

WATTS WATER TECHNOLOGIES INC

Form 10-Q

November 06, 2017

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended October 1, 2017

or

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

For the transition period from to

Commission file number 001-11499

WATTS WATER TECHNOLOGIES, INC.

(Exact Name of Registrant as Specified in Its Charter)

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Delaware
(State or Other Jurisdiction of Incorporation or Organization)

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

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

01845
(Zip Code)

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

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

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

(Do not check if a smaller reporting company)

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

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

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

Class	Outstanding at October 27 , 2017
Class A Common Stock, \$0.10 par value	27,769,085
Class B Common Stock, \$0.10 par value	6,379,290

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WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Amounts in millions, except share information)

(Unaudited)

	October 1, 2017	December 31, 2016
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 246.6	\$ 338.4
Trade accounts receivable, less allowance for doubtful accounts of \$14.3 million at October 1, 2017 and \$14.2 million at December 31, 2016	229.2	198.0
Inventories, net		
Raw materials	82.5	81.5
Work in process	16.5	13.7
Finished goods	160.1	144.2
Total Inventories	259.1	239.4
Prepaid expenses and other assets	28.1	40.5
Assets held for sale	2.0	3.1
Total Current Assets	765.0	819.4
PROPERTY, PLANT AND EQUIPMENT		
Property, plant and equipment, at cost	515.3	498.1
Accumulated depreciation	(323.2)	(308.4)
Property, plant and equipment, net	192.1	189.7
OTHER ASSETS:		
Goodwill	548.5	532.7
Intangible assets, net	190.0	202.5
Deferred income taxes	2.6	3.0
Other, net	17.4	15.9
TOTAL ASSETS	\$ 1,715.6	\$ 1,763.2
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$ 96.3	\$ 101.1
Accrued expenses and other liabilities	128.6	136.8
Accrued compensation and benefits	50.5	48.5
Current portion of long-term debt	22.5	139.1
Total Current Liabilities	297.9	425.5

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LONG-TERM DEBT, NET OF CURRENT PORTION	500.6	511.3
DEFERRED INCOME TAXES	50.8	48.6
OTHER NONCURRENT LIABILITIES	35.5	41.5
STOCKHOLDERS' EQUITY:		
Preferred Stock, \$0.10 par value; 5,000,000 shares authorized; no shares issued or outstanding	—	—
Class A common stock, \$0.10 par value; 80,000,000 shares authorized; 1 vote per share; issued and outstanding, 27,771,206 shares at October 1, 2017 and 27,831,013 shares at December 31, 2016	2.8	2.8
Class B common stock, \$0.10 par value; 25,000,000 shares authorized; 10 votes per share; issued and outstanding, 6,379,290 shares at October 1, 2017 and December 31, 2016	0.6	0.6
Additional paid-in capital	547.5	535.2
Retained earnings	386.4	348.5
Accumulated other comprehensive loss	(106.5)	(150.8)
Total Stockholders' Equity	830.8	736.3
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 1,715.6	\$ 1,763.2
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		Nine Months Ended	
	October 1, 2017	October 2, 2016	October 1, 2017	October 2, 2016
Net sales	\$ 364.7	\$ 341.1	\$ 1,090.4	\$ 1,056.4
Cost of goods sold	212.0	199.1	637.2	628.5
GROSS PROFIT	152.7	142.0	453.2	427.9
Selling, general and administrative expenses	107.0	104.5	324.8	317.6
Restructuring	1.4	1.0	3.6	5.6
Gain on disposition	—	—	—	(8.7)
OPERATING INCOME	44.3	36.5	124.8	113.4
Other (income) expense:				
Interest income	(0.2)	(0.3)	(0.6)	(0.8)
Interest expense	4.7	4.9	14.5	17.1
Other expense (income), net	0.3	(0.5)	0.8	(3.6)
Total other expense	4.8	4.1	14.7	12.7
INCOME BEFORE INCOME TAXES	39.5	32.4	110.1	100.7
Provision for income taxes	13.0	10.5	34.7	34.0
NET INCOME	\$ 26.5	\$ 21.9	\$ 75.4	\$ 66.7
Basic EPS				
NET INCOME PER SHARE	\$ 0.77	\$ 0.63	\$ 2.19	\$ 1.93
Weighted average number of shares	34.4	34.5	34.4	34.5
Diluted EPS				
NET INCOME PER SHARE	\$ 0.77	\$ 0.63	\$ 2.19	\$ 1.93
Weighted average number of shares	34.4	34.5	34.5	34.5
Dividends declared per share	\$ 0.19	\$ 0.18	\$ 0.56	\$ 0.53

See accompanying notes to consolidated financial statements.

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WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Amounts in millions)

(Unaudited)

	Third Quarter Ended		Nine Months Ended	
	October 1, 2017	October 2, 2016	October 1, 2017	October 2, 2016
Net income	\$ 26.5	\$ 21.9	\$ 75.4	\$ 66.7
Other comprehensive income (loss):				
Foreign currency translation adjustments	15.4	3.3	44.8	1.7
Reversal of foreign currency translation for sale of foreign entity, net of tax	—	—	—	6.9
Cash flow hedges, net of tax	0.1	1.3	(0.5)	(0.6)
Other comprehensive income	15.5	4.6	44.3	8.0
Comprehensive income	\$ 42.0	\$ 26.5	\$ 119.7	\$ 74.7

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 1, 2017	October 2, 2016
OPERATING ACTIVITIES		
Net income	\$ 75.4	\$ 66.7
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	21.9	22.7
Amortization of intangibles	16.8	15.3
Loss on disposal and impairment of property, plant and equipment and other	1.0	1.8
Gain on disposition	—	(8.6)
Gain on acquisition	—	(1.7)
Stock-based compensation	10.2	10.6
Deferred income tax	1.8	2.9
Changes in operating assets and liabilities, net of effects from business acquisitions and divestures:		
Accounts receivable	(21.9)	(24.3)
Inventories	(10.1)	1.4
Prepaid expenses and other assets	11.1	8.7
Accounts payable, accrued expenses and other liabilities	(32.8)	(25.9)
Net cash provided by operating activities	73.4	69.6
INVESTING ACTIVITIES		
Additions to property, plant and equipment	(17.1)	(26.3)
Proceeds from the sale of property, plant and equipment	0.4	—
Net proceeds from the sale of assets, and other	3.1	4.2
Business acquisitions, net of cash acquired	0.1	(2.1)
Net cash used in investing activities	(13.5)	(24.2)
FINANCING ACTIVITIES		
Proceeds from long-term borrowings	20.0	530.0
Payments of long-term debt	(151.8)	(501.1)
Payment of capital leases and other	(4.6)	(1.6)
Proceeds from share transactions under employee stock plans	1.0	7.3
Tax benefit of stock awards exercised	—	0.4
Payments to repurchase common stock	(13.6)	(22.2)
Debt issuance costs	—	(2.1)
Dividends	(19.4)	(18.2)
Net cash used in financing activities	(168.4)	(7.5)
Effect of exchange rate changes on cash and cash equivalents	16.7	4.5
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(91.8)	42.4

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Cash and cash equivalents at beginning of year	338.4	296.2
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 246.6	\$ 338.6
NON CASH INVESTING AND FINANCING ACTIVITIES		
Acquisition of businesses:		
Fair value of assets acquired	\$ —	\$ 5.7
Cash paid, net of cash acquired	—	2.1
Gain on acquisition	—	1.7
Liabilities assumed	\$ —	\$ 1.9
Acquisitions of fixed assets under financing agreement	\$ —	\$ —
Issuance of stock under management stock purchase plan	\$ 1.0	\$ 0.7
CASH PAID FOR:		
Interest	\$ 12.8	\$ 15.1
Income taxes	\$ 29.5	\$ 23.8

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 1, 2017, the Consolidated Statements of Operations for the third quarters and nine months ended October 1, 2017 and October 2, 2016, the Consolidated Statements of Comprehensive Income for the third quarters and nine months ended October 1, 2017 and October 2, 2016, and the Consolidated Statements of Cash Flows for the nine months ended October 1, 2017 and October 2, 2016.

The consolidated balance sheet at December 31, 2016 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, 2016. 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, 2016. Operating results for the interim periods presented are not necessarily indicative of the results to be expected for the year ending December 31, 2017. Certain prior year amounts have been reclassified to conform to the current year presentation. Reclassifications did not have a material impact on previously reported results of operations, financial position or cash flows.

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

Estimates

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

2. Accounting Policies

The significant accounting policies used in preparation of these consolidated financial statements for the three and nine months ended October 1, 2017 are consistent with those discussed in Note 2 of the Notes to Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

Recently Adopted Accounting Standards

In January 2017, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2017-04, "Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment." ASU 2017-04 eliminates the need to determine the fair value of individual assets and liabilities of a reporting unit to measure goodwill impairment. A goodwill impairment will now be the amount by which a reporting unit's carrying value exceeds its fair value. The revised guidance will be applied prospectively and is effective for calendar year-end SEC filers in 2020. Early adoption is permitted for any impairment tests performed after January 1, 2017. The Company's adoption of the new guidance effective January 1, 2017 did not have a material impact on the Company's financial statements.

In March 2016, the FASB issued ASU 2016-09, "Improvements to Employee Share-Based Payment Accounting." ASU 2016-09 simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as equity or liabilities, forfeitures, and classification on the statement of cash

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flows. The Company adopted this standard in the first quarter of 2017. The impact of the adoption of this standard resulted in the following:

The Company elected to account for forfeitures as they occur, rather than estimate expected forfeitures over the vesting period of the respective grant. This was adopted using a modified retrospective approach with a cumulative effect adjustment of \$0.5 million to retained earnings as of January 1, 2017.

The Company no longer reclassifies the excess tax benefit from operating activities to financing activities in the Consolidated Statement of Cash Flows. This change has been applied prospectively in the Statement of Cash Flows. The Company had an excess tax benefit of \$0.4 million in the nine months ended October 2, 2016.

The Company no longer records windfall or shortfall tax benefits to additional paid-in capital and records these tax benefits directly to operations. This change has been applied prospectively as is required by the standard and therefore the comparative period has not been adjusted. This change may create volatility in the Company's effective tax rate on a prospective basis.

In November 2015, the FASB issued ASU 2015-17, "Income Taxes: Balance Sheet Classification of Deferred Taxes." ASU 2015-17 requires that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. ASU 2015-17 is effective for financial statements issued for annual periods beginning after December 15, 2016 and all interim periods thereafter. The Company adopted the provision of this ASU during the first quarter of 2017 and applied it retrospectively. As of December 31, 2016, the Company had \$38.6 million of current deferred tax assets, \$1.5 million of noncurrent deferred tax assets, and \$85.7 million of noncurrent deferred tax liabilities. The adoption of this standard resulted in a reclassification of \$38.6 million of current deferred tax assets to noncurrent deferred tax liabilities and a reclassification of \$1.5 million of noncurrent deferred tax liabilities to noncurrent deferred tax assets. Therefore, the restated noncurrent deferred tax asset balance and noncurrent deferred tax liability balance as of December 31, 2016 was \$3.0 million and \$48.6 million, respectively. Adoption of this standard did not affect results of operations, retained earnings, or cash flows in the current or previous interim and annual reporting periods.

In July 2015, the FASB issued ASU 2015-11, "Inventory: Simplifying the Measurement of Inventory." This new standard changes inventory measurement from lower of cost or market to lower of cost and net realizable value. The standard eliminates the requirement to consider replacement cost or net realizable value less a normal profit margin when measuring inventory. ASU 2015-11 is effective in the first quarter of 2017 for public companies with calendar year ends, and should be applied prospectively with early adoption permitted. The adoption of this guidance did not have a material impact on the Company's financial statements.

Accounting Standards Updates

In August 2017, the FASB issued ASU 2017-12 “Derivatives and Hedging (Topic 815)-Targeted Improvements to Accounting for Hedging Activities.” ASU 2017-12 amends the hedge accounting guidance to improve the financial reporting of hedging relationships to better portray the economic results of an entity’s risk management activities in the financial statements. This guidance permits hedge accounting for risk components in hedging relationships that involve nonfinancial risk, reduces complexity in hedging for fair value hedges of interest rate risk, eliminates the requirement to separately measure and report hedging ineffectiveness, and simplifies certain hedge effectiveness assessment requirements. This standard is effective for fiscal years beginning after December 15, 2018, including interim periods within that reporting period. The Company is currently evaluating the impact of this guidance, including transition elections and required disclosures, on our financial statements.

In January 2017, the FASB issued ASU 2017-01 “Business Combinations (Topic 805)-Clarifying the Definition of a Business”, which clarifies the definition of a business to assist entities with evaluating whether transactions should be accounted for as acquisitions or disposals of assets or businesses. The standard introduces a screen for determining when assets acquired are not a business and clarifies that a business must include, at a minimum, an input and a substantive process that contribute to an output to be considered a business. This standard is effective for fiscal years beginning after December 15, 2017, including interim periods within that reporting period. The adoption of this guidance is not expected to have a material impact on the Company’s financial statements.

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers." ASU 2014-09 converges revenue recognition under U.S. GAAP and International Financial Reporting Standards ("IFRS"). For U.S. GAAP, the standard generally eliminates transaction and industry-specific revenue recognition guidance. This includes current guidance on long-term construction-type contracts, software arrangements, real estate sales, telecommunication

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arrangements, and franchise sales. Under the new standard, revenue is recognized based on a five-step model. The FASB issued ASU 2015-14 in August 2015 which deferred the effective date of ASU 2014-09 for public companies to periods beginning after December 15, 2017, with early adoption permitted. The Company is assessing the impact of the guidance on its revenues by reviewing its contract portfolio to identify potential differences that would result from applying the new standard to its current revenue arrangements, including evaluation of potential performance obligations and variable consideration. The Company has completed its contract portfolio analysis and does not expect the adoption of this guidance to have a material impact on the Company's financial results. The Company is continuing to evaluate changes to business processes, systems, enhanced disclosure requirements and controls under this new guidance. The Company will adopt this new standard effective January 1, 2018 using the modified retrospective approach, with a cumulative adjustment to opening retained earnings in the period of adoption.

Shipping and Handling

Shipping and handling costs included in selling, general and administrative expense amounted to \$12.8 million and \$12.7 million for the third quarters of 2017 and 2016, respectively, and were \$37.8 million and \$35.6 million for the first nine months of 2017 and 2016, respectively.

Research and Development

Research and development costs included in selling, general, and administrative expense amounted to \$7.3 million and \$6.6 million for the third quarters of 2017 and 2016, respectively, and were \$21.6 million and \$19.6 million for the first nine months of 2017 and 2016, respectively.

3. Acquisitions

PVI Industries, LLC

On November 2, 2016, the Company acquired 100% of the shares of PVI Riverside Holdings, Inc., the parent company of PVI Industries, LLC ("PVI"). The aggregate purchase price, including the final working capital adjustment, was approximately \$79.1 million.

PVI is a leading manufacturer of commercial stainless steel water heating equipment, focused on the high capacity market in North America and is based in Fort Worth, Texas. PVI's water heater product offering complements AERCO's boiler products, allowing the Company to address customers' heating and hot water requirements.

The Company accounted for the transaction as a purchased business combination and the acquisition was funded partially with available cash and partially from borrowings under the Company's Credit Agreement. During the second quarter of 2017, the Company finalized the purchase price allocation for the PVI purchase. The acquisition resulted in the recognition of \$41.1 million in goodwill and \$31.0 million in intangible assets. The intangible assets acquired consist of customer relationships valued at \$17.6 million, developed technology valued at \$10.2 million, and the trade name valued at \$3.2 million. The goodwill is attributable to the workforce of PVI and the strategic platform adjacency that will allow Watts to extend its product offerings as a result of the acquisition. Approximately \$6.9 million of the goodwill is deductible for tax purposes. The following table summarizes the value of the assets and liabilities acquired (in millions):

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Accounts receivable	\$ 5.7
Inventory	12.7
Fixed assets	8.1
Other assets	2.8
Intangible assets	31.0
Goodwill	41.1
Accounts payable	(4.0)
Accrued expenses and other	(9.2)
Deferred tax liability	(9.1)
Purchase price	\$ 79.1

Apex

On November 30, 2015, the Company acquired 80% of the outstanding shares of Apex Valves Limited (“Apex”). Apex specializes in the design and manufacturing of control valves for low and high pressure hot water and filtration systems. Apex also produces an extensive range of float and reservoir valves for the agricultural industry. The aggregate purchase price was approximately \$20.4 million and the Company recorded a long-term liability of \$5.5 million as the estimate of the acquisition date fair value on the contractual call option to purchase the remaining 20% within three years of closing. The Company acquired an additional 10% ownership in the first quarter of 2017 for approximately \$2.9 million and now owns 90% of the outstanding shares of Apex. The Company maintains a long-term liability of approximately \$3.0 million for the estimated fair value on the remaining 10% contractual call option.

4. Goodwill & Intangibles

The Company operates in three geographic segments: Americas, Europe, and APMEA (Asia-Pacific, Middle East, and Africa). The changes in the carrying amount of goodwill by geographic segment are as follows:

October 1, 2017		
Gross Balance	Accumulated Impairment Losses	Net Goodwill

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	Balance January 1, 2017 (in millions)	Acquired During the Period (1)	Foreign Currency Translation and Other	Balance October 1, 2017	Balance January 1, 2017	Impairment Loss During the Period	Balance October 1, 2017	October 1, 2017
Americas	\$ 434.7	2.0	0.7	437.4	\$ (24.5)	—	(24.5)	412.9
Europe	234.9	—	12.3	247.2	(129.7)	—	(129.7)	117.5
APMEA	30.2	—	0.8	31.0	(12.9)	—	(12.9)	18.1
Total	\$ 699.8	2.0	13.8	715.6	\$ (167.1)	—	(167.1)	548.5

(1) Americas goodwill additions during the first nine months of 2017 includes purchase accounting adjustments related to the PVI acquisition discussed in Note 3 of the Notes to the Consolidated Financial Statements.

	December 31, 2016 Gross Balance			Accumulated Impairment Losses			Net Goodwill	
	Balance January 1, 2016 (in millions)	Acquired During the Period	Foreign Currency Translation and Other	Balance December 31, 2016	Balance January 1, 2016	Impairment Loss During the Period	Balance December 31, 2016	
Americas	\$ 391.2	43.3	0.2	434.7	\$ (24.5)	—	(24.5)	410.2
Europe	238.6	—	(3.7)	234.9	(129.7)	—	(129.7)	105.2
APMEA	26.3	3.7	0.2	30.2	(12.9)	—	(12.9)	17.3
Total	\$ 656.1	47.0	(3.3)	699.8	\$ (167.1)	—	(167.1)	532.7

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Intangible assets include the following:

	October 1, 2017			December 31, 2016		
	Gross Carrying Amount (in millions)	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Patents	\$ 16.1	\$ (15.3)	\$ 0.8	\$ 16.1	\$ (14.9)	\$ 1.2
Customer relationships	233.1	(129.4)	103.7	231.5	(117.3)	114.2
Technology	53.3	(22.1)	31.2	53.1	(19.2)	33.9
Trade names	25.7	(9.3)	16.4	25.1	(8.1)	17.0
Other	6.8	(6.0)	0.8	6.8	(5.9)	0.9
Total amortizable intangibles	335.0	(182.1)	152.9	332.6	(165.4)	167.2
Indefinite-lived intangible assets	37.1	—	37.1	35.3	—	35.3
	\$ 372.1	\$ (182.1)	\$ 190.0	\$ 367.9	\$ (165.4)	\$ 202.5

Aggregate amortization expense for amortized intangible assets for the third quarter of 2017 and 2016 was \$5.7 million and \$5.1 million, respectively, and for the first nine months of 2017 and 2016, was \$16.8 million and \$15.3 million, respectively.

5. Financial Instruments and Derivative Instruments

Fair Value

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

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

	October 1, 2017	December 31, 2016
	(in millions)	
Carrying amount	\$ 525.8	\$ 653.6
Estimated fair value	\$ 528.1	\$ 658.3

Financial Instruments

The Company measures certain financial assets and liabilities at fair value on a recurring basis, including deferred compensation plan assets and related liabilities, redeemable financial instruments, and derivatives. The fair values of these certain financial assets and liabilities were determined using the following inputs at October 1, 2017 and December 31, 2016:

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	Fair Value Measurement at October 1, 2017 Using:			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(in millions)			
Assets				
Plan asset for deferred compensation(1)	\$ 3.3	\$ 3.3	\$ —	\$ —
Interest rate swaps (1)	\$ 3.9	\$ —	\$ 3.9	\$ —
Total assets	\$ 7.2	\$ 3.3	\$ 3.9	\$ —
Liabilities				
Plan liability for deferred compensation(2)	\$ 3.3	\$ 3.3	\$ —	\$ —
Redeemable financial instrument(3)	\$ 3.0	\$ —	\$ —	\$ 3.0
Total liabilities	\$ 6.3	\$ 3.3	\$ —	\$ 3.0

	Fair Value Measurements at December 31, 2016 Using:			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(in millions)			
Assets				
Plan asset for deferred compensation(1)	\$ 3.0	\$ 3.0	\$ —	\$ —
Interest rate swaps (1)	\$ 4.6	\$ —	\$ 4.6	\$ —
Total assets	\$ 7.6	\$ 3.0	\$ 4.6	\$ —
Liabilities				
Plan liability for deferred compensation(2)	\$ 3.0	\$ 3.0	\$ —	\$ —
Redeemable financial instrument(3)	5.8	—	—	5.8
Total liabilities	\$ 8.8	\$ 3.0	\$ —	\$ 5.8

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

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

(3)Included on the Company's consolidated balance sheet in other noncurrent liabilities and relates to a mandatorily redeemable equity instrument as part of the Apex acquisition in 2015.

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The table below provides a summary of the changes in fair value of all financial assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the period December 31, 2016 to October 1, 2017.

	Balance		Purchases	Total realized and unrealized (gains) losses included in:		Balance
	December 31, 2016	Settlements		Net earnings adjustments	Comprehensive income	
Redeemable financial instrument	\$ 5.8	(2.9)	\$ —	—	\$ 0.1	\$ 3.0

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

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

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

Interest Rate Swaps

On February 12, 2016, the Company entered into a Credit Agreement (the "Credit Agreement") pursuant to which it received a funding commitment under a Term Loan of \$300 million, of which the entire \$300 million has been drawn on, and a Revolving Commitment ("Revolver") of \$500 million, of which \$162.0 million has been drawn as of October 1, 2017. Both facilities mature on February 12, 2021. For each facility, the Company can choose either an Adjusted LIBOR or Alternative Base Rate ("ABR"). Upon intended election of Adjusted LIBOR as the interest rate, the Term Loan has quarterly interest payments that began in May 2016, quarterly principal repayments that commenced on March 31, 2017, with a balloon payment of principal on maturity date. The Revolver has quarterly interest payments that began in July 2016.

Accordingly, the Company's earnings and cash flows are exposed to interest rate risk from changes in Adjusted LIBOR. In order to manage the Company's exposure to changes in cash flows attributable to fluctuations in LIBOR-indexed interest payments related to the Company's floating rate debt, the Company entered into two interest rate swaps. For each interest rate swap, the Company receives the three-month USD-LIBOR subject to a 0% floor, and pays a fixed rate of 1.31375% on a notional amount of \$225.0 million. The swaps mature on February 12, 2021. The Company formally documents the hedge relationships at hedge inception to ensure that its interest rate swaps qualify for hedge accounting. On a quarterly basis, the Company assesses whether the interest rate swaps are highly effective in offsetting changes in the cash flow of the hedged item. The Company does not hold or issue interest rate swaps for trading purposes. The swaps are designated as cash flow hedges. For the three months and nine months ended October 1, 2017, a gain of \$0.1 million and a loss of \$0.4 million, respectively, was recorded in Accumulated Other Comprehensive Income to recognize the effective portion of the fair value of interest rate swaps that qualify as a cash flow hedge. For the three and nine months ended October 2, 2016, a gain of \$1.3 million and a loss of \$0.6 million, respectively, was recorded in Accumulated Other Comprehensive Income to recognize the effective portion of the fair value of interest rate swaps that qualify as a cash flow hedge.

Non-Designated Cash Flow Hedge

The Company's 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. The Company uses foreign currency forward exchange contracts from time to time to manage the risk related to intercompany loans, intercompany purchases that occur during the course of a year, and certain open foreign currency denominated commitments to sell products to third parties. These forward exchange contracts are not designated as cash flow or fair value hedges. The Company entered into one forward contract in the fourth quarter of 2016 and one forward contract in the first quarter of 2017 to manage the foreign currency rate exposure between the Hong Kong Dollar and the euro regarding two intercompany loans. These forward

contracts are marked-to-market with changes in the fair value recorded to earnings. The Company recognized a loss of \$0.8 million and \$2.9 million for the three and nine months ended October 1, 2017, respectively, related to the forward exchange contracts. These forward contracts were not renewed in September 2017 as the intercompany loans for which the Company was hedging the foreign currency rate exposure were settled.

6. Restructuring and Other Charges, Net

The Company's Board of Directors approves all major restructuring programs that may involve the discontinuance of significant product lines or the shutdown of significant facilities. From time to time, the Company takes additional restructuring actions, including involuntary terminations that are not part of a major program. The Company accounts for

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these costs in the period that the liability is incurred. These costs are included in restructuring charges in the Company's consolidated statements of operations.

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

	Third Quarter Ended October 2, 2017		Nine Months Ended October 2, 2017	
	2016	2016	2016	2016
			(in millions)	
Restructuring costs:				
2015 Actions	\$ 0.5	\$ 0.8	\$ 2.1	\$ 2.6
Other Actions	0.9	0.2	1.5	3.0
Total restructuring charges	\$ 1.4	\$ 1.0	\$ 3.6	\$ 5.6

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

	Third Quarter Ended October 2, 2017		Nine Months Ended October 2, 2017	
	2016	2016	2016	2016
			(in millions)	
Americas	\$ 0.7	\$ 0.8	\$ 2.6	\$ 2.4
Europe	0.5	0.3	0.6	3.2
APMEA	0.2	—	0.4	0.2
Corporate	—	(0.1)	—	(0.2)
Total	\$ 1.4	\$ 1.0	\$ 3.6	\$ 5.6

2015 Actions

In 2015, the Board of Directors of the Company approved a transformation program relating to the Company's Americas and APMEA businesses, which primarily involved the exit of low-margin, non-core product lines ("phase one"). The Company eliminated approximately \$165 million of the combined Americas and APMEA net sales primarily within the Company's do-it-yourself (DIY) distribution channel.

The second phase of the program involves the consolidation of manufacturing facilities and distribution center network optimization. The second phase of the program involves reducing the square footage of the Company's Americas facilities, which together with phase one, reduced the Americas net operating footprint by approximately 30%. The second phase is designed to improve the utilization of our remaining facilities, better leverage our cost structure, reduce working capital, and improve execution of customer delivery requirements. As of October 1, 2017, the second phase was substantially complete and is expected to be completed by the end of 2017.

On a combined basis, the total estimated pre-tax cost for the Company's transformation program related to its Americas and APMEA businesses is approximately \$60 million, of which approximately \$59 million was incurred as of October 1, 2017. The remaining costs are expected to be incurred through the end of 2017. In the third quarter of 2017, the total expected costs of the planned actions were reduced from approximately \$65 million to approximately \$60 million, primarily related to reduced expected facility exit costs and reduced other transformation and deployment costs. Total expected pre-tax charges include restructuring costs of approximately \$18.5 million, goodwill and intangible asset impairments of \$13.5 million and other transformation and deployment costs of approximately \$28 million. The other transformation and deployment costs include consulting and project management fees, inventory write-offs, and other associated costs.

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The following table summarizes by type, the total expected, incurred and remaining pre-tax restructuring costs for the Company's transformation program related to its Americas and APMEA businesses (phase one and phase two combined):

	Severance (in millions)	Legal and consultancy	Asset write downs	Facility exit and other	Total
Costs incurred—2015	\$ 8.5	0.7	1.6	2.8	13.6
Costs incurred—2016	(1.5)	0.2	2.9	0.5	2.1
Costs incurred—first quarter 2017	—	—	—	—	—
Costs incurred—second quarter 2017	0.2	—	1.2	0.2	1.6
Costs incurred—third quarter 2017	—	—	0.5	—	0.5
Remaining costs to be incurred	—	—	0.5	0.2	0.7
Total expected restructuring costs	\$ 7.2	\$ 0.9	\$ 6.7	\$ 3.7	\$ 18.5

The following table summarizes total restructuring costs incurred for the three and nine months ended October 1, 2017, incurred program to date and expected remaining pre-tax restructuring costs by business segment for the Company's Americas and APMEA 2015 transformation program:

	Third Quarter Ended October 1, 2017	Nine Months Ended October 1, 2017	Incurred to Date	Remaining costs	Total Expected Costs
APMEA	\$ —	\$ 0.2	\$ 4.6	\$ —	\$ 4.6
Americas	0.5	1.9	13.2	0.7	13.9
Total restructuring costs	\$ 0.5	\$ 2.1	\$ 17.8	\$ 0.7	\$ 18.5

Details of the restructuring reserve activity for the Company's Americas and APMEA 2015 transformation program for the period ended October 1, 2017 are as follows:

	Severance (in millions)	Legal and consultancy	Asset write-downs	Facility exit and other	Total
Balance at December 31, 2016	\$ 1.2	\$ —	\$ —	\$ —	\$ 1.2

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Net pre-tax restructuring charges	—	—	—	—	—
Utilization and foreign currency impact	(0.6)	—	—	—	(0.6)
Balance at April 2, 2017	\$ 0.6	\$ —	\$ —	\$ —	\$ 0.6
Net pre-tax restructuring charges	0.2	—	1.2	0.2	1.6
Utilization and foreign currency impact	(0.1)	—	(1.2)	(0.2)	(1.5)
Balance at July 2, 2017	\$ 0.7	\$ —	\$ —	\$ —	\$ 0.7
Net pre-tax restructuring charges	—	—	0.5	—	0.5
Utilization and foreign currency impact	—	—	(0.5)	—	(0.5)
Balance at October 1, 2017	\$ 0.7	\$ —	\$ —	\$ —	\$ 0.7

Other Actions

The Company periodically initiates other actions which are not part of a major program. In the fourth quarter of 2015, management initiated certain restructuring actions and strategic initiatives with respect to the Company's Europe segment in response to the economic challenges in Europe at the time and additional product rationalization efforts. The restructuring actions included severance benefits and limited costs relating to asset write offs, professional fees and relocation.

Total "Other Actions" pre-tax restructuring expense was \$0.9 million and \$1.5 million for the three and nine months ended October 1, 2017, respectively. Total "Other Actions" pre-tax restructuring expense was \$0.2 million and \$3.0

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million for the three and nine months ended October 2, 2016, respectively. Included in “Other Actions” is the 2015 Europe restructuring initiatives, in addition to other minor initiatives for which the Company incurred restructuring expenses through the first nine months of 2017 and 2016.

The total pre-tax charge for the Europe 2015 restructuring initiatives is expected to be approximately \$10 million, of which approximately \$8.4 million has been incurred as of October 1, 2017. The remaining expected costs relate to severance and legal costs and are expected to be completed in 2017.

The following table summarizes total expected, incurred and remaining pre-tax restructuring costs for the Europe 2015 restructuring actions:

	Severance (in millions)	Legal and consultancy	Facility Exit and other	Total
Costs incurred—2015	\$ 6.6	\$ —	\$ 0.3	\$ 6.9
Costs incurred—2016	1.3	0.5	—	1.8
Adjustments to restructuring costs — first quarter 2017	(0.3)	—	—	(0.3)
Costs incurred—second quarter 2017	—	—	—	—
Costs incurred—third quarter 2017	—	—	—	—
Remaining costs to be incurred	1.4	0.2	—	1.6
Total expected restructuring costs	\$ 9.0	\$ 0.7	\$ 0.3	\$ 10.0

Details of the Company’s Europe 2015 restructuring reserve activity for the nine months ended October 1, 2017 are as follows:

	Severance (in millions)	Legal and Consultancy	Facility exit and other	Total
Balance at December 31, 2016	\$ 4.8	\$ —	\$ —	\$ 4.8
Net pre-tax restructuring adjustments	(0.3)	—	—	(0.3)
Utilization and foreign currency impact	(0.9)	—	—	(0.9)
Balance at April 2, 2017	\$ 3.6	\$ —	\$ —	\$ 3.6
Net pre-tax restructuring charges	—	—	—	—
Utilization and foreign currency impact	(0.3)	—	—	(0.3)
Balance at July 2, 2017	\$ 3.3	\$ —	\$ —	\$ 3.3
Net pre-tax restructuring adjustments	—	—	—	—
Utilization and foreign currency impact	(0.7)	—	—	(0.7)

Balance at October 1, 2017	\$ 2.6	\$	—	\$	—	\$ 2.6
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7. Earnings per Share

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

	For the Third Quarter Ended October 1, 2017			For the Third Quarter Ended October 2, 2016		
	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)	Per Share Amount
(Amounts in millions, except per share information)						
Basic EPS:						
Net income	\$ 26.5	34.4	\$ 0.77	\$ 21.9	34.5	\$ 0.63
Effect of dilutive securities:						
Common stock equivalents		—			—	
Diluted EPS:						
Net income	\$ 26.5	34.4	\$ 0.77	\$ 21.9	34.5	\$ 0.63

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Options to purchase 0.1 million shares of Class A common stock were outstanding during the third quarters of 2017 and 2016, but were not included in the computation of diluted EPS because to do so would be anti-dilutive.

	For the Nine Months Ended October 1, 2017			For the Nine Months Ended October 2, 2016		
	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)	Per Share Amount
	(Amounts in millions, except per share information)					
Basic EPS:						
Net income	\$ 75.4	34.4	\$ 2.19	\$ 66.7	34.5	\$ 1.93
Effect of dilutive securities:						
Common stock equivalents		0.1		—		
Diluted EPS:						
Net income	\$ 75.4	34.5	\$ 2.19	\$ 66.7	34.5	\$ 1.93

Options to purchase 0.1 million shares of Class A common stock were outstanding during the first nine months of 2017 and 2016, but were not included in the computation of diluted EPS because to do so would be anti-dilutive.

On July 27, 2015, the Company's Board of Directors authorized the repurchase of up to \$100 million of the Company's Class A common stock from time to time on the open market or in privately negotiated transactions. In connection with this stock repurchase program, the Company entered into a Rule 10b5-1 plan, which permits shares to be repurchased when the Company might otherwise be precluded from doing so under insider trading laws. The repurchase program may be suspended or discontinued at any time, subject to the terms of the Rule 10b5-1 plan the Company entered into with respect to the repurchase program. As of October 1, 2017, there was approximately \$42.4 million remaining authorized for share repurchases under this program.

The following table summarizes the cost and the number of shares of Class A common stock repurchased under the July 27, 2015 program during the three and nine months ended October 1, 2017 and October 2, 2016:

For the Third Quarter Ended October 1, 2017		For the Third Quarter Ended October 2, 2016	
Number of shares repurchased	Cost of shares repurchased	Number of shares repurchased	Cost of shares repurchased

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(amounts in millions, except share amount)

Total stock repurchased during the period:	72,669	\$ 4.7	74,038	\$ 4.6
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For the Nine Months Ended
October 1, 2017

For the Nine Months Ended
October 2, 2016

Number of shares
repurchased

Cost of shares
repurchased

Number of shares
repurchased

Cost of shares
repurchased

(amounts in millions, except share amount)

Total stock repurchased during the period:	214,455	\$ 13.6	433,429	\$ 22.2
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8. Stock Based Compensation

The Company maintains one stock incentive plan, the Second Amended and Restated 2004 Stock Incentive Plan (the “2004 Stock Incentive Plan”). The Company grants shares of restricted stock and deferred shares to key employees and stock awards to non-employee members of the Company’s Board of Directors under the 2004 Stock Incentive Plan. Stock awards to non-employee members of the Company’s Board of Directors vest immediately. Employees’ restricted stock awards and deferred shares typically vest over a three-year period at the rate of one-third per year. The restricted stock awards and deferred shares are amortized to expense on a straight-line basis over the vesting period. The Company issued 127,960 and 134,775 shares of restricted stock awards and deferred shares during the first nine months of 2017 and 2016, respectively.

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

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performance goals set at the time the performance stock units were granted. The recipient of a performance stock unit award may earn from zero shares to twice the number of target shares awarded to such recipient. The performance stock units are amortized to expense over the vesting period, and based on the Company's performance relative to the performance goals, may be adjusted. Changes to the estimated shares expected to vest will result in adjustments to the related share-based compensation expense that will be recorded in the period of change. If the performance goals are not met, no awards are earned and previously recognized compensation expense is reversed. The Company granted 98,812 and 106,724 of annual awards for performance stock units during the first nine months of 2017 and 2016, respectively. The performance goals for the performance stock units are based on the compound annual growth rate of the Company's revenue over the three-year performance period and the Company's return on invested capital ("ROIC") for the third year of the performance period.

The Company also has a Management Stock Purchase Plan that allows for the granting of restricted stock units (RSUs) to key employees. On an annual basis, key employees may elect to receive a portion of their annual incentive compensation in RSUs instead of cash. Participating employees may use up to 50% of their annual incentive bonus to purchase RSUs for a purchase price equal to 80% of the fair market value of the Company's Class A common stock as of the date of grant. Upon vesting, each RSU is converted into one share of Class A common stock. Beginning with annual incentive compensation for 2016, the purchase price for RSUs was increased from 67% to 80% of the fair market value of the Company's Class A common stock. RSUs vest either annually over a three-year period from the grant date or upon the third anniversary of the grant date and receipt of the shares underlying RSUs is deferred for a minimum of three years, or such greater number of years as is chosen by the employee, from the date of grant. An aggregate of 2,000,000 shares of Class A common stock may be issued under the Management Stock Purchase Plan. The company granted 47,222 RSU's and 88,882 RSU's during the first nine months of 2017 and 2016, respectively.

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

	2017		2016	
Expected life (years)	3.0		3.0	
Expected stock price volatility	25.0	%	24.8	%
Expected dividend yield	1.2	%	1.3	%
Risk-free interest rate	1.5	%	0.9	%

The risk free interest rate is based upon the U.S. Treasury yield curve at the time of grant for the respective expected life of the RSUs. The expected life (estimated period of time outstanding) of RSUs and volatility were calculated using historical data. The expected dividend yield of stock is the Company's best estimate of the expected future dividend yield.

The above assumptions were used to determine the weighted average grant date fair value of RSUs granted of \$16.84 and \$18.15 in 2017 and 2016, respectively.

A more detailed description of each of these plans can be found in Note 12 of the Notes to Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

9. Segment Information

The Company operates in three geographic segments: Americas, Europe, and APMEA. Each of these segments sells similar products and has separate financial results that are reviewed by the Company's chief operating decision maker. Each segment earns revenue and income almost exclusively from the sale of our products. The Company sells its products into various end markets around the world, with sales by region based upon location of the entity recording the sale. Products are sold into four product categories: 1) residential & commercial flow control products, 2) HVAC & gas products, 3) drainage & water re-use products, and 4) water quality products. The Americas sells products across all four product categories, Europe primarily sells residential & commercial flow products, HVAC & gas products and drainage products, and APMEA primarily sells residential & commercial flow products and HVAC & gas products. All intercompany sales transactions have been eliminated. The accounting policies for each segment are the same as those described in Note 2 of the Notes to Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

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As of January 1, 2017, the Company began reporting the results of Watts Industries Middle East FZE (“Watts Middle East”), an indirect, wholly owned subsidiary, as part of the Company’s former Asia-Pacific segment, which is now referred to as APMEA. Watts Middle East had previously been reported within the former EMEA segment, which is now referred to as Europe. This change in segment composition aligns with the structure of the Company’s internal organization and did not result in a material change to previously reported segment information. The 2016 results by segment have been retrospectively revised for comparative purposes.

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

	Third Quarter Ended		Nine Months Ended	
	October 1, 2017	October 2, 2016	October 1, 2017	October 2, 2016
	(in millions)			
Net Sales				
Americas	\$ 239.1	\$ 215.8	\$ 718.3	\$ 677.6
Europe	109.0	107.0	324.6	329.6
APMEA	16.6	18.3	47.5	49.2
Consolidated net sales	\$ 364.7	\$ 341.1	\$ 1,090.4	\$ 1,056.4
Operating income (loss)				
Americas	\$ 39.8	\$ 32.2	\$ 110.5	\$ 95.7
Europe	13.4	12.3	38.5	32.3
APMEA	0.5	1.6	3.3	13.1
Subtotal reportable segments	53.7	46.1	152.3	141.1
Corporate(*)	(9.4)	(9.6)	(27.5)	(27.7)
Consolidated operating income	44.3	36.5	124.8	113.4
Interest income	(0.2)	(0.3)	(0.6)	(0.8)
Interest expense	4.7	4.9	14.5	17.1
Other expense (income), net	0.3	(0.5)	0.8	(3.6)
Income before income taxes	\$ 39.5	\$ 32.4	\$ 110.1	\$ 100.7
Capital Expenditures				
Americas	\$ 4.4	\$ 5.1	\$ 12.5	\$ 19.5
Europe	1.7	1.9	4.2	6.2
APMEA	0.1	0.1	0.4	0.6
Consolidated capital expenditures	\$ 6.2	\$ 7.1	\$ 17.1	\$ 26.3
Depreciation and Amortization				
Americas	\$ 7.6	\$ 7.7	\$ 22.8	\$ 20.9
Europe	4.9	4.8	13.8	14.6
APMEA	0.4	0.7	2.1	2.5
Consolidated depreciation and amortization	\$ 12.9	\$ 13.2	\$ 38.7	\$ 38.0
Identifiable assets (at end of period)				
Americas			\$ 1,074.0	\$ 1,011.1

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Europe	510.4	605.6
APMEA	131.2	130.6
Consolidated identifiable assets	\$ 1,715.6	\$ 1,747.3
Property, plant and equipment, net (at end of period)		
Americas	\$ 105.7	\$ 95.8
Europe	79.2	80.9
APMEA	7.2	8.1
Consolidated property, plant and equipment, net	\$ 192.1	\$ 184.8

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

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Other than the change in composition as noted above, the above operating segments are presented on a basis consistent with the presentation included in the Company's December 31, 2016 consolidated financial statements included in its Annual Report on Form 10-K.

The U.S. property, plant and equipment of the Company's Americas segment was \$102.0 million and \$92.0 million at October 1, 2017 and October 2, 2016, respectively.

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

	Third Quarter Ended		Nine Months Ended	
	October 1, 2017	October 2, 2016	October 1, 2017	October 2, 2016
	(in millions)			
U.S. net sales	\$ 222.0	\$ 200.5	\$ 670.6	\$ 631.9

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

	Third Quarter Ended		Nine Months Ended	
	October 1, 2017	October 2, 2016	October 1, 2017	October 2, 2016
	(in millions)			
Intersegment Sales				
Americas	\$ 2.5	\$ 2.9	\$ 9.0	\$ 9.1
Europe	4.0	2.9	11.9	8.8
APMEA	12.8	17.2	52.8	58.3
Intersegment sales	\$ 19.3	\$ 23.0	\$ 73.7	\$ 76.2

10. Accumulated Other Comprehensive Loss

Accumulated other comprehensive loss consists of the following:

	Foreign Currency Translation (in millions)	Cash Flow Hedges	Accumulated Other Comprehensive Loss
Balance December 31, 2016	\$ (153.7)	\$ 2.9	\$ (150.8)
Change in period	7.9	0.1	8.0
Balance April 2, 2017	\$ (145.8)	\$ 3.0	\$ (142.8)
Change in period	21.5	(0.7)	20.8
Balance July 2, 2017	\$ (124.3)	\$ 2.3	\$ (122.0)
Change in period	15.4	0.1	15.5
Balance October 1, 2017	\$ (108.9)	\$ 2.4	\$ (106.5)
Balance December 31, 2015	\$ (128.2)	\$ —	\$ (128.2)
Change in period	24.4	(0.2)	24.2
Balance April 03, 2016	\$ (103.8)	\$ (0.2)	\$ (104.0)
Change in period	(12.2)	(1.7)	(13.9)
Reversal of foreign currency translation	(6.9)	—	(6.9)
Balance July 03, 2016	\$ (122.9)	\$ (1.9)	\$ (124.8)
Change in period	3.3	1.3	4.6
Balance October 02, 2016	\$ (119.6)	\$ (0.6)	\$ (120.2)

11. Debt

On February 12, 2016, 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, JPMorgan Chase Bank, N.A.,

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as Administrative Agent, Swing Line Lender and Letter of Credit Issuer, and the other lenders referred to therein. The Credit Agreement provides for a \$500 million, five year, senior unsecured revolving credit facility (the “Revolving Credit Facility”) with a sublimit of up to \$100 million in letters of credit. As of October 1, 2017, the Company had drawn \$162.0 million on this line of credit. The Credit Agreement also provides for a \$300 million, five year, term loan facility (the “Term Loan Facility”) available to the Company in a single draw, of which the entire \$300 million had been drawn in February 2016. The Company had \$288.8 million of borrowings outstanding on the term loan as of October 1, 2017 and \$300.0 million outstanding as of October 2, 2016. Borrowings outstanding under the Revolving Credit Facility bear interest at a fluctuating rate per annum equal to an applicable percentage defined as (i) in the case of Eurocurrency rate loans, the ICE Benchmark Administration LIBOR rate plus an applicable percentage, ranging from 0.975% to 1.45%, determined by reference to the Company’s consolidated leverage ratio, or (ii) in the case of base rate loans and swing line loans, the highest of (a) the federal funds rate plus 0.5%, (b) the rate of interest in effect for such day as announced by JPMorgan Chase Bank, N.A. as its “prime rate,” and (c) the ICE Benchmark Administration LIBOR rate plus 1.0%, plus an applicable percentage, ranging from 0.00% to 0.45%, determined by reference to the Company’s consolidated leverage ratio. Borrowings outstanding under the Term Loan Facility will bear interest at a fluctuating rate per annum equal to an applicable percentage defined as the ICE Benchmark Administration LIBOR rate plus an applicable percentage, ranging from 1.125% to 1.75%, determined by reference to the Company’s consolidated leverage ratio. The interest rates as of October 1, 2017 on the Revolving Credit Facility and on the Term Loan Facility were 2.56% and 2.81%, respectively.

The loan under the Term Loan Facility amortizes as follows: 0% per annum during the first year, 7.5% in the second and third years, 10% in the fourth and fifth years, and the remaining unpaid balance paid in full on the maturity date. Payments when due are made ratably each year in quarterly installments. The Company paid quarterly installments totaling \$11.2 million during the first nine months of 2017. In addition to paying interest under the Credit Agreement, the Company is also required to pay certain fees in connection with the Revolving Credit Facility, including, but not limited to, an unused facility fee and letter of credit fees. The Credit Agreement matures on February 12, 2021, subject to extension under certain circumstances and subject to the terms of the Credit Agreement. The Company may repay loans outstanding under the Credit Agreement from time to time without premium or penalty, other than customary breakage costs, if any, and subject to the terms of the Credit Agreement. Once repaid, amounts borrowed under the Term Loan Facility may not be borrowed again.

The Company maintains letters of credit that guarantee its performance or payment to third parties in accordance with specified terms and conditions. Amounts outstanding were approximately \$25.7 million as of October 1, 2017 and \$25.6 million as of October 2, 2016. The Company’s letters of credit are primarily associated with insurance coverage. The Company’s letters of credit generally expire within one year of issuance and are drawn down against the Revolving Credit Facility. These instruments may exist or expire without being drawn down. Therefore, they do not necessarily represent future cash flow obligations.

On December 16, 2016, Watts International Holdings Limited (“Watts International”), a wholly owned subsidiary of the Company, entered into a Facility Agreement (the “Facility Agreement”) among Watts International, as original borrower and original guarantor, Watts Water Technologies EMEA B.V., a wholly owned subsidiary of the Company (“Watts EMEA”), as original guarantor, JPMorgan Chase Bank, N.A., as sole bookrunner and sole lead arranger., J.P. Morgan Europe Limited, as agent to the financial parties, and the other lenders referred to therein. The Facility Agreement provided for a €110 million, 364-day, term loan facility available to the Company in a single draw. On December 20,

2016, Watts International borrowed the full amount available for borrowing under the Facility Agreement. The loan bears interest at a rate per annum equal to (i) the Euro InterBank Offered Rate (EURIBOR), provided that if such rate is less than zero, then EURIBOR shall be deemed to be zero, plus (ii) a margin of 1.875%, provided that if no event of default is continuing and Watts International's consolidated leverage ratio is at a specified level, the margin shall decrease to 1.50%. Accrued interest on the loan is payable on the last day of each interest period. The first interest period is set at one month and may be changed subsequently to a period of one, two, or three months (or such other period agreed with all the lenders). The Facility Agreement matures on December 19, 2017, subject to the terms of the Facility Agreement. Substantially all of the proceeds of the borrowings made on December 20, 2016 under the Facility Agreement were used to pay down \$113 million outstanding under the Revolving Credit Facility. The Company made payments on the Facility Agreement of approximately €9.0 million during the three months ended October 1, 2017 and €110.0 million during the first nine months of 2017. As of October 1, 2017 the Company had repaid in full the Facility Agreement.

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As of October 1, 2017, the Company had \$312.3 million of unused and available credit under the Revolving Credit Facility and was in compliance with all covenants related to the Credit Agreement and the Facility Agreement.

The Company is a party to a note agreement as further detailed in Note 10 of the Notes to Consolidated Financial Statements of the Annual Report on Form 10-K for the year ended December 31, 2016. This note agreement requires the Company to maintain a fixed charge coverage ratio of consolidated EBITDA plus consolidated rent expense during the period to consolidated fixed charges. Consolidated fixed charges are the sum of consolidated interest expense for the period and consolidated rent expense. As of October 1, 2017, the Company was in compliance with all covenants regarding this note agreement.

12. Contingencies and Environmental Remediation

The Company is a defendant in numerous legal matters arising from its ordinary course of operations, including those involving product liability, environmental matters, and commercial disputes.

Other than the items described below, significant commitments and contingencies at October 1, 2017 are consistent with those discussed in Note 14 of the Notes to Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

As of October 1, 2017, the Company estimates that the aggregate amount of reasonably possible loss in excess of the amount accrued for its legal contingencies is approximately \$4.5 million pre tax. With respect to the estimate of reasonably possible loss, management has estimated the upper end of the range of reasonably possible loss based on (i) the amount of money damages claimed, where applicable, (ii) the allegations and factual development to date, (iii) available defenses based on the allegations, and/or (iv) other potentially liable parties. This estimate is based upon currently available information and is subject to significant judgment and a variety of assumptions, and known and unknown uncertainties. The matters underlying the estimate will change from time to time, and actual results may vary significantly from the current estimate. In the event of an unfavorable outcome in one or more of the matters, the ultimate liability may be in excess of amounts currently accrued, if any, and may be material to the Company's operating results or cash flows for a particular quarterly or annual period. However, based on information currently known to it, management believes that the ultimate outcome of all matters, as they are resolved over time, is not likely to have a material adverse effect on the financial condition of the Company, though the outcome could be material to the Company's operating results for any particular period depending, in part, upon the operating results for such period.

Chemetco, Inc. Superfund Site, Hartford, Illinois

In August 2017, Watts Regulator Co. received a “Notice of Environmental Liability” from the U.S. Environmental Protection Agency (“USEPA”) for the Chemetco, Inc. Superfund Site in Hartford, Illinois (the Site). The letter from the Chemetco Site Group (“Group”) alleges that Watts Regulator Co. is a potentially responsible party because it arranged for the disposal or treatment of hazardous substances that were contained in materials sent to the Site and that resulted in the release or threat of release of hazardous substances at the Site. As of August 2017, 162 companies were members of the Group; the final number of members is subject to change and unknown at this time. The letter offered Watts Regulator Co. the opportunity to join the Group and participate in the Remedial Investigation and Feasibility Study (“RI/FS”) at the Site. Watts Regulator Co. joined the Group in September 2017. Based on information currently known to it, management believes that Watts Regulator Co.’s share of the costs of the RI/FS is not likely to have a material adverse effect on the financial condition of the Company, or have a material adverse effect to the Company’s operating results for any particular period. The Company is unable to estimate a range of reasonably possible loss for the above matter in which damages have not been specified because: (i) the RI/FS has not been completed to determine what remediation plan will be implemented and the costs of such plan; (ii) the total number of potentially responsible parties who may or may not agree to fund or perform any remediation has not yet been determined; (iii) the share contribution for potentially responsible parties to any remediation has not been determined; and (iv) the number of years required to complete the RI/FS and implement a remediation plan acceptable to USEPA is uncertain.

Connector Class Actions

In November and December 2014, Watts Water Technologies, Inc. and Watts Regulator Co. were named as defendants in three separate putative nationwide class action complaints (Meyers v. Watts Water Technologies, Inc., United States District Court for the Southern District of Ohio; Ponzo v. Watts Regulator Co., United States District Court for the

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District of Massachusetts; Sharp v. Watts Regulator Co., United States District Court for the District of Massachusetts) seeking to recover damages and other relief based on the alleged failure of water heater connectors. On June 26, 2015, plaintiffs in the three actions filed a consolidated amended complaint, under the case captioned Ponzo v. Watts Regulator Co., in the United States District Court for the District of Massachusetts (hereinafter “Ponzo”). Watts Water Technologies was voluntarily dismissed from the Ponzo case. The complaint sought among other items, damages in an unspecified amount, replacement costs, injunctive relief, declaratory relief, and attorneys’ fees and costs. On August 7, 2015, the Company filed a motion to dismiss the complaint, which motion was mooted by the class settlements.

In February 2015, Watts Regulator Co. was named as a defendant in a putative nationwide class action complaint (Klug v. Watts Water Technologies, Inc., et al., United States District Court for the District of Nebraska) seeking to recover damages and other relief based on the alleged failure of the Company’s Floodsafe connectors (hereinafter “Klug”). On June 26, 2015, the Company filed a partial motion to dismiss the complaint. In response, on July 17, 2015, plaintiff filed an amended complaint which added additional named plaintiffs and sought to correct deficiencies in the original complaint, Klug v. Watts Regulator Co., United States District Court for the District of Nebraska. The complaint seeks among other items, damages in an unspecified amount, injunctive relief, declaratory relief, and attorneys’ fees and costs. On July 31, 2015, the Company filed a partial motion to dismiss the complaint which was granted in part and denied in part on December 29, 2015. The Company answered the amended complaint on February 2, 2016. No formal discovery was conducted.

The Company participated in mediation sessions of the Ponzo and Klug cases in December 2015 and January 2016. On February 16, 2016, the Company reached an agreement in principle to settle all claims. The proposed total settlement amount is \$14 million, of which the Company is expected to pay approximately \$4.1 million after insurance proceeds of up to \$9.9 million. The parties executed final written settlement agreements in April 2016. Motions for preliminary approval of the settlements were submitted on May 4, 2016 before the District of Nebraska Federal Court. On December 7, 2016, the Court issued an order preliminarily approving the settlements. After a fairness hearing held on April 12, 2017, the Court entered Final Orders and Judgments approving the settlements on April 13, 2017. No appeals were filed and the settlements became final on May 15, 2017.

During the fourth quarter of 2015, the Company recorded a liability of \$14 million related to the Ponzo and Klug matters of which \$7.8 million was included in current liabilities and \$6.2 million in other noncurrent liabilities. The liability was reduced by \$8.7 million during the first nine months of 2017 for \$0.8 million in notice and claims administrator payments, counsel fees of \$4.3 million and initial contributions to the class action fund of \$3.6 million. The remaining liability of \$5.3 million will be paid over three years. A \$9.5 million receivable was recorded in current assets related to insurance proceeds due as of December 31, 2015 and was subsequently increased in the first quarter of 2017 to \$9.9 million based on costs incurred as of April 3, 2017. The Company received the \$9.9 million insurance proceeds in the second quarter of 2017.

13. Subsequent Events

On October 30, 2017, the Company declared a quarterly dividend of nineteen cents (\$0.19) per share on each outstanding share of Class A common stock and Class B common stock payable on December 15, 2017 to stockholders of record on December 1, 2017.

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

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

We are a leading supplier of products and solutions that conserve water and manage the flow of fluids and energy into, through and out of buildings in the residential and commercial markets in the Americas, Europe and Asia-Pacific, Middle East and Africa (“APMEA”). For over 140 years, we have designed and produced valve systems that safeguard and regulate water systems, energy efficient heating and hydronic systems, drainage systems and water filtration technology that helps conserve water. We earn revenue and income almost exclusively from the sale of our products. Our principal product lines include:

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

HVAC & gas products—includes commercial high efficiency boilers, water heaters and heating solutions, hydronic and electric heating systems for under floor radiant applications, custom heat and hot water solutions, hydronic pump groups for boiler manufacturers and alternative energy control packages, and flexible stainless steel connectors for natural and liquid propane gas in commercial food service and residential applications. HVAC is an acronym for heating, ventilation and air conditioning.

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

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

Our business is reported in three geographic segments: Americas, Europe and APMEA. Our Europe segment was formerly referred to as EMEA (Europe, Middle East and Africa) and our APMEA segment was formerly referred to as Asia-Pacific. As of January 1, 2017, we began reporting the results of Watts Industries Middle East, an indirect, wholly owned subsidiary, within our APMEA segment to align with internal operating responsibility changes. These results had previously been reported within the Company's former EMEA segment. This change does not affect the Company's reportable segments but represents only a change in composition that better aligns with the structure of our internal organization. The 2016 results by segment have been retrospectively revised for comparative purposes.

We believe that the factors relating to our future growth include continued product innovation that meets the needs of our customers and our end markets; our ability to continue to make selective acquisitions, both in our core markets as well as in new complementary markets; regulatory requirements relating to the quality and conservation of water and the safe use of water; increased demand for clean water; continued enforcement of plumbing and building codes; and a healthy economic environment. We have completed 11 acquisitions in the last decade. Our acquisition strategy focuses on businesses that promote our key macro themes around safety and regulation, energy efficiency and water conservation. We target businesses that will provide us with one or more of the following: an entry into new markets and/or new geographies, improved channel access, unique and/or proprietary technologies, advanced production capabilities or complementary solution offerings.

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

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

During the third quarter of 2017, sales increased 6.9%, or \$23.6 million, compared to the third quarter of 2016. The increase was primarily related to an increase in organic sales of 1%, or \$3.3 million, an increase in sales due to foreign exchange of \$5.9 million, and an increase from acquired sales from PVI of \$14.4 million. As a percentage of segment net sales, organic sales in the Americas increased approximately 3.8% while organic sales in Europe and APMEA decreased approximately 3% and 9.7%, respectively, compared to the third quarter of 2016. Organic sales is a non-GAAP measure that excludes the impacts of acquisitions, divestitures and foreign exchange from year-over-year comparisons. Management believes reporting organic sales growth provides useful information to investors, potential investors and others, because it allows for a more complete understanding of underlying sales trends by providing sales growth on a consistent basis. We reconcile the change in organic sales to our reported sales for each region within our results below. Operating income of \$44.3 million increased by \$7.8 million, or 21.3%, in the third quarter of 2017 as compared to the third quarter of 2016. This increase is primarily driven by higher sales volume together with the impact of the acquisition of PVI, incremental transformation and productivity savings, and lower transformation costs.

Recent Events

On October 30, 2017, the Company declared a quarterly dividend of nineteen cents (\$0.19) per share on each outstanding share of Class A common stock and Class B common stock payable on December 15, 2017 to stockholders of record on December 1, 2017.

Results of Operations

Third Quarter Ended October 1, 2017 Compared to Third Quarter Ended October 2, 2016

Net Sales. Our business is reported in three geographic segments: Americas, Europe and APMEA. Our net sales in each of these segments for each of the third quarters of 2017 and 2016 were as follows:

	Third Quarter Ended October 1, 2017			Third Quarter Ended October 2, 2016			Change	% Change to Consolidated Net Sales	
	Net Sales	% Sales		Net Sales	% Sales				
	(dollars in millions)								
Americas	\$ 239.1	65.6	%	\$ 215.8	63.3	%	\$ 23.3	6.8	%
Europe	109.0	29.9		107.0	31.4		2.0	0.6	
APMEA	16.6	4.5		18.3	5.3		(1.7)	(0.5)	
Total	\$ 364.7	100.0	%	\$ 341.1	100.0	%	\$ 23.6	6.9	%

The change in net sales was attributable to the following:

Americas	Europe	APMEA	Total	Change As a % of Consolidated Net Sales				Change As a % of Segment Net Sales							
				Americas	Europe	APMEA	Total	Americas	Europe	APMEA	Total				
(dollars in millions)															
\$ 8.2	\$ (3.2)	\$ (1.7)	\$ 3.3	2.4	%	(0.9)	%	(0.5)	%	1.0	%	3.8	%	(3.0)	%
0.7	5.2	—	5.9	0.2		1.5		—		1.7		0.3		4.9	
14.4	—	—	14.4	4.2		—		—		4.2		6.7		—	
\$ 23.3	\$ 2.0	\$ (1.7)	\$ 23.6	6.8	%	0.6	%	(0.5)	%	6.9	%	10.8	%	1.9	%

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

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	Wholesale/DIY (dollars in millions)				Total	Change As a % of Prior Year Sales				
						Wholesale	DIY	OEMs	Specialty	
Americas	\$ 7.3	\$ (1.1)	\$ 0.4	\$ 1.6	\$ 8.2	5.8	% (8.0)	% 2.2	% 2.7	%
Europe	1.5	(0.3)	(4.4)	—	(3.2)	2.1	(22.3)	(12.4)	—	—
APMEA	0.2	—	(1.9)	—	(1.7)	1.2	—	(85.0)	—	—
Total	\$ 9.0	\$ (1.4)	\$ (5.9)	\$ 1.6	\$ 3.3					

Total organic net sales increased \$3.3 million compared to the third quarter of 2016. This increase was muted by the \$3.1 million impact of our ongoing product rationalization efforts across the regions, as we continue to focus on our core product lines. Product rationalization represents the exit of low-margin, non-core products across the regions. The product rationalization mainly affected our DIY and OEM channels.

Organic net sales in the Americas increased \$8.2 million compared to the third quarter of 2016. This increase was primarily due to higher sales volume in our plumbing products through the wholesale channel, particularly relating to backflow, valve, and drainage products. There was also an increase in specialty channel sales related to increased sales in our AERCO boiler business and increased aftermarket sales.

Organic net sales in Europe decreased \$3.2 million compared to the third quarter of 2016. This decrease was due to the impact of our continued product rationalization efforts as well as decreased demand for our HVAC products in Italy. These decreases were partially offset by continued growth in our drains business.

Organic net sales in APMEA decreased \$1.7 million as compared to the third quarter of 2016 primarily related to the impact of product rationalization efforts as well as project timing in the Middle East. These decreases were partially offset by increased demand within China for our underfloor heating products in residential applications and for our commercial valves products.

The net increase in sales due to foreign exchange was primarily due to the appreciation of the euro against the U.S. dollar in the third quarter of 2017. We cannot predict whether foreign currencies will appreciate or depreciate against the U.S. dollar in future periods or whether future foreign exchange rate fluctuations will have a positive or negative impact on our net sales.

The increase in net sales from acquisition in the Americas segment is related to the fourth quarter 2016 acquisition of PVI.

Gross Profit. Gross profit and gross profit as a percent of net sales (gross margin) for the third quarters of 2017 and 2016 were as follows:

	Third Quarter Ended	
	October 1, 2017	October 2, 2016
	(dollars in millions)	
Gross profit	\$ 152.7	\$ 142.0
Gross margin	41.9 %	41.6 %

The slight increase in gross margin percentage is attributable to the Americas and Europe and relates to increased manufacturing productivity, changes to our product mix and incremental savings from our transformation and restructuring programs within each region.

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Selling, General and Administrative Expenses. Selling, general and administrative, or SG&A, expenses increased \$2.5 million, or 2.4%, in the third quarter of 2017 compared to the third quarter of 2016. The increase in SG&A expenses was attributable to the following:

	(in millions)	% Change	
Organic	\$ (2.9)	(2.8)	%
Foreign exchange	1.4	1.3	
Acquisition	4.0	3.9	
Total	\$ 2.5	2.4	%

The increase primarily related to \$4.0 million of SG&A expenses attributable to our 2016 PVI acquisition, and an increase in foreign exchange of \$1.4 million, mainly due to the appreciation of the euro and the Canadian dollar against the U.S. dollar. The increase was partially offset by a decrease in organic SG&A expenses of \$2.9 million, driven by a decline in product liability costs of \$2.9 million, and a decrease in transformation costs of \$2.1 million as our current transformation programs ramp down. The decline in product liability costs is primarily related to the resolution of our recent class action lawsuits and associated reduction in reported claims. These decreases were partially offset by increased variable costs related to sales volume and increased investments in our strategic growth initiatives compared to the third quarter of 2016. Total SG&A expenses, as a percentage of sales, were 29.3% in the third quarter of 2017 compared to 30.6% in the third quarter of 2016.

Restructuring. In the third quarter of 2017, we recorded a net charge of \$1.4 million primarily for costs related to the transformation of our Americas business and other costs incurred as part of other restructuring initiatives within each region, as compared to \$1.0 million in the third quarter of 2016. For a more detailed description of our current restructuring plans, see Note 6 of Notes to Consolidated Financial Statements.

Operating Income. Operating income (loss) by segment for the third quarters of 2017 and 2016 was as follows:

	Third Quarter Ended			% Change to	
	October 1, 2017	October 2, 2016	Change	Consolidated	Operating
	(dollars in millions)			Income	
Americas	\$ 39.8	\$ 32.2	\$ 7.6	20.8	%
Europe	13.4	12.3	1.1	3.0	
APMEA	0.5	1.6	(1.1)	(3.0)	
Corporate	(9.4)	(9.6)	0.2	0.5	
Total	\$ 44.3	\$ 36.5	\$ 7.8	21.3	%

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

Europe in millions)	APMEA	Corporate	Total	Change As a % of Consolidated Operating Income						Change As a % of Segment Operating Income		
				Americas	Europe	APMEA	Corporate	Total	Americas	Europe	Total	
\$ 0.7	\$ (0.9)	\$ 0.2	\$ 6.3	17.3	% 1.9	% (2.5)	% 0.5	% 17.2	% 19.6	% 5.7	%	
0.7	—	—	0.8	0.3	1.9	—	—	2.2	0.3	5.7		
—	—	—	1.1	3.0	—	—	—	3.0	3.4	—		
(0.3)	(0.2)	—	(0.4)	0.2	(0.8)	(0.5)	—	(1.1)	0.3	(2.5)		
\$ 1.1	\$ (1.1)	\$ 0.2	\$ 7.8	20.8	% 3.0	% (3.0)	% 0.5	% 21.3	% 23.6	% 8.9	%	

Organic operating income increased by \$6.3 million compared to the third quarter of 2016, mainly due to increased savings from restructuring actions, sourcing, and productivity in the Americas and Europe. The organic increase is also related to stronger sales volume and reduced transformation costs compared to the third quarter of 2016 in the Americas. This increase in operating income was partially offset by a decrease in APMEA operating income primarily related to reduced volumes, unfavorable sales mix, and higher growth investments.

Interest Expense. Interest expense decreased \$0.2 million, or 4.1%, in the third quarter of 2017 as compared to the third quarter of 2016 due to a reduction in principal balance of debt outstanding. The impact of the lower outstanding principal balance is partially offset by increased interest rates in the third quarter of 2017 compared to the third quarter of 2016. Refer to Note 11 of the Notes to Consolidated Financial Statements for further details.

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Other expense (income), net. Other expense (income), net, decreased \$0.8 million to a net expense balance of \$0.3 million in the third quarter of 2017 as compared to a net income balance of (\$0.5) million in the third quarter of 2016. The decrease is primarily due to net foreign currency transaction losses.

Income Taxes. Our effective income tax rate increased to 32.9% in the third quarter of 2017, from 32.4% in the third quarter of 2016. The increase in the effective tax rate is primarily related to worldwide earnings mix.

Net Income. Net income was \$26.5 million, or \$0.77 per common share, for the third quarter of 2017, compared to \$21.9 million, or \$0.63 per common share, for the third quarter of 2016. Results for the third quarter of 2017 include an after-tax charge of \$0.9 million, or \$0.03 per common share, for restructuring.

Results for the third quarter of 2016 include net after-tax charges of \$0.6 million, or \$0.02 per common share, for restructuring and \$2.3 million, or \$0.07 per common share, for the Europe and Americas transformation deployment costs.

Nine Months Ended October 1, 2017 Compared to Nine Months Ended October 2, 2016

Net Sales. Our business is reported in three geographic segments: Americas, Europe and APMEA. Our net sales in each of these segments for each of the first nine months of 2017 and 2016 were as follows:

	Nine Months Ended October 1, 2017		Nine Months Ended October 2, 2016			% Change to Consolidated Net Sales
	Net Sales	% Sales	Net Sales	% Sales	Change	
	(dollars in millions)					
Americas	\$ 718.3	65.9 %	\$ 677.6	64.2 %	\$ 40.7	3.9 %
Europe	324.6	29.8	329.6	32.0	(5.0)	(0.5)
APMEA	47.5	4.3	49.2	3.8	(1.7)	(0.2)
Total	\$ 1,090.4	100.0 %	\$ 1,056.4	100.0 %	\$ 34.0	3.2 %

The change in net sales was attributable to the following:

Change as a %

Change as a %

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				of Consolidated Net Sales				of Segment Net Sales			
Americas	Europe	APMEA	Total	Americas	Europe	APMEA	Total	Americas	Europe	APMEA	Total
(dollars in millions)											
\$ 1.9	\$ (2.1)	\$ (2.9)	\$ (3.1)	0.2	% (0.2)	% (0.3)	% (0.3)	0.3	% (0.6)	% (0.5)	% (0.5)
0.4	(2.9)	(0.1)	(2.6)	—	(0.3)	—	(0.3)	—	(0.9)	(0.3)	(0.3)
41.9	—	1.3	43.2	4.0	—	0.1	4.1	6.2	—	—	2.6
(3.5)	—	—	(3.5)	(0.3)	—	—	(0.3)	(0.5)	—	—	—
\$ 40.7	\$ (5.0)	\$ (1.7)	\$ 34.0	3.9	% (0.5)	% (0.2)	% 3.2	% 6.0	% (1.5)	% (3.1)	% (3.1)

The change in organic net sales as a percentage of consolidated net sales and of segment net sales in the Americas excludes divested sales for both periods presented.

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

					Change As a % of Prior Year Sales					
	Wholesale	DIY	OEMs	Specialty	Total	Wholesale	DIY	OEMs	Specialty	
(dollars in millions)										
Americas	\$ 15.5	\$ (3.7)	\$ 0.5	\$ (10.4)	\$ 1.9	4.0	% (8.3)	% 1.0	% (5.6)	% (5.6)
Europe	1.8	(1.6)	(2.3)	—	(2.1)	0.8	(35.3)	(2.1)	—	—
APMEA	2.3	—	(5.2)	—	(2.9)	5.5	—	(72.6)	—	—
Total	\$ 19.6	\$ (5.3)	\$ (7.0)	\$ (10.4)	\$ (3.1)					

Total organic net sales decreased \$3.1 million compared to the first nine months of 2016. Included in the decrease was the \$12.6 million impact of our ongoing product rationalization efforts across our regions, as we continue to focus on our core product lines. The product rationalization mainly affected our DIY and OEM channels.

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Organic net sales in the Americas increased \$1.9 million compared to the first nine months of 2016. The increase was mainly due to growth in the wholesale channel, particularly related to backflow, valve, and drainage products. This increase was partially offset by declines in the specialty channel, where we experienced weakness in our tankless water heater and condensing boiler products. There was also a decrease in the DIY channel due to the product rationalization discussed above.

Organic net sales in Europe decreased \$2.1 million compared to the first nine months of 2016. This was mainly due to our product rationalization efforts, and declines in our water and plumbing product sales in France and the UK. This decrease was also related to reduced demand for our HVAC products in Italy. These decreases were partially offset by increased demand for our drains and electronics products during the first nine months of 2017.

Organic net sales in APMEA decreased \$2.9 million as compared to the first nine months of 2016 primarily related to the impact of our product rationalization efforts as well as project delays in the Middle East. This decrease was partially offset by increased demand for our underfloor heating products for residential applications and increased demand for our commercial valves products.

The net decrease in sales due to foreign exchange was primarily due to the depreciation of the euro against the U.S. dollar in the first nine months of 2017. We cannot predict whether foreign currencies will appreciate or depreciate against the U.S. dollar in future periods or whether future foreign exchange rate fluctuations will have a positive or negative impact on our net sales.

The decrease in total net sales due to divested products of \$3.5 million relates to sales of product lines we divested by the end of the first quarter of 2016 in the Americas segment as part of our Americas transformation program.

The increase in net sales from acquisitions in the Americas and APMEA segments is related to the fourth quarter 2016 acquisition of PVI and the first quarter 2016 acquisition of Watts Korea, respectively.

Gross Profit. Gross profit and gross profit as a percent of net sales (gross margin) for the first nine months of 2017 and 2016 were as follows:

Nine Months Ended

	October 1, 2017	October 2, 2016
	(dollars in millions)	
Gross profit	\$ 453.2	\$ 427.9
Gross margin	41.6 %	40.5 %

The gross margin increase compared to the first nine months of 2016 is primarily attributable to the Americas and Europe. Americas' gross margin increased primarily from transformation and sourcing savings, while Europe's gross margin improved due to increased manufacturing productivity and restructuring savings. The increase is also due to changes to our product mix, including the impact of our ongoing product rationalization efforts.

Selling, General and Administrative Expenses. Selling, general and administrative, or SG&A, expenses for the first nine months of 2017 increased \$7.2 million, or 2.2%, compared to the first nine months of 2016. The increase in SG&A expenses was attributable to the following:

	(in millions)	% Change
Organic	\$ (4.4)	(1.4) %
Foreign exchange	(0.9)	(0.3)
Acquisitions	12.5	3.9
Total	\$ 7.2	2.2 %

SG&A expenses increased primarily as a result of our 2016 acquisitions of PVI and Watts Korea. This increase was partially offset by reductions in foreign exchange primarily from the depreciation of the euro against the U.S. dollar in the first nine months of 2017. Organically SG&A expenses decreased \$4.4 million compared to the first nine months of 2016, primarily related to a decline in product liability costs of \$7.2 million, and lower transformation costs of \$4.6 million as our current transformation program ramps down. The decline in product liability costs is primarily related to the resolution of our recent class action lawsuits and the associated reduction in reported claims. The organic decrease

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was partially offset by an increase of \$3.1 million of higher distribution and freight costs, \$5.0 million for investments in strategic initiatives which includes \$2.0 million in research and development costs, and the remaining offset was due to increased variable costs from sales volume increases and inflation. Total SG&A expenses, as a percentage of sales, were 29.8% in the first nine months of 2017 compared to 30.1% in the first nine months of 2016.

Restructuring. In the first nine months of 2017, we recorded a net charge of \$3.6 million, primarily for the transformation of our Americas business, involuntary terminations and other costs incurred as part of our restructuring initiatives, as compared to a net charge of \$5.6 million for the first nine months of 2016. For a more detailed description of our current restructuring plans, see Note 6 of Notes to Consolidated Financial Statements.

Gain on disposition. In the second quarter of 2016, we recorded a pre-tax gain of \$8.7 million related to the sale of a China subsidiary that was dedicated to the production of non-core products and part of the transformation of our Americas and APMEA businesses. The pre-tax gain included a non-cash accumulated currency translation adjustment of \$7.3 million.

Operating Income. Operating income (loss) by segment for the first nine months of 2017 and 2016 was as follows:

	Nine Months Ended			% Change to Consolidated Operating Income	
	October 1, 2017	October 2, 2016	Change		
	(Dollars in millions)				
Americas	\$ 110.5	\$ 95.7	\$ 14.8	13.1	%
Europe	38.5	32.3	6.2	5.4	
APMEA	3.3	13.1	(9.8)	(8.6)	
Corporate	(27.5)	(27.7)	0.2	0.2	
Total	\$ 124.8	\$ 113.4	\$ 11.4	10.1	%

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

						Change as a % of Consolidated Operating Income							
	Americas	Europe	APMEA	Corp.	Total	Americas	Europe	APMEA	Corp.	Total			
	(Dollars in millions)												
Organic	\$ 12.1	\$ 3.9	\$ (0.8)	\$ 0.4	\$ 15.6	10.7	%	3.4	%	(0.7)	%	0.4	%

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Foreign exchange	0.1	(0.4)	—	—	(0.3)	0.1	(0.4)	—	—	
Acquisitions	2.8	—	—	—	2.8	2.5	—	—	—	
Gain on disposition	—	—	(8.7)	—	(8.7)	—	—	(7.7)	—	
Restructuring	(0.2)	2.7	(0.3)	(0.2)	2.0	(0.2)	2.4	(0.2)	(0.2)	
Total	\$ 14.8	\$ 6.2	\$ (9.8)	\$ 0.2	\$ 11.4	13.1	% 5.4	% (8.6)	% 0.2	%

The increase in consolidated operating income was primarily driven by increased volume and gross margin improvements in the Americas, as well as savings from our restructuring initiatives in Europe and fewer restructuring costs. The increase in operating income was also driven by reduced transformation costs compared to the first nine months of 2016 in the Americas and APMEA as our transformation program ramps down. Contributing to the increase in consolidated operating income was \$2.8 million from the fourth quarter 2016 acquisition of PVI. Included in operating income for the first nine months of 2016 was an \$8.7 million gain on a disposition of a China subsidiary in the second quarter of 2016.

Interest Expense. Interest expense decreased \$2.6 million, or 15.2%, in the first nine months of 2017 as compared to the first nine months of 2016 due in part to a lower interest rate being paid on the Facility Agreement debt compared to the Revolving Credit Facility debt it replaced, and a lower interest rate being paid on the Revolving Credit Facility debt that replaced a higher interest \$225 million private placement note in April 2016. The decrease is also due to a reduction in the principal balance of debt outstanding. Refer to Note 11 of the Notes to Consolidated Financial Statements for further details.

Other expense (income), net. Other expense (income), net, decreased \$4.4 million to a net expense balance of \$0.8 million in the first nine months of 2017 as compared to a net income balance of (\$3.6) million in the first nine months of 2016. Included in other income in the first nine months of 2016 was a \$1.7 million non-cash gain recognized on the acquisition of Watts Korea. The remaining decrease is primarily due to net foreign currency transaction losses in the first nine months of 2017.

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Income Taxes. Our effective income tax rate decreased to 31.5% in the first nine months of 2017, from 33.8% in the first nine months of 2016. The decrease in the effective tax rate is primarily related to worldwide earnings mix. Included in the 2016 effective tax rate was a reserve for an ongoing tax audit.

Net Income. Net income for the first nine months of 2017 was \$75.4 million, or \$2.19 per common share, compared to \$66.7 million, or \$1.93 per common share, for the first nine months of 2016. Results for the first nine months of 2017 include an after-tax charge of \$1.9 million, or \$0.06 per common share, for the Europe and Americas transformation costs; \$2.4 million, or \$0.07 per common share, for restructuring charges; partially offset by \$1.3 million or \$0.04 per common share in tax benefits.

Results through the first nine months of 2016 include after-tax benefits of \$8.3 million, or \$0.24 per common share, for a gain on disposition and \$0.5 million, or \$0.01 per common share, for acquisition related accounting, offset by an after-tax charge of \$7.3 million, or \$0.22 per common share, for the Europe and Americas transformation costs; \$3.6 million, or \$0.10 per common share, for restructuring charges; and \$1.5 million, or \$0.04 per common share for tax charges related to the transformation.

Liquidity and Capital Resources

We generated \$73.4 million of net cash from operating activities in the first nine months of 2017 as compared to \$69.6 million of net cash generated from operating activities in the first nine months of 2016. The increase was primarily related to higher net income, including the impact of non-cash adjustments, partially offset by the timing of working capital fluctuations compared to the first nine months of 2016.

We used \$13.5 million of net cash for investing activities compared to \$24.2 million in the first nine months of 2016. We used \$9.2 million less cash in the first nine months of 2017 for purchases of capital equipment compared to the first nine months of 2016. In the fourth quarter of 2017, we expect to invest approximately \$13 to 16 million in capital equipment as part of our ongoing commitment to improve our operating capabilities.

We used \$168.4 million of net cash from financing activities for the first nine months of 2017 primarily due to payments of long-term debt of \$151.8 million, payment of dividends of \$19.4 million, and payments to repurchase approximately 214,000 shares of Class A common stock at a cost of \$13.6 million. This was partially offset by proceeds from an additional draw on our line of credit of \$20.0 million during the first nine months of 2017.

On February 12, 2016, we terminated our prior Credit Agreement and entered into a new Credit Agreement (the “Credit Agreement”) among the Company, certain subsidiaries of the Company who became borrowers under the Credit Agreement, JPMorgan Chase Bank, N.A., as Administrative Agent, Swing Line Lender and Letter of Credit Issuer, and the other lenders referred to therein. The Credit Agreement provides for a \$500 million, five year, senior unsecured revolving credit facility (the “Revolving Credit Facility”) with a sublimit of up to \$100 million in letters of credit. The Credit Agreement also provided for a \$300 million, five year, term loan facility (the “Term Loan Facility”) available to us in a single draw. The Credit Agreement matures on February 12, 2021, subject to extension under certain circumstances and subject to the terms of the Credit Agreement. As of October 1, 2017, we had \$288.8 million of borrowings outstanding on the term loan and \$162.0 million drawn on the Revolving Credit Facility; had \$25.7 million of stand-by letters of credit outstanding and had \$312.3 million of unused and available credit under the Revolving Credit Facility. As of October 1, 2017, we were in compliance with all covenants related to the Credit Agreement.

On December 16, 2016, Watts International Holdings Limited (“Watts International”), our wholly owned subsidiary, entered into a Facility Agreement (the “Facility Agreement”) among Watts International, as original borrower and original guarantor, Watts Water Technologies EMEA B.V., our wholly owned subsidiary (“Watts EMEA”), as original guarantor, JPMorgan Chase Bank, N.A., as sole bookrunner and sole lead arranger, J.P. Morgan Europe Limited, as agent to the financial parties, and the other lenders referred to therein. The Facility Agreement provided for a €110 million, 364 day, term loan facility in a single draw. On December 20, 2016, Watts International borrowed the full amount available for borrowing under the Facility Agreement. The loan bears interest at a rate per annum equal to (i) the Euro InterBank Offered Rate (EURIBOR), provided that if such rate is less than zero, then EURIBOR shall be deemed to be zero, plus (ii) a margin of 1.875%, provided that if no event of default is continuing and Watts International’s consolidated leverage ratio is at a specified level, the margin shall decrease to 1.50%. Accrued interest on the loan is payable on the last day of each interest period. The first interest period is set at one month and may be changed

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subsequently to a period of one, two, or three months (or such other period agreed with all the lenders). Substantially all of the proceeds of the borrowings made on December 20, 2016 under the Facility Agreement were used to pay down \$113 million previously outstanding under the Revolving Credit Facility. The Company made payments on the Facility Agreement of approximately €9.0 million during the three months ended October 1, 2017 and €110.0 million during the first nine months of 2017. As of October 1, 2017, the Company has repaid in full the Facility Agreement.

As of October 1, 2017, we held \$246.6 million in cash and cash equivalents. Our ability to fund operations from cash and cash equivalents could be limited by market liquidity as well as possible tax implications of moving proceeds across jurisdictions. Of this amount, approximately \$218.7 million of cash and cash equivalents were held by foreign subsidiaries. Our U.S. operations typically generate sufficient cash flows to meet our domestic obligations. We may have to borrow to fund some or all of our expected cash outlay, which we can do at reasonable interest rates by utilizing the uncommitted borrowings under our Revolving Credit Facility. However, if amounts held by foreign subsidiaries were needed to fund operations in the United States, we could be required to accrue and pay taxes to repatriate these funds. Such charges may include a federal tax of up to 35.0% on dividends received in the U.S., potential state income taxes and an additional withholding tax payable to foreign jurisdictions of up to 10.0%. However, our intent is to permanently reinvest undistributed earnings of foreign subsidiaries and we do not have any current plans to repatriate them to fund operations in the United States.

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 \$25.7 million and \$25.6 million as of October 1, 2017 and December 31, 2016, respectively. Our letters of credit are associated with insurance coverage and generally expire within one year of issuance. These instruments may exist or expire without being drawn down; therefore they do not necessarily represent future cash flow obligations.

Non GAAP Financial Measures

In accordance with the SEC's Regulation G and item 10(e) of Regulation S-K, the following provides definitions of the non-GAAP measures used by management. We believe that these measures provide for a more complete perspective of underlying business results and trends. These non-GAAP measures are not intended to be considered by the user in place of the related GAAP measure, but rather as supplemental information to more fully understand our business results. These non-GAAP measures may not be the same as similar measures used by other companies due to possible differences in method and in the items or events being adjusted.

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

Free cash flow is a non-GAAP measure that does not represent cash generated from operating activities in accordance with U.S. GAAP. Therefore it should not be considered an alternative to net cash provided by operating activities as an indication of our performance. The cash conversion rate of free cash flow to net income is also a measure of our performance in cash flow generation. 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, repay debt, pay dividends, repurchase stock and fund acquisitions.

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

	Nine Months Ended	
	October 1, 2017	October 2, 2016
	(in millions)	
Net cash provided by operating activities	\$ 73.4	\$ 69.6
Less: additions to property, plant, and equipment	(17.1)	(26.3)
Plus: proceeds from the sale of property, plant, and equipment	0.4	—
Free cash flow	\$ 56.7	\$ 43.3
Net income	\$ 75.4	\$ 66.7
Cash conversion rate of free cash flow to net income	75.2 %	64.9 %

Our free cash flow improved in the first nine months of 2017 when compared to the free cash flow for the first nine months 2016 due to increased net income, including the impact of non-cash adjustments, and lower capital spend in the first nine months of 2017.

Our net debt to capitalization ratio, a non GAAP financial measure used by management, at October 1, 2017 was 25.0% compared to 29.8% at December 31, 2016. Management believes the net debt to capitalization ratio is an appropriate supplemental measure because it helps investors understand our ability to meet our financing needs and serves as a basis to evaluate our financial structure. Our computation may not be comparable to other companies that may define their net debt to capitalization ratios differently.

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

	October 1, 2017	December 31, 2016
	(in millions)	
Current portion of long-term debt	\$ 22.5	\$ 139.1
Plus: long-term debt, net of current portion	500.6	511.3
Less: cash and cash equivalents	(246.6)	(338.4)
Net debt	\$ 276.5	\$ 312.0

A reconciliation of capitalization is provided below:

	October 1, 2017 (in millions)	December 31, 2016		
Net debt	\$ 276.5	\$ 312.0		
Total stockholders' equity	830.8	736.3		
Capitalization	\$ 1,107.3	\$ 1,048.3		
Net debt to capitalization ratio	25.0	29.8	%	%

Off Balance Sheet Arrangements

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

Application of Critical Accounting Policies and Key Estimates

We believe that our critical accounting policies are those related to revenue recognition, allowance for doubtful accounts, inventory valuation, goodwill and other intangibles, product liability and workers' compensation costs, legal contingencies and income taxes. We believe these accounting policies are particularly important to an understanding of

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our financial position and results of operations and requires application of significant judgment by our management. In applying these policies, management uses its judgment in making certain assumptions and estimates. Our critical accounting policies are more fully described under the heading “Accounting Policies” in Note 2 of the Notes to Consolidated Financial Statements in our Annual Report on Form 10-K as filed with the SEC on February 24, 2017.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We use derivative financial instruments primarily to reduce exposure to adverse fluctuations in foreign exchange rates, interest rates and costs of certain raw materials used in the manufacturing process. We do not enter into derivative financial instruments for trading purposes. As a matter of policy, all derivative positions are used to reduce risk by hedging underlying economic exposure. The derivatives we use are instruments with liquid markets. See Note 5 of Notes to the Consolidated Financial Statements for further details.

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

Our non-U.S. subsidiaries transact most business, including certain intercompany transactions, in foreign currencies. Such transactions are principally purchases or sales of materials and are denominated in European currencies or the U.S. or Canadian dollar. We use foreign currency forward exchange contracts from time to time to manage the risk related to intercompany loans, intercompany purchases that occur during the course of a year, and certain open foreign currency denominated commitments to sell products to third parties. At October 1, 2017, we did not renew the two forward exchange contracts which were entered to manage the foreign currency rate exposure between the Hong Kong dollar and the euro regarding two intercompany loans, as the two intercompany loans have been settled. These forward contracts were marked-to-market with changes in the fair value recorded to earnings throughout the first nine months of 2017.

Prior to 2016, we generally had a low exposure on the cost of our debt to changes in interest rates. On February 12, 2016, the Company entered into a new Credit Agreement pursuant to which it received a funding commitment under a Term Loan of \$300 million, of which the entire \$300 million has been drawn on, and \$288.8 million is outstanding and a Revolving Commitment of \$500 million, of which \$162.0 million has been drawn as of October 1, 2017. Both facilities mature on February 12, 2021. For each facility, the Company can choose either an Adjusted LIBOR or Alternative Base Rate (“ABR”). Accordingly, the Company’s earnings and cash flows are exposed to interest rate risk from changes in Adjusted LIBOR. In order to manage the Company’s exposure to changes in cash flows attributable to fluctuations in LIBOR-indexed interest payments related to our floating rate debt, the Company entered into two interest rate swaps. For each interest rate swap, the Company receives the three-month USD-LIBOR subject to a 0% floor, and pays a fixed rate of 1.31375% on a notional amount of \$225.0 million. Information about our long term debt including principal amounts and related interest rates appears in Note 11 of Notes to the Consolidated Financial Statements.

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

Item 4. Controls and Procedures

As required by Rule 13a-15(b) under the Securities Exchange Act of 1934, as amended, or Exchange Act, as of the end of the period covered by this report, we carried out an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer and 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

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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 1, 2017, 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, “Product Liability, Environmental and Other Litigation Matters” and Item 3, “Legal Proceedings” of our Annual Report on Form 10-K for the year ended December 31, 2016, we are party to certain litigation. There have been no material developments with respect to our contingencies and environmental remediation proceedings during the quarter ended October 1, 2017, other than as described in Note 12 of the Notes to Consolidated Financial Statements, which is incorporated herein by reference.

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, including statements relating to our long-term growth strategy, our expected capital expenditures, our transformation and restructuring initiatives and the timing and expected costs and savings associated with those initiatives. These forward-looking statements reflect our current views about future events. You should not rely on forward-looking statements because our actual results may differ materially from those predicted as a result of a number of potential risks and uncertainties. These potential risks and uncertainties include, but are not limited to: the effectiveness, the timing and the expected costs and savings associated with our restructuring and transformation programs and initiatives; the current economic and financial condition, which can affect the housing and construction markets where our products are sold, manufactured and marketed; shortages in and pricing of raw materials and supplies; our ability to compete effectively; changes in variable interest rates on our borrowings; failure to expand our markets through acquisitions; failure to successfully develop and introduce new product offerings or enhancements to existing products; failure to manufacture products that meet required performance and safety standards; foreign exchange rate fluctuations; cyclicity of industries where we market our products, such as plumbing and heating wholesalers and home improvement retailers; environmental compliance costs; product liability risks; changes in the status of current litigation; and other risks and uncertainties discussed under the heading “Item 1A. Risk Factors” and in Note 14 of the Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2016 filed with the Securities and Exchange Commission and our subsequent filings 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 1, 2017.

Period	Issuer Purchases of Equity Securities			(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
	(a) Total Number of Shares (or Units) Purchased	(b) Average Price Paid per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	
July 3, 2017 - July 30, 2017	11,133	\$ 65.66	—	—
July 31, 2017 - August 27, 2017	4,148	\$ 63.78	—	—
August 28, 2017 - October 1, 2017	—	\$ —	—	—
Total	15,281	\$ 64.72	—	—

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The following table includes information with respect to repurchases of our Class A common stock during the three month period ended October 1, 2017 under our stock repurchase program.

Period	Issuer Purchases of Equity Securities			(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
	(a) Total Number of Shares (or Units) Purchased(1)	(b) Average Price Paid per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	
July 3, 2017 - July 30, 2017	21,594	\$ 63.45	21,594	\$ 45,704,128
July 31, 2017 - August 27, 2017	22,700	\$ 64.46	22,700	\$ 44,240,865
August 28, 2017 - October 1, 2017	28,375	\$ 64.30	28,375	\$ 42,416,345
Total	72,669	\$ 64.10	72,669	

(1) On July 27, 2015, the Board of Directors authorized a new stock repurchase program of up to \$100 million of the Company's Class A common stock to be purchased from time to time on the open market or in privately negotiated transactions. The timing and number of shares repurchased will be determined by the Company's management based on its evaluation of market conditions and other factors.

Item 6. Exhibits

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

EXHIBIT INDEX

Exhibit No.	Description
3.1	<u>Restated Certificate of Incorporation, as amended(1)</u>
3.2	<u>Amended and Restated By Laws(2)</u>
31.1†	<u>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</u>
31.2†	<u>Certification of Principal Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended</u>
32.1††	<u>Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350</u>

32.2††	<u>Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350</u>
101.INS*	XBRL Instance Document.
101.SCH*	XBRL Taxonomy Extension Schema Document.
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document.

† Filed herewith.

†† Furnished herewith.

* Attached as Exhibit 101 to this report are the following formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Balance Sheets at October 1, 2017 and December 31, 2016, (ii) Consolidated Statements of Operations for the Third Quarters and Nine Months Ended October 1, 2017 and October 2, 2016, (iii) Consolidated Statements of Comprehensive Income (Loss) for the Third Quarters and Nine Months Ended October 1, 2017 and October 2, 2016, (iv) Consolidated Statements of Cash Flows for the Nine Months Ended October 1, 2017 and October 2, 2016, and (v) Notes to Consolidated Financial Statements.

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- (1) Incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarter ended July 3, 2005 (File No. 001 11499).
- (2) Incorporated by reference to the Registrant's Current Report on Form 8-K dated July 27, 2015 (File No. 001 11499).

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SIGNATURES

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

WATTS WATER TECHNOLOGIES, INC.

Date: November 6, 2017 By: /s/ Robert J. Pagano, Jr.
Robert J. Pagano, Jr.
Chief Executive Officer (principal executive officer)

Date: November 6, 2017 By: /s/ Todd A. Trapp
Todd A. Trapp
Chief Financial Officer (principal financial officer)

Date: November 6, 2017 By: /s/ Virginia A. Halloran
Virginia A. Halloran
Chief Accounting Officer (principal accounting officer)