017 |       |
|----------|--|-------------------------------------|---|---------------------------------|-------------------------------|---|--------------------------------------|-------|
|          | Gross Balance<br>January 1,<br>2017<br>(in millions) | Acquired<br>During<br>the<br>Period | Foreign<br>Currency<br>Translation<br>and Other |                                 | Balance<br>January 1,<br>2017 | Impairment<br>Loss During<br>the Period<br>2017 |                                      |       |
| Americas | \$ 434.7   | 2.0                                 | 0.7   | 437.4                           | \$ (24.5)                     | —   | (24.5)                               | 412.9 |
| Europe   | 234.9  | —                                   | 14.4  | 249.3                           | (129.7)                       | —   | (129.7)                              | 119.6 |
| APMEA    | 30.2   | —                                   | 0.7   | 30.9                            | (12.9)                        | —   | (12.9)                               | 18.0  |
| Total    | \$ 699.8   | 2.0                                 | 15.8  | 717.6                           | \$ (167.1)                    | —   | (167.1)                              | 550.5 |

(1) Americas goodwill additions during the first quarter of 2018 relate to an immaterial acquisition.

Intangible assets include the following:

|                                       | April 1, 2018                                |                             |                           | December 31, 2017           |                             |                           |
|---------------------------------------|--|-----------------------------|---------------------------|-----------------------------|-----------------------------|---------------------------|
|                                       | Gross<br>Carrying<br>Amount<br>(in millions) | Accumulated<br>Amortization | Net<br>Carrying<br>Amount | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net<br>Carrying<br>Amount |
| Patents                               | \$ 16.1                                      | \$ (15.6)                   | \$ 0.5                    | \$ 16.1                     | \$ (15.4)                   | \$ 0.7                    |
| Customer relationships                | 233.9  | (137.4)                     | 96.5                      | 233.2                       | (133.5)                     | 99.7                      |
| Technology                            | 54.0   | (24.1)                      | 29.9                      | 53.9                        | (23.1)                      | 30.8                      |
| Trade names                           | 26.2   | (10.3)                      | 15.9                      | 25.5                        | (9.7)                       | 15.8                      |
| Other                                 | 4.3  | (3.5)                       | 0.8                       | 6.9                         | (6.0)                       | 0.9                       |
| Total amortizable intangibles         | 334.5  | (190.9)                     | 143.6                     | 335.6                       | (187.7)                     | 147.9                     |
| Indefinite-lived intangible<br>assets | 37.3   | —                           | 37.3                      | 37.3                        | —                           | 37.3                      |
|                                       | \$ 371.8                                     | \$ (190.9)                  | \$ 180.9                  | \$ 372.9                    | \$ (187.7)                  | \$ 185.2                  |

Aggregate amortization expense for amortized intangible assets for the first quarters of 2018 and 2017 was \$5.6 million and \$5.5 million, respectively.

## 6. Financial Instruments and Derivative Instruments

## Fair Value

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

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

|                      | April 1,<br>2018 | December 31,<br>2017 |
|----------------------|------------------|----------------------|
|                      | (in millions)    |                      |
| Carrying amount      | \$ 448.9         | \$ 499.5             |
| Estimated fair value | \$ 449.9         | \$ 501.1             |

Table of Contents

## Financial Instruments

The Company measures certain financial assets and liabilities at fair value on a recurring basis, including deferred compensation plan assets and related liabilities, redeemable financial instruments, and derivatives. The fair values of these certain financial assets and liabilities were determined using the following inputs at April 1, 2018 and December 31, 2017:

|  | Fair Value Measurement at April 1, 2018 Using: |   |  |  |
|--|--|---|--|--|
|  | Total  | Quoted Prices in Active<br>Markets for Identical<br>Assets<br>(Level 1) | Significant Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|  | (in millions)                                  |   |  |  |
| Assets   |  |   |  |  |
| Plan asset for deferred compensation(1)        | \$ 3.1   | \$ 3.1  | \$ —   | \$ —   |
| Interest rate swaps (1)                        | \$ 8.1   | \$ —  | \$ 8.1   | \$ —   |
| Designated foreign currency hedge (2)          | \$ 0.2   | \$ —  | \$ 0.2   | \$ —   |
| Total assets                                   | \$ 11.4  | \$ 3.1  | \$ 8.3   | \$ —   |
| Liabilities                                    |  |   |  |  |
| Plan liability for deferred<br>compensation(3) | \$ 3.1   | \$ 3.1  | \$ —   | \$ —   |
| Redeemable financial instrument(4)             | \$ 3.0   | \$ —  | \$ —   | \$ 3.0   |
| Total liabilities                              | \$ 6.1   | \$ 3.1  | \$ —   | \$ 3.0   |

|  | Fair Value Measurements at December 31, 2017 Using: |   |  |  |
|--|---|---|--|--|
|  | Total   | Quoted Prices in Active<br>Markets for Identical<br>Assets<br>(Level 1) | Significant Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|  | (in millions)                                       |   |  |  |
| Assets   |   |   |  |  |
| Plan asset for deferred compensation(1)        | \$ 3.2  | \$ 3.2  | \$ —   | \$ —   |
| Interest rate swaps (1)                        | \$ 5.6  | \$ —  | \$ 5.6   | \$ —   |
| Total assets                                   | \$ 8.8  | \$ 3.2  | \$ 5.6   | \$ —   |
| Liabilities                                    |   |   |  |  |
| Plan liability for deferred<br>compensation(2) | \$ 3.2  | \$ 3.2  | \$ —   | \$ —   |
| Redeemable financial instrument(3)             | 2.9   | —   | —  | 2.9  |
| Total liabilities                              | \$ 6.1  | \$ 3.2  | \$ —   | \$ 2.9   |

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



(2) Included on the Company’s consolidated balance sheet in prepaid expenses and other current assets.

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

(4) Included on the Company’s consolidated balance sheet in other current liabilities and relates to a mandatorily redeemable equity instrument as part of the Apex Valves Limited (“Apex”) acquisition in 2015.

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, 2017 to April 1, 2018.

|                                    | Balance<br>December 31,<br>2017<br>(in millions) | Settlements | Purchases | Total realized and unrealized<br>(gains) losses included in: |                         | Balance<br>April 1,<br>2018 |
|------------------------------------|--|-------------|-----------|--|-------------------------|-----------------------------|
|                                    |  |             |           | Net earnings<br>adjustments                                  | Comprehensive<br>income |                             |
| Redeemable financial<br>instrument | \$ 2.9   | —           | \$ —      | —  | \$ 0.1                  | \$ 3.0                      |

## Table of Contents

In connection with the acquisition of Apex, a liability of \$5.5 million was recognized on November 30, 2015 as the estimate of the acquisition date fair value of the mandatorily redeemable equity instrument. The Company acquired an additional 10% ownership in the first quarter of 2017 for approximately \$2.9 million and now owns 90% of Apex outstanding shares. The remaining liability is classified as Level 3 under the fair value hierarchy as it is based on the commitment to purchase the remaining 10% of Apex shares within the next year, which is not observable in the market.

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 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.

## Interest Rate Swaps

On February 12, 2016, the Company entered into a Credit Agreement (the "Credit Agreement") pursuant to which it received a funding commitment under a Term Loan of \$300 million, of which the entire \$300 million has been drawn on, and a Revolving Commitment ("Revolver") of \$500 million, of which \$102.0 million had been drawn as of April 1, 2018. Both facilities mature on February 12, 2021. For each facility, the Company can choose either an Adjusted LIBOR or Alternative Base Rate ("ABR"). Upon intended election of Adjusted LIBOR as the interest rate, the Term Loan has quarterly interest payments that began in May 2016, quarterly principal repayments that commenced on March 31, 2017, with a balloon payment of principal on maturity date. The Revolver has quarterly interest payments.

Accordingly, the Company's earnings and cash flows are exposed to interest rate risk from changes in Adjusted LIBOR. In order to manage the Company's exposure to changes in cash flows attributable to fluctuations in LIBOR-indexed interest payments related to the Company's floating rate debt, the Company entered into two interest rate swaps. For each interest rate swap, the Company receives the three-month USD-LIBOR subject to a 0% floor, and pays a fixed rate of 1.31375% on a notional amount of \$225.0 million. The swaps mature on February 12, 2021. The Company formally documents the hedge relationships at hedge inception to ensure that its interest rate swaps qualify for hedge accounting. On a quarterly basis, the Company assesses whether the interest rate swaps are highly effective in offsetting changes in the cash flow of the hedged item. The Company does not hold or issue interest rate swaps for trading purposes. The swaps are designated as cash flow hedges. For the three months ended April 1, 2018 and April 2, 2017, gains of \$1.9 million and \$0.2 million, respectively, were recorded in Accumulated Other Comprehensive

Income to recognize the effective portion of the fair value of interest rate swaps that qualify as a cash flow hedge.

#### Designated Foreign Currency Hedges

The Company's foreign subsidiaries transact most business, including certain intercompany transactions in foreign currencies. Such transactions are principally purchases or sales of materials. The Company has exposure to a number of foreign currencies, including the Canadian Dollar, the euro, and the Chinese Yuan. Beginning in the first quarter of 2018, the Company has used a layering methodology, whereby at the end of each quarter, the Company enters into forward exchange contracts which hedge approximately 70% of the forecasted intercompany purchase transactions between one of the Company's Canadian and U.S. operating subsidiaries for the next twelve months. As of April 1, 2018, all designated foreign exchange hedge contracts were cash flow hedges under ASC 815, Derivatives and Hedging ("ASC 815"). The Company records the effective portion of the designated foreign currency hedge contracts in other comprehensive income until inventory turns and is sold to a third-party. Once the third-party transaction occurs associated with the hedged forecasted transaction, the effective portion of any related gain or loss on the designated foreign currency hedge will be reclassified into earnings. In the event the notional amount of the derivatives exceeds the forecasted intercompany purchases for a given month, the excess hedge position will be attributed to the following month's forecasted purchases. However, if the following month's forecasted purchases cannot absorb the excess hedge position from the current month, the effective portion of the hedge recorded in other comprehensive income will be

Table of Contents

reclassified to earnings. The Company had designated foreign hedge contracts outstanding as of April 1, 2018 of \$0.2 million. At April 1, 2018, the amount expected to be reclassified into earnings from other comprehensive income in the next twelve months is not material to the financial statements.

## 7. Earnings per Share and Stock Repurchase Program

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

|   | For the First Quarter Ended April 1,<br>2018 |                         |                        | For the First Quarter Ended April 2,<br>2017 |                         |                        |
|---|--|-------------------------|------------------------|--|-------------------------|------------------------|
|   | Income<br>(Numerator)                        | Shares<br>(Denominator) | Per<br>Share<br>Amount | Income<br>(Numerator)                        | Shares<br>(Denominator) | Per<br>Share<br>Amount |
| (Amounts in millions, except per share information) |  |                         |                        |  |                         |                        |
| Basic EPS:  |  |                         |                        |  |                         |                        |
| Net income  | \$ 28.2                                      | 34.3                    | \$ 0.82                | \$ 21.7                                      | 34.4                    | \$ 0.63                |
| Effect of dilutive securities:                      |  |                         |                        |  |                         |                        |
| Common stock equivalents                            |  | 0.1                     |                        |  | 0.1                     |                        |
| Diluted EPS:  |  |                         |                        |  |                         |                        |
| Net income  | \$ 28.2                                      | 34.4                    | \$ 0.82                | \$ 21.7                                      | 34.5                    | \$ 0.63                |

There were no options to purchase Class A common stock outstanding as of the first quarter of 2018 that would have been anti-dilutive. Options to purchase 0.1 million shares of Class A common stock were outstanding during the first quarter of 2017 but were not included in the computation of diluted EPS because to do so would be anti-dilutive.

On July 27, 2015, the Company's Board of Directors authorized the repurchase of up to \$100 million of the Company's Class A common stock from time to time on the open market or in privately negotiated transactions. In connection with this stock repurchase program, the Company entered into a Rule 10b5-1 plan, which permits shares to be repurchased when the Company might otherwise be precluded from doing so under insider trading laws. The repurchase program may be suspended or discontinued at any time, subject to the terms of the Rule 10b5-1 plan the Company entered into with respect to the repurchase program. As of April 1, 2018, there was approximately \$31.6 million remaining authorized for share repurchases under this program.

The following table summarizes the cost and the number of shares of Class A common stock repurchased under the July 27, 2015 program during the quarters ended April 1, 2018 and April 2, 2017:

|   | For the First Quarter Ended<br>April 1, 2018 |                               | For the First Quarter Ended<br>April 2, 2017 |                               |
|---|--|-------------------------------|--|-------------------------------|
|   | Number of shares<br>repurchased              | Cost of shares<br>repurchased | Number of shares<br>repurchased              | Cost of shares<br>repurchased |
| Total stock repurchased during the<br>period: | 80,055                                       | \$ 6.2                        | 69,112                                       | \$ 4.4                        |

## 8. Stock Based Compensation

The Company maintains one stock incentive plan, the Second Amended and Restated 2004 Stock Incentive Plan (the “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. Employees’ restricted stock awards and deferred shares typically 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 issued 105,902 and 115,408 shares of restricted stock awards and deferred shares during the first three months of 2018 and 2017, respectively.

The Company also grants performance stock units to key employees under the 2004 Stock Incentive Plan. Performance stock units cliff vest at the end of a three-year performance period set by the Compensation Committee of the Board of Directors at the time of grant. Upon vesting, the number of shares of the Company’s Class A common stock awarded to each performance stock unit recipient will be determined based on the Company’s performance relative to certain performance goals set at the time the performance stock units were granted. The recipient of a performance stock unit award may earn from zero shares to twice the number of target shares awarded to such recipient. The performance stock

Table of Contents

units are amortized to expense over the vesting period, and based on the Company's performance relative to the performance goals, may be adjusted. Changes to the estimated shares expected to vest will result in adjustments to the related share-based compensation expense that will be recorded in the period of change. If the performance goals are not met, no awards are earned and previously recognized compensation expense is reversed. The Company granted 94,215 and 98,812 of annual awards for performance stock units during the first three months of 2018 and 2017, respectively. The performance goals for the performance stock units are based on the compound annual growth rate of the Company's revenue over the three-year performance period and the Company's return on invested capital ("ROIC") for the third year of the performance period.

The 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. Participating employees may use up to 50% of their annual incentive bonus to purchase RSUs for a purchase price equal to 80% of the fair market value of the Company's Class A common stock as of the date of grant. Upon vesting, each RSU is converted into one share of Class A common stock. RSUs vest either annually over a three-year period from the grant date or upon the third anniversary of the grant date. 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, from the date of grant. An aggregate of 2,000,000 shares of Class A common stock may be issued under the Management Stock Purchase Plan. The company granted 36,208 RSU's and 47,222 RSU's during the first three months of 2018 and 2017, 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:

|                                 | 2018   | 2017   |
|---------------------------------|--------|--------|
| Expected life (years)           | 3.0    | 3.0    |
| Expected stock price volatility | 24.1 % | 25.0 % |
| Expected dividend yield         | 1.0 %  | 1.2 %  |
| Risk-free interest rate         | 2.4 %  | 1.5 %  |

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 above assumptions were used to determine the weighted average grant date fair value of RSUs granted of \$21.80 and \$16.84 in 2018 and 2017, respectively.

A more detailed description of each of these plans can be found in Note 13 of the Notes to Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

## 9. Segment Information

The Company operates in three geographic segments: Americas, Europe, and APMEA. Each of these segments sells similar products and has separate financial results that are reviewed by the Company's chief operating decision maker. Each segment earns revenue and income almost exclusively from the sale of its products. The Company sells its products into various end markets around the world, with sales by region based upon location of the entity recording the sale. Products are sold into four product categories: 1) residential & commercial flow control products, 2) HVAC & gas products, 3) drainage & water re-use products, and 4) water quality products. The Americas sells products across all four product categories, Europe primarily sells residential & commercial flow products, HVAC & gas products and drainage products, and APMEA primarily sells residential & commercial flow products and HVAC & gas products. All intercompany sales transactions have been eliminated. The accounting policies for each segment are the same as those described in Note 2, and in Note 2 of the Notes to Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

Table of Contents

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

|   | First Quarter Ended |                  |
|---|---------------------|------------------|
|   | April 1,<br>2018    | April 2,<br>2017 |
| Net Sales   |                     |                  |
| Americas  | \$ 241.1            | \$ 228.7         |
| Europe  | 123.0               | 104.9            |
| APMEA   | 14.4                | 13.6             |
| Consolidated net sales                                | \$ 378.5            | \$ 347.2         |
| Operating income                                      |                     |                  |
| Americas  | \$ 36.4             | \$ 31.1          |
| Europe  | 14.9                | 12.4             |
| APMEA   | 1.4                 | 1.0              |
| Subtotal reportable segments                          | 52.7                | 44.5             |
| Corporate(*)  | (8.8)               | (8.8)            |
| Consolidated operating income                         | 43.9                | 35.7             |
| Interest income                                       | (0.4)               | (0.2)            |
| Interest expense                                      | 4.3                 | 4.8              |
| Other expense, net                                    | 0.7                 | 0.3              |
| Income before income taxes                            | \$ 39.3             | \$ 30.8          |
| Capital Expenditures                                  |                     |                  |
| Americas  | \$ 4.6              | \$ 4.3           |
| Europe  | 2.5                 | 1.3              |
| APMEA   | 0.2                 | 0.2              |
| Consolidated capital expenditures                     | \$ 7.3              | \$ 5.8           |
| Depreciation and Amortization                         |                     |                  |
| Americas  | \$ 7.1              | \$ 7.1           |
| Europe  | 4.9                 | 4.3              |
| APMEA   | 0.7                 | 0.7              |
| Consolidated depreciation and amortization            | \$ 12.7             | \$ 12.1          |
| Identifiable assets (at end of period)                |                     |                  |
| Americas  | \$ 1,001.9          | \$ 1,071.0       |
| Europe  | 548.2               | 564.6            |
| APMEA   | 138.4               | 106.6            |
| Consolidated identifiable assets                      | \$ 1,688.5          | \$ 1,742.2       |
| Property, plant and equipment, net (at end of period) |                     |                  |
| Americas  | \$ 110.3            | \$ 106.6         |
| Europe  | 83.7                | 75.6             |
| APMEA   | 7.1                 | 7.6              |
| Consolidated property, plant and equipment, net       | \$ 201.1            | \$ 189.8         |



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

The above operating segments are presented on a basis consistent with the presentation included in the Company's December 31, 2017 consolidated financial statements included in its Annual Report on Form 10-K.

The U.S. property, plant and equipment of the Company's Americas segment was \$106.2 million and \$102.8 million at April 1, 2018 and April 2, 2017, respectively.

Table of Contents

The following includes U.S. net sales of the Company's Americas segment:

|                | First Quarter Ended |                  |
|----------------|---------------------|------------------|
|                | April 1,<br>2018    | April 2,<br>2017 |
|                | (in millions)       |                  |
| U.S. net sales | \$ 225.2            | \$ 213.9         |

The following includes intersegment sales for Americas, Europe and APMEA:

|                    | First Quarter Ended |                  |
|--------------------|---------------------|------------------|
|                    | April 1,<br>2018    | April 2,<br>2017 |
|                    | (in millions)       |                  |
| Intersegment Sales |                     |                  |
| Americas           | \$ 2.6              | \$ 2.8           |
| Europe             | 3.4                 | 3.9              |
| APMEA              | 16.7                | 19.6             |
| Intersegment sales | \$ 22.7             | \$ 26.3          |

## 10. Accumulated Other Comprehensive Loss

Accumulated other comprehensive loss consists of the following:

|                           | Foreign<br>Currency<br>Translation<br>(in millions) | Cash Flow<br>Hedges (1) | Accumulated<br>Other<br>Comprehensive<br>Loss |
|---------------------------|---|-------------------------|---|
| Balance December 31, 2017 | \$ (102.6)  | \$ 3.5                  | \$ (99.1)                                     |
| Change in period          | 9.7   | 2.8                     | 12.5  |
| Balance April 1, 2018     | \$ (92.9)   | \$ 6.3                  | \$ (86.6)                                     |

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|                           |            |        |            |
|---------------------------|------------|--------|------------|
| Balance December 31, 2016 | \$ (153.7) | \$ 2.9 | \$ (150.8) |
| Change in period          | 7.9        | 0.1    | 8.0        |
| Balance April 02, 2017    | \$ (145.8) | \$ 3.0 | \$ (142.8) |

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- (1) Cash flow hedges include interest rate swaps and designated foreign currency hedges. See Note 6 for further details.

## 11. Debt

On February 12, 2016, the Company entered into the Credit Agreement among the Company, certain subsidiaries of the Company who become borrowers under the Credit Agreement, JPMorgan Chase Bank, N.A., as Administrative Agent, Swing Line Lender and Letter of Credit Issuer, and the other lenders referred to therein. The Credit Agreement provides for a \$500 million, five year, senior unsecured revolving credit facility (the “Revolving Credit Facility”) with a sublimit of up to \$100 million in letters of credit. As of April 1, 2018, the Company had drawn \$102.0 million on this line of credit. The Credit Agreement also provides for a \$300 million, five year, term loan facility (the “Term Loan Facility”) available to the Company in a single draw, of which the entire \$300 million had been drawn in February 2016. The Company had \$271.9 million of borrowings outstanding on the Term Loan Facility as of April 1, 2018 and \$294.4 million outstanding as of April 2, 2017. Borrowings outstanding under the Revolving Credit Facility bear interest at a fluctuating rate per annum equal to an applicable percentage defined as (i) in the case of Eurocurrency rate loans, the ICE Benchmark Administration LIBOR rate plus an applicable percentage, ranging from 0.975% to 1.45%, determined by reference to the Company’s consolidated leverage ratio, 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 ICE Benchmark Administration 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. Borrowings outstanding under the Term Loan Facility will bear interest at a fluctuating rate per annum equal to an

## Table of Contents

applicable percentage defined as the ICE Benchmark Administration LIBOR rate plus an applicable percentage, ranging from 1.125% to 1.75%, determined by reference to the Company's consolidated leverage ratio. The interest rates as of April 1, 2018 on the Revolving Credit Facility and on the Term Loan Facility were 3.08% and 3.55%, respectively.

The loan under the Term Loan Facility amortizes as follows: 0% per annum during the first year, 7.5% in the second and third years, 10% in the fourth and fifth years, and the remaining unpaid balance paid in full on the maturity date. Payments when due are made ratably each year in quarterly installments. The Company paid a quarterly installment of \$5.6 million during the first quarter of 2018. In addition to paying interest under the Credit Agreement, the Company is also required to pay certain fees in connection with the Revolving Credit Facility, including, but not limited to, an unused facility fee and letter of credit fees. The Credit Agreement matures on February 12, 2021, subject to extension under certain circumstances and subject to the terms of the Credit Agreement. The Company may repay loans outstanding under the Credit Agreement from time to time without premium or penalty, other than customary breakage costs, if any, and subject to the terms of the Credit Agreement. Once repaid, amounts borrowed under the Term Loan Facility may not be borrowed again.

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 \$25.7 million as of April 1, 2018 and \$25.6 million as of April 2, 2017. The Company's letters of credit are primarily associated with insurance coverage. 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.

As of April 1, 2018, the Company had \$372.3 million of unused and available credit under the Revolving Credit Facility and was in compliance with all covenants related to the Credit Agreement.

The Company is a party to a note agreement as further detailed in Note 11 of the Notes to Consolidated Financial Statements of the Annual Report on Form 10-K for the year ended December 31, 2017. This note agreement requires 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 1, 2018, the Company was in compliance with all covenants regarding this note agreement.

## 12. Contingencies and Environmental Remediation

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.

Other than the items described below, significant commitments and contingencies at April 1, 2018 are consistent with those discussed in Note 15 of the Notes to Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

As of April 1, 2018, the Company estimates that the aggregate amount of reasonably possible loss in excess of the amount accrued for its legal contingencies is approximately \$6.0 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, 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.

Table of Contents

Chemetco, Inc. Superfund Site, Hartford, Illinois

In August 2017, Watts Regulator Co. received a “Notice of Environmental Liability” from the Chemetco Site Group (“Group”) alleging that it is a potentially responsible party for the Chemetco, Inc. Superfund Site in Hartford, Illinois (the Site) because it arranged for the disposal or treatment of hazardous substances that were contained in materials sent to the Site and that resulted in the release or threat of release of hazardous substances at the Site. As of August 2017, 162 companies were members of the Group. The letter offered Watts Regulator Co. the opportunity to join the Group and participate in the Remedial Investigation and Feasibility Study (“RI/FS”) at the Site. Watts Regulator Co. joined the Group in September 2017 and was added in March 2018 as a signatory, together with 43 other new Group members, to the Administrative Settlement Agreement and Order on Consent with the United States Environmental Protection Agency (“USEPA”) governing completion of the RI/FS. Based on information currently known to it, management believes that Watts Regulator Co.’s share of the costs of the RI/FS is not likely to have a material adverse effect on the financial condition of the Company, or have a material adverse effect on the Company’s operating results for any particular period. In February 2018, the Group commenced suit in the United States District Court for the Southern District of Illinois seeking response costs from other potentially responsible parties for the Site. The Group has identified more than 2,000 additional potentially responsible parties to date. The Company is unable to estimate a range of reasonably possible loss for the above matter in which damages have not been specified because: (i) the RI/FS has not been completed to determine what remediation plan will be implemented and the costs of such plan; (ii) the total number of potentially responsible parties who may or may not agree to fund or perform any remediation has not yet been determined; (iii) the share contribution for potentially responsible parties to any remediation has not been determined; and (iv) the number of years required to complete the RI/FS and implement a remediation plan acceptable to USEPA is uncertain.

13. Subsequent Events

On May 7, 2018, the Company declared a quarterly dividend of twenty-one cents (\$0.21) per share on each outstanding share of Class A common stock and Class B common stock payable on June 15, 2018 to stockholders of record on June 1, 2018.

Table of Contents

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

Overview

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

We operate on a 52-week calendar year ending on December 31. Any quarterly data contained in this Quarterly Report on Form 10-Q generally reflect the results of operations for a 13-week period.

We are a leading supplier of products and solutions that conserve water and manage the flow of fluids and energy into, through and out of buildings in the residential and commercial markets in Americas, Europe and APMEA. For over 140 years, we have designed and produced valve systems that safeguard and regulate water systems, energy efficient heating and hydronic systems, drainage systems and water filtration technology that helps purify and conserve water. 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 commercial high efficiency boilers, water heaters and heating solutions, hydronic and electric heating systems for under floor radiant applications, custom heat and hot water solutions, 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.

Drainage & 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.

We believe that the factors relating to our future growth include continued product innovation that meets the needs of our customers and our end markets; 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 11 acquisitions in the last decade. Our acquisition strategy focuses on businesses that promote our key macro themes around safety and regulation, energy efficiency and water conservation. We target businesses that will provide us with one or more of the following: an entry into new markets and/or new geographies, improved channel access, unique and/or proprietary technologies, advanced production capabilities or complementary solution offerings.

Our innovation strategy is focused on differentiated products that provide greater opportunity to distinguish ourselves in the marketplace. Conversely, we want to migrate away from commoditized products where we cannot add value. Our goal is to be a solutions provider, not just a components supplier. We continually look for strategic opportunities to invest in new products and markets or divest existing product lines where necessary in order to meet those objectives.

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 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.



Table of Contents

During the first quarter of 2018, sales increased 9.0%, or \$31.3 million, compared to the first quarter of 2017. The increase was related to foreign exchange of 4.9%, or \$17.0 million and organic sales growth of 4.1%, or \$14.3 million. Organic sales is a non-GAAP financial measure that excludes the impacts of acquisitions, divestitures and foreign exchange from year-over-year comparisons. Management believes reporting organic sales growth provides useful information to investors, potential investors and others, because it allows for additional insight into underlying sales trends by providing sales growth on a consistent basis. We reconcile the change in organic sales to our reported sales for each region within our results below. Operating income of \$43.9 million increased by \$8.2 million, or 22.9%, in the first quarter of 2018 as compared to the first quarter of 2017. This increase is primarily driven by higher sales volume, increased pricing, and growth from foreign exchange due to the appreciation of the euro against the U.S. dollar.

## Recent Events

On May 7, 2018, the Company declared a quarterly dividend of twenty-one cents (\$0.21) per share on each outstanding share of Class A common stock and Class B common stock payable on June 15, 2018 to stockholders of record on June 1, 2018.

## Results of Operations

## First Quarter Ended April 1, 2018 Compared to First Quarter Ended April 2, 2017

Net Sales. Our business is reported in three geographic segments: Americas, Europe and APMEA. Our net sales in each of these segments for each of the first quarters of 2018 and 2017 were as follows:

|          | First Quarter Ended<br>April 1, 2018 |         | First Quarter Ended<br>April 2, 2017 |         |         | % Change to<br>Consolidated<br>Net Sales |   |
|----------|--------------------------------------|---------|--------------------------------------|---------|---------|--|---|
|          | Net Sales                            | % Sales | Net Sales                            | % Sales | Change  |  |   |
|          | (dollars in millions)                |         |                                      |         |         |  |   |
| Americas | \$ 241.1                             | 63.7    | \$ 228.7                             | 65.9    | \$ 12.4 | 3.6                                      | % |
| Europe   | 123.0                                | 32.5    | 104.9                                | 30.2    | 18.1    | 5.2                                      |   |
| APMEA    | 14.4                                 | 3.8     | 13.6                                 | 3.9     | 0.8     | 0.2                                      |   |
| Total    | \$ 378.5                             | 100.0   | \$ 347.2                             | 100.0   | \$ 31.3 | 9.0                                      | % |

The change in net sales was attributable to the following:

| Americas<br>(dollars in millions) | Europe  | APMEA  | Total   | Change As a %<br>of Consolidated Net Sales |        |       |       | Change As a %<br>of Segment Net Sales |        |       |       |     |   |      |   |     |
|-----------------------------------|---------|--------|---------|--|--------|-------|-------|---------------------------------------|--------|-------|-------|-----|---|------|---|-----|
|                                   |         |        |         | Americas                                   | Europe | APMEA | Total | Americas                              | Europe | APMEA | Total |     |   |      |   |     |
| \$ 11.7                           | \$ 2.3  | \$ 0.3 | \$ 14.3 | 3.4  | %      | 0.6   | %     | 0.1                                   | %      | 4.1   | %     | 5.1 | % | 2.1  | % | 2.6 |
| 0.7                               | 15.8    | 0.5    | 17.0    | 0.2  |        | 4.6   |       | 0.1                                   |        | 4.9   |       | 0.3 |   | 15.2 |   | 3.3 |
| \$ 12.4                           | \$ 18.1 | \$ 0.8 | \$ 31.3 | 3.6  | %      | 5.2   | %     | 0.2                                   | %      | 9.0   | %     | 5.4 | % | 17.3 | % | 5.9 |

Our products are sold to wholesalers, OEMs, DIY chains, and through various specialty channels. The change in organic net sales by channel was attributable to the following:

|          | Wholesale<br>(dollars in millions) | OEMs     | DIY    | Specialty | Total   | Change As a %<br>of Prior Year Sales |      |        |           |        |   |     |   |
|----------|------------------------------------|----------|--------|-----------|---------|--------------------------------------|------|--------|-----------|--------|---|-----|---|
|          |                                    |          |        |           |         | Wholesale                            | OEMs | DIY    | Specialty |        |   |     |   |
| Americas | \$ 4.3                             | \$ 0.2   | \$ 3.9 | \$ 3.3    | \$ 11.7 | 3.3                                  | %    | 1.1    | %         | 28.3   | % | 5.1 | % |
| Europe   | 4.8                                | (2.2)    | (0.3)  | —         | 2.3     | 7.1                                  |      | (6.0)  |           | (32.7) |   | —   |   |
| APMEA    | 0.6                                | (0.3)    | —      | —         | 0.3     | 4.7                                  |      | (42.9) |           | —      |   | —   |   |
| Total    | \$ 9.7                             | \$ (2.3) | \$ 3.6 | \$ 3.3    | \$ 14.3 |                                      |      |        |           |        |   |     |   |

The increase in Americas organic net sales was primarily due to higher sales volume in our plumbing products through the wholesale and DIY channels, particularly relating to valve, drainage, and water quality products. There was also an increase in specialty channel sales related to improved sales in our AERCO boiler business and aftermarket sales. We also realized a price increase that positively impacted sales.

Table of Contents

Organic net sales in Europe increased primarily from growth in the wholesale channel from increased sales of our drains products. These increases were partially offset by our ongoing product rationalization efforts within our DIY and OEM channels, as we continue to focus on our core product lines.

Organic net sales in APMEA increased primarily from increases in sales outside of China, including New Zealand, the Middle East and Korea, and increased demand within China for our commercial valves products. These increases were partially offset by softness in the underfloor heating market in China and product rationalization in the OEM channel.

The net increase in sales due to foreign exchange was primarily due to the appreciation of the euro against the U.S. dollar in the first quarter of 2018. We cannot predict whether foreign 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.

Gross Profit. Gross profit and gross profit as a percent of net sales (gross margin) for the first quarters of 2018 and 2017 were as follows:

|              | First Quarter Ended   |                  |  |  |
|--------------|-----------------------|------------------|--|--|
|              | April 1,<br>2018      | April 2,<br>2017 |  |  |
|              | (dollars in millions) |                  |  |  |
| Gross profit | \$ 156.7              | \$ 143.8         |  |  |
| Gross margin | 41.4 %                | 41.4 %           |  |  |

Gross margin percentage was consistent in the first quarter of 2018 compared to the first quarter of 2017. Increases to gross profit during the first quarter of 2018 included increased sales volume, pricing, productivity initiatives, as well as savings from transformation and restructuring programs. These increases were offset by higher material costs, mainly due to increased copper and stainless steel commodity costs, as well as higher transportation costs and wage inflation.

Selling, General and Administrative Expenses. Selling, general and administrative, or SG&A, expenses increased \$5.2 million, or 4.8%, in the first quarter of 2018 compared to the first quarter of 2017. The increase in SG&A expenses was attributable to the following:

(in millions)      % Change

|                  |    |     |     |   |
|------------------|----|-----|-----|---|
| Organic          | \$ | 0.9 | 0.8 | % |
| Foreign exchange |    | 4.3 | 4.0 |   |
| Total            | \$ | 5.2 | 4.8 | % |

The increase in foreign exchange was mainly due to the appreciation of the euro against the U.S. dollar. The organic increase was primarily related to increased research and development costs of \$1.4 million from new product development initiatives and engineering costs. The organic increase was also due to additional variable costs such as commissions and freight totaling \$0.9 million from sales volume increases. The remaining organic increase was related to investments in commercial excellence of \$1.4 million and inflation of \$0.7 million. These were partially offset by decreased transformation and acquisition costs of \$1.3 million, restructuring savings within the Americas and Europe of \$1.0 million, and productivity savings within the Americas and Europe of \$1.0 million compared to the first quarter of 2017. Total SG&A expenses, as a percentage of sales, were 29.8% in the first quarter of 2018 compared to 31.0% in the first quarter of 2017.

Table of Contents

Operating Income. Operating income (loss) by segment for the first quarters of 2018 and 2017 was as follows:

|           | First Quarter Ended   |               | Change | % Change to Consolidated Operating Income |   |
|-----------|-----------------------|---------------|--------|---|---|
|           | April 1, 2018         | April 2, 2017 |        |   |   |
|           | (dollars in millions) |               |        |   |   |
| Americas  | \$ 36.4               | \$ 31.1       | \$ 5.3 | 14.8                                      | % |
| Europe    | 14.9                  | 12.4          | 2.5    | 7.0                                       |   |
| APMEA     | 1.4                   | 1.0           | 0.4    | 1.1                                       |   |
| Corporate | (8.8)                 | (8.8)         | —      | —   |   |
| Total     | \$ 43.9               | \$ 35.7       | \$ 8.2 | 22.9                                      | % |

The increase in operating income was attributable to the following:

| Americas | Europe | APMEA | Corporate | Total  | Change As a % of Consolidated Operating Income |        |       |           |        | Change As a % of Segment Operating Income |        |        |
|----------|--------|-------|-----------|--------|--|--------|-------|-----------|--------|---|--------|--------|
|          |        |       |           |        | Americas                                       | Europe | APMEA | Corporate | Total  | Americas                                  | Europe | APMEA  |
| \$ 0.6   | \$ 0.3 | \$ —  | \$ —      | \$ 5.6 | 13.1   | % 1.7  | % 0.8 | % —       | % 15.6 | % 15.1                                    | % 4.9  | % 30.0 |
| 1.9      | 0.1    | —     | —         | 2.1    | 0.3  | 5.3    | 0.3   | —         | 5.9    | 0.3                                       | 15.3   | 10.0   |
| —        | —      | —     | —         | 0.5    | 1.4  | —      | —     | —         | 1.4    | 1.6                                       | —      | —      |
| \$ 2.5   | \$ 0.4 | \$ —  | \$ —      | \$ 8.2 | 14.8   | % 7.0  | % 1.1 | % —       | % 22.9 | % 17.0                                    | % 20.2 | % 40.0 |

Organic operating income increased by \$5.6 million compared to the first quarter of 2017, mainly due to increased sales volume, pricing, operating savings from restructuring actions, and reduced transformation costs. This increase in operating income was partially offset by higher material costs due to increases in the price of copper and stainless steel and increased R&D expenses and investments in strategic growth initiatives.

Interest Expense. Interest expense decreased \$0.5 million, or 10.4%, compared to the first quarter of 2017 due to a reduction in the principal balance of debt outstanding. The impact of the lower outstanding principal balance was partially offset by increased interest rates in the first quarter of 2018 compared to the first quarter of 2017. Refer to Note 11 of the Notes to Consolidated Financial Statements for further details.

Other expense. Other expense increased \$0.4 million compared to the first quarter of 2017. The increase was primarily due to net foreign currency transaction losses.

Income Taxes. Our effective income tax rate decreased to 28.2% in the first quarter of 2018, from 29.5% in the first quarter of 2017. The lower rate in the first quarter is associated with the lower U.S. federal tax rate in 2018 as a result of U.S. Tax Reform. In the first quarter of 2017, we recognized a benefit for decreases in tax rates for certain foreign jurisdictions.

Net Income. Net income was \$28.2 million, or \$0.82 per common share, for the first quarter of 2018, compared to \$21.7 million, or \$0.63 per common share, for the first quarter of 2017. Results for the first quarter of 2017 include an after-tax charge of \$1.3 million, or \$0.04 per common share, for transformation deployment costs; \$0.4 million, or \$0.01 per common share, for restructuring; partially offset by \$1.2 million or \$0.04 per common share in tax benefits.

#### Liquidity and Capital Resources

We used \$26.1 million of net cash from operating activities in the first quarter of 2018 as compared to \$9.1 million of net cash used in operating activities in the first quarter of 2017. The increase in cash used was primarily related to the timing of working capital fluctuations and the impact of non-cash adjustments to net income, partially offset by higher net income compared to the first quarter of 2017.

We used \$8.8 million of net cash for investing activities compared to \$3.8 million used in the first quarter of 2017. We used \$1.5 million more cash in the first quarter of 2018 for purchases of capital equipment and \$1.5 million for immaterial acquisitions. We received \$1.9 million less in cash proceeds from the sale of assets compared to the first quarter of 2017. For the remainder of 2018, we expect to invest approximately \$30 million in capital equipment as part of our ongoing commitment to improve our operating capabilities.

## Table of Contents

We used \$63.9 million of net cash from financing activities for the first quarter of 2018 primarily due to payments of long-term debt of \$70.6 million, payment of dividends of \$6.7 million, and payments to repurchase approximately 80,000 shares of Class A common stock at a cost of \$6.2 million. This was partially offset by proceeds from additional draws on our line of credit of \$20.0 million during the first quarter of 2018.

On February 12, 2016, we terminated our prior Credit Agreement and entered into a new Credit Agreement (the “Credit Agreement”) among the Company, certain subsidiaries of the Company who became borrowers under the Credit Agreement, JPMorgan Chase Bank, N.A., as Administrative Agent, Swing Line Lender and Letter of Credit Issuer, and the other lenders referred to therein. The Credit Agreement provides for a \$500 million, five year, senior unsecured revolving credit facility (the “Revolving Credit Facility”) with a sublimit of up to \$100 million in letters of credit. The Credit Agreement also provided for a \$300 million, five year, term loan facility (the “Term Loan Facility”) available to us in a single draw. The Credit Agreement matures on February 12, 2021, subject to extension under certain circumstances and subject to the terms of the Credit Agreement. As of April 1, 2018, we had \$271.9 million of borrowings outstanding on the Term Loan Facility and \$102.0 million drawn on the Revolving Credit Facility; had \$25.7 million of stand-by letters of credit outstanding and had \$372.3 million of unused and available credit under the Revolving Credit Facility. As of April 1, 2018, we were in compliance with all covenants related to the Credit Agreement.

As of April 1, 2018, we held \$184.7 million in cash and cash equivalents. Of this amount, approximately \$169.5 million of cash and cash equivalents were held by foreign subsidiaries. The 2017 Tax Act requires us to pay a one-time deemed repatriation toll charge on cumulative undistributed foreign earnings for which we had not previously recorded U.S. taxes. Cumulative earnings in the form of cash and cash equivalents, as defined in the 2017 Tax Act, will be taxed at a rate of 15.5% and all other earnings will be taxed at a rate of 8.0%. We estimate that our obligation associated with this one-time deemed repatriation toll charge to be \$23.3 million, which will be paid in installments over eight years. During 2018, we expect to repatriate approximately \$125 million of cash back to the U.S. As of April 1, 2018, we had repatriated approximately \$71 million in undistributed foreign earnings, and have used the majority of that cash to reduce our outstanding debt. Our U.S. operations typically generate sufficient cash flows to meet our domestic obligations. However, if we did have to borrow to fund some or all of our expected cash outlay, we can do so at reasonable interest rates by utilizing the uncommitted borrowings under our Revolving Credit Facility. Our intent is to permanently reinvest undistributed future earnings of foreign subsidiaries, and we do not have any current plans to repatriate future earnings to fund operations in the United States. 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 potential state income taxes and other tax charges.

## Non GAAP Financial Measures

In accordance with the SEC's Regulation G and Item 10(e) of Regulation S-K, the following provides definitions of the non-GAAP financial measures used by management. We believe that these measures provide additional insight into underlying business results and trends. These non-GAAP financial measures are not intended to be considered by the user in place of the related GAAP financial measure, but rather as supplemental information to more fully understand our business results. These non-GAAP financial measures may not be the same as similar measures used

by other companies due to possible differences in method and in the items or events being adjusted.

Organic sales growth is a non-GAAP financial measure of sales growth that excludes the impacts of acquisitions, divestitures and foreign exchange from period-over-period comparisons. A reconciliation to the most closely related U.S. GAAP financial measure, net sales, has been included in our discussion within “Results of Operations” above. Organic net sales should be considered in addition to, and not as a replacement for or as a superior measure to net sales. Management believes reporting organic sales growth provides useful information to investors, potential investors and others, by facilitating easier comparisons of our revenue performance with prior and future periods.

Free cash outflow is a non-GAAP financial measure that does not represent cash generated from operating activities in accordance with U.S. GAAP. Therefore it should not be considered an alternative to net cash used in operating activities as an indication of our performance. The cash conversion rate of free cash outflow to net income is also a measure of our performance in cash flow generation. We believe free cash outflow to be an appropriate supplemental measure of our operating performance because it provides investors with a measure of our ability to generate cash, repay debt, pay dividends, repurchase stock and fund acquisitions.



Table of Contents

A reconciliation of net cash used in operating activities to free cash outflow and calculation of our cash conversion rate is provided below:

|   | First Quarter Ended |                  |
|---|---------------------|------------------|
|   | April 1,<br>2018    | April 2,<br>2017 |
|   | (in millions)       |                  |
| Net cash used in operating activities                   | \$ (26.1)           | \$ (9.1)         |
| Less: additions to property, plant, and equipment       | (7.3)               | (5.8)            |
| Free cash outflow                                       | \$ (33.4)           | \$ (14.9)        |
| <br>  |                     |                  |
| Net income  | \$ 28.2             | \$ 21.7          |
| <br>  |                     |                  |
| Cash conversion rate of free cash outflow to net income | (118.4) %           | (68.7) %         |

Our free cash outflow increased in the first quarter of 2018 when compared to the free cash outflow for the first quarter of 2017 due to the timing of working capital fluctuations and higher capital expenditures in the first quarter of 2018.

Our net debt to capitalization ratio, a non GAAP financial measure used by management, at April 1, 2018 was 23.4% compared to 20.7% at December 31, 2017. Management believes the net debt to capitalization ratio is an appropriate supplemental measure because it helps investors understand our ability to meet our financing needs and serves as a basis to evaluate our financial structure. Our computation may not be comparable to other companies that may define their net debt to capitalization ratios differently.

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

|  | April 1,<br>2018 | December<br>31,<br>2017 |
|--|------------------|-------------------------|
|  | (in millions)    |                         |
| Current portion of long term debt            | \$ 22.5          | \$ 22.5                 |
| Plus: long-term debt, net of current portion | 424.1            | 474.6                   |
| Less: cash and cash equivalents              | (184.7)          | (280.2)                 |
| Net debt                                     | \$ 261.9         | \$ 216.9                |

A reconciliation of capitalization is provided below:

|                                  | April 1,<br>2018 | December<br>31,<br>2017 |
|----------------------------------|------------------|-------------------------|
|                                  | (in millions)    |                         |
| Net debt                         | \$ 261.9         | \$ 216.9                |
| Total stockholders' equity       | 855.8            | 829.0                   |
| Capitalization                   | \$ 1,117.7       | \$ 1,045.9              |
| Net debt to capitalization ratio | 23.4 %           | 20.7 %                  |

#### 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

We believe that our critical accounting policies are those related to revenue recognition, inventory valuation, goodwill and other intangibles, product liability costs, legal contingencies and income taxes. We believe these accounting policies are particularly important to an understanding of our financial position and results of operations and requires application of significant judgment by our management. In applying these policies, management uses its judgment in making certain assumptions and estimates. Our critical accounting policies are more fully described under the heading "Accounting

Table of Contents

Policies” in Note 2 of the Notes to Consolidated Financial Statements in our Annual Report on Form 10-K as filed with the SEC on February 23, 2018, with the exception of the change in our Revenue Recognition accounting policy resulting from the adoption of ASC 606 as described in Note 2 in the Notes to Consolidated Financial Statements in this Form 10-Q.

Item 3. 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 6 of Notes to the Consolidated Financial Statements for further details.

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.

Our non-U.S. 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 from time to time to manage the risk related to intercompany loans, intercompany purchases that occur during the course of a year, and certain open foreign currency denominated commitments to sell products to third parties. Beginning in the first quarter of 2018, the Company entered into forward exchange contracts which hedge approximately 70% of the forecasted intercompany purchases between one of our Canadian and U.S. operating subsidiaries for the next twelve months. The Company will record the effective portion of the designated foreign currency hedge contracts in other comprehensive income until inventory turns and is sold to a third-party. Once the third-party transaction occurs associated with the hedged forecasted transaction, the effective portion of any related gain or loss on the designated foreign currency hedge will be reclassified into earnings. The Company had designated foreign hedge contracts outstanding as of April 1, 2018 of \$0.2 million.

Prior to 2016, we generally had a low exposure on the cost of our debt to changes in interest rates. On February 12, 2016, the Company entered into a new Credit Agreement pursuant to which it received a funding commitment under a Term Loan Facility of \$300 million, of which the entire \$300 million has been drawn on, and \$271.9 million is outstanding and a Revolving Credit Facility of \$500 million, of which \$102.0 million has been drawn as of April 1, 2018. Both facilities mature on February 12, 2021. For each facility, the Company can choose either an Adjusted LIBOR or Alternative Base Rate (“ABR”). Accordingly, the Company’s earnings and cash flows are exposed to interest rate risk from changes in Adjusted LIBOR. In order to manage the Company’s exposure to changes in cash flows attributable to fluctuations in LIBOR-indexed interest payments related to our floating rate debt, the Company entered into two interest rate swaps. For each interest rate swap, the Company receives the three-month USD-LIBOR subject

to a 0% floor, and pays a fixed rate of 1.31375% on a notional amount of \$225.0 million. Information about our long term debt including principal amounts and related interest rates appears in Note 11 of Notes to the Consolidated Financial Statements.

We purchase significant amounts of bronze ingot, brass rod, cast iron, stainless 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 4. 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 interim 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

Table of Contents

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 interim 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 interim 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 April 1, 2018, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting, with the exception of the change in our Revenue Recognition controls resulting from the adoption of ASC 606 as described in Note 2 in the Notes to Consolidated Financial Statements. Although the new revenue standard is expected to have an immaterial impact on our ongoing revenue recognition, we did implement changes to our processes related to revenue recognition and the control activities within them. These included the development of new policies based on the five-step model provided in the new revenue standard, new training, ongoing contract review and certification requirements, and gathering information provided for disclosures. 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.

Table of Contents

Part II. OTHER INFORMATION

Item 1. Legal Proceedings

As disclosed in Part I, Item 1, “Product Liability, Environmental and Other Litigation Matters” and Item 3, “Legal Proceedings” of our Annual Report on Form 10-K for the year ended December 31, 2017, we are party to certain litigation. There have been no material developments with respect to our contingencies and environmental remediation proceedings during the quarter ended April 1, 2018, other than as described in Note 12 of the Notes to Consolidated Financial Statements, which is incorporated herein by reference.

Item 1A. Risk Factors

There have been no material changes to the risk factors included in our Annual Report on Form 10-K for the year ended December 31, 2017, which risk factors are incorporated herein by reference.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

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 three month period ended April 1, 2018.

| 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 |
|        |   |  |   |   |

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|                                      |        |          |   |   |
|--------------------------------------|--------|----------|---|---|
| January 1, 2018 - January 28, 2018   | 52     | \$ 79.80 | — | — |
| January 29, 2018 - February 25, 2018 | 43,099 | \$ 76.38 | — | — |
| February 26, 2018 - April 1, 2018    | 24,196 | \$ 80.94 | — | — |
| Total                                | 67,347 | \$ 79.04 | — | — |

The following table includes information with respect to repurchases of our Class A common stock during the three month period ended April 1, 2018 under our stock repurchase program.

| Period                               | Issuer Purchases of Equity Securities              |  |   | (d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs |
|--------------------------------------|--|--|---|---|
|                                      | (a) Total Number of Shares (or Units) Purchased(1) | (b) Average Price Paid per Share (or Unit) | (c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs |   |
| January 1, 2018 - January 28, 2018   | 30,449   | \$ 77.76                                   | 30,449  | \$ 35,411,820   |
| January 29, 2018 - February 25, 2018 | 32,296   | \$ 77.43                                   | 32,296  | \$ 32,911,184   |
| February 26, 2018 - April 1, 2018    | 17,310   | \$ 78.32                                   | 17,310  | \$ 31,555,454   |
| Total                                | 80,055   | \$ 77.75                                   | 80,055  |   |

Table of Contents

(1) On July 27, 2015, the Board of Directors authorized a new stock repurchase program of up to \$100 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 shares repurchased will be determined by the Company's management based on its evaluation of market conditions and other factors.

## Item 6. Exhibits

| Exhibit No. | Description   |
|-------------|---|
| 3.1         | <u>Restated Certificate of Incorporation, as amended. Incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarter ended July 3, 2005 (File No. 001 11499).</u>  |
| 3.2         | <u>Amended and Restated By Laws. Incorporated by reference to the Registrant's Current Report on Form 8-K dated July 27, 2015 (File No. 001 11499).</u>   |
| 10.1        | <u>Watts Water Technologies, Inc. Executive Severance Plan, as amended and restated as of February 8, 2018. Incorporated by reference to the Registrant's Current Report on Form 8-K dated February 8, 2018 (File No. 001-11499).</u> |
| 10.2†       | <u>Form of Indemnification Agreement between the Registrant and certain directors and officers of the Registrant.</u>   |
| 10.3†       | <u>Form of 2018 Performance Stock Unit Award Agreement under the Watts Water Technologies, Inc. Second Amended and Restated 2004 Stock Incentive Plan.</u>  |
| 31†         | <u>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</u>   |
| 32††        | <u>Certification of Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. Section 1350</u>  |
| 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.   |

† Filed herewith.

†† Furnished herewith.

\* Attached as Exhibit 101 to this report are the following formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Balance Sheets at April 1, 2018 and December 31, 2017, (ii) Consolidated Statements of Operations for the First Quarters Ended April 1, 2018 and April 2, 2017, (iii) Consolidated Statements of Comprehensive Income for the First Quarters Ended April 1, 2018 and April 2, 2017, (iv) Consolidated Statements of Cash Flows for the First Quarters Ended April 1, 2018 and April 2, 2017, and (v) Notes to Consolidated Financial



Statements.

30

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Table of Contents

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.

Date: May 8, 2018 By: /s/ Robert J. Pagano, Jr.

Robert J. Pagano, Jr.  
Chief Executive Officer and interim Chief Financial Officer (principal executive and principal financial officer)

Date: May 8, 2018 By: /s/ Virginia A. Halloran  
Virginia A. Halloran

Chief Accounting Officer (principal accounting officer)