

WATTS WATER TECHNOLOGIES INC

Form 10-Q

November 12, 2010

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

**For the quarterly period ended October 3, 2010**

**or**

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

**For the transition period from            to**

**Commission file number 001-11499**

**WATTS WATER TECHNOLOGIES, INC.**

(Exact Name of Registrant as Specified in Its Charter)

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**Delaware**  
(State or Other Jurisdiction of Incorporation or  
Organization)

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

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

**01845**  
(Zip Code)

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

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

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

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

Class	Outstanding at October 31, 2010
Class A Common Stock, \$0.10 par value	30,078,677
Class B Common Stock, \$0.10 par value	6,953,680



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## WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

(Amounts in millions, except share information)

(Unaudited)

	October 3, 2010	December 31, 2009
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 292.3	\$ 258.2
Short-term investment securities	4.0	6.5
Trade accounts receivable, less allowance for doubtful accounts of \$9.0 million at October 3, 2010 and \$7.5 million at December 31, 2009	196.1	181.3
Inventories, net:		
Raw materials	109.1	88.0
Work in process	24.7	36.5
Finished goods	150.7	142.2
Total Inventories	284.5	266.7
Prepaid expenses and other assets	30.4	22.1
Deferred income taxes	37.5	35.4
Assets held for sale	10.9	11.3
Assets of discontinued operations	10.4	23.1
Total Current Assets	866.1	804.6
<b>PROPERTY, PLANT AND EQUIPMENT:</b>		
Property, plant and equipment, at cost	455.1	454.9
Accumulated depreciation	(253.8)	(248.4)
Property, plant and equipment, net	201.3	206.5
<b>OTHER ASSETS:</b>		
Goodwill	434.2	425.1
Intangible assets, net	153.4	151.2
Deferred income taxes	4.7	3.0
Other, net	11.0	8.8
<b>TOTAL ASSETS</b>	<b>\$ 1,670.7</b>	<b>\$ 1,599.2</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 109.4	\$ 102.3
Accrued expenses and other liabilities	132.1	105.9
Accrued compensation and benefits	43.4	45.9
Current portion of long-term debt	0.7	50.9
Liabilities of discontinued operations	5.8	9.8

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Total Current Liabilities	291.4	314.8
LONG-TERM DEBT, NET OF CURRENT PORTION	378.2	304.0
DEFERRED INCOME TAXES	44.0	43.0
OTHER NONCURRENT LIABILITIES	52.1	57.8
STOCKHOLDERS EQUITY:		
Preferred Stock, \$0.10 par value; 5,000,000 shares authorized; no shares issued or outstanding		
Class A Common Stock, \$0.10 par value; 80,000,000 shares authorized; 1 vote per share; issued and outstanding, 30,062,677 shares at October 3, 2010 and 29,506,523 shares at December 31, 2009	3.0	3.0
Class B Common Stock, \$0.10 par value; 25,000,000 shares authorized; 10 votes per share; issued and outstanding, 6,953,680 shares at October 3, 2010 and 7,193,880 shares at December 31, 2009	0.7	0.7
Additional paid-in capital	402.9	393.7
Retained earnings	485.8	452.1
Accumulated other comprehensive income	12.6	30.1
Total Stockholders Equity	905.0	879.6
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	\$ 1,670.7	\$ 1,599.2

See accompanying notes to consolidated financial statements.

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## WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS

(Amounts in millions, except per share information)

(Unaudited)

	Third Quarter Ended	
	October 3, 2010	September 27, 2009
Net sales	\$ 314.6	\$ 303.8
Cost of goods sold	200.8	194.4
<b>GROSS PROFIT</b>	<b>113.8</b>	<b>109.4</b>
Selling, general & administrative expenses	79.3	78.8
Restructuring and other charges	3.0	6.3
<b>OPERATING INCOME</b>	<b>31.5</b>	<b>24.3</b>
Other (income) expense:		
Interest income	(0.2)	(0.3)
Interest expense	6.1	5.5
Other income, net	(0.5)	(0.5)
Total other expense	5.4	4.7
<b>INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES</b>	<b>26.1</b>	<b>19.6</b>
Provision for income taxes	8.8	8.0
<b>NET INCOME FROM CONTINUING OPERATIONS</b>	<b>17.3</b>	<b>11.6</b>
Loss from discontinued operations, net of taxes		(8.2)
<b>NET INCOME</b>	<b>\$ 17.3</b>	<b>\$ 3.4</b>
<b>BASIC EPS</b>		
Net income (loss) per share:		
Continuing operations	\$ 0.46	\$ 0.31
Discontinued operations		(0.22)
<b>NET INCOME</b>	<b>\$ 0.46</b>	<b>\$ 0.09</b>
Weighted average number of shares	37.3	37.0
<b>DILUTED EPS</b>		
Net income (loss) per share:		
Continuing operations	\$ 0.46	\$ 0.31
Discontinued operations		(0.22)
<b>NET INCOME</b>	<b>\$ 0.46</b>	<b>\$ 0.09</b>
Weighted average number of shares	37.5	37.1
Dividends per share	\$ 0.11	\$ 0.11

See accompanying notes to consolidated financial statements.

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## WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS

(Amounts in millions, except per share information)

(Unaudited)

	Nine Months Ended	
	October 3, 2010	September 27, 2009
Net sales	\$ 957.9	\$ 902.7
Cost of goods sold	605.9	587.1
<b>GROSS PROFIT</b>	<b>352.0</b>	<b>315.6</b>
Selling, general & administrative expenses	252.4	238.7
Restructuring and other charges	8.8	8.6
<b>OPERATING INCOME</b>	<b>90.8</b>	<b>68.3</b>
Other (income) expense:		
Interest income	(0.7)	(0.8)
Interest expense	16.7	16.8
Other income, net	(1.3)	(1.0)
Total other expense	14.7	15.0
<b>INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES</b>	<b>76.1</b>	<b>53.3</b>
Provision for income taxes	24.4	22.4
<b>NET INCOME FROM CONTINUING OPERATIONS</b>	<b>51.7</b>	<b>30.9</b>
Loss from discontinued operations, net of taxes	(4.2)	(27.7)
<b>NET INCOME</b>	<b>\$ 47.5</b>	<b>\$ 3.2</b>
<b>BASIC EPS</b>		
Net income (loss) per share:		
Continuing operations	\$ 1.39	\$ 0.84
Discontinued operations	(0.11)	(0.75)
<b>NET INCOME</b>	<b>\$ 1.28</b>	<b>\$ 0.09</b>
Weighted average number of shares	37.2	37.0
<b>DILUTED EPS</b>		
Net income (loss) per share:		
Continuing operations	\$ 1.38	\$ 0.83
Discontinued operations	(0.11)	(0.75)
<b>NET INCOME</b>	<b>\$ 1.27</b>	<b>\$ 0.09</b>
Weighted average number of shares	37.4	37.1
Dividends per share	\$ 0.33	\$ 0.33

See accompanying notes to consolidated financial statements.



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## WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in millions)

(Unaudited)

	Nine Months Ended	
	October 3, 2010	September 27, 2009
<b>OPERATING ACTIVITIES</b>		
Net income	\$ 47.5	\$ 3.2
Less: Loss from discontinued operations, net of taxes	(4.2)	(27.7)
Net income from continuing operations	51.7	30.9
Adjustments to reconcile net income from continuing operations to net cash provided by continuing operating activities:		
Depreciation	22.8	23.6
Amortization	10.2	9.7
Stock-based compensation	3.5	3.7
Deferred income taxes	(3.6)	(4.5)
Loss on disposal/impairment of property, plant & equipment	0.8	5.5
Other	(0.3)	1.3
Changes in operating assets and liabilities, net of effects from business acquisitions and divestitures:		
Accounts receivable	(16.0)	21.1
Inventories	(16.1)	61.7
Prepaid expenses and other assets	(6.9)	1.2
Accounts payable, accrued expenses and other liabilities	29.2	(8.0)
Net cash provided by continuing operations	75.3	146.2
<b>INVESTING ACTIVITIES</b>		
Additions to property, plant and equipment	(18.4)	(15.4)
Proceeds from the sale of property, plant and equipment	1.2	0.4
Purchase of short-term investment securities	(4.0)	
Proceeds from the sale of short-term investment securities	6.5	1.7
Other, net		0.8
Business acquisitions, net of cash acquired	(36.1)	(0.3)
Net cash used in investing activities	(50.8)	(12.8)
<b>FINANCING ACTIVITIES</b>		
Proceeds from long-term debt	75.0	1.7
Payments of long-term debt	(50.7)	(61.1)
Payment of capital leases	(1.0)	(0.9)
Proceeds from share transactions under employee stock plans	2.6	0.2
Tax benefit of stock awards exercised		(0.5)
Debt issuance cost	(3.2)	
Dividends	(12.3)	(12.2)
Net cash provided by (used in) financing activities	10.4	(72.8)
Effect of exchange rate changes on cash and cash equivalents	(3.5)	6.3
Net cash provide by (used in) operating activities of discontinued operations	(2.4)	1.1
Net cash provided by (used in) investing activities of discontinued operations	5.1	(0.3)
<b>INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>34.1</b>	<b>67.7</b>

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Cash and cash equivalents at beginning of year		<b>258.2</b>		165.6
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$	<b>292.3</b>	\$	233.3
<b>NON-CASH INVESTING AND FINANCING ACTIVITIES</b>				
Acquisition of businesses:				
Fair value of assets acquired	\$	<b>45.5</b>	\$	0.3
Cash paid, net of cash acquired		<b>36.1</b>		0.3
Liabilities assumed	\$	<b>9.4</b>	\$	
Issuance of stock under management stock purchase plan	\$	<b>2.1</b>	\$	1.4
<b>CASH PAID FOR:</b>				
Interest	\$	<b>10.9</b>	\$	11.6
Income taxes	\$	<b>20.8</b>	\$	27.0

See accompanying notes to consolidated financial statements.

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**WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

**1. Basis of Presentation**

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included in the Watts Water Technologies, Inc. (the Company) Consolidated Balance Sheet as of October 3, 2010, the Consolidated Statements of Operations for the third quarter and nine months ended October 3, 2010 and for the third quarter and nine months ended September 27, 2009, and the Consolidated Statements of Cash Flows for the nine months ended October 3, 2010 and the nine months ended September 27, 2009.

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

The Company operates on a 52-week fiscal year ending on December 31st. Any quarterly data contained in this Quarterly Report on Form 10-Q generally reflects the results of operations for a 13-week period. There were four additional working days in the nine months ended October 3, 2010 than there were in the nine months ended September 27, 2009.

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

**2. Accounting Policies**

*Estimates*

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

*Impairment of Goodwill and Long-Lived Assets*

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

	North America	Europe (in millions)	China	Total
<b>Gross balance at January 1, 2010</b>	\$ 210.4	\$ 228.8	\$ 7.9	\$ 447.1
<b>Accumulated impairment losses</b>	(22.0)			(22.0)
<b>Net goodwill at January 1, 2010</b>	188.4	228.8	7.9	425.1
<b>Goodwill acquired during the period</b>	2.7	14.7		17.4
<b>Effect of change in exchange rates used for translation</b>	0.2	(8.6)	0.1	(8.3)
<b>Gross balance at October 3, 2010</b>	\$ 213.3	\$ 234.9	\$ 8.0	\$ 456.2
<b>Accumulated impairment losses</b>	(22.0)			(22.0)
<b>Net goodwill at October 3, 2010</b>	\$ 191.3	\$ 234.9	\$ 8.0	\$ 434.2

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

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

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weighted average cost of capital based on the market and guideline public companies market for the related business and does not allocate interest charges to the asset or asset group being measured. Judgment is required to estimate future operating cash flows.

Intangible assets include the following:

	Gross Carrying Amount	October 3, 2010 Accumulated Amortization (in millions)	Net Carrying Amount
Patents	\$ 16.5	\$ (9.3)	\$ 7.2
Customer relationships	118.0	(39.8)	78.2
Technology	17.7	(5.2)	12.5
Other	8.7	(5.7)	3.0
Total amortizable intangibles	160.9	(60.0)	100.9
Intangible assets not subject to amortization	52.5		52.5
Total	\$ 213.4	\$ (60.0)	\$ 153.4

Aggregate amortization expense for amortized intangible assets for the third quarters of 2010 and 2009 was \$3.6 million and \$3.4 million, respectively, and for the first nine-month periods of 2010 and 2009 was \$10.2 million and \$9.7 million, respectively. Additionally, future amortization expense for the next five years on amortizable intangible assets approximates \$3.8 million for the remainder of 2010, \$14.1 million for 2011, \$12.4 million for 2012, \$11.2 million for 2013 and \$11.2 million for 2014. Amortization expense is provided on a straight-line basis over the estimated useful lives of the intangible assets. The weighted-average remaining life of total amortizable intangible assets is 9.5 years. Patents, customer relationships, technology and other amortizable intangibles have weighted-average remaining lives of 8.1 years, 7.7 years, 13.6 years and 44.7 years, respectively. Intangible assets not subject to amortization consist of trademarks.

*Stock-Based Compensation*

The Company maintains three stock incentive plans under which key employees and non-employee members of the Company's Board of Directors have been granted incentive stock options (ISOs) and nonqualified stock options (NSOs) to purchase the Company's Class A Common Stock. Only one plan, the 2004 Stock Incentive Plan, is currently available for the grant of new equity awards. Stock options granted under prior plans became exercisable over a five-year period at the rate of 20% per year and expire ten years after the date of grant. Under the 2004 Stock Incentive Plan, options become exercisable over a four-year period at the rate of 25% per year and expire ten years after the grant date. ISOs and NSOs granted under the plans may have exercise prices of not less than 100% and 50% of the fair market value of the Class A Common Stock on the date of grant, respectively. The Company's current practice is to grant all options at fair market value on the grant date. The Company issued 282,500 and 213,500 options to key employees, under the 2004 Stock Incentive Plan in the third quarters and in the first nine months of 2010 and 2009, respectively.

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

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	2010	2009
Expected life (years)	<b>6.0</b>	6.0
Expected stock price volatility	<b>41.3%</b>	41.2%
Expected dividend yield	<b>1.3%</b>	1.7%
Risk-free interest rate	<b>1.9%</b>	2.8%

The above assumptions were used to determine the weighted average grant-date fair value of stock options of \$12.36 and \$9.70 in 2010 and 2009, respectively.

The Company has also granted shares of restricted stock to key employees and non-employee members of the Company's Board of Directors under the 2004 Stock Incentive Plan, which vest either immediately, over a one-year period, or over a three-year period at the rate of one-third per year. The restricted stock awards are amortized to expense on a straight-line basis over the vesting period. The Company issued 104,975 and 84,535 shares of restricted stock under the 2004 Stock Incentive Plan in third quarters of 2010 and 2009, respectively. The Company issued 104,975 and 86,241 shares of restricted stock under the 2004 Stock Incentive Plan in the first nine months of 2010 and 2009, respectively.

The Company also has a Management Stock Purchase Plan that allows for the granting of restricted stock units (RSUs) to key employees. On an annual basis, key employees may elect to receive a portion of their annual incentive compensation in RSUs instead of cash. Each RSU provides the key employee with the right to purchase a share of Class A Common Stock at 67% of the fair market value on the date of grant. RSUs vest annually over a three-year period from the grant date. An aggregate of 2,000,000 shares of Class A Common Stock may be issued under the Management Stock Purchase Plan. The Company granted 158,473 and 150,098 RSUs in the first nine months of 2010 and 2009, respectively. The Company did not grant any RSUs in the third quarters of 2010 or 2009.

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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:

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

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

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

*Shipping and Handling*

The Company's shipping costs included in selling, general and administrative expenses were \$8.6 million and \$8.1 million for the third quarters of 2010 and 2009, respectively, and were \$25.7 million and \$23.2 million for the first nine months of 2010 and 2009, respectively.

*Research and Development*

Research and development costs included in selling, general and administrative expenses were \$4.3 million and \$4.2 million for the third quarters of 2010 and 2009, respectively, and were \$14.0 million and \$12.9 million for the first nine months of 2010 and 2009, respectively.

*Taxes, Other than Income Taxes*

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

*Income Taxes*

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Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. During 2010, the Company recorded an income tax benefit of approximately \$2.8 million primarily from the release of a valuation allowance on net operating losses in Europe.

### *New Accounting Standards*

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

In October 2009, the FASB issued an accounting standard update to address accounting for multiple-deliverable arrangements, specifically addressing how to separate deliverables and how to measure and allocate arrangement consideration to one or more units of accounting. This update established a hierarchy for determining the selling price of a deliverable. This standard also expands disclosures relating to an entity's multiple-deliverable revenue arrangements. This update is effective prospectively for all arrangements entered into or materially modified in fiscal years beginning after June 15, 2010. The adoption of this update will not have a material impact on the Company's consolidated financial statements.



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In September 2009, the Company's Board of Directors approved the sale of its investment in Watts Valve (Changsha) Co., Ltd. (CWV). CWV manufactured large diameter hydraulic-actuated butterfly valves for thermo-power and hydro-power plants, water distribution projects and water works projects in China. Management determined that CWV's business no longer fit strategically with the Company. The Company completed the sale of CWV in January 2010. During 2009, the Company evaluated the classification of the assets and liabilities of CWV and concluded that the net assets qualified as discontinued operations. The Company evaluated the fair value (less cost to sell) of the net assets of CWV and recorded a pre-tax loss of approximately \$8.5 million in 2009, based on the final agreement with the buyer. The Company concluded that the future cash flows associated with CWV would be completely eliminated from the continuing operations of the Company. As such, the Company classified CWV's results of operations and the loss from the disposition as discontinued operations for all periods presented. See Note 10 for further information related to CWV.

In May 2009, the Company liquidated its TEAM Precision Pipework, Ltd. (TEAM) business, located in Ammanford, U.K. TEAM custom designed and manufactured manipulated pipe and hose tubing assemblies and served the heating, ventilation and air conditioning and automotive markets in Western Europe. Management determined the business no longer fit strategically with the Company and that a sale of TEAM was not feasible. On May 22, 2009, the Company appointed an administrator for TEAM under the United Kingdom Insolvency Act of 1986. During the administration process, the administrator had sole control over, and responsibility for, TEAM's operations, assets and liabilities. The Company deconsolidated TEAM when the administrator obtained control of TEAM. The deconsolidation resulted in the recognition of a \$18.8 million pre-tax non-cash loss in the second quarter of 2009. The Company evaluated the operations of TEAM and determined that it would not have a continuing involvement in TEAM's operations and cash flows. As a result of the loss of control, TEAM's cash flows and operations were eliminated from the continuing operations of the Company. As such, the Company classified TEAM's results of operations and the loss from deconsolidation as discontinued operations for all periods presented.

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

Condensed operating statements for discontinued operations are summarized below:

	<b>Third Quarter Ended</b>	
	<b>October 3, 2010</b>	<b>September 27, 2009</b>
	(in millions)	
Operating loss - CWV	\$	\$ (0.9)
Write down of net assets - CWV		(5.9)
Loss before income taxes		(6.8)
Income tax expense		1.4
Loss from discontinued operations, net of taxes	\$	\$ (8.2)

Revenues reported in discontinued operations are as follows:

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Third Quarter Ended  
 October 3,                      September 27,  
 2010                                      2009  
 (in millions)

Revenues	CWV	\$		\$	3.4
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Nine Months Ended  
 October 3,                      September 27,  
 2010                                      2009  
 (in millions)

Operating loss	TEAM	\$		\$	(0.3)
Operating loss	CWV				(1.3)
Loss on disposal	TEAM		(0.1)		(18.8)
Loss on sale	CWV		(0.1)		(5.9)
Costs and expenses	FCPA investigation (CWV)		(5.6)		
Costs and expenses	Municipal Water Group				(0.2)
Loss before income taxes			(5.8)		(26.5)
Income tax (benefit) expense			(1.6)		1.2
Loss from discontinued operations, net of taxes		\$	(4.2)	\$	(27.7)

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Revenues reported in discontinued operations are as follows:

	Nine Months Ended	
	October 3, 2010	September 27, 2009
	(in millions)	
Revenues CWV	\$	\$ 10.4
Revenues TEAM		2.6
Total revenues discontinued operations	\$	\$ 13.0

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

	October 3, 2010	December 31, 2009
	(in millions)	
Accounts receivable	\$	\$ 4.2
Inventories		4.2
Prepaid expenses and other assets	0.9	2.3
Property, plant & equipment, net		1.3
Deferred income taxes	1.5	1.8
Intangible assets		1.5
Income taxes receivable	8.0	7.8
Assets of discontinued operations	\$ 10.4	\$ 23.1
Accounts payable	\$	\$ 2.1
Accrued expenses and other liabilities	5.8	7.2
Deferred taxes payable		0.5
Liabilities of discontinued operations	\$ 5.8	\$ 9.8

**4. Financial Instruments and Derivatives Instruments**

The Company measures certain financial assets and liabilities at fair value on a recurring basis, including short-term investment securities, foreign currency derivatives and deferred compensation plan assets and related liability. The fair values of these financial assets and liabilities were determined using the following inputs at October 3, 2010:

	Total	Fair Value Measurements at Reporting Date Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(in millions)			
Assets				
Short-term investment securities (1)	\$ 4.0	\$	\$ 4.0	\$
Plan asset for deferred compensation(2)	3.4		3.4	
Total assets	\$ 7.4	\$ 3.4	\$ 4.0	\$

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Liabilities					
Contingent consideration(3)	\$	1.9	\$	\$	1.9
Plan liability for deferred compensation(3)		3.4		3.4	
Total liabilities	\$	5.3	\$	3.4	\$ 1.9

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

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

(3) Included in other noncurrent liabilities on the Company's consolidated balance sheet.

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The table below provides a summary of the changes in fair value of all financial assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the period December 31, 2009 to October 3, 2010.

	<b>Balance December 31, 2009</b>	<b>Purchases, sales, settlements, net</b>	<b>Total realized and unrealized gains (losses) included in: Earnings (in millions)</b>	<b>Comprehensive income</b>	<b>Balance October 3, 2010</b>
Trading securities	\$ 6.5	\$ (6.5)	\$	\$	\$

The Company elected to participate in a settlement offer from UBS, AG (UBS) for all of its outstanding auction rate securities (ARS) investments. Under the terms of the settlement offer, the Company was issued rights by UBS entitling the holder to require UBS to purchase the underlying ARS at par value during the period from June 30, 2010, through July 2, 2012. The Company elected to exercise this right and, on July 1, 2010 received \$6.3 million from UBS in settlement of all outstanding ARS investments. The Company had previously received \$0.2 million from UBS during the first quarter of 2010. The Company recorded income of approximately \$0.6 million to other (income) expense in the consolidated statement of operations for its investment in ARS in the first nine months of 2009.

As discussed in Note 12, a contingent liability of \$1.9 million was recognized as a preliminary estimate of the acquisition date fair value of the contingent consideration in the Blue Ridge Atlantic Enterprises, Inc. (BRAE) acquisition. This liability was classified as Level 3 under the fair value hierarchy as it was based on the weighted probability as of the date of the acquisition of achievement of a performance metric, which was not observable in the market.

Short-term investment securities as of October 3, 2010 consist of certificates of deposit with remaining maturities of greater than three months at the date of purchase, for which the carrying amount is a reasonable estimate of fair value.

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

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

The Company has exposure to a number of foreign currency rates, including the Canadian Dollar, the Euro, the Chinese Yuan and the British Pound. To manage this risk, the Company generally uses a layering methodology whereby at the end of any quarter, the Company has generally entered into forward exchange contracts, which hedge approximately 50% of the projected intercompany purchase transactions for the next twelve months. The Company uses this strategy for the purchases between Canada and the U.S., for purchases between the Euro zone and the

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U.S., and for purchases between the Euro zone and the United Kingdom. The average volume of contracts can vary but generally approximates \$10 to \$15 million in open contracts at the end of any given quarter. At October 3, 2010, the Company had contracts for purchases between Canada and the U.S. for notional amounts aggregating approximately \$15.0 million to buy various currencies. The fair value of the foreign exchange contracts as of October 3, 2010 was immaterial. The Company accounts for the forward exchange contracts as an economic hedge and has not elected to use hedge accounting. Realized and unrealized gains and losses on the contracts are recognized in other (income) expense in the consolidated statements of operations. During the third quarters ended October 3, 2010 and September 27, 2009, the Company recorded unrealized losses of \$0.2 million and \$1.2 million, respectively, and during the nine months ended October 3, 2010 and September 27, 2009, the Company recorded unrealized gains of \$0.7 million and unrealized losses of \$0.3 million, respectively, on foreign currency derivatives contracts. These contracts do not subject the Company to significant market risk from exchange movement because they offset gains and losses on the related foreign currency denominated transactions.

### *Fair Value*

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

The fair values of the Company's 5.05% senior notes due 2020, 5.47% senior notes due 2013 and 5.85% senior notes due 2016 are based on a discounted cash flow model using like industrial companies, the Company's credit metrics, the Company's size, as well as, current market demand. The fair value of the Company's variable rate debt approximates its carrying value. The carrying amount and the estimated fair market value of the Company's long-term debt, including the current portion, are as follows:

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	October 3, 2010	December 31, 2009
	(in millions)	
Carrying amount	\$ 378.9	\$ 354.9
Estimated fair value	\$ 423.9	\$ 360.9

**5. Restructuring and Other Charges**

The Company's Board of Directors approves all major restructuring programs that involve the discontinuance of product lines or the shutdown of facilities. From time to time, the Company takes additional restructuring actions, including involuntary terminations that are not part of a major program. The Company accounts for these costs in the period that the individual employees are notified or the liability is incurred. These costs are included in restructuring and other charges in the Company's consolidated statements of operations. The Company also includes as part of other charges, expenses associated with asset impairments. See Note 4 of the Company's Annual Report on Form 10-K for the year ended December 31, 2009, for a detailed description of the 2009 and 2010 Europe actions. Additionally, on September 13, 2010, the Board of Directors of the Company approved a restructuring program with respect to certain of the Company's operating facilities in the United States. The restructuring program includes the shutdown of two manufacturing facilities in North Carolina. Operations at these facilities will be consolidated into the Company's manufacturing facilities in New Hampshire, Missouri and other locations. The program is expected to include pre-tax charges totaling approximately \$4.9 million, including costs for severance, shutdown costs and equipment write-downs. Additionally, the Company is expecting pre-tax training and pre-production set-up costs of approximately \$2.0 million. The total net after-tax charge for this restructuring program is expected to be approximately \$4.1 million (including \$0.4 million in non-cash charges), with costs being incurred through 2011. The Company expects to spend approximately \$1.2 million in capital expenditures to consolidate operations. Annual cash savings, net of tax, are estimated to be approximately \$1.6 million, which the Company expects to fully realize by the second half of 2012. The restructuring program is expected to be completed by the end of the third quarter of 2011.

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

	Third Quarter Ended October 3, 2010	Nine Months Ended October 3, 2010
	(in millions)	
2009 Actions	\$ 0.2	\$ 1.3
2010 Actions	2.7	8.3
Other Actions	0.1	0.3
Total	\$ 3.0	\$ 9.9

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

	Third Quarter Ended October 3, 2010	Nine Months Ended October 3, 2010
	(in millions)	
North America	\$ 2.1	\$ 2.9
Europe	0.9	6.7

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China				0.3
Total	\$	3.0	\$	9.9

The third quarter charge for 2010 of \$3.0 million consists of approximately \$1.9 million related to involuntary termination benefits and \$0.8 million for other costs associated with the 2010 actions. Additionally, the Company recorded \$0.2 million related to involuntary termination benefits associated with the 2009 actions. The remaining costs of approximately \$0.1 million related to involuntary termination benefits which were not part of a previously announced restructuring plan.

The first nine months charge for 2010 of \$9.9 million consists of approximately \$5.2 million related to involuntary termination benefits, \$1.3 million for accelerated depreciation for manufacturing operations, which was charged to cost of sales, and \$1.8 million for other costs associated with the 2010 actions. Additionally, the Company recorded \$0.7 million related to involuntary termination benefits and \$0.6 million for relocation expenses associated with the 2009 actions. The remaining costs of approximately \$0.3 million related to involuntary termination benefits which were not part of a previously announced restructuring plan. Additionally, the Company recorded \$0.2 million and \$0.3 million in the first nine months of 2010 and 2009, respectively, for charges associated with asset impairments.

In March 2010, in connection the Company's manufacturing footprint consolidation, the Company closed the operations of Tianjin Watts Valve Company Ltd. (TWVC) and relocated its manufacturing to other facilities. On April 12, 2010, the Company signed a definitive equity transfer agreement with a third party to sell its equity ownership and remaining assets of TWVC. The sale is expected to be finalized before the end of 2010, subject to receiving all applicable government approvals. The Company expects to receive net



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proceeds of approximately \$5.9 million from the sale. The Company recorded a tax charge of approximately \$1.5 million in the first quarter of 2010 in connection with the expected sale of TWVC.

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

Reportable Segment	Total Expected Costs	Incurred through October 3, 2010 (in millions)	Remaining Costs at October 3, 2010
North America	\$ 2.7	\$ 1.8	\$ 0.9
China	9.0	8.8	0.2
Total	\$ 11.7	\$ 10.6	\$ 1.1

The Company does not expect to incur the remaining cost associated with the North America segment, as the project is substantially complete.

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

	Severance	Asset write-downs	Facility exit and other	Total
	(in millions)			
Balance at December 31, 2009	\$	\$	\$	\$
Net pre-tax restructuring charges	0.3		0.5	0.8
Utilization	(0.3)		(0.5)	(0.8)
Balance at April 4, 2010	\$	\$	\$	\$
Net pre-tax restructuring charges	0.2		0.1	0.3
Utilization	(0.2)		(0.1)	(0.3)
Balance at July 4, 2010	\$	\$	\$	\$
Net pre-tax restructuring charges	0.2			0.2
Utilization	(0.2)			(0.2)
Balance at October 3, 2010	\$	\$	\$	\$

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

	Severance	Asset write-downs	Facility exit and other	Total
	(in millions)			
Expected costs	\$ 3.2	\$ 5.2	\$ 3.3	\$ 11.7
Costs incurred 2009	(1.8)	(7.4)	(0.1)	(9.3)
Costs incurred quarter ended April 4, 2010	(0.3)		(0.5)	(0.8)
Costs incurred quarter ended July 4, 2010	(0.2)		(0.1)	(0.3)
	(0.2)			(0.2)

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Costs incurred	quarter ended October 3,						
2010							
Balance at October 3, 2010		\$	0.7	\$	(2.2)	\$	2.6
						\$	1.1

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

Reportable Segment	Total Expected Costs	Incurred through October 3, 2010	Remaining Costs at October 3, 2010
	(in millions)		
Europe	\$ 12.5	\$ 11.0	\$ 1.5

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Details of the Company's 2010 Europe footprint consolidation-restructuring program for the first nine months of 2010 are as follows:

	Severance	Asset write-downs	Facility exit and other	Total
	(in millions)			
Balance at December 31, 2009	\$ 4.2	\$	\$	\$ 4.2
Net pre-tax restructuring charges	2.0	0.7	0.2	2.9
Utilization and foreign currency impact	(0.3)	(0.7)	(0.2)	(1.2)
Balance at April 4, 2010	\$ 5.9	\$	\$	\$ 5.9
Net pre-tax restructuring charges	1.3	0.6	0.8	2.7
Utilization and foreign currency impact	(0.9)	(0.6)	(0.8)	(2.3)
Balance at July 4, 2010	\$ 6.3	\$	\$	\$ 6.3
<b>Net pre-tax restructuring charges</b>			<b>0.8</b>	<b>0.8</b>
<b>Utilization and foreign currency impact</b>	<b>0.1</b>		<b>(0.8)</b>	<b>(0.7)</b>
<b>Balance at October 3, 2010</b>	<b>\$ 6.4</b>	<b>\$</b>	<b>\$</b>	<b>\$ 6.4</b>

The following table summarizes expected, incurred and remaining costs for 2010 Europe footprint consolidation- restructuring actions by type:

	Severance	Asset write-downs	Facility exit and other	Total
	(in millions)			
Expected costs	\$ 7.5	\$ 1.6	\$ 3.4	\$ 12.5
Costs incurred 2009	(4.2)		(0.4)	(4.6)
Costs incurred quarter ended April 4, 2010	(2.0)	(0.7)	(0.2)	(2.9)
Costs incurred quarter ended July 4, 2010	(1.3)	(0.6)	(0.8)	(2.7)
<b>Costs incurred quarter ended October 3, 2010</b>			<b>(0.8)</b>	<b>(0.8)</b>
<b>Remaining costs at October 3, 2010</b>	<b>\$</b>	<b>\$ 0.3</b>	<b>\$ 1.2</b>	<b>\$ 1.5</b>

The following table summarizes the total expected, incurred and remaining pre-tax costs for the 2010 North America footprint consolidation-restructuring program by the Company's reportable segments:

Reportable Segment	Total Expected Costs	Incurred through October 3, 2010	Remaining Costs at October 3, 2010
	(in millions)		
North America	\$ 4.9	\$ 1.9	\$ 3.0

Details of the Company's 2010 North America footprint consolidation-restructuring program for the first nine months of 2010 are as follows:

Severance	Asset write-downs	Facility exit and other	Total
(in millions)			

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Balance at December 31, 2009	\$		\$		\$		\$
Net pre-tax restructuring charges		1.9					1.9
Utilization and foreign currency impact							
Balance at October 3, 2010	\$	1.9	\$		\$		1.9

The following table summarizes expected, incurred and remaining costs for 2010 North America footprint consolidation- restructuring actions by type:

	Severance	Asset write-downs	Facility exit and other	Total
	(in millions)			
Expected costs	\$ 1.9	\$ 0.6	\$ 2.4	\$ 4.9
Costs incurred quarter ended October 3, 2010	(1.9)			(1.9)
Remaining costs at October 3, 2010	\$	\$ 0.6	\$ 2.4	\$ 3.0

Table of Contents**6. Earnings per Share**

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

	For the Third Quarter Ended October 3, 2010			For the Third Quarter Ended September 27, 2009		
	Income (loss) (Numerator)	Shares (Denominator)	Per Share Amount	Income (loss) (Numerator)	Shares (Denominator)	Per Share Amount
(amounts in millions, except per share amounts)						
<b>Basic EPS</b>						
Net income (loss) per share:						
Continuing operations	\$ 17.3	37.3	\$ 0.46	\$ 11.6	37.0	\$ 0.31
Discontinued operations				(8.2)		(0.22)
Net income	\$ 17.3		\$ 0.46	\$ 3.4		\$ 0.09
Effect of dilutive securities						
Common stock equivalents		0.2			0.1	
<b>Diluted EPS</b>						
Net income (loss) per share:						
Continuing operations	\$ 17.3		\$ 0.46	\$ 11.6		\$ 0.31
Discontinued operations				(8.2)		(0.22)
Net income	\$ 17.3	37.5	\$ 0.46	\$ 3.4	37.1	\$ 0.09

Options to purchase 0.6 million and 0.8 million shares of Class A Common Stock were outstanding during the third quarters of 2010 and 2009, respectively, but were not included in the computation of diluted EPS because to do so would be anti-dilutive.

	For the Nine Months Ended October 3, 2010			For the Nine Months Ended September 27, 2009		
	Income (loss) (Numerator)	Shares (Denominator)	Per Share Amount	Income (loss) (Numerator)	Shares (Denominator)	Per Share Amount
(amounts in millions, except per share amounts)						
<b>Basic EPS</b>						
Net income (loss) per share:						
Continuing operations	\$ 51.7	37.2	\$ 1.39	\$ 30.9	37.0	\$ 0.84
Discontinued operations	(4.2)		(0.11)	(27.7)		(0.75)
Net income	\$ 47.5		\$ 1.28	\$ 3.2		\$ 0.09
Effect of dilutive securities						
Common stock equivalents		0.2			0.1	
<b>Diluted EPS</b>						
Net income (loss) per share:						
Continuing operations	\$ 51.7		\$ 1.38	\$ 30.9		\$ 0.83
Discontinued operations	(4.2)		(0.11)	(27.7)		(0.75)
Net income	\$ 47.5	37.4	\$ 1.27	\$ 3.2	37.1	\$ 0.09

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Options to purchase 0.6 million and 0.9 million shares of Class A Common Stock were outstanding during the first nine months of 2010 and 2009, respectively, but were not included in the computation of diluted EPS because to do so would be anti-dilutive.

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

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

	Three Months Ended		Nine Months Ended	
	October 3, 2010	September 27, 2009	October 3, 2010	September 27, 2009
<b>Net Sales</b>				
North America	\$ 191.8	\$ 182.6	\$ 596.6	\$ 554.5
Europe	117.8	116.4	346.4	333.7
China	5.0	4.8	14.9	14.5
Consolidated net sales	\$ 314.6	\$ 303.8	\$ 957.9	\$ 902.7
<b>Operating income (loss)</b>				
North America	\$ 25.6	\$ 22.3	\$ 82.2	\$ 55.9
Europe	15.0	14.9	37.2	36.8
China	(0.9)	(4.5)	(1.2)	(3.7)
Subtotal reportable segments	39.7	32.7	118.2	89.0
Corporate (*)	(8.2)	(8.4)	(27.4)	(20.7)
Consolidated operating income	31.5	24.3	90.8	68.3
Interest income	0.2	0.3	0.7	0.8
Interest expense	(6.1)	(5.5)	(16.7)	(16.8)
Other	0.5	0.5	1.3	1.0
Income from continuing operations before income taxes	\$ 26.1	\$ 19.6	\$ 76.1	\$ 53.3
<b>Capital Expenditures</b>				
North America	\$ 2.4	\$ 2.0	\$ 7.7	\$ 5.2
Europe	3.9	4.8	10.3	9.8
China	0.1		0.4	0.4
Consolidated capital expenditures	\$ 6.4	\$ 6.8	\$ 18.4	\$ 15.4
<b>Depreciation and Amortization</b>				
North America	\$ 4.4	\$ 4.4	\$ 13.2	\$ 13.1
Europe	5.6	6.5	18.3	17.4
China	0.5	0.6	1.5	2.8
Consolidated depreciation and amortization	\$ 10.5	\$ 11.5	\$ 33.0	\$ 33.3
<b>Identifiable Assets</b>				
North America			\$ 868.8	\$ 819.6
Europe			707.4	692.5

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China		<b>84.1</b>		91.2
Discontinued operations		<b>10.4</b>		27.3
Consolidated identifiable assets		<b>\$ 1,670.7</b>		\$ 1,630.6
<b>Long-Lived Assets</b>				
North America		<b>\$ 79.4</b>		\$ 88.1
Europe		<b>106.3</b>		109.9
China		<b>15.6</b>		24.5
Consolidated long-lived assets		<b>\$ 201.3</b>		\$ 222.5

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

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

The North American segment includes U.S. net sales of \$172.7 million and \$165.2 million for the third quarters of 2010 and 2009, respectively. The North American segment includes U.S. net sales of \$541.3 million and \$507.5 million for the first nine months of



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2010 and 2009, respectively. The North American segment also includes U.S. long-lived assets of \$74.4 million and \$81.4 million at October 3, 2010 and September 27, 2009, respectively.

The North American and China segment include \$4.8 million and \$6.1million, respectively, in assets held for sale at October 3, 2010.

Intersegment sales for the third quarter of 2010 for North America, Europe and China were \$1.0 million, \$2.3 million and \$25.8 million, respectively. Intersegment sales for the third quarter of 2009 for North America, Europe and China were \$0.9 million, \$1.4 million and \$28.2 million, respectively.

Intersegment sales for the first nine months of 2010 for North America, Europe and China were \$2.9 million, \$6.2 million and \$85.5 million, respectively. Intersegment sales for the first nine months of 2009 for North America, Europe and China were \$2.9 million, \$4.7 million and \$83.6 million, respectively.

**8. Accumulated Other Comprehensive Income (Loss)**

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

	Foreign Currency Translation	Pension Adjustment (in millions)	Accumulated Other Comprehensive Income (Loss)
<b>Balance December 31, 2009</b>	\$ 51.6	\$ (21.5)	\$ 30.1
<b>Change in period</b>	(23.8)	0.6	(23.2)
<b>Balance April 4, 2010</b>	\$ 27.8	\$ (20.9)	\$ 6.9
<b>Change in period</b>	(41.6)	0.7	(40.9)
<b>Balance July 4, 2010</b>	\$ (13.8)	\$ (20.2)	\$ (34.0)
<b>Change in period</b>	45.9	0.7	46.6
<b>Balance October 3, 2010</b>	\$ 32.1	\$ (19.5)	\$ 12.6
Balance December 31, 2008	\$ 25.4	\$ (25.2)	\$ 0.2
Change in period	(13.2)	0.8	(12.4)
Balance March 29, 2009	\$ 12.2	\$ (24.4)	\$ (12.2)
Change in period	24.7	0.8	25.5
Balance June 28, 2009	\$ 36.9	\$ (23.6)	\$ 13.3
Change in period	24.7	0.8	25.5
Balance September 27, 2009	\$ 61.6	\$ (22.8)	\$ 38.8

Accumulated other comprehensive income (loss) in the consolidated balance sheets as of October 3, 2010 and September 27, 2009 consist primarily of cumulative translation adjustments and pension related prior service costs and net actuarial loss. The Company's total comprehensive income was as follows:

**Third Quarter Ended**  
**October 3, 2010**                      **September 27, 2009**  
(in millions)

Net income	\$	17.3	\$	3.4
Foreign currency translation and pension adjustments		46.6		25.5
Total comprehensive income	\$	63.9	\$	28.9

**Nine Months Ended**  
**October 3, 2010**                      **September 27, 2009**  
(in millions)

Net income	\$	47.5	\$	3.2
Foreign currency translation and pension adjustments		(17.5)		38.6
Total comprehensive income	\$	30.0	\$	41.8

**9. Debt**

On June 18, 2010, the Company entered into a note purchase agreement with certain institutional investors (the 2010 Note Purchase Agreement). Pursuant to the 2010 Note Purchase Agreement, the Company issued senior notes of \$75.0 million in principal at 5.05%, due June 18, 2020 (the Notes). The Company will pay interest on the outstanding balance of the Notes at the rate of 5.05% per annum, payable semi-annually on June 18 and December 18 until the principal on the Notes shall become due and payable. The Company may, at its option, upon notice, and subject to the terms of the 2010 Note Purchase Agreement, prepay at any time all or part

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of the Notes in an amount not less than \$1 million by paying the principal amount plus a make-whole amount (as defined in the 2010 Note Purchase Agreement).

The 2010 Note Purchase Agreement includes operational and financial covenants, with which the Company is required to comply, including, among others, maintenance of certain financial ratios and restrictions on additional indebtedness, liens and dispositions. Events of defaults under the 2010 Note Purchase Agreement include failure to comply with the financial and operational covenants, as well as bankruptcy and other insolvency events. If an event of default occurs and is continuing, then a majority of the note holders have the right to accelerate and require the Company to repay all the outstanding notes under the 2010 Note Purchase Agreement. In limited circumstances, such acceleration is automatic. The Company will use the proceeds from the private placement for general corporate purposes. As of October 3, 2010, the Company was in compliance with all covenants related to the 2010 Note Purchase Agreement.

On June 18, 2010, the Company entered into a credit agreement (the Credit Agreement) among the Company, certain subsidiaries of the Company who become borrowers under the Credit Agreement, Bank of America, N.A., as Administrative Agent, swing line lender and letter of credit issuer, and the other lenders referred to therein. The Credit Agreement provides for a \$300 million, five-year, senior unsecured revolving credit facility which may be increased by an additional \$150 million under certain circumstances and subject to the terms of the Credit Agreement. The Credit Agreement has a sublimit of up to \$75 million in letters of credit.

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

The Credit Agreement matures on June 18, 2015. 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.

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

As of October 3, 2010, the Company was in compliance with all covenants related to the Credit Agreement and had \$265.3 million of unused and available credit under the Credit Agreement and \$34.7 million of stand-by letters of credit outstanding on the Credit Agreement. There were no borrowings under the Credit Agreement at October 3, 2010.

On May 17, 2010, the Company repaid its \$50.0 million principal obligations under the 4.87% senior notes upon their maturity.

The Company is a party to several note agreements as further detailed in Note 11 of Notes to Consolidated Financial Statements of the Annual Report on Form 10-K for the year ended December 31, 2009. These note agreements require the Company to maintain a fixed charge coverage ratio of consolidated EBITDA plus consolidated rent expense during the period to consolidated fixed charges. Consolidated fixed charges are the sum of consolidated interest expense for the period and consolidated rent expense. As of October 3, 2010, the Company was in compliance with all covenants regarding these note agreements.

#### **10. Contingencies and Environmental Remediation**

As disclosed in Part I, Item 1, "Product Liability, Environmental and Other Litigation Matters" of the Company's Annual Report on Form 10-K for the year ended December 31, 2009, and Part II, Item 1, "Legal Proceedings" of the Company's Quarterly Report on Form 10-Q for the quarter ended April 4, 2010, the Company is a party to certain litigation, has conducted an investigation regarding information that employees of CWV made payments to employees of state-owned agencies and whether such payments may violate the Foreign Corrupt Practices Act (FCPA), and the Company is engaged in certain environmental remediation. There have been no material developments with respect to its contingencies and environmental remediation proceedings during the first nine months ended October 3, 2010 except as discussed in the Company's Form 10-Q for the quarter ended April 4, 2010 regarding the FCPA investigation.

#### **11. Employee Benefit Plans**

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

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The components of net periodic benefit cost are as follows:

	Third Quarter Ended	
	October 3, 2010	September 27, 2009
	(in millions)	
Service cost benefits earned	\$ 1.1	\$ 1.1
Interest costs on benefits obligation	1.4	1.3
Expected return on assets	(1.5)	(1.0)
Prior service costs and net actuarial loss amortization	0.7	0.8
Net periodic benefit cost	\$ 1.7	\$ 2.2

	Nine Months Ended	
	October 3, 2010	September 27, 2009
	(in millions)	
Service cost benefits earned	\$ 3.3	\$ 3.3
Interest costs on benefits obligation	4.2	3.9
Expected return on assets	(4.5)	(3.0)
Prior service costs and net actuarial loss amortization	2.0	2.4
Net periodic benefit cost	\$ 5.0	\$ 6.6

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

	Nine Months Ended	
	October 3, 2010	September 27, 2009
	(in millions)	
Employer contributions	\$ 7.7	\$ 4.8

The Company expects to contribute approximately \$2.6 million for the remainder of 2010.

## 12. Acquisitions

On April 13, 2010, a wholly owned subsidiary of the Company acquired 100% of the outstanding stock of BRAE located in Oakboro, North Carolina for up to \$5.3 million, net of cash acquired. Of the total purchase price, \$0.5 million was paid at closing and the remaining \$4.8 million is contingent upon BRAE achieving a certain performance metric during the year ending December 31, 2014, and, to the extent achieved, is expected to be paid in cash in 2015. The Company recognized a liability of \$1.9 million as an estimate of the acquisition date fair value of the contingent consideration, which is based on the net present value of \$3.7 million and the weighted probability of achievement of the performance metric as of the date of the acquisition. Failure to meet the performance metric would reduce this liability to \$0, while complete achievement would increase this liability to the full remaining purchase price of \$4.8 million. Any change in the fair value of the acquisition-related contingent consideration subsequent to the acquisition date is recognized in earnings in the period the estimated fair value changes. The preliminary excess fair value of the consideration transferred over the fair value of the net assets acquired of \$2.7 million was

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allocated to goodwill. None of the goodwill is expected to be tax deductible. BRAE is a provider of engineered rain water harvesting solutions and addresses the commercial, industrial and residential markets. BRAE had annual sales prior to the acquisition of approximately \$2.0 million.

On June 28, 2010, a wholly owned subsidiary of the Company acquired 100% of the outstanding stock of Austroflex Rohr-Isoliersysteme GmbH (Austroflex) for approximately \$33.7 million. Austroflex is an Austrian-based manufacturer of pre-insulated flexible pipe systems for district heating, solar applications and under-floor radiant heating systems. The acquisition of Austroflex provides the Company with a full range of pre-insulated PEX tubing, pre-insulated solar tubes and under-floor heating insulation, distribution capability and positions the Company as a major supplier of pre-insulated pipe systems in Europe. The Company completed a preliminary purchase price allocation that resulted in the recognition of \$13.9 million of intangible assets and \$14.7 million of goodwill. Intangible assets were based on preliminary fair value estimates and are comprised primarily of customer relationships with estimated useful lives of 8 years and trade names with indefinite lives. Goodwill is expected to be tax deductible up to a certain limit established under Austrian tax rules. Austroflex had annual sales prior to the acquisition of approximately \$23.0 million.

The results of operations for BRAE are included in the Company's North America segment and the results of operations of Austroflex are included in the Company's Europe segment since their respective acquisition dates and were not material to the Company's consolidated financial statements. Pro forma information has not been provided, as it is not material.

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

**Overview**

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

We operate on a 52-week fiscal year ending on December 31. Any nine months ended data contained in this quarterly report on Form 10-Q reflect the results of operations for the applicable 39-week period ended and any third quarter ended data reflect the results of operations for the applicable 13-week period ended. There were four additional working days in the nine months ended October 3, 2010 than there were in the nine months ended September 27, 2009.

We are a leading supplier of products for use in the water quality, water safety, water flow control and water conservation markets in both North America and Europe with a presence in Asia. For over 135 years, we have designed and manufactured products that promote the comfort and safety of people and the quality and conservation of water used in commercial and residential applications. We earn revenue and income almost exclusively from the sale of our products. Our principal product lines include:

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

- systems for under-floor radiant applications and hydraulic pump groups for gas boiler manufacturers and renewable energy applications, including solar and heat pump control packages; and
- flexible stainless steel connectors for natural and liquid propane gas in commercial food service and residential applications.

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

During the third quarter and first nine months of 2010, organic sales increased by 4.9% and 6.0%, respectively, over last year's comparable periods, partially due to the additional working days in the first nine months of 2010 mentioned previously and partially due to increased sales volume. Organic sales in the third quarter of 2010 increased in all three segments over the third quarter of 2009; North America by \$7.6 million, or 4.1%, Europe by \$6.9 million, or 5.9%, and China by \$0.2 million, or 4.2%. We define organic sales growth as the increase or decrease in sales for the current period compared to the prior period, excluding the impact of the change in foreign currency exchange, and excluding sales in the: (1) current period from business and product line acquisitions that are included in our actual results of operations for less than twelve months, and (2) prior period from business and product line divestitures that are included in our actual results of operations for the twelve-month period prior to the divestiture. Key drivers of the increase in sales are from our principal product lines, particularly plumbing and heating products and backflow preventers in North America, drain products in Europe, and to new product introductions. Despite these increases, we are experiencing a softening in our North American business partially due to destocking at our major retail customers due to the expiration of the first-time homebuyer tax credit. We are continuing to drive greater plant absorption in many of our facilities and, along with productivity initiatives through Lean and Six Sigma programs, continuing to improve incremental gross margin and operating margin performance. The effects of foreign currency movements and the U.S. commercial marketplace partially offset these increases in organic sales. Foreign currency movements, mainly related to the weakening of the euro against the U.S. dollar, negatively affected both our third quarter and first nine months diluted earnings by (\$0.03) as compared to the comparable periods of 2009. The U.S. commercial marketplace continues to be weak, and we do not expect improvement in this end market during the balance of 2010 and well into 2011.

We believe that the factors relating to our future growth include the demand for clean water around the world, regulatory requirements relating to the quality and conservation of water, continued enforcement of plumbing and building codes, our ability to grow organically in select attractive market segments, the successful completion of selective acquisitions, both in our core markets as well



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as in new complementary markets, and a healthy economic environment. We have completed 34 acquisitions since divesting our industrial and oil and gas business in 1999. Our acquisition strategy focuses on businesses that manufacture preferred brand name products that address our themes of water quality, water conservation, water safety and water flow control and related complementary markets. We target businesses that will provide us with one or more of the following: an entry into new markets, an increase in shelf space with existing customers, a new or improved technology or an expansion of the breadth of our water quality, water conservation, water safety and water flow control products for the residential and commercial construction markets.

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

We require substantial amounts of raw materials to produce our products, including bronze, brass, cast iron, steel and plastic, and substantially all of the raw materials we require are purchased from outside sources. The commodity markets, particularly copper, have experienced significant volatility over the past several years. Bronze and brass are copper-based alloys. The spot price of copper at October 3, 2010 was approximately 10.5% higher than the spot price at December 31, 2009 and approximately 24.4% higher than the spot price at July 7, 2010. We typically carry several months of inventory on-hand primarily due to the significant extent of our international sourcing.

Historically, we have faced a risk relating to our ability to deal effectively with increases in raw material costs. We manage this risk by monitoring related market prices, working with our suppliers to achieve the maximum level of stability in their costs and related pricing, seeking alternative supply sources when necessary, purchasing forward commitments for raw materials, when available, implementing cost reduction programs and passing increases in costs to our customers.

Another risk we face in all areas of our business is competition. We consider brand preference, engineering specifications, code requirements, price, technological expertise, delivery times and breadth of product offerings to be the primary competitive factors. As mentioned previously, we believe that the product development, product testing capability and investment in plant and equipment needed to manufacture products in compliance with code requirements represent a barrier to entry for competitors. We are committed to maintaining our capital equipment at a level consistent with current technologies, and thus we expect to spend approximately \$4.0 to \$7.0 million during the remainder of 2010.

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

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

In September 2010, our Board of Directors approved a restructuring program with respect to certain operating facilities in the United States. The restructuring program includes the shutdown of two manufacturing facilities in North Carolina. Operations at these facilities will be consolidated into our manufacturing facilities in New Hampshire, Missouri and other locations. The program is expected to include pre-tax charges totaling approximately \$4.9 million, including costs for severance, shutdown costs and equipment write-downs. Additionally, we are expecting training and pre-production set-up costs of approximately \$2.0 million. The total net after-tax charge for this restructuring program is expected to be approximately \$4.1 million (including \$0.4 million in non-cash charges), with costs being incurred through 2011. We expect to spend approximately \$1.2 million in capital expenditures to consolidate operations. Annual cash savings, net of tax, are estimated to be approximately \$1.6 million, which we expect to fully realize by the second half of 2012. The restructuring program is expected to be completed by the end of the third quarter of 2011.

### **Acquisitions**

During the nine months ended October 3, 2010, we made two acquisitions with an estimated aggregate purchase price of \$36.1 million, including the estimated fair value of contingent consideration. We also made a payment of approximately \$0.5 million on an earn-out of a previously acquired company.

On April 13, 2010, we acquired 100% of the outstanding stock of Blue Ridge Atlantic Enterprises, Inc. (BRAE) located in Oakboro, North Carolina. BRAE is a provider of engineered rain water harvesting solutions and addresses the commercial, industrial and residential markets. BRAE had annual sales prior to the acquisition of approximately \$2.0 million.

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On June 28, 2010, we acquired all of the outstanding stock of Austroflex Rohr-Isoliertechnik GmbH (Austroflex). Austroflex is an Austrian-based manufacturer of pre-insulated flexible pipe systems for district heating, solar applications and under-floor radiant heating systems. The acquisition of Austroflex provides us with a full range of pre-insulated PEX tubing, pre-insulated solar tubes and under-floor heating insulation, distribution capability and positions us as a major supplier of pre-insulated pipe systems in Europe. Austroflex had annual sales prior to the acquisition of approximately \$23.0 million.

The results of operations for BRAE are included in our North America segment and the results of operations of Austroflex are included in our Europe segment since their respective acquisition dates and were not material to our consolidated financial statements.

**Results of Operations**

**Third Quarter Ended October 3, 2010 Compared to Third Quarter Ended September 27, 2009**

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

	Third Quarter Ended October 3, 2010		Third Quarter Ended September 27, 2009		Change	% Change to Consolidated Net Sales
	Net Sales	% Sales	Net Sales	% Sales		
	(dollars in millions)					
North America	\$ 191.8	61.0%	\$ 182.6	60.1%	\$ 9.2	3.0%
Europe	117.8	37.4	116.4	38.3	1.4	0.5
China	5.0	1.6	4.8	1.6	0.2	0.1
Total	\$ 314.6	100%	\$ 303.8	100%	\$ 10.8	3.6%

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

	Change As a % of Consolidated Net Sales				Change As a % of Segment Net Sales		
	North America	Europe	China	Total	North America	Europe	China
	(dollars in millions)						
Organic	\$ 7.6	\$ 6.9	\$ 0.2	\$ 14.7	2.5%	2.3%	0.1%
Foreign exchange	1.1	(11.4)		(10.3)	0.3	(3.7)	
Acquired	0.5	5.9		6.4	0.2	1.9	
Total	\$ 9.2	\$ 1.4	\$ 0.2	\$ 10.8	3.0%	0.5%	0.1%

Organic net sales in the North American wholesale market in the third quarter of 2010 increased by 7.1% compared to the third quarter of 2009. This increase was primarily due to increased unit sales of our plumbing and heating and backflow product lines. Organic sales into the North American DIY market in the third quarter of 2010 decreased 5.4% compared to the third quarter of 2009, primarily from decreased product sales volume associated with customer destocking.

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Organic net sales in the European wholesale market increased by 2.3% compared to the third quarter of 2009. This increase was primarily due to strong sales in our drain product lines partially offset by a weak Italian wholesale market. Organic sales into the European OEM market in the third quarter of 2010 increased 12.9% compared to the third quarter of 2009, primarily from increased sales in the German OEM market. Organic sales into the European DIY market in the third quarter of 2010 decreased 4.3% compared to the third quarter of 2009, due primarily to lower customer restocking after the summer holidays.

The decreases in net sales due to foreign exchange are primarily due to the depreciation of the euro, partially offset by the appreciation of the Canadian dollar against the U.S. dollar. We cannot predict whether these currencies will continue to appreciate or depreciate against the U.S. dollar in future periods or whether future foreign exchange rate fluctuations will have a positive or negative impact on our net sales.

Acquired net sales growth in Europe and North America was due to the inclusion of Austroflex and BRAE, respectively.

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

	Third Quarter Ended	
	October 3, 2010	September 27, 2009
	(dollars in millions)	
Gross profit	\$ 113.8	\$ 109.4
Gross margin	36.2%	36.0%

Gross margin increased 0.2 percentage points in the third quarter of 2010 compared to the third quarter of 2009. Europe's improved gross margin was due to a better product mix, with the discontinuance of various low-margin products, increased sales volumes and better absorption at the factories partially offset by inefficiencies from our restructuring program in France. North America's gross margin improved marginally primarily attributable to increased sales volumes, better absorption at the factories and productivity gains from our Lean and Six Sigma cost savings initiatives, partially offset by increased raw materials costs and inefficiencies due to manufacturing relocation.

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*Selling, General and Administrative Expenses.* Selling, General and Administrative, or SG&A, expenses for the third quarter of 2010 increased \$0.5 million, or 0.6%, compared to the third quarter of 2009. The increase in SG&A expenses was attributable to the following:

	(in millions)	% Change
Organic	\$ 1.3	1.6%
Foreign exchange	(2.4)	(3.0)
Acquired	1.6	2.0
Total	\$ 0.5	0.6%

The organic increase in SG&A expenses was primarily due to increased personnel-related costs and increased variable selling expenses due to higher sales volumes offset by lower product liability costs and lower legal costs. The decrease in SG&A expenses from foreign exchange was primarily due to the depreciation of the euro against the U.S. dollar. The increase in SG&A from acquisitions is primarily from Austroflex. Total SG&A expenses, as a percentage of sales, were 25.2% in the third quarter of 2010 compared to 25.9% in the third quarter of 2009.

*Restructuring and Other Charges.* In the third quarter of 2010, we recorded a charge of \$3.0 million primarily for severance and other costs incurred as part of our 2010 restructuring programs, as compared to \$6.3 million for the third quarter of 2009. For a more detailed description of our current restructuring plans, see Note 5 of Notes to Consolidated Financial Statements.

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

	Third Quarter Ended			Change	% Change to Consolidated Operating Income
	October 3, 2010	September 27, 2009	(dollars in millions)		
North America	\$ 25.6	\$ 22.3	\$ 3.3	13.6%	
Europe	15.0	14.9	0.1	0.4	
China	(0.9)	(4.5)	3.6	14.8	
Corporate	(8.2)	(8.4)	0.2	0.8	
Total	\$ 31.5	\$ 24.3	\$ 7.2	29.6%	

The increase (decrease) in operating income (loss) is attributable to the following:

	Change As a % of Consolidated Operating Income					Change As a % of Segment Operating Income				
	North America	Europe	China	Corp.	Total	North America	Europe	China	Corp.	
	(dollars in millions)									
Organic	\$ 4.6	\$ 2.5	\$ (1.6)	\$ 0.2	\$ 5.7	18.9%	10.4%	(6.6)%	0.8%	23.5%
Foreign exchange	0.2	(1.4)		(1.2)	0.8	(5.8)		(5.0)	0.9	(9.4)
Acquired	(0.2)	(0.4)		(0.6)	(0.8)	(1.7)		(2.5)	(0.9)	(2.7)

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Restructuring/other	(1.3)	(0.6)	5.2	3.3	(5.3)	(2.5)	21.4	13.6	(5.8)	(4.0)	115.6			
Total	3.3	\$ 0.1	\$ 3.6	\$ 0.2	\$ 7.2	13.6%	0.4%	14.8%	0.8%	29.6%	14.8%	0.7%	80.0%	2.4%

The increase in consolidated organic operating income was due primarily to increased unit volume sales and stronger gross margins in North America and Europe, partially offset by decreased gross margins in China. The North America organic operating income increase was primarily due to decreased SG&A expenses. Europe's organic operating income increase was primarily due to increased gross margins. Acquired operating losses primarily result from acquisition accounting.

*Interest Expense.* Interest expense increased \$0.6 million, or 10.9%, for the third quarter of 2010 as compared to the third quarter of 2009, primarily due the expense related to the senior notes of \$75.0 million in principal amount at 5.05%, issued on June 18, 2010.

*Income Taxes.* Our effective rate for continuing operations decreased to 33.7% in the third quarter of 2010, from 40.8% for the third quarter of 2009. In the third quarter of 2009, we had a significant write-down of assets at one of our Chinese facilities on which we derived no tax benefit. This did not recur in the third quarter of 2010. This is partially offset by higher European taxes due to mix of income.

*Net Income From Continuing Operations.* Net income from continuing operations for the third quarter of 2010 was \$17.3 million, or \$0.46 per common share, compared to \$11.6 million, or \$0.31 per common share, for the third quarter of 2009. Results for the third quarter of 2010 include an after-tax charge of \$2.3 million, or \$0.06 per common share, for restructuring and other charges related primarily to severance and other costs compared to an after-tax restructuring and other charge of \$5.8 million, or \$0.16 per common share, for the third quarter of 2009. The depreciation of the euro against the U.S. dollar resulted in a negative impact on our operations of \$0.03 per common share for the third quarter of 2010 compared to the comparable period in 2009. We cannot predict whether the euro, Canadian dollar or Chinese yuan will appreciate or depreciate against the U.S. dollar in future periods or whether future foreign exchange rate fluctuations will have a positive or negative impact on our net income.



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months of 2009, primarily from initial new store sales to a major retail customer.

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

Acquired net sales growth in Europe and North America was due to the inclusion of Austroflex and BRAE, respectively.

*Gross Profit.* Gross profit and gross margin for the first nine months of 2010 and 2009 were as follows:

	Nine Months Ended	
	October 3, 2010	September 27, 2009
	(dollars in millions)	
Gross profit	\$ 352.0	\$ 315.6
Gross margin	36.7%	35.0%

Gross margin increased 1.7 percentage points in the first nine months of 2010 compared to the first nine months of 2009. Gross profit included a charge of \$1.3 million in 2010 for accelerated depreciation related to production facilities in France that are part of our restructuring program. North America's improved gross margin was primarily attributable to increased sales volumes, better absorption at the factories and productivity gains from our Lean and Six Sigma cost savings initiatives, partially offset by increased raw materials costs. Europe's improved gross margin was primarily attributable to increased sales volumes, better absorption at the factories and better product mix, partially offset by new customer credits and inefficiencies from the restructuring program.



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*Selling, General and Administrative Expenses.* SG&A expenses for the first nine months of 2010 increased \$13.7 million, or 5.7%, compared to the first nine months of 2009. The increase in SG&A expenses was attributable to the following:

	(in millions)		% Change
Organic	\$ 13.3		5.6%
Foreign exchange	(1.4)		(0.6)
Acquired	1.8		0.7
Total	\$ 13.7		5.7%

The organic increase in SG&A expenses was primarily due to increased personnel-related costs, legal costs and increased variable selling expenses due to higher sales volumes. The decrease in SG&A expenses from foreign exchange was primarily due to the depreciation of the euro dollar against the U.S. dollar. Total SG&A expenses, as a percentage of sales, were 26.3% in the first nine months of 2010 compared to 26.4% in the first nine months of 2009.

*Restructuring and Other Charges.* In the first nine months of 2010, we recorded a charge of \$8.8 million primarily for severance and other costs incurred as part of our previously announced restructuring programs, as compared to \$8.6 million for the first nine months of 2009. For a more detailed description of our current restructuring plans, see Note 5 of Notes to Consolidated Financial Statements.

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

	Nine Months Ended				% Change to Consolidated Operating Income
	October 3, 2010	September 27, 2009	Change		
	(dollars in millions)				
North America	\$ 82.2	\$ 55.9	\$ 26.3	38.5%	
Europe	37.2	36.8	0.4	0.6	
China	(1.2)	(3.7)	2.5	3.6	
Corporate	(27.4)	(20.7)	(6.7)	(9.8)	
Total	\$ 90.8	\$ 68.3	\$ 22.5	32.9%	

The increase (decrease) in operating income (loss) is attributable to the following:

	Change As a % of Consolidated Operating Income					Change As a % of Segment Operating Income				
	North America	Europe	China	Corp.	Total	North America	Europe	China	Corp.	
	(dollars in millions)									
Organic	\$ 26.7	\$ 8.0	\$ (2.6)	\$ (6.7)	\$ 25.4	39.1%	11.7%	(3.9)%	(9.8)%	37.1%
Foreign exchange	1.3	(2.0)		(0.7)	1.9	(2.9)			(1.0)	2.3
Acquired	(0.3)	(0.4)		(0.7)	(0.4)	(0.6)			(1.0)	(0.5)
										(1.1)

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Restructuring/other	(1.4)	(5.2)	5.1	(1.5)	(2.1)	(7.6)	7.5		(2.2)	(2.5)	(14.1)	137.8		
Total	\$ 26.3	\$ 0.4	\$ 2.5	\$ (6.7)	\$ 22.5	38.5%	0.6%	3.6%	(9.8)%	32.9%	47.0%	1.1%	67.6%	(32.4)%

The increase in consolidated organic operating income was due primarily to increased unit volume sales and stronger gross margins, partially offset by increased SG&A expenses. The North America margin increase was primarily due to increased sales volumes, better factory absorption levels and the impact of cost savings initiatives. Corporate costs increased due to higher legal costs primarily as a result of a favorable legal settlement in 2009.

*Income Taxes.* Our effective rate for continuing operations decreased to 32.1% from 42.0% for the nine months ended October 3, 2010 and September 27, 2009, respectively. The decrease was due to reversal of a valuation allowance in Europe recorded during the second quarter of 2010. Also, in 2009 we had a significant write-down of assets at one of our Chinese facilities on which we derived no tax benefit. Additionally, we recorded the reversal of previously recognized tax benefits in China in the first quarter of 2009. These China items did not recur in 2010. This is partially offset by higher European taxes due to mix of income.

*Net Income From Continuing Operations.* Net income from continuing operations for the first nine months of 2010 was \$51.7 million, or \$1.38 per common share, compared to \$30.9 million, or \$0.83 per common share, for the first nine months of 2009. Results for the first nine months of 2010 include an after-tax charge of \$8.5 million, or \$0.23 per common share, for restructuring and other charges related primarily to severance and accelerated depreciation compared to an after-tax restructuring and other charge of \$11.3 million, or \$0.31 per common share, for the first nine months of 2009. The release of the valuation allowance on net operating losses in Europe as noted above contributed a tax benefit of \$0.08 per common share to the first nine months of 2010. The depreciation of the euro, partially offset by the appreciation of Canadian dollar against the U.S. dollar, resulted in a negative impact on our operations of \$0.03 per common share for the first nine months of 2010 compared to the comparable period in 2009. We cannot predict whether the euro, Canadian dollar or Chinese yuan will appreciate or depreciate against the U.S. dollar in future periods or whether future foreign exchange rate fluctuations will have a positive or negative impact on our net income.

*Loss From Discontinued Operations.* The loss from discontinued operations in the first nine months of 2010 was primarily attributable to legal costs related to the FCPA investigation. The loss from discontinued operations in the first nine months of 2009

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was primarily attributable to the deconsolidation of TEAM and the write-down of net assets of CWV. These matters are more fully described in Note 3 of Notes to Consolidated Financial Statements.

**Liquidity and Capital Resources**

We generated \$75.3 million of cash from operating activities in the first nine months of 2010 as compared to \$146.2 million of cash in the first nine months of 2009. Higher income from continuing operations in 2010 was offset by increased accounts receivable in all three segments. This increase in accounts receivable was primarily due to an increase in and the timing of revenues. Additionally, our Europe segment increased its inventory due to our restructuring program in France and increased safety stock prior to a plant being moved. Commodity cost increases since last year have also caused our inventory dollars to increase as well.

We used \$50.8 million of net cash from investing activities for the first nine months of 2010 primarily for purchases of Austroflex and capital equipment. For the remainder of fiscal year 2010, we expect to invest approximately \$4.0 to \$7.0 million for manufacturing machinery and equipment as part of our ongoing commitment to improve our manufacturing capabilities. The Company elected to participate in a settlement offer from UBS, AG (UBS) for all of its outstanding auction rate securities (ARS) investments. Under the terms of the settlement offer, the Company was issued rights by UBS entitling the holder to require UBS to purchase the underlying ARS at par value during the period from June 30, 2010, through July 2, 2012. We elected to exercise this right and received \$6.5 million from UBS in settlement of all outstanding ARS investments. In addition, during the nine months ended October 3, 2010, we invested in nine-month certificates of deposits totaling approximately \$4.0 million.

We generated \$10.4 million of net cash from financing activities for the first nine months of 2010, primarily from issuing \$75.0 million, 10-year private placement notes in June, partially offset by the repayment of our \$50.0 million private placement notes and \$12.3 million of dividend payments.

On June 18, 2010, we entered into a note purchase agreement with certain institutional investors (the 2010 Note Purchase Agreement). Pursuant to the 2010 Note Purchase Agreement, we issued senior notes of \$75.0 million in principal amount at 5.05%, due June 18, 2020 (the Notes), for aggregate gross proceeds of \$75.0 million in a private placement solely to institutional investors. We will pay interest on the outstanding balance of the Notes at the rate of 5.05% per annum, payable semi-annually on June 18 and December 18 until the principal on the Notes shall become due and payable. We may, at our option, upon notice, subject to the terms of the 2010 Note Purchase Agreement, prepay at any time all or part of the Notes in an amount not less than \$1 million by paying the principal amount plus a make-whole amount (as defined in the 2010 Note Purchase Agreement).

The 2010 Note Purchase Agreement includes operational and financial covenants, with which we are required to comply, including, among others, maintenance of certain financial ratios and restrictions on additional indebtedness, liens and dispositions. Events of defaults under the 2010 Note Purchase Agreement include failure to comply with the financial and operational covenants, as well as bankruptcy and other insolvency events. If an event of default occurs and is continuing, then a majority of the note holders have the right to accelerate and require us to repay all the outstanding notes under the 2010 Note Purchase Agreement. In limited circumstances, such acceleration is automatic. We will use the proceeds from the private placement for general corporate purposes. As of October 3, 2010 we were in compliance with all covenants related to the 2010 Note Purchase Agreement.

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On June 18, 2010, we entered into a credit agreement (the Credit Agreement) among the Company, certain subsidiaries of the Company who become borrowers under the Credit Agreement, Bank of America, N.A., as Administrative Agent, swing line lender and letter of credit issuer, and the other lenders referred to therein. The Credit Agreement provides for a \$300 million, five-year, senior unsecured revolving credit facility which may be increased by an additional \$150 million under certain circumstances and subject to the terms of the Credit Agreement. The Credit Agreement has a sublimit of up to \$75 million in letters of credit.

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

The Credit Agreement matures on June 18, 2015. We 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.

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

As of October 3, 2010, we were in compliance with all covenants related to the Credit Agreement and had \$265.3 million of unused and available credit under the Credit Agreement and \$34.7 million of stand-by letters of credit outstanding on the Credit Agreement. There were no borrowings under the Credit Agreement at October 3, 2010.

We maintain letters of credit that guarantee our performance or payment to third parties in accordance with specified terms and conditions. Amounts outstanding were approximately \$35.0 million as of October 3, 2010 and \$37.0 million as of December 31, 2009. Our letters of credit are primarily associated with insurance coverage and to a lesser extent foreign purchases and generally expire

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within one year of issuance. These instruments may exist or expire without being drawn down, therefore they do not necessarily represent future cash flow obligations.

We used \$2.4 million of net cash from operating activities of discontinued operations in the first nine months of 2010 primarily due to payments to outside counsel in connection with the FCPA investigation.

We generated \$5.1 million of net cash from investing activities of discontinued operations in the first nine months of 2010 primarily from cash received from the sale of CWV.

Working capital (defined as current assets less current liabilities) as of October 3, 2010 was \$574.7 million compared to \$489.8 million as of December 31, 2009. This increase was primarily due to the net cash received from the issuance and repayment of debt and increases in inventory and accounts receivable. Cash and cash equivalents increased to \$292.3 million as of October 3, 2010 compared to \$258.2 million as of December 31, 2009 primarily due to the net cash received from the issuance and repayment of debt and from cash generated from higher earnings, partially offset by increased working capital and the acquisition of Austroflex. The ratio of current assets to current liabilities was 3.0 to 1 as of October 3, 2010 compared to 2.6 to 1 as of December 31, 2009.

We believe free cash flow to be an appropriate supplemental measure of our operating performance because it provides investors with a measure of our ability to generate cash, to repay debt and to fund acquisitions. In addition, free cash flow is used as a criterion to measure and pay certain incentive compensation. We may not be comparable to other companies that may define free cash flow differently. Free cash flow does not represent cash generated from operating activities in accordance with generally accepted accounting principles (GAAP). Therefore it should not be considered an alternative to net cash provided by operations as an indication of our performance. Free cash flow should also not be considered an alternative to net cash provided by operations as defined by GAAP.

A reconciliation of net cash provided by continuing operating activities to free cash flow is provided below:

	Nine Months Ended	
	October 3, 2010	September 27, 2009
	(in millions)	
Net cash provided by continuing operating activities	\$ 75.3	\$ 146.2
Less: additions to property, plant, and equipment	(18.4)	(15.4)
Plus: proceeds from the sale of property, plant, and equipment	1.2	0.4
Free cash inflow	\$ 58.1	\$ 131.2

Free cash inflow is lower in the first nine months of 2010 compared to the first nine months of 2009 primarily due to higher working capital requirements to support our sales growth along with increased safety stock supporting our restructuring efforts in Europe.

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

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

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

The preparation of our consolidated financial statements in accordance with GAAP requires management to make judgments, assumptions and estimates that affect the amounts reported. A critical accounting estimate is an assumption about highly uncertain matters and could have a material effect on the consolidated financial statements if another, also reasonable, amount were used, or, a change in the estimate is reasonably likely from period to period. We base our assumptions on historical experience and on other estimates that we believe are reasonable under the circumstances. Actual results could differ significantly from these estimates. There were no changes in accounting policies or significant changes in accounting estimates during the first nine months of 2010.

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

#### *Revenue recognition*

We recognize revenue when all of the following criteria are met: (1) we have entered into a binding agreement, (2) the product has shipped and title has passed, (3) the sales price to the customer is fixed or is determinable and (4) collectability is reasonably assured. We recognize revenue based upon a determination that all criteria for revenue recognition have been met, which, based on the majority of our shipping terms, is considered to have occurred upon shipment of the finished product. Some shipping terms require the goods to be received by the customer before title passes. In those instances, revenues are not recognized until the customer has

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received the goods. We record estimated reductions to revenue for customer returns and allowances, cash discounts and for customer programs. Provisions for returns and allowances and cash discounts are made at the time of sale, derived from historical trends and form a portion of the allowance for doubtful accounts. Customer rebate programs, which are primarily annual volume incentive plans, allow customers to earn credit for attaining agreed upon purchase targets from us. We record estimated reductions to revenue, made at the time of sale, for customer rebate programs based on estimated purchase targets.

*Allowance for doubtful accounts*

The allowance for doubtful accounts is established to represent our best estimate of the net realizable value of the outstanding accounts receivable. The development of our allowance for doubtful accounts varies by region but in general is based on a review of past due amounts, historical write-off experience, as well as aging trends affecting specific accounts and general operational factors affecting all accounts. In North America, management specifically analyzes individual accounts receivable and establishes specific reserves against financially troubled customers. In addition, factors are developed utilizing historical trends in bad debts, returns and allowances. The ratio of these factors to sales on a rolling twelve-month basis is applied to total outstanding receivables (net of accounts specifically identified) to establish a reserve. In Europe, management develops its bad debt allowance through an aging analysis of all their accounts. In China, management specifically analyzes individual accounts receivable and establishes specific reserves as needed along with providing reserves based on aging analysis.

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

*Inventory valuation*

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

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

*Goodwill and other intangibles*

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We have made numerous acquisitions over the years which included the recognition of a significant amount of goodwill. Goodwill is tested for impairment annually or more frequently if an event or circumstance indicates that an impairment loss may have been incurred. Application of the goodwill impairment test requires judgment, including the identification of reporting units, assignment of assets and liabilities to reporting units, and determination of the fair value of each reporting unit. We estimate the fair value of our reporting units using an income approach based on the present value of estimated future cash flows. We believe this approach yields the most appropriate evidence of fair value as our reporting units are not easily compared to other corporations involved in similar businesses.

Intangible assets such as purchased technology are generally recorded in connection with a business acquisition. Values assigned to intangible assets are determined by an independent valuation firm based on our estimates and judgments regarding expectations of the success and life cycle of products and technology acquired. With the acquisition of BRAE in April 2010, we have determined we have eight reporting units in continuing operations, one of which has no goodwill.

We review goodwill for impairment utilizing a two-step process. The first step of the impairment test requires a comparison of the fair value of each of our reporting units to the respective carrying value. If the carrying value of a reporting unit is less than its fair value, no indication of impairment exists and a second step is not performed. If the carrying amount of a reporting unit is higher than its fair value, there is an indication that an impairment may exist and a second step must be performed. In the second step, the impairment is computed by comparing the implied fair value of the reporting unit's goodwill with the carrying amount of the goodwill. If the carrying amount of the reporting unit's goodwill is greater than the implied fair value of its goodwill, an impairment loss must be recognized for the excess and charged to operations.

Inherent in our development of the present value of future cash flow projections are assumptions and estimates derived from a review of our operating results, business plans, expected growth rates, cost of capital and tax rates. We also make certain assumptions about future economic conditions and other market data. We develop our assumptions based on our historical results including sales growth, operating profits, working capital levels and tax rates.

We believe that the discounted cash flow model is sensitive to the selected discount rate. We use third-party valuation specialists to help develop appropriate discount rates for each reporting unit. We use standard valuation practices to arrive at a weighted average



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cost of capital based on the market and guideline public companies. The higher the discount rate, the lower the discounted cash flows. While we believe that our estimates of future cash flows are reasonable, different assumptions could significantly affect our valuations and result in impairments in the future.

The Orion reporting unit's operating results are being hindered by the downturn in the commercial and institutional end markets in the U.S., where Orion sells a majority of its products. Should Orion's sales decline because the commercial marketplace deteriorates more than our current expectations, then the reporting unit's goodwill may be at risk for impairment in the future. Orion's goodwill balance as of October 3, 2010 was \$24.6 million. As of October 25, 2009, our last impairment analysis date, the fair value of the Orion reporting unit exceeded the carrying value by 11%.

*Product liability and workers' compensation costs*

Because of retention requirements associated with our insurance policies, we are generally self-insured for potential product liability claims and for workers' compensation costs associated with workplace accidents. For product liability cases in the U.S., management estimates expected settlement costs by utilizing loss reports provided by our third-party administrators as well as developing internal historical trend factors based on our specific claims experience. Management utilizes the internal trend factors that reflect final expected settlement costs. In other countries, we maintain insurance coverage with relatively high deductible payments, as product liability claims tend to be smaller than those experienced in the U.S. Changes in the nature of claims or the actual settlement amounts could affect the adequacy of this estimate and require changes to the provisions. Because the liability is an estimate, the ultimate liability may be more or less than reported.

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

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

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

*Legal contingencies*

We are a defendant in numerous legal matters including those involving environmental law and product liability as discussed in more detail in Part I, Item 1, Business - Product Liability, Environmental and Other Litigation Matters, of our Annual Report on Form 10-K for the year ended

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December 31, 2009 and Part II, Item 1, Legal Proceedings of our Quarterly Report on Form 10-Q for the quarter ended April 4, 2010. As required by GAAP, we determine whether an estimated loss from a loss contingency should be accrued by assessing whether a loss is deemed probable and the loss amount can be reasonably estimated, net of any applicable insurance proceeds. Estimates of potential outcomes of these contingencies are developed in consultation with outside counsel. While this assessment is based upon all available information, litigation is inherently uncertain and the actual liability to fully resolve this litigation cannot be predicted with any assurance of accuracy. Final resolution of these matters could possibly result in significant effects on our results of operations, cash flows and financial position.

### *Pension benefits*

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

- **Weighted average discount rate** this rate is used to estimate the current value of future benefits. This rate is adjusted based on movement in long-term interest rates.
- **Expected long-term rate of return on assets** this rate is used to estimate future growth in investments and investment earnings. The expected return is based upon a combination of historical market performance and anticipated future returns for a portfolio reflecting the mix of equity, debt and other investments indicative of our plan assets.
- **Rates of increase in compensation levels** this rate is used to estimate projected annual pay increases, which are used to determine the wage base used to project employees' pension benefits at retirement.

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

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*Income taxes*

We estimate and use our expected annual effective income tax rates to accrue income taxes. Effective tax rates are determined based on budgeted earnings before taxes, including our best estimate of permanent items that will affect the effective rate for the year. Management periodically reviews these rates with outside tax advisors and changes are made if material variances from expectations are identified.

We recognize deferred taxes for the expected future consequences of events that have been reflected in the consolidated financial statements. Deferred tax assets and liabilities are determined based on differences between the book values and tax bases of particular assets and liabilities, using tax rates in effect for the years in which the differences are expected to reverse. A valuation allowance is provided to offset any net deferred tax assets if, based upon the available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized. We consider estimated future taxable income and ongoing prudent tax planning strategies in assessing the need for a valuation allowance. We account for tax benefits when the item in question meets the more-likely-than-not (greater than 50% likelihood of being sustained upon examination by the taxing authorities) threshold.

*New Accounting Standards*

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

In October 2009, the FASB issued an accounting standard update to address accounting for multiple-deliverable arrangements, specifically addressing how to separate deliverables and how to measure and allocate arrangement consideration to one or more units of accounting. This update established a hierarchy for determining the selling price of a deliverable. This standard also expands disclosures relating to an entity's multiple-deliverable revenue arrangements. This update is effective prospectively for all arrangements entered into or materially modified in fiscal years beginning after June 15, 2010. The adoption of this update will not have a material impact on our consolidated financial statements.

**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.

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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 foreign subsidiaries transact most business, including certain intercompany transactions, in foreign currencies. Such transactions are principally purchases or sales of materials and are denominated in European currencies or the U.S. or Canadian dollar. We use foreign currency forward exchange contracts to manage the risk related to intercompany purchases that occur during the course of a year and certain open foreign currency denominated commitments to sell products to third parties. For the third quarter and first nine months of 2010, unrealized income recorded in other (income) expense for the change in the fair value of such contracts was \$0.2 million and \$0.7 million, respectively, of income.

We have historically had a low exposure on the cost of our debt to changes in interest rates. Information about our new and current long-term debt, including principal amounts and related interest rates, appears in Notes 4 and 9 of this report and in Note 11 of Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2009.

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

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

There was no change in our internal control over financial reporting that occurred during the quarter ended October 3, 2010, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. In connection with these rules, we will continue to review and document our disclosure controls and procedures, including our internal control over financial reporting, and may from time to time make changes aimed at enhancing their effectiveness and to ensure that our systems evolve with our business.

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**Part II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

As disclosed in Part I, Item 1, Business Product Liability, Environmental and Other Litigation Matters of our Annual Report on Form 10-K for the year ended December 31, 2009 and Part II, Item 1, Legal Proceedings of our Quarterly Report on Form 10-Q for the quarter ended April 4, 2010, we are a party to certain litigation and we are engaged in certain environmental remediation. There have been no material developments with respect to these other contingencies and environmental remediation proceedings during the three months ended October 3, 2010.

**Item 1A. Risk Factors**

This report may include statements that are not historical facts and are considered forward-looking within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements reflect our current views about future results of operations and other forward-looking information. In some cases you can identify these statements by forward-looking words such as anticipate, believe, could, estimate, expect, intend, may, should and would or similar words. You should not rely on forward-looking statements because our actual may differ materially from those indicated by these forward-looking statements as a result of a number of important factors. These factors include, but are not limited to, the following: the current economic and financial condition, which can affect levels of housing starts and remodeling, affecting the markets where our products are sold, manufactured, or marketed; shortages in and pricing of raw materials and supplies; loss of market share through competition; introduction of competing products by other companies; pressure on prices from competitors, suppliers, and/or customers; changes in variable interest rates on our borrowings; identification and disclosure of material weaknesses in our internal control over financial reporting; failure to expand our markets through acquisitions; failure or delay in developing new products; lack of acceptance of new products; failure to manufacture products that meet required performance and safety standards; foreign exchange rate fluctuations; cyclicity of industries, such as plumbing and heating wholesalers and home improvement retailers, in which we market certain of our products; environmental compliance costs; product liability risks; the results and timing of our manufacturing restructuring plan; changes in the status of current litigation, the outcome of our investigation into potential violations of the Foreign Corrupt Practices Act; and other risks and uncertainties discussed under the heading Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2009 filed with the Securities Exchange Commission, and in other reports we file from time to time with the Securities and Exchange Commission.

**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 October 3, 2010.

**Issuer Purchases of Equity Securities**

<b>Period</b>	<b>(a) Total Number of Shares (or Units) Purchased</b>	<b>(b) Average Price Paid per Share (or Unit)</b>	<b>(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs</b>	<b>(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs</b>
July 5, 2010 - August 1, 2010				
August 2, 2010 - August 29, 2010	18,420	\$ 32.92		
August 30, 2010 - October 3, 2010				
<b>Total</b>	<b>18,420</b>	<b>\$ 32.92</b>		

**Item 6. Exhibits**

The exhibits listed in the Exhibit Index immediately preceding the exhibits are filed as part of this Quarterly Report on Form 10-Q and such Exhibit Index is incorporated herein by reference.

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SIGNATURES

Pursuant to the requirements 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: November 12, 2010

By:

/s/ Patrick S. O Keefe  
Patrick S. O Keefe  
Chief Executive Officer

Date: November 12, 2010

By:

/s/ William C. McCartney  
William C. McCartney  
Chief Financial Officer and Treasurer



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EXHIBIT INDEX

Listed and indexed below are all Exhibits filed as part of this report.

Exhibit No.	Description
3.1	Restated Certificate of Incorporation, as amended (1)
3.2	Amended and Restated By-Laws (2)
10.1	Form of Restricted Stock Award Agreement for Non-Employee Directors under the Watts Water Technologies, Inc. 2004 Stock Incentive Plan (3)
31.1	Certification of Principal Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended
31.2	Certification of Principal Financial Officer pursuant Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended
32.1	Certification of Principal Executive Officer pursuant to 18 U.S.C. 1350
32.2	Certification of Principal Financial Officer pursuant to 18 U.S.C. 1350
101.INS*	XBRL Instance Document.
101.SCH*	XBRL Taxonomy Extension Schema Document.
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document.

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\* Attached as Exhibit 101 to this report are the following formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Balance Sheets at October 3, 2010 and December 31, 2009, (ii) Consolidated Statements of Operations for the Third Quarters Ended October 3, 2010 and September 27, 2009, (iii) Consolidated Statements of Operations for the Nine Months Ended October 3, 2010 and September 27, 2009, (iv) Consolidated Statements of Cash Flows for the Nine Months Ended October 3, 2010 and September 27, 2009, and (v) Notes to Consolidated Financial Statements.

In accordance with Rule 406T of Regulation S-T, the XBRL-related information in Exhibit 101 to this Quarterly Report on Form 10-Q is deemed not filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act, is deemed not filed for purposes of section 18 of the Exchange Act, and otherwise is not subject to liability under these sections.

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- (1) Incorporated by reference to the Registrant's Quarterly Report on Form 10-Q (File No. 001-11499) for the quarter ended July 3, 2005.
- (2) Incorporated by reference to the Registrant's Current Report on Form 8-K (File No. 001-11499) dated July 12, 2010.
- (3) Incorporated by reference to the Registrant's Current Report on Form 10-Q (File No. 001-11499) for the quarter ended July 4, 2010.