WATTS WATER TECHNOLOGIES INC
Form 424B5
November 07, 2006

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Pursuant to Rule 424(B)(5)
Registration No. 333-124615

Subject to completion, dated November 7, 2006

We will amend and complete the information in this prospectus supplement. This prospectus supplement and the prospectus are part of a registration statement filed with the Securities and Exchange Commission. This prospectus supplement and the prospectus are not offers to sell these securities or our solicitation of your offer to buy these securities in any jurisdiction where that would not be permitted or legal.

PROSPECTUS SUPPLEMENT
(TO PROSPECTUS DATED MAY 18, 2005)

5,000,000 Shares

Class A Common Stock

We are offering 5,000,000 shares of Class A common stock.

Our Class A common stock is listed on the New York Stock Exchange under the symbol "WTS." On November 6, 2006, the closing price of our Class A common stock on the New York Stock Exchange was $42.13 per share.

	Per Share	Total
Public offering price	$	$
Underwriting discounts and commissions	$	$
Proceeds to Watts Water Technologies, before expenses	$	$

We have granted the underwriters an option for a period of 30 days to purchase up to 750,000 additional shares of our Class A common stock at the public offering price less the underwriting discounts and commissions to cover over-allotments.

Investing in our Class A common stock involves risks. See "Risk factors" beginning on page S-7 of this prospectus supplement for more information.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus supplement or the accompanying prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The underwriters expect to deliver the shares on or about , 2006.

JPMorgan

KeyBanc Capital Markets

Robert W. Baird & Co.

SunTrust Robinson Humphrey

, 2006

Table of contents

	Page
Prospectus supplement	
About this prospectus supplement	S-iii
Forward-looking statements	S-iii
Summary	S-1
The offering	S-6
Risk factors	S-7
Use of proceeds	S-15
Capitalization	S-16
Price range of Class A common stock	S-17
Selected consolidated financial data	S-18
Management's discussion and analysis of financial condition and results of operations	S-20
Business	S-49
Underwriting	S-63
Legal matters	S-66
Where you can find more information	S-66

Table of contents

	Page
Prospectus	
Risk factors	1
About this prospectus	7
Where you can find more information	7
Information incorporated by reference	7
Cautionary statement regarding forward-looking statements	8
About Watts Water Technologies, Inc.	9
Ratios of earnings to fixed charges	10
How we intend to use the proceeds	10
Description of the securities	11

	Page
Description of debt securities	12
Description of preferred stock	28

Description of Class A common stock	34
Description of depositary shares	35
Description of warrants	39
Description of stock purchase contracts and stock purchase units	40
How we plan to sell the securities	41
Experts	44
Legal matters	44

You should rely only on the information contained or incorporated by reference in this prospectus supplement and the accompanying prospectus. We have not, and the underwriters have not, authorized any other person to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. We are not, and the underwriters are not, making an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. You should assume that the information appearing in this prospectus supplement, the accompanying prospectus and the documents incorporated by reference is accurate only as of their respective dates. Our business, financial condition, results of operations and prospects may have changed since those dates.

Unless otherwise provided in this prospectus supplement, trademarks identified by ® and are registered trademarks or trademarks, respectively, of Watts Water Technologies, Inc. or its subsidiaries.

About this prospectus supplement

This prospectus supplement supplements the accompanying prospectus that is part of a registration statement that we filed with the Securities and Exchange Commission, or the SEC, using a "shelf" registration process. Under the shelf registration statement, we may sell Class A common stock, preferred stock, debt securities, depositary shares, warrants, stock purchase contracts and stock purchase units, or any combination of these securities, in one or more offerings with a total offering price of up to $300,000,000. This prospectus supplement provides specific information about the offering of shares of our Class A common stock under the shelf registration statement. You should carefully read this prospectus supplement, the accompanying prospectus and the information incorporated by reference. In case there are any differences or inconsistencies among this prospectus supplement, the accompanying prospectus and the information incorporated by reference, you should only rely on the information contained in the document with the latest date. Please refer to the information and documents listed under the heading "Information Incorporated By Reference" in the accompanying prospectus.

Forward-looking statements

This prospectus supplement, including the information incorporated by reference in this prospectus supplement, contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. All statements, other than statements of historical facts, included in this prospectus supplement, or in information incorporated by reference in this prospectus supplement, regarding our strategy, future operations, financial position, future revenues, projected costs, prospects, plans and objectives of management are forward-looking statements. The words "anticipates," "believes," "estimates," "expects," "predicts," "potential," "intends," "continue," "may," "plans," "projects," "will," "should," "could," "would" and similar expressions are intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words.

We cannot guarantee that we actually will achieve the plans, intentions or expectations disclosed in our forward-looking statements, and you should not place undue reliance on our forward-looking statements. Forward-looking statements are inherently subject to risks, uncertainties and assumptions. Actual results or events could differ materially from the plans, intentions and expectations disclosed in the forward-looking statements that we make. We have included important factors in the cautionary statements included in this prospectus supplement and the accompanying prospectus, particularly under the heading "Risk Factors," that we believe could cause actual results or events to differ materially from the forward-looking statements that we make. Our forward-looking statements do not reflect the potential impact of any future acquisitions, mergers, dispositions, joint ventures or investments that we may be a party to or make. We do not assume any obligation to update any forward-looking statements.

Summary

Because this is a summary, it does not contain all the information about Watts Water Technologies, Inc. that may be important to you. To understand the specific terms of the offering, you should read this prospectus supplement and the accompanying prospectus carefully. You should also carefully read the section entitled "Risk Factors" in this prospectus supplement and in the accompanying prospectus and the documents identified under the caption "Information Incorporated By Reference" in the accompanying prospectus. Unless otherwise indicated, references to "we," "our," "ours," "us," "our company," "Watts" and "Watts Water Technologies" refer, collectively, to Watts Water Technologies, Inc. and its consolidated subsidiaries.

Our business

We are a leading supplier of products used in the water quality, water conservation, water safety and water flow control markets in North America and Europe, with an emerging presence in China. For over 130 years, we have designed and manufactured products that promote the comfort and safety of people and the quality and conservation of water used in commercial and residential applications. We believe that we have the broadest range of products in terms of design distinction, size and configuration in a majority of our principal product lines. Our principal product lines include:

- backflow preventers for preventing contamination of potable water caused by reverse flow within water supply lines and fire protection systems;
- a wide range of water pressure regulators for both commercial and residential applications;
- water supply and drainage products for commercial and residential applications;
- temperature and pressure relief valves for water heaters, boilers and associated systems;
- point-of-use water filtration and reverse osmosis systems for both commercial and residential applications;
- thermostatic mixing valves for tempering water in commercial and residential applications;
- systems for under-floor radiant applications and hydraulic pump groups for gas boiler manufacturers and renewable energy applications, including solar heat pumps;
- flexible stainless steel connectors for natural and liquid propane gas in commercial food service and residential applications; and
- large diameter butterfly valves for use in China's water infrastructure.

We sell our products to wholesale distributors, do-it-yourself, or DIY, chains, such as The Home Depot, Inc. and Lowe's Companies, Inc., and original equipment manufacturers, or OEMs. Most of our sales are of products approved under regulatory standards incorporated into state and municipal plumbing, heating, building and fire protection codes in North America and Europe. We have consistently advocated the development and enforcement of such codes and remain committed to providing products to meet these standards, in particular, safety and control valve products. We maintain quality control and testing procedures at each of our

manufacturing facilities in order to manufacture products in compliance with code requirements. Additionally, a majority of our manufacturing facilities are ISO 9000, 9001 or 9002 certified by the International Organization for Standardization.

Our industry

We estimate the annual global water market to be approximately $365 billion, of which the market that our products address is approximately $60 billion. Within the markets we serve, our sales are relatively balanced between residential and commercial segments, with renovations and remodeling driving a significant portion of demand for our products.

Competition for sales in the water quality, water conservation, water safety and water flow control markets is generally based on brand preference, engineering specifications, plumbing code requirements, price, technological expertise, delivery times and breadth of product offerings. The competitive environment in our industry is characterized by:

Consolidation of manufacturers. Our industry has experienced significant consolidation over the past decade due to the benefits of increased scale and broader product offerings. Many of our competitors have made numerous acquisitions or have been acquired themselves one or more times. Despite the ongoing consolidation, our industry remains highly fragmented, with numerous competitors and continued opportunities for further acquisitions.

Consolidation of North American and European wholesale distributors. The wholesale distribution channels for our products in North America and Europe are becoming more concentrated each year. For example, in March 2006, The Home Depot, Inc. acquired Hughes Supply, Inc., one of the largest wholesale distributors in North America. We believe that our product breadth and ability to act as a single source of supply continues to make us an attractive vendor to wholesale distributors in North America.

Large DIY market. The DIY market in the U.S. is estimated to be approximately $200 billion. We have experienced significant growth in sales of our products in the DIY market since entering that market in 1995, resulting in sales of approximately $165 million in 2005. We believe that our sales in the DIY market have increased primarily due to our development of unique new products and successful merchandising efforts, the expansion of the market with the growth of large national chains, and our ability to fill orders completely and on-time. In addition, our recent acquisition of ATS Expansion Group in France will allow us to expand into the DIY market in various European markets.

Our competitive strengths

Comprehensive portfolio of leading water-related products. We focus on supplying products for water-related markets, including water quality, water conservation, water safety and water flow control. Our comprehensive portfolio of water-related products provides our customers with purchasing efficiency and ease of service. As wholesale distribution customers have consolidated their vendor base to reduce costs, our broad product offerings have made us more attractive as a single source for their product needs.

Brand preference and leading market positions. We believe our leading product lines of backflow preventers, water pressure regulators, temperature and pressure relief valves, and thermostatic mixing valves have the highest brand name preference and brand name

recognition in North America. We further believe end-users of valves and related systems place a high premium on product quality and reliability, and our strength and reputation in these areas have contributed to our leading market positions.

Successful track record of identifying and integrating acquisitions. We have successfully acquired and integrated 30 companies since 1999. Our experience in acquiring businesses has resulted in improved financial performance of the acquired companies, increased our global presence and expanded our product line. We invest in opportunities that enable us to expand our existing product offering, enter new product and geographic markets, and acquire new technology and manufacturing capabilities.

Global manufacturing capabilities. Our sophisticated manufacturing equipment and processes allow us to shift manufacturing of a particular product across our global manufacturing network. We can therefore source our products globally according to costs and customer demand. In addition, we are continuing to source more of our manufacturing from lower-cost majority- or wholly-owned operations in China, Bulgaria and Tunisia.

Technological expertise and new product introductions. We have developed technological expertise in the design and manufacture of water-related products and solutions. For instance, we recently developed and marketed the first line of flexible water supply connectors with a built-in shutoff device. Our FloodSafe auto-shutoff connectors protect homes and businesses from potentially catastrophic water damage resulting from burst or broken water supply connectors. In addition, our Watts Radiant division recently designed Hydronex radiant heating panels. Our Hydronex panels are pre-engineered and manufactured in three typical modular configurations for radiant heating applications, providing installers with an alternative to costly custom-built panels.

Efficient distribution and reduced transaction costs. Over the past five years, we have made significant improvements in our distribution capabilities that have increased the quality of customer service and resulted in reduced transaction costs. We have upgraded our information technology systems, enabling us to increase our level of electronic data interchange transactions, which has improved delivery time and fill rates, allowing our customers to maintain lower inventories.

Experienced management team. Our senior management team has significant experience in the design, manufacturing, distribution, merchandising and sale of products in our industry. Our executive management team has an average of nine years of service with our company. In addition, this team has substantial experience in the acquisition and integration of businesses, aggressive cost management, global operations and efficient manufacturing techniques, all of which are critical to our long-term growth strategy.

Our growth strategy

Our "Water by Watts" strategy is to be the leading provider of water quality, water conservation, water safety and water flow control products for the residential and commercial markets in North America, Europe and China. Our primary objective is to grow earnings by increasing sales within existing markets, expanding into new markets, leveraging our distribution channels and customer base, making selected acquisitions, reducing manufacturing costs and advocating for the development and enforcement of industry standards.

Growing sales within existing markets. We intend to continue to introduce products in existing markets by enhancing our preferred brands, developing new complementary products, promoting plumbing code development to drive sales of safety and water quality products and continually improving merchandising in both the DIY and wholesale distribution channels. For example, with our June 2005 acquisition of the water softener business of Alamo Water Refiners, Inc., or Alamo, we broadened our product line in the water purification market by adding a well-known brand of water softeners for both residential and commercial applications.

Expanding into new product and geographic markets. We continually target selected new product and geographic markets based on growth potential, including our ability to leverage our existing distribution channels. For instance, in January 2005, we acquired HF Scientific, Inc., a manufacturer of instrumentation, test kits and chemical reagents used for monitoring water quality, with applications for laboratory and field use. With the acquisition of HF, we entered the water monitoring market, which complements our market for filtration and other water quality products. In addition, with our acquisition of Changsha Valve Works in April 2006, we entered the water works and water distribution markets in China.

Leverage our distribution channels and customer base. We continually leverage our distribution channels through the introduction of new products, as well as the integration of products of our acquired companies. For example, our recent acquisition of ATS Expansion Group based in France will allow us to expand into the DIY market in various European markets. We also intend to introduce ATS' product lines into our existing wholesale distribution channels in other European markets. Another example is our December 2005 acquisition of Dormont Manufacturing Company based in Export, Pennsylvania. Dormont is a leading manufacturer of gas connectors in the United States. Watts has a strong presence in the North American wholesale market, which will allow us to introduce Dormont's line of gas connectors in a more meaningful way into that distribution channel. We also intend to introduce Watts' line of plumbing and heating safety products into Dormont's commercial food service distribution channel.

Making selected acquisitions. We intend to continue to generate growth by targeting selected acquisitions, both in our core markets as well as new complementary markets. We have completed 30 acquisitions since divesting our industrial and oil and gas business in 1999, including nine acquisitions in 2005 and five acquisitions during the first three quarters of 2006. Our acquisition strategy focuses on businesses that manufacture preferred brand name products that address our themes of water quality, water safety, water conservation, water flow control and related complementary markets. We target businesses that will provide us with one or more of the following: an entry into new markets, an increase in shelf space with existing customers, strong brand names, a new or improved technology or an expansion of the breadth of our Water by Watts offering. In the first nine months of 2006, sales from acquisitions contributed approximately 21.1% to our total sales growth over the comparable period of 2005.

Reducing manufacturing costs. We are committed to reducing our manufacturing costs through a combination of expanding manufacturing in lower-cost countries and consolidating our diverse manufacturing operations in North America and Europe. We have acquired a number of manufacturing facilities in lower-cost regions such as China, Bulgaria and Tunisia, and plan to continue to shift production to these lower-cost regions.

Advocate development and enforcement of standards. We have consistently advocated the development and enforcement of plumbing codes and are committed to providing products to meet these standards, particularly for safety and control valve products. For example, we participated in the effort to include thermostatic scald protection in the American Society of Sanitary Engineers Standard ASSE 1016 and the subsequent adoption of that standard into national and state plumbing codes. These codes serve as a competitive barrier to entry by requiring that products sold in select states meet stringent criteria.

Corporate information

We were incorporated in Delaware in 1985. Our principal executive offices are located at 815 Chestnut Street, North Andover, Massachusetts 01845-6098, and our telephone number at that location is (978) 688-1811. We maintain a web site at *www.wattswater.com*. The information contained on our web site is not part of this prospectus supplement or the accompanying prospectus.

The offering

Class A common stock offered	5,000,000 shares
Over-allotment option	We have granted the underwriters an option to purchase up to 750,000 shares of Class A common stock solely to cover over-allotments.
Class A common stock to be outstanding after this offering	30,440,882 shares. This number excludes 7,293,880 shares of Class A common stock issuable upon the conversion of outstanding shares of our Class B common stock.
Use of proceeds	We expect to use the net proceeds from the sale of the Class A common stock sold by us hereby for general corporate purposes, including the funding of future acquisitions.
Voting rights	Holders of our Class A common stock have one vote per share of Class A common stock. Holders of our Class B common stock have ten votes per share of Class B common stock. See "Description of Class A Common Stock" on page 34 of the accompanying prospectus for more information.
Dividends	We have paid cash dividends since our initial public offering in 1986. See "Price range of Class A common stock" on page S-17 of this prospectus supplement for more information.
New York Stock Exchange symbol	WTS

The number of shares of our Class A common stock to be outstanding after this offering is based on the number of shares of Class A common stock outstanding as of October 31, 2006. This number does not include:

- an aggregate of 1,191,895 shares issuable upon exercise of stock options outstanding under our stock option plans as of October 31, 2006;
- an additional 2,221,027 shares available for future grant or issuance pursuant to our stock option plans as of October 31, 2006;
- 510,170 shares reserved for issuance under our management stock purchase plan as of October 31, 2006;
- 750,000 shares issuable upon exercise of the underwriters' over-allotment option; and
- 7,293,880 shares reserved for issuance upon conversion of shares of our Class B common stock as of October 31, 2006.

Risk factors

You should carefully consider the risk factors set forth below, as well as the other information appearing in this prospectus supplement, the accompanying prospectus and the documents to which we refer you, including those incorporated by reference, before making an investment in our Class A common stock.

Risk factors relating to our business

We face intense competition and, if we are not able to respond to competition in our markets, our revenues may decrease.

Competitive pressures in our markets could adversely affect our competitive position, leading to a possible loss of market share or a decrease in prices, either of which could result in decreased revenues and profits. We encounter intense competition in all areas of our business. Additionally, customers for our products are attempting to reduce the number of vendors from which they purchase in order to reduce the size and diversity of their inventories and their transaction costs. To remain competitive, we will need to invest continually in manufacturing, marketing, customer service and support and our distribution networks. We may not have sufficient resources to continue to make such investments and we may be unable to maintain our competitive position. In addition, we anticipate that we may have to reduce the prices of some of our products to stay competitive, potentially resulting in a reduction in the profit margin for, and inventory valuation of, these products. Some of our competitors are based in foreign countries and have cost structures and prices in foreign currencies. Accordingly, currency fluctuations could cause our U.S. dollar-priced products to be less competitive than our competitors' products which are priced in other currencies.

Reductions or interruptions in the supply of raw materials and increases in the costs of raw materials could reduce our profit margins and adversely affect our ability to meet our customer delivery commitments.

We require substantial amounts of raw materials, including bronze, brass, cast iron, steel and plastic and substantially all of the raw materials we require are purchased from outside sources. The availability and costs of raw materials may be subject to curtailment or change due to, among other things, new laws or regulations, suppliers' allocations to other purchasers, interruptions in production by suppliers and changes in exchange rates and worldwide price and demand levels. We typically do not enter into long-term supply agreements. Our inability to obtain adequate supplies of raw materials for our products at favorable costs, or at all, could have a material adverse effect on our business, financial condition or results of operations by decreasing our profit margins and by hindering our ability to deliver products to our customers on a timely basis. The costs of many of these raw materials are at the highest levels that they have been in many years. We may continue to experience further cost increases of these materials. During the first nine months of 2006, cost increases in raw materials were not completely recovered by increased selling prices or other product cost reductions. If we are not able to reduce or eliminate the effect of these cost increases through lowering other costs of production or successfully implementing price increases to our customers, such cost increases from our vendors could continue to have a negative effect on our financial results. Additionally, we continue to purchase increased levels of finished product from international sources. If there is an interruption in delivering these finished products to our domestic warehouses, this could have a negative effect on our financial results.

Implementation of our acquisition strategy may not be successful, which could affect our ability to increase our revenues or our profitability.

One of our strategies is to increase our revenues and profitability and expand our markets through acquisitions that will provide us with complementary water-related products and increase market share for our existing product lines. We cannot be certain that we will be able to identify, acquire or profitably manage additional companies or successfully integrate such additional companies without substantial costs, delays or other problems. Also, companies acquired recently and in the future may not achieve revenues, profitability or cash flows that justify our investment in them. We expect to spend significant time and effort in expanding our existing businesses and identifying, completing and integrating acquisitions. In particular, we expect that management will continue to devote a significant amount of time and effort over the next several months to improve the operational results of our recently acquired subsidiary, Core Industries Inc., including improvements in its profitability, customer satisfaction and revenue growth rate. If we are not successful in implementing these improvements, our financial results may be negatively affected. We have faced increasing competition for acquisition candidates which have resulted in significant increases in the purchase prices of many acquisition candidates. This competition, and the resulting purchase price increases, may limit the number of acquisition opportunities available to us, possibly leading to a decrease in the rate of growth of our revenues and profitability. In addition, acquisitions may involve a number of special risks, including, but not limited to:

- inadequate internal controls over financial reporting and our ability to bring such controls into compliance with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002 in a timely manner;
- adverse short-term effects on our reported operating results;
- diversion of management's attention;
- investigations of, or challenges to, acquisitions by competition authorities;
- loss of key personnel at acquired companies; and
- unanticipated management or operational problems or legal liabilities.

We are subject to risks related to product defects, which could result in product recalls and could subject us to warranty claims in excess of our warranty provisions or which are greater than anticipated due to the unenforceability of liability limitations.

We maintain strict quality controls and procedures, including the testing of raw materials and safety testing of selected finished products. However, we cannot be certain that our testing will reveal latent defects in our products or the materials from which they are made, which may not become apparent until after the products have been sold into the market. Accordingly, there is a risk that product defects will occur, which could require a product recall. Product recalls can be expensive to implement and, if a product recall occurs during the product's warranty period, we may be required to replace the defective product. In addition, a product recall may damage our relationship with our customers and we may lose market share with our customers. Our insurance policies may not cover the costs of a product recall.

Our standard warranties contain limits on damages and exclusions of liability for consequential damages and for misuse, improper installation, alteration, accident or mishandling while in the

possession of someone other than us. We record an accrual for estimated warranty costs at the time revenue is recognized. We may incur additional operating expenses if our warranty provision does not reflect the actual cost of resolving issues related to defects in our products. If these additional expenses are significant, it could adversely affect our business, financial condition and results of operations.

We face risks from product liability and other lawsuits, which may adversely affect our business.

We have been and may continue to be subject to various product liability claims or other lawsuits, including, among others, that our products include inadequate or improper instructions for use or installation, or inadequate warnings concerning the effects of the failure of our products. In the event that we do not have adequate insurance or contractual indemnification, damages from these claims would have to be paid from our assets and could have a material adverse effect on our results of operations, liquidity and financial condition. We, like other manufacturers and distributors of products designed to control and regulate fluids and gases, face an inherent risk of exposure to product liability claims and other lawsuits in the event that the use of our products results in personal injury, property damage or business interruption to our customers. Although we maintain strict quality controls and procedures, including the testing of raw materials and safety testing of selected finished products, we cannot be certain that our products will be completely free from defect. In addition, in certain cases, we rely on third-party manufacturers for our products or components of our products. Although we have product liability and general insurance coverage, we cannot be certain that this insurance coverage will continue to be available to us at a reasonable cost, or, if available, will be adequate to cover any such liabilities. For more information, see "Business Product liability, environmental and other litigation matters."

Down economic cycles, particularly reduced levels of residential and non-residential starts and remodeling, could have an adverse effect on our revenues and operating results.

We have experienced and expect to continue to experience fluctuations in revenues and operating results due to economic and business cycles. The businesses of most of our customers, particularly plumbing and heating wholesalers and home improvement retailers, are cyclical. Therefore, the level of our business activity has been cyclical, fluctuating with economic cycles. We also believe our level of business activity is influenced by residential and non-residential starts and renovation and remodeling, which are, in turn, heavily influenced by interest rates, consumer debt levels, changes in disposable income, employment growth and consumer confidence. If these and other factors cause a material reduction in residential and non-residential and remodeling starts, our revenues and profits would decrease and result in a material adverse effect on our financial condition and results of operations.

Economic and other risks associated with international sales and operations could adversely affect our business and future operating results.

Since we sell and manufacture our products worldwide, our business is subject to risks associated with doing business internationally. Our business and future operating results could be harmed by a variety of factors, including:

- trade protection measures and import or export licensing requirements, which could increase our costs of doing business internationally;

- potentially negative consequences from changes in tax laws, which could have an adverse impact on our profits;
- difficulty in staffing and managing widespread operations, which could reduce our productivity;
- costs of compliance with differing labor regulations, especially in connection with restructuring our overseas operations;
- natural disasters and public health emergencies;
- laws of some foreign countries, which may not protect our intellectual property rights to the same extent as the laws of the United States; and
- unexpected changes in regulatory requirements, which may be costly and require time to implement.

Fluctuations in foreign exchange rates could materially affect our reported results.

We are exposed to fluctuations in foreign currencies, as a portion of our sales and certain portions of our costs, assets and liabilities are denominated in currencies other than U.S. dollars. Approximately 37.0% of our sales during the year ended December 31, 2005 were from sales outside of the U.S. compared to 38.5% for the year ended December 31, 2004. For the year ended December 31, 2005, the depreciation of the euro against the U.S. dollar had a negative impact on sales of approximately $2.9 million. For the years ended December 31, 2004 and 2003, the appreciation of the euro against the U.S. dollar had a positive impact on sales of approximately $20.9 million and $31.1 million, respectively. Additionally, our Canadian operations require significant amounts of U.S. purchases for their operations. Instead of buying or manufacturing domestically, we currently have a favorable cost structure for goods we source from our joint venture, our wholly-owned subsidiaries in China and our outside vendors. In 2005, China revalued its currency higher against the U.S. dollar and stated it would no longer tie the yuan to a fixed rate against the U.S. currency. The yuan was revalued to 8.11 yuan per dollar from 8.28, or 2.1%. At December 31, 2005, the yuan was valued at 8.07. China also stated it will now peg the yuan against numerous currencies, although it will keep the yuan in a tight band rather than letting it trade freely. For the period January 1, 2006 to October 1, 2006, the euro, Canadian dollar and yuan increased in value by approximately 7%, 4% and 2%, respectively, against the U.S. dollar. If our share of revenue and purchases in non-dollar denominated currencies continues to increase in future periods, exchange rate fluctuations will likely have a greater impact on our results of operations and financial condition.

There are risks in expanding our manufacturing operations and acquiring companies in China.

As part of our strategy, we are shifting a portion of our manufacturing operations to China to reduce our production costs and to sell product into the Chinese market. This shift will subject a greater portion of our operations to the risks of doing business in China. In addition, we have increased our participation in the Chinese water and power infrastructure markets with our recent acquisition of Changsha Valve Works. Changsha sells exclusively into the domestic Chinese marketplace and enters into long-term sales contracts. The increased production levels in China require increased levels of working capital as we are rapidly increasing headcount and manufacturing equipment. If we are unable to quickly train these new employees we may experience product quality issues. The Chinese central and local government authorities have a

higher degree of control over our businesses in China than is customary in many of the countries in which we operate and makes the process of obtaining necessary regulatory approval in China inherently unpredictable. For instance, the local Chinese authorities in Tianjin, China informed us that property owned by our TWT joint venture will be taken over by eminent domain by December 31, 2007, and we will incur significant costs in connection with the plan of relocation. In addition, the protection accorded our proprietary technology and know-how under the Chinese legal system is not as strong as in the United States and, as a result, we may lose valuable trade secrets and competitive advantage.

If we cannot continue operating our manufacturing facilities at current or higher utilization levels, our results of operations could be adversely affected.

The equipment and management systems necessary for the operation of our manufacturing facilities may break down, perform poorly or fail, resulting in fluctuations in our ability to manufacture our products and to achieve manufacturing efficiencies. We operate a number of manufacturing facilities, all of which are subject to this risk, and such fluctuations at any of these facilities could cause an increase in our production costs and a corresponding decrease in our profitability. We also have a vertically-integrated manufacturing process. Each segment is dependent upon the prior process and any breakdown in one segment will adversely affect all later components. Fluctuations in our production process may affect our ability to deliver products to our customers on a timely basis. Our inability to meet our delivery obligations could result in a loss of our customers and negatively affect our business, financial condition and results of operations.

In addition, we have an ongoing manufacturing restructuring program to reduce our manufacturing costs. As we transition more of our operations overseas as a result of the manufacturing restructuring plan, we are transferring capacity utilization. If our planned manufacturing plant consolidations in the United States and Europe and our production capability expansion in China are not successful, our results of operations and financial condition could be materially adversely affected.

If we experience delays in introducing new products or if our existing or new products do not achieve or maintain market acceptance and regulatory approvals, our revenues and our profitability may decrease.

Our failure to develop new and innovative products or to custom design existing products could result in the loss of existing customers to competitors or the inability to attract new business, either of which may adversely affect our revenues. Our industry is characterized by:

- intense competition;
- changes in specifications required by our customers, plumbing codes and/or regulatory agencies;
- technically complex products; and
- constant improvement to existing products and introductions of new products.

We believe our future success will depend, in part, on our ability to anticipate or adapt to these factors and to offer, on a timely basis, products that meet customer demands and the requirements of plumbing codes and/or regulatory agencies. The development of new or enhanced products is a complex and uncertain process requiring the anticipation of

technological and market trends. We may experience design, manufacturing, marketing or other difficulties, such as an inability to attract a sufficient number of experienced engineers, that could delay or prevent our development, introduction, approval or marketing of new products or enhancements and result in unexpected expenses. Such difficulties could cause us to lose business from our customers and could adversely affect our competitive position; in addition, added expenses could decrease the profitability associated with those products that do not gain market acceptance.

Environmental compliance costs and liabilities could increase our expenses or reduce our profitability.

Our operations and properties are subject to extensive and increasingly stringent laws and regulations relating to environmental protection, including laws and regulations governing air emissions, water discharges, waste management and disposal and workplace safety. Such laws and regulations can impose substantial fines and sanctions for violations and require the installation of costly pollution control equipment or operational changes to limit pollution emissions and/or decrease the likelihood of accidental hazardous substance releases. We could be required to halt one or more portions of our operations until a violation is cured. We could also be liable for the costs of property damage or personal injury to others. Although we attempt to operate in compliance with these environmental laws, we may not succeed in this effort at all times. The costs of curing violations or resolving enforcement actions that might be initiated by government authorities could be substantial.

Under certain environmental laws, the current and past owners or operators of real property may be liable for the costs of cleaning up contamination, even if they did not know of or were not responsible for such contamination. These laws also impose liability on any person who arranges for the disposal or treatment of hazardous waste at any site. We have been named as a potentially responsible party or are otherwise conducting remedial activities with respect to a limited number of identified contaminated sites, including sites we currently own or operate. There can be no assurances that our ownership and operation of real property and our disposal of waste will not lead to other liabilities under these laws.

We have incurred, and expect to continue to incur, costs relating to environmental matters. In addition, new laws and regulations, stricter enforcement of existing laws and regulations, the discovery of previously unknown contamination or the imposition of new clean-up requirements could require us to incur additional costs or become the basis for new or increased liabilities that could be significant. Environmental litigation, enforcement and compliance are inherently uncertain and we may experience significant costs in connection with environmental matters. For more information, see "Business Product liability, environmental and other litigation matters."

Third parties may infringe our intellectual property and we may expend resources enforcing our rights or suffer competitive injury.

We rely on a combination of patents, copyrights, trademarks, trade secrets, confidentiality provisions and licensing arrangements to establish and protect our proprietary rights. We may be required to spend resources to monitor and police our intellectual property rights. If we fail to successfully enforce our intellectual property rights, our competitive position could suffer, which could harm our operating results. We have been limited from selling products from time-to-time because of existing patents.

The requirements of Financial Accounting Standards Board Statement No. 142, "Goodwill and Other Intangible Assets" (FAS 142) may result in a write-off of all or a portion of our goodwill, which would negatively affect our operating results and financial condition.

As of October 1, 2006, we recorded goodwill and non-amortizable intangible assets of $349.6 million and $51.5 million, respectively. If we are required to take an impairment charge to our goodwill or intangible assets in connection with the requirements of FAS 142, our operating results may decrease and our financial condition may be harmed. Under FAS 142, goodwill and identifiable intangible assets that have indefinite useful lives are no longer amortized. In lieu of amortization, we are required to perform an annual impairment review of both goodwill and non-amortizable intangible assets. We concluded that no impairment existed at October 30, 2005, the time of our latest annual review. We perform our annual test for indications of goodwill and non-amortizable intangible assets impairment in the fourth quarter of our fiscal year or sooner if indicators of impairment exist.

The loss of a major customer could have an adverse effect on our results of operations.

Our largest customer, Home Depot and its wholly-owned subsidiaries, accounted for approximately $98.5 million, or 10.7%, of our total net sales for the year ended December 31, 2005, and $84.5 million, or 10.3%, of our total net sales for year ended December 31, 2004. Our customers generally are not obligated to purchase any minimum volume of products from us and are able to terminate their relationships with us at any time. In addition, increases in the prices of our products could result in a reduction in orders for our products from Home Depot and other customers. A significant reduction in orders from, or change in terms of contracts with, Home Depot or other significant customers could have a material adverse effect on our future results of operations.

Certain indebtedness may limit our ability to pay dividends, incur additional debt and make acquisitions and other investments.

Our revolving credit facility and other senior indebtedness contain operational and financial covenants that restrict our ability to make distributions to stockholders, incur additional debt and make acquisitions and other investments unless we satisfy certain financial tests and comply with various financial ratios. If we do not maintain compliance with these covenants, our creditors could declare a default under our revolving credit facility or senior notes and our indebtedness could be declared immediately due and payable. Our ability to comply with the provisions of our indebtedness may be affected by changes in economic or business conditions beyond our control.

Risk factors associated with our Class A common stock

One of our stockholders can exercise substantial influence over our company.

As of October 31, 2006, Timothy P. Horne, a member of our board of directors, beneficially owned approximately 22.2% of our outstanding shares of Class A common stock (assuming conversion of all shares of Class B common stock beneficially owned by Mr. Horne into Class A common stock) and approximately 99.0% of our outstanding shares of Class B common stock, which represents approximately 73.5% of the total outstanding voting power. As long as Mr. Horne controls shares representing at least a majority of the total voting power of our outstanding stock, Mr. Horne will be able to unilaterally determine the outcome of all stockholder votes and other stockholders will not be able to affect the outcome of any stockholder vote.

Conversion and sale of a significant number of shares of our Class B common stock could adversely affect the market price of our Class A common stock.

As of October 31, 2006, there were outstanding 25,440,882 shares of our Class A common stock and 7,293,880 shares of our Class B common stock. Shares of our Class B common stock may be converted into Class A common stock at any time on a one for one basis. Under the terms of a registration rights agreement with respect to outstanding shares of our Class B common stock, the holders of our Class B common stock have rights with respect to the registration of the underlying Class A common stock. Under these registration rights, the holders of Class B common stock may require, on up to two occasions, that we register their shares for public resale. If we are eligible to use Form S-3 or a similar short-form registration statement, the holders of Class B common stock may require that we register their shares for public resale up to two times per year. If we elect to register any shares of Class A common stock for any public offering, the holders of Class B common stock are entitled to include shares of Class A common stock into which such shares of Class B common stock may be converted in such registration. However, we may reduce the number of shares proposed to be registered in view of market conditions. We will pay all expenses in connection with any registration, other than underwriting discounts and commissions. If all of the available registered shares are sold into the public market the trading price of our Class A common stock could decline.

Our Class A common stock has insignificant voting power.

Our Class B common stock entitles its holders to ten votes for each share and our Class A common stock entitles its holders to one vote per share. As of October 31, 2006, our Class B common stock constituted 22.3% of our total outstanding common stock and 74.1% of the total outstanding voting power and thus is able to exercise a controlling influence over our business.

The trading price of our Class A common stock may be volatile.

The trading price of our Class A common stock may be volatile, and fluctuations in the trading price may result in substantial losses for investors. The trading price of our Class A common stock could decline or fluctuate in response to a variety of factors, including, but not limited to, our failure to meet the performance estimates of securities analysts, changes in financial estimates of our revenues and operating results and/or buy/sell recommendations by securities analysts, the timing of announcements by us or our competitors concerning significant product line developments, contracts or acquisitions or publicity regarding actual or potential results or performance, fluctuation in our quarterly operating results caused by fluctuations in revenues and expenses, substantial sales of our Class A common stock by our existing shareholders, general stock market conditions and other economic or external factors.

Use of proceeds

We estimate that the net proceeds from the sale of our Class A common stock by us in this offering will be approximately $200.3 million, after deducting the estimated underwriting discounts and commissions and our estimated offering expenses. If the underwriters exercise the over-allotment in full, the net proceeds from this offering will be approximately $230.4 million. Such estimates assume an offering price of $42.13 per share, which was the last reported sale price of our Class A common stock on November 6, 2006 on the New York Stock Exchange. Each $1.00 increase (decrease) in the offering price per share of Class A common stock would increase (decrease) our net proceeds, after deducting the estimated underwriting discounts and commissions and our estimated offering expenses, by $4.76 million. We will use the net proceeds from the sale of the Class A common stock by us in this offering for general corporate purposes, including the funding of future acquisitions. Pending the application of the net proceeds, we expect to invest the proceeds in investment-grade, interest-bearing securities.

Capitalization

The following table sets forth our consolidated capitalization:

as of October 1, 2006, and

on an adjusted basis to reflect our receipt of the estimated net proceeds from this offering of 5,000,000 shares of our Class A common stock, assuming an offering price of $42.13 per share (the closing price of our Class A common stock on the New York Stock Exchange on November 6, 2006), after deducting estimated underwriting discounts and commissions and estimated offering expenses. Each $1 increase (decrease) in the public offering price per share would increase (decrease) the as-adjusted figures shown below for "cash and cash equivalents," "additional paid-in capital," "total stockholders' equity" and "total long-term debt and stockholders' equity" by $4.76 million, after deducting estimated underwriting discounts and commissions and estimated offering expenses. The table below assumes no exercise of the underwriters' option to purchase an additional 750,000 shares of Class A common stock.

	October 1, 2006	
(Amounts in thousands, except share information)	**Actual**	**As adjusted**
Cash and cash equivalents	$ 116,621	$ 316,915
Current portion of long-term debt	$ 7,616	$ 7,616
Long-term debt, net of current portion	$ 457,981	$ 457,981
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; 25,440,882 shares issued and outstanding actual, 30,440,882 shares issued and outstanding as adjusted)	2,544	3,044
Class B common stock ($0.10 par value, 25,000,000 shares authorized; 7,293,880 shares issued and outstanding)	729	729
Additional paid-in capital	146,829	346,623
Retained earnings	414,882	414,882
Accumulated other comprehensive income	21,597	21,597
Total stockholders' equity	586,581	786,875
Total long-term debt and stockholders' equity	$ 1,044,562	$ 1,244,856

Price range of Class A common stock

Our Class A common stock is listed on the New York Stock Exchange under the symbol "WTS." The following table sets forth, for the period indicated, the high and low sales prices of our Class A common stock on the New York Stock Exchange and cash dividends paid per share.

	2006			2005			2004		
	High	Low	Dividend	High	Low	Dividend	High	Low	Dividend
First Quarter	$ 37.00	$ 29.55	$ 0.09	$ 34.87	$ 29.00	$ 0.08	$ 24.56	$ 21.36	$ 0.07
Second Quarter	40.03	29.00	0.09	36.22	29.70	0.08	27.11	22.39	0.07
Third Quarter	36.24	28.08	0.09	37.55	27.46	0.08	27.99	24.51	0.07
Fourth Quarter	42.60(1)	30.71(1)		31.72	25.80	0.08	32.59	24.96	0.07

(1) Through November 6, 2006.

There is no established public trading market for our Class B common stock, which is held exclusively by members of the Horne family. The principal holders of such stock are subject to restrictions on transfer with respect to their shares. Each share of our Class B common stock (10 votes per share) is convertible into one share of Class A common stock (1 vote per share).

Aggregate common stock dividend payments for 2005 and 2004 were approximately $10.5 million and approximately $9.1 million, respectively, and for the nine months ended October 1, 2006 were approximately $9.0 million. While we presently intend to continue to pay cash dividends, the payment of future cash dividends depends upon the Board of Directors' assessment of our earnings, financial condition, capital requirements and other factors.

The number of record holders of our Class A common stock as of October 31, 2006 was 156. The number of record holders of our Class B common stock as of October 31, 2006 was 8.

Selected consolidated financial data

You should read the following selected consolidated financial data in conjunction with our consolidated financial statements and notes and the other information contained in or incorporated by reference into this prospectus supplement and the accompanying prospectus. The selected consolidated balance sheet data as of December 31, 2003, 2004 and 2005 and the selected consolidated statement of operations data for the years ended December 31, 2003, 2004 and 2005 have been derived from our consolidated financial statements that have been audited by KPMG LLP, our independent registered public accounting firm, and are incorporated by reference into this prospectus supplement. The selected consolidated statement of operations data for the nine months ended October 2, 2005 and October 1, 2006 and the selected consolidated balance sheet data as of October 2, 2005 and October 1, 2006 are derived from unaudited consolidated financial statements incorporated by reference into this prospectus supplement. The unaudited consolidated financial statements for the nine-month periods have been prepared on a basis consistent with our audited consolidated financial statements and, in the opinion of management, include all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of our consolidated financial position and consolidated results of operations for these periods. The consolidated results of operations for the nine months ended October 1, 2006 are not necessarily indicative of results for the year ending December 31, 2006 or any future period.

When you read the selected consolidated financial data, it is important that you also read the historical financial statements and related notes incorporated by reference into this prospectus supplement and the accompanying prospectus, as well as the section of this prospectus supplement entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations." The historical results are not necessarily indicative of future results.

(Amounts in thousands, except per share information)	Year ended December 31,			Nine months ended	
	2003(1)(2)	2004(1)(3)(4)	2005(1)(5)(6)	October 2, 2005(1)(7)	October 1, 2006(1)(8)
Statement of operations data:					
Net sales	$ 701,859	$ 824,558	$ 924,346	$ 679,939	$ 900,262
Income from continuing operations	36,419	48,738	55,020	39,824	58,954
Loss from discontinued operations, net of taxes	(3,057)	(1,918)	(421)	(185)	(3,358)
Net income	33,362	46,820	54,599	39,639	55,596
Income per share from continuing operations diluted	1.32	1.49	1.67	1.21	1.79
Loss per share from discontinued operations diluted	(0.11)	(0.06)	(0.01)	(0.01)	(0.10)
Net income per share diluted	1.21	1.43	1.66	1.20	1.68
Cash dividends declared per common share	$ 0.25	$ 0.28	$ 0.32	$ 0.24	$ 0.27

	As of December 31,			As of	
(Amounts in thousands)	2003	2004	2005	October 2, 2005	October 1, 2006
Balance Sheet Data					
Total assets	$ 840,918	$ 922,680	$ 1,100,970	$ 953,518	$ 1,435,034
Long-term debt, net of current portion	179,061	180,562	293,350	185,081	457,981

(1) In December 2004, we decided to divest our interest in our minority owned subsidiary, Jameco International, LLC (Jameco LLC). We recorded in discontinued operations, net of taxes, an impairment charge of $739,000 for the year ended December 31, 2004. Also included in discontinued operations is the net of tax operating results of Jameco LLC of $54,000 of income and $54,000 of loss for the years ended December 31, 2003 and 2004, respectively. In September 1996, we divested our Municipal Water Group of businesses, which included Henry Pratt, James Jones Company and Edward Barber and Company Ltd. Costs and expenses related to the Municipal Water Group, for 2003, 2004 and 2005 relate to legal and settlement costs associated with the James Jones Litigation. The loss, net of taxes, consists of $3,111,000, $1,125,000 and $421,000 for the years ended December 31, 2003, 2004 and 2005, respectively. Costs, net of taxes, of $185,000 and $3,358,000 for the nine months ended October 2, 2005 and October 1, 2006, respectively, were recorded for costs associated with the James Jones Litigation.

(2) For the year ended December 31, 2003, net income includes the following pre-tax costs: restructuring of $426,000; other costs consist of: inventory and other asset write-downs and accelerated depreciation of $479,000; and $750,000 of other related charges. The after-tax cost of these items was $1,084,000.

(3) For the year ended December 31, 2004, net income includes a net after-tax charge of $2,289,000 for certain accrued expense adjustments, which includes in selling, general and administrative expense after-tax charges of $3,475,000 related to a contingent earn-out agreement and $724,000 for various accrual adjustments and $462,000 recorded as an income tax benefit.

(4) For the year ended December 31, 2004, net income includes the following pre-tax costs: restructuring of $95,000 and other costs consisting of accelerated depreciation of $2,873,000. The after-tax cost of these items was $1,825,000.

(5) For the year ended December 31, 2005, net income includes the following pre-tax costs: restructuring of $729,000 and other costs consisting of accelerated depreciation and asset write downs of $1,816,000. The after-tax cost of these items was $1,633,000.

(6) For the year ended December 31, 2005, net income includes a net after-tax charge of $933,000 for a selling, general and administrative expense charge of $1,505,000 related to a contingent earn-out agreement.

(7) For the nine months ended October 2, 2005, net income includes the following pre-tax costs: restructuring of $462,000 and other costs consisting of accelerated depreciation and asset write-downs of $1,705,000. The after-tax cost of these items was $1,392,000.

(8) For the nine months ended October 1, 2006, net income includes the following pre-tax income and costs: a gain of $6,500,000 related to the sale of a building in Italy partially offset by restructuring changes of $2,347,000, primarily for severance costs. After-tax income for these items was $2,571,000.

Management's discussion and analysis of financial condition and results of operations

Overview

We are a leading supplier of products used in the water quality, water conservation, water safety and water flow control markets in North America and Europe, with an emerging presence in China. For over 130 years, we have designed and manufactured products that promote the comfort and safety of people and the quality and conservation of water used in commercial and residential applications. We earn revenue and income almost exclusively from the sale of our products. Our principal product lines include:

- backflow preventers for preventing contamination of potable water caused by reverse flow within water supply lines and fire protection systems;
- a wide range of water pressure regulators for both commercial and residential applications;
- water supply and drainage products for commercial and residential applications;
- temperature and pressure relief valves for water heaters, boilers and associated systems;
- point-of-use water filtration and reverse osmosis systems for both commercial and residential applications;
- thermostatic mixing valves for tempering water in commercial and residential applications;
- systems for under-floor radiant applications and hydraulic pump groups for gas boiler manufacturers and renewable energy applications, including solar heat pumps;
- flexible stainless steel connectors for natural and liquid propane gas in commercial food service and residential applications; and
- large diameter butterfly valves for use in China's water infrastructure.

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

We believe that the factors relating to our future growth include our ability to continue to make selective acquisitions, both in our core markets as well as new complementary markets, regulatory requirements relating to the quality and conservation of water, increased demand for clean water and continued enforcement of plumbing and building codes and a healthy economic environment. We have completed 30 acquisitions since divesting our industrial and oil and gas business in 1999. Our acquisition strategy focuses on businesses that manufacture preferred brand name products that address our themes of water quality, water conservation,

water safety and water flow control and related complementary markets. We target businesses that will provide us with one or more of the following: an entry into new markets, an increase in shelf space with existing customers, a new or improved technology or an expansion of the breadth of our water quality, water conservation, water safety and water flow control products for the residential and commercial markets. In the first nine months of 2006, sales from acquisitions contributed approximately 21.1% to our total sales growth over the comparable period of 2005.

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

We require substantial amounts of raw materials to produce our products, including bronze, brass, cast iron, steel and plastic, and substantially all of the raw materials we require are purchased from outside sources. We have experienced increases in the costs of certain raw materials, particularly copper. Bronze and brass are copper-based alloys. The spot price of copper has increased approximately 89% from September 30, 2005 to September 30, 2006, and approximately 57% from December 31, 2005 to October 26, 2006.

A risk we face is our ability to deal effectively with increases in raw material costs. We manage this risk by monitoring related market prices, working with our suppliers to achieve the maximum level of stability in their costs and related pricing, seeking alternative supply sources when necessary, implementing cost reduction programs and passing increases in costs to our customers, to the maximum extent possible, when they occur. Additionally from time to time we may use commodity futures contracts on a limited basis to manage this risk. We are not able to predict whether or for how long these cost increases will continue. If these cost increases continue and we are not able to reduce or eliminate the effect of the cost increases by reducing production costs or implementing price increases, our profit margins could decrease.

Another risk we face in all areas of our business is competition. We consider brand preference, engineering specifications, code requirements, price, technological expertise, delivery times and breadth of product offerings to be the primary competitive factors. As mentioned previously, we believe that the product development, product testing capability and investment in plant and equipment needed to manufacture products in compliance with code requirements, represent a barrier to entry for competitors. We are committed to maintaining our capital equipment at a level consistent with current technologies, and thus we expect to spend approximately $40,000,000 in 2006 (including approximately $18,000,000 related to the purchase and subsequent sale-leaseback of a building in Italy). We are committed to expanding our manufacturing capacity in lower cost countries such as China, Tunisia and Bulgaria.

Manufacturing plant relocations and consolidations are an important part of our ongoing commitment to reduce production costs.

Acquisitions

On August 14, 2006, we acquired 100% of the outstanding stock of Black Teknigas, Limited (Teknigas) located in St. Neots, United Kingdom for approximately $8,700,000, which is net of cash acquired of approximately $300,000, plus assumed debt of approximately $1,087,000. The preliminary allocations for goodwill and intangible assets are approximately $4,186,000 and $3,718,000, respectively. The amount recorded as intangible assets is primarily for technology and customer relationships that have estimated useful lives ranging from 8 to 12 years and trade names with indefinite lives. Teknigas designs, develops and manufactures a range of gas control products and systems for combustion, industrial, medical, laboratory and specialty gas.

On June 7, 2006, we acquired 100% of the outstanding stock of Kim Olofsson Safe Corporation AB (KimSafe) located in Almhult, Sweden for approximately $5,700,000, which is net of cash acquired of approximately $2,900,000. The preliminary allocations for goodwill and intangible assets are approximately $1,627,000 and $3,532,000, respectively. The amount recorded as intangible assets is primarily for customer relationships that have estimated useful lives of 5 years and trade names with indefinite lives. KimSafe manufactures electronic controls for heat pump, solar and pellet heaters, which provide the ability to heat water using renewable energy.

On June 2, 2006, we acquired the assets and business of Calflex Manufacturing, Inc. (Calflex) located in Vernon, California and the stock of Ningbo Best Metal & Plastic Manufacturing, Ltd (Ningbo) located in Ningbo, China for approximately $6,600,000. The preliminary allocation for intangible assets is approximately $2,333,000. The amount recorded as intangible assets is primarily for customer relationships that have estimated useful lives of 12 years and trade names with indefinite lives. Calflex and Ningbo distribute and manufacture water connectors.

On May 19, 2006, we acquired 100% of the outstanding stock of ATS Expansion Group (ATS) located in Sorgues, Grenoble and Hautvilliers, France for approximately $62,000,000, which is net of cash acquired of approximately $5,600,000 plus assumed debt of approximately $14,100,000. The preliminary allocations for goodwill and intangible assets are approximately $32,644,000 and $26,858,000, respectively. The amount recorded as intangible assets is primarily for customer relationships with estimated useful lives ranging from 8 to 10 years, patents with estimated useful lives from 7 to 12 years and trade names with indefinite lives. ATS' products include a broad range of fittings, valves and manifolds for water, gas and heating applications and stainless steel flexible hoses.

On April 26, 2006, we acquired the assets and business of Changsha Valve Works (Changsha) located in Changsha, China for approximately $8,500,000 of which approximately $600,000 remains to be paid subject to certain conditions being met. The preliminary allocations for goodwill and intangible assets are approximately $5,975,000 and $2,800,000, respectively. The amount recorded as intangible assets is primarily for non-compete agreements that have estimated useful lives of 10 years and customer order backlog with an estimated useful life of 1 year. Changsha is a leading manufacturer of large diameter hydraulic-actuated butterfly valves for thermo-power and hydro-power plants, water distribution projects and water works projects in China.

On April 5, 2006, we completed the planned increase of our ownership in Watts Stern Rubinetti, S.r.l. (Stern) from 85% to 100%. The price paid for this additional 15% interest was approximately $378,000.

On December 28, 2005, we acquired 100% of the stock of Dormont Manufacturing Company (Dormont) located in Export, Pennsylvania, for approximately $93,916,000 net of cash acquired of approximately $1,506,000. The preliminary allocations for goodwill and intangible assets are approximately $38,804,000 and $38,600,000, respectively. The amount recorded as intangible assets is primarily for customer relationships that have estimated 13-year lives and trade names with indefinite lives. Dormont provides flexible stainless steel connectors for natural and liquid propane gas. Dormont works with appliance OEM's to provide internal component assemblies and private label gas connectors, which are sold under the OEM brand with the appliance in multiple leading retail chains. Dormont also supplies residential gas connectors through multiple trade channels and home improvement retailers. Dormont provides a core-plumbing product, which is complementary to our existing water product lines.

On December 2, 2005, we acquired 100% of the stock of Core Industries Inc. (Core) from SPX Corporation for approximately $46,192,000 in cash. Core consists of FEBCO, Mueller Steam Specialty and Polyjet Valves product lines. The preliminary allocations for goodwill and intangible assets are approximately $16,560,000 and $8,320,000, respectively. The amount recorded as intangible assets is primarily for trade names with indefinite lives and customer relationships that have estimated 12-year lives. FEBCO is a manufacturer of backflow prevention valves and has a strong presence in both residential and commercial landscape irrigation. Mueller Steam Specialty allows us to expand into large diameter commercial strainers and check valves. Polyjet Valves offers a customized sleeve valve, which is used in severe service applications to provide precise flow and pressure control. We expect that this acquisition will allow us to offer a broader product line, improve operating efficiencies and provide better customer service.

On November 4, 2005, we acquired the assets of Flexflow Tubing LLP (Flexflow), located in Langley, British Columbia, Canada for approximately $6,220,000. The purchase agreement contains an earn-out provision to be calculated over a five-year period ending December 31, 2010. Earn-out payments under the purchase agreement, if any, will not exceed $4,300,000 and will be treated as additional purchase price. Flexflow manufactures pex tubing for potable and non-potable applications. The allocations for goodwill and intangible assets are approximately $3,195,000 and $868,000, respectively. The amount recorded as intangible assets is primarily for customer relationships that have estimated 12-year lives. The acquisition of Flexflow is consistent with our strategy to increase our presence in the under floor radiant heating and potable water markets. This acquisition allows us to expand our presence in the market for flexible pex pipes for hot and cold-water transport.

On July 8, 2005, we acquired the water connector business of the Donald E. Savard Company (Savard) in an asset purchase transaction for approximately $3,680,000. The allocations for goodwill and intangible assets are approximately $1,350,000 and $1,750,000, respectively. The amount recorded as intangible assets is primarily for trade names with indefinite lives and customer relationships that have 14-year lives. The acquisition of the water connector business of Savard is consistent with our theme of water safety and control. This acquisition allows us to expand our presence in one of our leading product lines with a brand name that is well known to the plumbing wholesale market.

On July 5, 2005, we acquired 100% of the outstanding stock of Microflex N.V. (Microflex) located in Rotselaar, Belgium for approximately $14,900,000 net of cash acquired of approximately $875,000. The allocations for goodwill and intangible assets are approximately $6,507,000 and $5,315,000, respectively. The amount recorded as intangible assets is primarily for customer relationships that have 7-year lives and trade names that have indefinite lives. Microflex produces and distributes flexible, pre-insulated, pex pipes for hot and cold-water transport, as well as a range of accessory products including couplings, caps, and insulation kits to the HVAC and water protection markets.

On June 20, 2005, we acquired the water softener business of Alamo Water Refiners, Inc. (Alamo) located in San Antonio, Texas in an asset purchase transaction for approximately $5,100,000. The allocation for intangible assets is approximately $285,000 and is primarily for the trade name with an indefinite life. There was no allocation to goodwill. The water softener products of Alamo are consistent with our theme of water quality and provide many synergistic opportunities when utilized in conjunction with our existing water filtration and water quality businesses. The acquisition of Alamo also expands our distribution presence into the southwestern U.S. markets.

On May 11, 2005, we acquired 100% of the outstanding stock of Electro Controls Ltd. (Electro Controls) located in Hounslow, United Kingdom for approximately $11,737,000 net of cash acquired of approximately $5,014,000. The allocations for goodwill and intangible assets are approximately $5,788,000 and $315,000, respectively. The amount recorded as intangible assets is primarily for trade names that have indefinite lives. Electro Controls designs and assembles a range of electrical controls for the HVAC market, with sales primarily in the United Kingdom.

On January 5, 2005, we acquired 100% of the outstanding stock of HF Scientific, Inc. (HF) located in Fort Myers, Florida for approximately $7,260,000 in cash plus $800,000 in assumed debt. The allocations for goodwill and intangible assets are approximately $4,178,000 and $2,660,000, respectively. The amount recorded as intangible assets is primarily for customer relationships that have 15-year lives and trade names that have indefinite lives. HF manufactures and distributes a line of instrumentation equipment, test kits and chemical reagents used for monitoring water quality in a variety of applications.

On January 4, 2005, we acquired substantially all of the assets of Sea Tech, Inc. (Sea Tech) located in Wilmington, North Carolina for approximately $10,100,000 in cash. The purchase agreement contains an earn-out provision to be calculated on a cumulative basis over a three-year period ending December 31, 2007. Payments under the agreement, if any, will not exceed $5,000,000 and will be treated as additional purchase price. The allocations for goodwill and intangible assets are approximately $6,505,000 and $3,033,000, respectively. The amount recorded as intangible assets is primarily for customer relationships that have 15-year lives and trade names that have indefinite lives. Sea Tech provides cost-effective solutions for fluidic connection needs. Sea Tech offers a wide range of standard and custom quick connect fittings, valves and manifolds and pex tubing designed to address specific customer requirements.

Results of operations

Nine months ended October 1, 2006 compared to nine months ended October 2, 2005

Net sales. Our net sales in each of the segments for each of the first nine months of 2006 and 2005 were as follows:

(Dollars in thousands)	Nine months ended October 1, 2006		Nine months ended October 2, 2005			
	Net sales	% sales	Net sales	% sales	Change	% change to consolidated net sales
North America	$ 616,584	68.5%	$ 464,622	68.3%	$ 151,962	22.3%
Europe	257,553	28.6	195,624	28.8	61,929	9.1
China	26,125	2.9	19,693	2.9	6,432	1.0
Total	$ 900,262	100%	$ 679,939	100%	$ 220,323	32.4%

The increase in net sales is attributable to the following:

(Dollars in thousands)	North America	Europe	China	Total	Change as a % of consolidated net sales				Change as a % of segment net sales		
					North America	Europe	China	Total	North America	Europe	China
Internal growth	$ 40,925	$ 31,636	$ 878	$ 73,439	6.0%	4.7%	0.1%	10.8%	8.8%	16.2%	4.5%
Foreign exchange	3,206	(520)	553	3,239	0.5	(0.1)	0.1	0.5	0.7	(0.2)	2.8
Acquisitions	107,831	30,813	5,001	143,645	15.8	4.5	0.8	21.1	23.2	15.7	25.4
Total	$ 151,962	$ 61,929	$ 6,432	$ 220,323	22.3%	9.1%	1.0%	32.4%	32.7%	31.7%	32.7%

The internal growth in net sales in North America was due to increased price and unit sales in certain product lines into both the wholesale and DIY markets. Our wholesale market in the first nine months of 2006, excluding the sales from the acquisitions of Alamo, Savard, Calflex, Flexflow, Core and Dormont, grew by 10.1% compared to the first nine months of 2005, primarily due to increased sales of water pressure regulators, relief valves and backflow preventer units, as well as in our plumbing and under-floor radiant heating product lines. Our sales into the North American DIY market in the first nine months of 2006 increased by 5.3% compared to the first nine months of 2005, primarily due to increased sales of fittings and supply lines and plumbing and under-floor radiant heating product lines partially offset by fewer new retail product introductions in 2006 than during 2005.

The increase in net sales due to foreign exchange in North America was due to the Canadian dollar appreciating against the U.S. dollar. We cannot predict whether the Canadian dollar will continue to appreciate 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 acquired growth in net sales in North America was due to the inclusion of net sales of Alamo, acquired on June 20, 2005, Savard, acquired on July 8, 2005, Flexflow, acquired on November 4, 2005, Core, acquired on December 2, 2005, Dormont, acquired on December 28, 2005, and Calflex acquired on June 2, 2006.

The internal sales growth in Europe was broad-based with most markets and channels exhibiting improvement. Our sales into the wholesale and OEM markets in the first nine months of 2006, excluding the sales from the acquisitions of Electro Controls, Microflex, ATS, KimSafe and Teknigas, grew by 15.7% and 18.2%, respectively, compared to the first nine months of 2005.

The decrease in net sales due to foreign exchange in Europe was primarily due to the depreciation of the euro against the U.S. dollar, primarily in the first quarter of 2006. We cannot predict whether the euro 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 acquired growth in net sales in Europe was due to the inclusion of the net sales of Electro Controls, acquired on May 11, 2005, Microflex, acquired on July 5, 2005, ATS, acquired on May 19, 2006, KimSafe, acquired on June 7, 2006, and Teknigas, acquired on August 14, 2006.

The internal sales growth in China was due to increased sales into the domestic and export markets, partially offset by decreased sales due to disruptions caused by recent changes made in our domestic Chinese sales channels. Additionally, the yuan strengthened against the U.S. dollar.

The acquired growth in net sales in China was due to the inclusion of the net sales of Changsha, acquired on April 26, 2006, and Ningbo, acquired on June 2, 2006.

Gross profit. Gross profit and gross profit as a percent of net sales (gross margin) for the first nine months of 2006 and 2005 were as follows:

	Nine months ended		
(Dollars in thousands)	**October 1, 2006**	**October 2, 2005**	**Point change**
Gross profit	$ 314,096	$ 238,374	
Percent of net sales	34.9%	35.1%	(0.2)%

Gross margin for the first nine months of 2006 decreased slightly from the first nine months of 2005. Raw materials cost increases have been predominantly offset by increased sales prices with exceptions, such as the North American retail market and certain markets in Europe. Margins have also been negatively affected by sales of lower margin Core products and by European acquisition costs. In North America, year-to-date gross margin was positively affected because of a favorable sales mix toward higher margin wholesale sales.

Gross margin was also positively affected in the first nine months of 2006 from lower charges related to our manufacturing restructuring efforts. We recorded $956,000 to cost of sales for primarily severance costs in the first nine months of 2006 as compared to $1,705,000 in the first nine months of 2005 for accelerated depreciation and other costs.

Selling, general and administrative (SG&A) expenses. SG&A expenses for the first nine months of 2006 increased $48,903,000, or 28.9%, compared to the first nine months of 2005. The increase in SG&A expenses was attributable to the following:

		(in thousands)	% change
Internal growth	$	17,079	10.1%
Foreign exchange		610	0.4
Acquisitions		31,214	18.4
Total	$	48,903	28.9%

The internal increase in SG&A expenses was primarily due to increased variable selling expenses due to increased sales volumes, increased insurance costs, corporate administration costs, a reclassification of product liability costs from costs of sales to SG&A expenses and incremental variable compensation costs, including costs incurred for compliance with FAS 123R, partially offset by lower costs for complying with Section 404 of the Sarbanes-Oxley Act of 2002 (SOX) and lower earn-out costs related to a prior acquisition. The increase in SG&A expenses from foreign exchange was primarily due to the appreciation of the euro, Canadian dollar and yuan against the U.S. dollar. The increase in SG&A expenses from acquisitions was due to the inclusion of Electro Controls, Alamo, Microflex, Savard, Flexflow, Core, Dormont, Changsha, ATS, Calflex, Ningbo, KimSafe and Teknigas.

Restructuring and other charges. Restructuring and other charges for the first nine months of 2006 decreased $5,571,000 primarily due to a gain of approximately $6,500,000 related to the sale of a building in Italy partially offset by a charge of $929,000 primarily for severance costs related to our European and Chinese restructuring plans. During the nine-month period ended October 1, 2005, we recorded $462,000 primarily for severance costs related to our European restructuring plans.

Operating income. Operating income by geographic segment for each of the first nine months of 2006 and 2005 was as follows:

	Nine months ended						
(Dollars in thousands)		**October 1, 2006**		**October 2, 2005**		**Change**	**% change to consolidated operating income**
North America	$	74,254	$	57,088	$	17,166	25.1%
Europe		38,067		23,299		14,768	21.6
China		6,968		2,550		4,418	6.4
Corporate		(18,483)		(14,521)		(3,962)	(5.8)
Total	$	100,806	$	68,416	$	32,390	47.3%

The increase in operating income was attributable to the following:

					Change as a % of consolidated operating income					Change as a % of segment operating income			
(Dollars in thousands)	North America	Europe	China	Corp.	Total	North America	Europe	China	Corp.	Total	North America	Europe	China	Corp.
Internal growth	$ 5,473	$ 5,328	$ 4,924	$ (3,962)	$ 11,763	8.0%	7.8%	7.2%	(5.8)%	17.2%	9.6%	22.9%	193.1%	(27.3)%
Foreign exchange	725	24	177		926	1.1		0.2		1.3	1.3	0.1	6.9	
Acquisitions	9,708	3,207	466		13,381	14.2	4.7	0.7		19.6	17.0	13.8	18.3	
Restructuring	1,260	6,209	(1,149)		6,320	1.8	9.1	(1.7)		9.2	2.2	26.6	(45.1)	
Total	$ 17,166	$ 14,768	$ 4,418	$ (3,962)	$ 32,390	25.1%	21.6%	6.4%	(5.8)%	47.3%	30.1%	63.4%	173.2%	(27.3)%

The internal growth in North America was primarily due to our increased gross profit from price increases and increased unit sales in the wholesale market, benefits resulting from our completed manufacturing restructuring projects and product outsourcing, partially offset by increased net SG&A expense and inventory write-downs. In the first nine months of 2006, we did not record any costs associated with our manufacturing restructuring plan compared to costs of $1,260,000 for the same period in 2005. The acquired growth was due to the inclusion of operating income from of Alamo, Savard, Flexflow, Core, Dormont and Calflex.

The internal growth in Europe was primarily due to increased gross profit from price and unit increases in the wholesale and OEM markets and benefits resulting from our completed manufacturing restructuring projects, partially offset by increased net SG&A expense. In the first nine months of 2006, we recorded a gain of $5,302,000 associated with our manufacturing restructuring plan compared to a charge of $907,000 for the same period in 2005. We recorded a gain of $6,500,000 for the building sale in Italy partially offset by $1,198,000 of primarily severance costs. The acquired growth in Europe was due to the inclusion of the operating income from Electro Controls, Microflex, ATS, KimSafe and Teknigas.

The increase in internal growth in China of $4,924,000 was primarily attributable to improved manufacturing efficiencies associated with our wholly owned manufacturing plant in Tianjin, partially offset by increased net SG&A expense. The acquired growth in China was due to the inclusion of the operating income from Changsha and Ningbo. In the first nine months of 2006, we recorded $1,149,000 of severance and accelerated depreciation costs associated with our manufacturing restructuring plan in China. We anticipate recording an additional approximately $700,000 in severance and accelerated depreciation costs for the remainder of 2006.

The decrease in internal operating income in Corporate of $3,962,000 was primarily attributable to incremental administration charges for variable compensation, including costs incurred for compliance with FAS 123R, increased audit costs and increased pension costs, partially offset by lower costs incurred for SOX compliance.

The net increase in operating income from foreign exchange was primarily due to the appreciation of the euro, Canadian dollar and yuan against the U.S. dollar. We cannot predict whether these currencies will continue to appreciate against the U.S. dollar in future periods or whether future foreign exchange rate fluctuations will have a positive or negative impact on our operating income.

Interest expense. Interest expense increased $7,997,000, or 104.3%, for the first nine months of 2006 compared to the first nine months of 2005, primarily due to the private placement of

$225,000,000 5.85% senior notes, increased debt levels for acquisitions made in 2005 and 2006, and an increase in the average variable rates charged on the revolving credit facility.

We entered into an interest rate swap for a notional amount of €25,000,000 outstanding on our revolving credit facility. We swapped three month EURIBOR plus 0.6%, for a fixed rate of 3.02%. We recorded a reduction to interest expense of approximately $673,000 to recognize the fair value of the swap for the nine months ended October 1, 2006. The swap was terminated on October 3, 2006.

Other (income) expense. Other (income) expense increased $1,400,000 for the first nine months of 2006 compared to the first nine months of 2005, primarily due to the gains on settlements of officers' life insurance policies and foreign exchange.

Income taxes. Our effective rate for continuing operations decreased to 34.3% in the nine months ended October 1, 2006 from 35.7% in the nine months ended October 2, 2005. The decrease is primarily due to higher earnings in our European and China segments. The shift in the mix of earnings to these segments causes our rate to decrease as these segments have lower effective tax rates than our worldwide average. The effect of the European earnings mix is partially offset by a higher effective tax from the gain on the sale of our Italian facility. We were able to claim tax credits based on qualified fixed asset purchases in China that helped reduce the worldwide rate.

Income from continuing operations. Income from continuing operations for the first nine months of 2006 increased $19,130,000, or 48.0%, to $58,954,000, or $1.79 per common share, from $39,824,000, or $1.21 per common share, for the first nine months of 2005, in each case, on a diluted basis. Income from continuing operations for the first nine months of 2006 and 2005 includes income, net of tax, for our restructuring plan of $2,571,000, or $0.08 per share, and costs of $1,392,000, or ($0.04) per share, respectively. The gain on the sale of our building in Italy resulted in an after-tax gain of $4,100,000, or $0.12 per share. The appreciation of the Canadian dollar, euro and Chinese yuan against the U.S. dollar resulted in a positive impact on income from continuing operations of $610,000, or $0.02 per common share, for the first nine months of 2006 compared to the comparable period last year. We cannot predict whether the euro, Canadian dollar or yuan will continue to appreciate against the U.S. dollar in future periods or whether future foreign exchange rate fluctuations will have a positive or negative impact on our net income.

Loss from discontinued operations. We recorded a charge, net of tax, to discontinued operations for the first nine months of 2006 and 2005 of $3,358,000, or ($0.10) per common share, and $185,000, or $0.01 per common share, respectively, in each case, on a diluted basis. In the third quarter of 2006 we recorded a pre-tax charge of $5,000,000 due to a recent federal appellate court decision which affirmed that an arbitration panel could decide which deductible agreements between Watts and Zurich American Insurance Company (Zurich) would control Zurich's reimbursement claim for defense costs paid in the James Jones case. Other charges were primarily attributable to legal fees associated with the James Jones litigation, as described in "Business Product liability, environmental and other litigation matters James Jones litigation."

Year ended December 31, 2005 compared to year ended December 31, 2004

Net sales. Our business is reported in three geographic segments: North America, Europe and China. Our net sales in each of these segments for the years ended December 31, 2005 and 2004 were as follows:

(Dollars in thousands)	Year ended December 31, 2005		Year ended December 31, 2004			
	Net sales	% sales	Net sales	% sales	Change	Change to consolidated net sales
North America	$ 629,937	68.2%	$ 545,139	66.1%	$ 84,798	10.3%
Europe	266,346	28.8	253,234	30.7	13,112	1.6
China	28,063	3.0	26,185	3.2	1,878	0.2
Total	$ 924,346	100%	$ 824,558	100%	$ 99,788	12.1%

The increase in net sales is attributable to the following:

(Dollars in thousands)					Change as a % of consolidated net sales				Change as a % of segment net sales		
	North America	Europe	China	Total	North America	Europe	China	Total	North America	Europe	China
Internal growth	$ 51,796	$ 5,533	$ 1,529	$ 58,858	6.3%	0.7%	0.2%	7.1%	9.5%	2.2%	5.9%
Foreign exchange	3,112	(2,857)	349	604	0.4	(0.4)		0.1	0.6	(1.1)	1.3
Acquisitions	29,890	10,436		40,326	3.6	1.3		4.9	5.5	4.1	
Total	$ 84,798	$ 13,112	$ 1,878	$ 99,788	10.3%	1.6%	0.2%	12.1%	15.6%	5.2%	7.2%

The internal growth in net sales in North America was broad-based in both our wholesale and DIY markets. Our wholesale market for 2005, excluding the sales from acquisitions, grew by 8.5% compared to 2004, primarily due to increased sales of backflow preventer units, as well as increased under-floor radiant heating product lines and increased unit selling prices in most of our product lines. Our sales into the North American DIY market for 2005 increased organically by 12.3% compared to 2004 primarily due to increased sales of fittings and supply lines and under-floor radiant heating products.

The increase in net sales due to foreign exchange in North America is due to the Canadian dollar appreciating against the U.S. dollar. We cannot predict whether the Canadian dollar will continue to appreciate against the U.S. dollar in future periods or whether future foreign exchange rate fluctuations will have a positive or negative impact on our net sales.

Acquired growth in net sales in North America is due to the inclusion of net sales of Dormont, acquired on December 28, 2005, Core, acquired on December 2, 2005, Flexflow, acquired on November 4, 2005, Savard, acquired on July 8, 2005, Alamo, acquired on June 20, 2005, HF, acquired on January 5, 2005, Sea Tech, acquired on January 4, 2005, and Orion, acquired on May 21, 2004.

Internal growth in Europe net sales results from increased sales into the wholesale market as a result of gaining market share, particularly in Germany. Sales into the European OEM market were primarily flat compared to last year.

Net sales were negatively impacted by foreign exchange in Europe primarily from the depreciation of the euro against the U.S. dollar. We cannot predict whether the euro will

continue to depreciate against the U.S. dollar in future periods or whether future foreign exchange rate fluctuations will have a positive or negative impact on our net sales.

Acquired growth in Europe net sales is due to the inclusion of the net sales of Microflex, which we acquired on July 5, 2005, Electro Controls, which we acquired on May 11, 2005, and TEAM, acquired on April 16, 2004.

The increase in net sales in China is primarily attributable to increased sales in both the Chinese domestic and export markets.

Gross profit. Gross profit for 2005 increased $34,141,000, or 11.7%, compared to 2004. The increase in gross profit is attributable to the following:

		(in thousands)	% change
Internal growth	$	16,079	5.5%
Foreign exchange		699	0.2
Acquisitions		16,306	5.6
Other		1,057	0.4
Total	$	34,141	11.7%

Internal margin growth was $6,891,000, $2,569,000 and $3,646,000 in North America, Europe and China, respectively. Internal growth resulted from increased sales volume in all regions. However, commodity costs, especially for copper-based products and oil, and a sales mix shift in North America and Europe, dampened margin growth. In 2005, we experienced raw material cost increases, which we were not able to fully recover through price increases on some of our products. North America experienced higher growth in lower-margin retail sales partially offset by a reclassification of product liability costs from cost of sales to selling, general and administrative expense. Europe's OEM business was flat with an increase in lower margin wholesale product sales. Both regions benefited from completed manufacturing restructuring efforts. The China segment increased gross margin primarily due to increased sales volume in the domestic marketplace. The increase in gross margin from foreign exchange is primarily due to the appreciation of the Canadian dollar and the yuan against the U.S. dollar partially offset by a depreciation of the euro against the U.S. dollar. The increase in gross margin from acquisitions is due to the inclusion of gross profit from Dormont, Core, Flexflow, Savard, Microflex, Alamo, Electro Controls, HF, Sea Tech, Orion and TEAM.

Additionally, the increase in gross profit was due to decreased manufacturing restructuring and other costs. For 2005, we charged $1,816,000 of accelerated depreciation and other costs to cost of sales compared to $2,873,000 of accelerated depreciation and other costs for 2004.

Selling, general and administrative expenses. SG&A expenses for 2005 increased $22,552,000, or 10.9%, compared to 2004. The increase in SG&A expenses is attributable to the following:

	(in thousands)	% change
Internal growth	$ 14,151	6.8 %
Foreign exchange	391	0.2
Acquisitions	10,464	5.1
Other	(2,454)	(1.2)
Total	$ 22,552	10.9 %

Internal SG&A expenses increased primarily from higher variable selling expenses caused by increased sales volumes in North America and China, from due-diligence related charges, and from increased bad debt reserves. These cost increases were partially offset by lower costs for complying with SOX. Additionally, we recorded $1,000,000 in reserve reductions in 2004 related to a favorable ruling in a legal matter. The increase in SG&A expenses from foreign exchange is primarily due to the appreciation of the Canadian dollar and the yuan against the U.S. dollar partially offset by the depreciation of the euro against the U.S. dollar. The increase in SG&A expenses from acquisitions is due to the inclusion of Dormont, Core, Savard, Microflex, Alamo, Electro Controls, HF, Sea Tech, Orion and TEAM. Other includes costs of $2,454,000 for prior period corrections including an earn-out arrangement from a prior period acquisition that was accounted for as compensation expense. The earn-out arrangement was completed on August 31, 2005.

Operating income. Operating income by geographic segment for 2005 and 2004 was as follows:

	Years ended			
(Dollars in thousands)	December 31, 2005	December 31, 2004	Change	% change to consolidated operating income
North America	$ 76,757	$ 68,558	$ 8,199	9.8 %
Europe	31,528	31,597	(69)	(0.1)
China	3,533	1,857	1,676	2.0
Corporate	(17,263)	(18,412)	1,149	1.4
Total	$ 94,555	$ 83,600	$ 10,955	13.1 %

The increase in operating income is attributable to the following:

						Change as a % of consolidated operating income					Change as a % of segment operating income			
(Dollars in thousands)	North America	Europe	China	Corp	Total	North America	Europe	China	Corp	Total	North America	Europe	China	Corp
Internal growth	$ (467)	$ (1,100)	$ 1,622	$ 1,873	$ 1,928	(0.6)%	(1.3)%	1.9%	2.3%	2.3%	(0.7)%	(3.5)%	87.4%	(10.2)%
Foreign exchange	658	(404)	54		308	0.8	(0.5)	0.1		0.4	1.0	(1.3)	2.9	
Acquisitions	2,867	2,975			5,842	3.4	3.6			7.0	4.2	9.4		
Other	3,178			(724)	2,454	3.8			(0.9)	2.9	4.6			4.0
Other Restructuring	1,963	(1,540)			423	2.4	(1.9)			0.5	2.9	(4.9)		
Total	$ 8,199	$ (69)	$ 1,676	$ 1,149	$ 10,955	9.8%	(0.1)%	2.0%	1.4%	13.1%	12.0%	(0.3)%	90.3%	(6.2)%

Internally our North American segment experienced a decrease in operating income primarily from increased commodity costs and increased SG&A expenses, partially offset by benefits resulting from our completed manufacturing restructuring projects and outsourcing. In 2005, we experienced raw material cost increases, which we were not able to fully recover through price increases on some of our products. For 2005, we recorded $1,005,000 for net costs associated with our manufacturing restructuring plan compared to $2,968,000 for 2004. The acquired growth is due to the inclusion of operating income from Dormont, Core, Savard, Alamo, HF, Sea Tech and Orion. Other represents costs accrued for an earn-out arrangement from a prior period acquisition. This earn-out arrangement was completed on August 31, 2005.

The increase in operating income due to foreign exchange in North America is due to the Canadian dollar appreciating against the U.S. dollar. We cannot predict whether the Canadian dollar will continue to appreciate 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.

Internally our European segment also experienced a decrease in operating income. This was primarily due to a soft European economy, increased sales in lower margin wholesale products and increased SG&A expenses, offset by benefits resulting from our completed manufacturing restructuring projects and outsourcing. For 2005, we recorded $1,540,000 for costs associated with our manufacturing restructuring plan and we did not record any costs for 2004.

The decrease in Europe's operating income from foreign exchange is primarily due to the depreciation of the euro against the U.S. dollar. We cannot predict whether the euro will continue to 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 operating income.

The increase in internal growth in China of $1,622,000 is primarily attributable to increased capacity utilization and low cost sourcing to our domestic facilities offset by increased SG&A expenses primarily related to increased variable selling expenses due to increased sales volumes and increased bad debt reserves.

The increase in internal operating income in Corporate of $1,149,000 is primarily attributable to reductions in SOX expenses and audit expenses partially offset by a $1,000,000 reserve reduction in the first quarter of 2004 due to a favorable ruling in a legal matter. Other consists of $724,000 of adjustments made in the fourth quarter of 2004 to correct errors for accrued expenses.

Interest expense. Interest expense decreased $211,000, or 2.0%, for 2005 compared to 2004, primarily due to reduced debt levels in Europe. Debt levels increased in the U.S., but not until December 2005, as a result of the fourth quarter acquisition activity.

Effective July 1, 2005, we entered into a three-year interest rate swap with a counter party for a notional amount of €25,000,000, which is outstanding under our revolving credit facility. We swapped the three-month EURIBOR plus 0.6% rate for a fixed rate of 3.02%. The impact of the swap was immaterial to the overall interest expense. The swap was terminated on October 3, 2006.

We had previously entered into an interest rate swap for a notional amount of €25,000,000 outstanding on our prior revolving credit facility. We swapped the three-month EURIBOR plus 0.7%, for a fixed rate of 2.3%. The swap was terminated at June 30, 2005. The impact of the swap was immaterial to the overall interest expense.

Income taxes. Our effective tax rate for continuing operations for 2005 increased to 35.9% from 32.9% for 2004. The increase is primarily due to the benefits realized in 2004 of approximately $800,000 for previously unrecognized deferred tax assets in China. In addition, in 2004 we recorded multi-year refund claims relating to state tax credits; in 2005 those tax credits were realized for the current year only. This increase was partially offset by a decrease in our European tax rate for 2005 compared to 2004 due to earnings mix in Europe.

Income from continuing operations. Income from continuing operations for 2005 increased $6,282,000, or 12.9%, to $55,020,000, or $1.67 per common share, from $48,738,000, or $1.49 per common share, for 2004, in each case, on a diluted basis. Income from continuing operations for 2005 and 2004 includes net costs incurred for our manufacturing restructuring plan of $1,633,000, or ($0.05) per share, and $1,825,000, or ($0.06) per share, respectively. Also included in income from continuing operations for 2004 is the net charge of $2,289,000, or ($0.07) per share, for accounting corrections relating to certain accrued expenses.

Loss from discontinued operations. We recorded a charge net of tax to discontinued operations for 2005 of $421,000, or ($0.01) per common share, and $1,918,000, or ($0.06) per common share, for 2004, in each case, on a diluted basis. Included in loss from discontinued operations for 2005 and 2004 are charges attributable to legal fees associated with the James Jones litigation and obligations to the former shareholders of the James Jones Company of $421,000, or ($0.01) per share and $1,125,000, or ($0.04) per share, respectively. See "Business Product liability, environmental and other litigation matters." Additionally, losses from discontinued operations for 2004 include an impairment charge and an operating loss totaling $793,000 or ($0.02) per share for the divesture of our minority interest in Jameco International LLC.

Year ended December 31, 2004 compared to year ended December 31, 2003

During the fourth quarter of 2004, we identified and corrected errors related to certain accrued expenses. The after-tax adjustments, which affected selling, general and administrative and tax expense, necessary to correct these errors amounted to $2,289,000, or ($0.07) per share. The portions of these adjustments that related to the year ended December 31, 2004 and the fourth quarter of 2004 were $1,520,000, or ($0.05) per share, and $411,000, or ($0.01) per share, respectively. The impact of the amount that related to prior periods was not

material to any of the financial statements of prior periods, thus the amount related to prior periods was also recorded in the fourth quarter of 2004.

The following table illustrates the effects of the adjustments on earnings per share from continuing operations:

	Fourth quarter ended December 31, 2004	Year ended December 31, 2004
Adjustments:		
Related to 2004	$ (0.01)	$ (0.05)
Related to earlier periods	(0.06)	(0.02)
	$ (0.07)	$ (0.07)

Net sales. Our business is reported in three geographic segments: North America, Europe and China. Our net sales in each of these segments for the years ended December 31, 2004 and 2003 were as follows:

	Year ended December 31, 2004		Year ended December 31, 2003			
(Dollars in thousands)	Net sales	% sales	Net sales	% sales	Change	% change to consolidated net sales
North America	$ 545,139	66.1%	$ 472,518	67.3%	$ 72,621	10.3%
Europe	253,234	30.7	210,614	30.0	42,620	6.1
China	26,185	3.2	18,727	2.7	7,458	1.1
Total	$ 824,558	100%	$ 701,859	100%	$ 122,699	17.5%

The increase in net sales is attributable to the following:

					Change as a % of consolidated net sales				Change as a % of segment net sales		
(Dollars in thousands)	North America	Europe	China	Total	North America	Europe	China	Total	North America	Europe	China
Internal growth	$ 45,041	$ 8,822	$ 7,458	$ 61,321	6.4%	1.3%	1.1%	8.8%	9.6%	4.2%	39.8%
Foreign exchange	2,463	20,935		23,398	0.4	3.0		3.4	0.5	9.9	
Acquisitions	25,117	12,863		37,980	3.5	1.8		5.3	5.3	6.1	
Total	$ 72,621	$ 42,620	$ 7,458	$ 122,699	10.3%	6.1%	1.1%	17.5%	15.4%	20.2%	39.8%

The internal growth in net sales in North America is due to increased price and unit sales into both the wholesale and DIY markets. Our sales into the wholesale market for 2004, excluding sales from acquisitions, grew by 10% compared to 2003, primarily due to increased sales of

backflow preventer units, as well as in our plumbing and under-floor radiant heating product lines. Our sales into the North American DIY market for 2004 increased by 10% compared to 2003 primarily due to increased sales of our brass and tubular products.

The increase in net sales due to foreign exchange in North America is due to the Canadian dollar appreciating against the U.S. dollar. We cannot predict whether the Canadian dollar will continue to appreciate 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 acquired growth in net sales in North America is due to the inclusion of net sales of Flowmatic, acquired on January 5, 2004 and Orion, acquired on May 21, 2004.

The internal growth in net sales in Europe is primarily due to increased sales into the European OEM market and market share gains in the European wholesale markets.

The increase in net sales due to foreign exchange in Europe is primarily due to the appreciation of the euro against the U.S. dollar. We cannot predict whether the euro will continue to appreciate 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 acquired growth in net sales in Europe is due to the inclusion of the net sales of Martin Orgee, acquired on April 18, 2003, Anello, acquired on July 30, 2003, and TEAM, acquired on April 16, 2004.

The increase in net sales in China is primarily attributable to downward adjustments made in 2003 for previously recorded sales and increased sales rebates and returns recorded at our TWT joint venture located in Tianjin, China that did not repeat in 2004, and to internal growth primarily due to increased domestic shipments from our wholly-owned subsidiary located in Taizhou, China.

Gross profit. Gross profit for 2004 increased $50,696,000, or 21.1%, compared to 2003. The increase in gross profit is attributable to the following:

		(in thousands)	% change	
Internal growth	$	31,628	13.2	%
Foreign exchange		7,415	3.1	
Acquisitions		13,722	5.7	
Other		(2,069)	(0.9)	
Total	$	50,696	21.1	%

The internal growth is primarily due to a $21,449,000 increase in internal gross profit in the North American segment. This increase is primarily due to improved sales mix due to increased sales volume in the North American wholesale market, which typically generates higher gross margins than the North American retail market, and to benefits resulting from our completed manufacturing restructuring projects and outsourcing. The European segment increased internal gross profit by $3,972,000, primarily due to sales growth with European OEM and wholesale customers and to benefits resulting from our completed manufacturing restructuring projects. The China segment increased gross profit by $7,076,000, primarily due to inventory write-downs, increased sales rebates and returns and other net adjustments recorded in 2003 that did not repeat in 2004, and to increased sales volumes at WPT (formerly referred to as Shida) and improved manufacturing efficiencies at our wholly-owned manufacturing plant in Tianjin in 2004. The increase in gross profit from foreign exchange is primarily due to the appreciation of the euro and Canadian dollar against the U.S. dollar. The increase in gross profit from acquisitions is due to the inclusion of gross profit from Orion, TEAM, Flowmatic, Martin Orgee and Anello. These factors contributed to an increased consolidated gross profit percent of 35.2% for 2004 compared to 34.2% in 2003.

The increase in gross profit was partially offset by increased manufacturing restructuring and other costs. For 2004, we charged $2,873,000 of accelerated depreciation to cost of sales compared to $804,000 of accelerated depreciation and other costs for 2003.

Selling, general and administrative expenses. SG&A expenses for 2004 increased $37,428,000, or 22.1%, compared to 2003. The increase in SG&A expenses is attributable to the following:

		(in thousands)	% change	
Internal growth	$	20,118	11.9	%
Foreign exchange		4,573	2.7	
Acquisitions		7,811	4.6	
Other		4,926	2.9	
Total	$	37,428	22.1	%

The internal increase in SG&A expenses is primarily due to increased variable selling expense due to increased sales volume and costs incurred to comply with the requirements of SOX partially offset by a reserve reduction due to a favorable ruling in one of our legal cases. For 2004, commission expense and selling expense were approximately 4.2% and 11.5%, respectively, of sales. These expense percentages are consistent with 2003. For 2004, we recorded approximately $5,900,000 for SOX-related expenses.

As discussed previously, during the fourth quarter of 2004, we identified and corrected errors related to certain accrued expenses. The adjustments to net income necessary to correct these errors included a pre-tax charge to SG&A expenses of $4,926,000.

Our SG&A expenses as a percentage of sales for 2004 increased to 25.1% compared to 24.1% for 2003 primarily from SOX costs and the fourth quarter accrual adjustments.

Operating income. Operating income by geographic segment for 2004 and 2003 was as follows:

	Years ended							
(Dollars in thousands)		December 31, 2004		December 31, 2003		Change	% change to consolidated operating income	
North America	$	68,558	$	64,375	$	4,183	6.0	%
Europe		31,597		22,592		9,005	12.9	
China		1,857		(3,834)		5,691	8.1	
Corporate		(18,412)		(13,132)		(5,280)	(7.6)	
Total	$	83,600	$	70,001	$	13,599	19.4	%

The increase in operating income is attributable to the following:

						Change as a % of consolidated operating income					Change as a % of segment operating income			
(Dollars in thousands)	**North America**	**Europe**	**China**	**Corp**	**Total**	**North America**	**Europe**	**China**	**Corp**	**Total**	**North America**	**Europe**	**China**	**Corp**
Internal growth	$ 9,920	$ 2,065	$ 5,529	$ (6,004)	$ 11,510	14.2%	3.0%	7.9%	(8.6)%	16.5%	15.4%	9.1%	144.2%	(45.7)%
Foreign exchange	434	2,408			2,842	0.6	3.4			4.1	0.7	10.7		
Acquisitions	2,285	3,626			5,911	3.3	5.2			8.4	3.6	16.1		
Other	(5,650)			724	(4,926)	(8.1)			1.0	(7.1)	(8.8)			5.5
Other Restructuring	(2,806)	906	162		(1,738)	(4.0)	1.3	0.2		(2.5)	(4.4)	4.0	4.2	
Total	$ 4,183	$ 9,005	$ 5,691	$ (5,280)	$ 13,599	6.0%	12.9%	8.1%	(7.6)%	19.4%	6.5%	39.9%	148.4%	(40.2)%

The internal growth in North America is primarily due to our increased gross profit in the wholesale market, benefits resulting from our completed manufacturing restructuring projects and outsourcing, partially offset by increased net SG&A expenses. In 2004, we experienced raw material cost increases, which we were able to recover by implementing price increases on some of our products. For 2004, we recorded $2,968,000 for costs associated with our manufacturing restructuring plan compared to $162,000 for 2003. We expect to record an additional $750,000 in the first half of 2005 for approved costs associated with our manufacturing restructuring plan. The acquired growth is due to the inclusion of operating income from Orion and Flowmatic. Other of $5,650,000 relates to compensation expense regarding the accrual adjustment.

The internal growth in Europe is primarily due to increased gross profit from the increased sales volume in the OEM and wholesale markets and to benefits resulting from our previous manufacturing restructuring projects, partially offset by increased SG&A expenses. For 2004, we did not record any costs associated with our manufacturing restructuring plan compared to $906,000 for 2003. The increase in operating income from foreign exchange is primarily due to the appreciation of the euro against the U.S. dollar. We cannot predict whether the euro will continue to appreciate against the U.S. dollar in future periods or whether future foreign exchange rate fluctuations will have a positive or negative impact on our operating income. The acquired growth includes operating income from TEAM, Martin Orgee and Anello.

The increase in internal growth in China of $5,529,000 is attributable to inventory write-downs and other net adjustments recorded in 2003 that did not repeat in 2004, and to internal growth primarily due to increased sales volumes and improved manufacturing efficiencies associated with our manufacturing plant in Tianjin, which in 2003 was in a start-up phase.

The decrease in operating income in Corporate of $5,280,000 is primarily attributable to costs incurred for compliance with SOX. Other of $724,000 includes the adjustments to correct errors for accrued expenses.

Interest expense. Interest expense decreased $1,544,000, or 12.8%, for 2004 compared to 2003, primarily due to overlapping interest charges on three separate senior note issues that were outstanding in 2003, while only two senior note issues remain outstanding in 2004, partially offset by the elimination of favorable amortization from our interest rate swap, increased indebtedness on our $125,000,000 senior notes and decreased indebtedness under our U.S. revolving credit facility. On September 1, 2001, we entered into an interest rate swap with respect to our $75,000,000 8.375% notes due December 2003. The swap converted the

interest from fixed to floating. On August 5, 2002, we sold the swap and received $2,315,000 in cash. In 2003, we reduced interest expense by $1,420,000 by amortizing the adjustment to the fair value of the swap. The amortization of the swap was completed upon repayment of the $75,000,000 8.375% notes on December 1, 2003. On May 15, 2003, we refinanced our $75,000,000 8.375% notes with proceeds from the issuance of $125,000,000 senior notes.

On July 1, 2003, we entered into an interest rate swap for a notional amount of €25,000,000 outstanding on our prior revolving credit facility. We swapped the three-month EURIBOR plus 0.7%, for a fixed rate of 2.3%. For 2004, the EURIBOR rate did not fluctuate materially and the impact of swap was immaterial to the overall interest expense.

Income taxes. Our effective tax rate for continuing operations for 2004 decreased to 32.9% from 38.0% for 2003. The decrease is primarily due to improvements in the results of our Chinese operations that have allowed us to recognize the benefit of deferred tax assets and also have provided a favorable mix of earnings. We also recognized the benefit of a significant amount of state income tax credits in 2004. In addition, a credit of $462,000 was recorded for accounting corrections made in the fourth quarter of 2004 for an accrual that was related to prior years.

Income from continuing operations. Income from continuing operations for 2004 increased $12,319,000, or 33.8%, to $48,738,000, or $1.49 per common share, from $36,419,000, or $1.32 per common share, for 2003, in each case, on a diluted basis. The appreciation of the euro and the Canadian dollar against the U.S. dollar resulted in a positive impact on income from continuing operations of $0.05 per share for 2004 compared to 2003. We cannot predict whether the euro or the Canadian dollar will continue to appreciate against the U.S. dollar in future periods or whether future foreign exchange rate fluctuations will have a positive or negative impact on our net income. Income from continuing operations for 2004 and 2003 includes net costs incurred for our manufacturing restructuring plan of $1,825,000, or ($0.06) per share, and $1,084,000, or ($0.04) per share, respectively. Also included in income from continuing operations for 2004 is the net charge of $2,289,000, or ($0.07) per share, for accounting corrections relating to certain accrued expenses.

Loss from discontinued operations. We recorded a charge net of tax to discontinued operations for 2004 of $1,918,000, or ($0.06) per common share, and $3,057,000, or ($0.11) per common share, for 2003, in each case, on a diluted basis. Included in loss from discontinued operations for 2004 are charges attributable to legal fees associated with the James Jones litigation and obligations to the former shareholders of the James Jones Company of $1,125,000, or ($0.04) per share, compared to $3,111,000, or ($0.11) per share, for 2003. See "Business Product liability, environmental and other litigation matters." Additionally, losses from discontinued operations for 2004 and 2003 include an impairment charge and an operating loss totaling $793,000, or ($0.02) per share, and income of $54,000, or $0.00 per share, respectively, for the planned divesture of our minority interest in Jameco International LLC.

Liquidity and capital resources

We generated $33,411,000 of cash from continuing operations for the first nine months of 2006. We experienced an increase in inventory and accounts receivable in North America, Europe and China. The increase in accounts receivable is primarily due to increased sales

volume and selling prices. The increase in inventory was primarily due to increased cost of raw materials, planned increases in European safety stocks and seasonality.

We used $101,423,000 of net cash for investing activities for the first nine months of 2006. We used $90,877,000 to fund the acquisitions of Changsha, ATS, Calflex and Ningbo, KimSafe and Teknigas, $1,763,0000 in additional costs related to 2005 acquisitions and $387,000 to complete the planned increase of our ownership in Stern. We invested $35,348,000 in capital equipment. Capital expenditures consisted of approximately $17,348,000 for manufacturing machinery and equipment as part of our ongoing commitment to improve our manufacturing capabilities and approximately $18,000,000 for the purchase of land and building and for infrastructure improvements for a site in Italy. We subsequently entered into a sale-leaseback transaction with respect to the building. We expect to invest an additional $5,000,000 in capital equipment in 2006. We received proceeds of $27,615,000, which primarily included $15,957,000 related to the sale-leaseback in Italy and $9,148,000 from the sale of our facility in northern Italy. We also received proceeds from two buildings held for sale, totaling approximately $2,331,000, during the first nine months of 2006.

We generated $136,450,000 of net cash from financing activities for the first nine months of 2006 primarily through the completion of our $225,000,000 private placement of 5.85% senior unsecured notes, increased borrowings under the European line of credit and proceeds from the exercise of stock options, partially offset by payments of debt, dividend payments and debt issue costs.

In April 2006, we amended our revolving credit facility with a syndicate of banks to provide for multi-currency unsecured borrowings and stand-by letters of credit of up to $350,000,000 and to extend the maturity date through April 2011. The original facility provided $300,000,000 in borrowings and would have expired in September 2009. The revolving credit facility is being used to support our acquisition program, working capital requirements and for general corporate purposes.

Outstanding indebtedness under the revolving credit facility bears interest at a rate determined by the type of loan plus an applicable margin determined by our debt rating, depending on the applicable base rate and our bond rating. For the first nine months of 2006 the average interest rate under the revolving credit facility for euro-based borrowings was approximately 3.3%. There were no U.S. dollar borrowings at October 1, 2006. The revolving credit facility includes operational and financial covenants customary for facilities of this type, including, among others, restrictions on additional indebtedness, liens and investments and maintenance of certain leverage ratios. As of October 1, 2006, we were in compliance with all covenants related to the revolving credit facility; had $210,069,000 of unused and potentially available credit under the revolving credit facility; and had $107,290,000 of euro-based borrowings outstanding and $32,641,000 for stand-by letters of credit outstanding on our revolving credit facility.

Effective July 1, 2005, we entered into a three-year interest rate swap with a counter party for a notional amount of €25,000,000, which is outstanding under the revolving credit facility. We swapped the three-month EURIBOR plus 0.6% for a fixed rate of 3.02%. At October 1, 2006, the fair value of the swap was approximately $673,000. The swap was terminated on October 3, 2006.

We generated $998,000 of net cash by operations from discontinued operations. During the first nine months of 2006, we received approximately $16,500 in cash as an indemnification payment for settlement costs we incurred in the James Jones Litigation. This cash has been recorded as a liability at October 1, 2006 because of the possibility that we might have to reimburse the insurance company if it is ultimately successful with a future appeal. We also received approximately $2,606,000 in cash for reimbursement of defense costs related to the James Jones Litigation. During the first nine months of 2006, we paid approximately $390,000 for defense costs and approximately $445,000 for indemnity costs we incurred in the James Jones Litigation.

Working capital (defined as current assets less current liabilities) as of October 1, 2006 was $445,866,000 compared to $305,092,000 as of December 31, 2005. This increase is primarily due to increases in cash, inventories and accounts receivable. Cash and cash equivalents increased to $116,621,000 as of October 1, 2006 compared to $45,758,000 as of December 31, 2005 primarily due to residual proceeds from the completion of the $225,000,000 private placement and from cash generated by operations. The ratio of current assets to current liabilities was 2.5 to 1 as of October 1, 2006 compared to 2.4 to 1 as of December 31, 2005.

We anticipate that available funds from current operations, existing cash, proceeds from this offering and other sources of liquidity will be sufficient to meet current operating requirements and anticipated capital expenditures for at least the next 12 months. However, we may have to consider external sources of financing for any large future acquisitions.

Our long-term contractual obligations as of October 1, 2006 are presented in the following table:

	Payments due by period				
Contractual obligations (in thousands)	**Total**	**Less than 1 year**	**1-3 years**	**3-5 years**	**More than 5 years**
Long-term debt obligations, including current maturities(a)	$ 465,597	$ 7,616	$ 304	$ 50,387	$ 407,290
Operating lease obligations	20,448	2,289	10,372	5,457	2,330
Capital lease obligations(a)	15,347	53	2,347	2,319	10,628
Pension contributions	11,104	90	3,406	198	7,410
Interest(b)	192,055	14,835	48,046	46,375	82,799
Other(c)	29,444	12,000	14,245	2,700	499
Total	$ 733,995	$ 36,883	$ 78,720	$ 107,436	$ 510,956

(a) as recognized in the consolidated balance sheet

(b) assumes the balance on the revolving credit facility remains at $107,290,000 and the interest rate remains at approximately 3.6% for the presented periods

(c) includes commodity, capital expenditure commitments, taxes and other benefits at October 1, 2006

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 $53,201,000 as of October 1, 2006 and $48,651,000 as of December 31, 2005. Our letters of credit are primarily associated with insurance coverage and to a lesser extent foreign purchases 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.

We divested our 20% interest in www.plumbworld.co.uk Limited (Plumbworld), a variable interest entity, on August 21, 2006. We had a nominal investment of approximately $500 in Plumbworld and maintained a loan receivable that was paid in full, at which time we relinquished our shares in Plumbworld.

Off-balance sheet arrangements

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 are material to investors.

Application of critical accounting policies and key estimates

The preparation of our consolidated financial statements in accordance with U.S. GAAP requires management to make judgments, assumptions and estimates that affect the amounts reported. A critical accounting estimate is an assumption about highly uncertain matters and could have a material effect on the consolidated financial statements if another, also reasonable, amount were used, or, a change in the estimate is reasonably likely from period to period. We base our assumptions on historical experience and on other estimates that we believe are reasonable under the circumstances. Actual results could differ significantly from these estimates. There were no changes in accounting policies or significant changes in accounting estimates during the first nine months of 2006.

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

Revenue recognition

We recognize revenue when all of the following criteria are met: (1) we have entered into a binding agreement, (2) the product has shipped and title has passed, (3) the sales price to the customer is fixed or is determinable and (4) collectibility is reasonably assured. We recognize revenue based upon a determination that all criteria for revenue recognition have been met, which, based on the majority of our shipping terms, is considered to have occurred upon shipment of the finished product. Some shipping terms require the goods to be received by the customer before title passes. In those instances, revenues are not recognized until the customer has received the goods. We record estimated reductions to revenue for customer returns and allowances and for customer programs. Provisions for returns and allowances are made at the time of sale, derived from historical trends and form a portion of the allowance for doubtful accounts. Customer programs, which are primarily annual volume incentive plans, allow customers to earn credit for attaining agreed upon purchase targets from us. We record customer programs as an adjustment to net sales.

Allowance for doubtful accounts

The allowance for doubtful accounts is established to represent our best estimate of the net realizable value of the outstanding accounts receivable. The development of our allowance for

doubtful accounts varies by region but in general is based on a review of past due amounts, historical write-off experience, as well as aging trends affecting specific accounts and general operational factors affecting all accounts. In North America, management specifically analyzes individual accounts receivable and establishes specific reserves against financially troubled customers. In addition, factors are developed utilizing historical trends in bad debts, returns and allowances. The ratio of these factors to sales on a rolling twelve-month basis is applied to total outstanding receivables (net of accounts specifically identified) to establish a reserve. In Europe, management develops their bad debt allowance through an aging analysis of all their accounts. In China, management specifically analyzes individual accounts receivable and establishes specific reserves as needed. In addition, for waterworks customers, whose payment terms are generally extended, we reserve the majority of accounts receivable in excess of one year from the invoice date.

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

Inventory valuation

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

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

Goodwill and other intangibles

We adopted Financial Accounting Standards Board Statement No. 142 "Goodwill and Other Intangible Assets" (FAS 142) on January 1, 2002, and as a result we no longer amortize goodwill. Goodwill and intangible assets with indefinite lives are tested annually for impairment in accordance with the provisions of FAS 142. We use judgment in assessing whether assets may have become impaired between annual impairment tests. We concluded that no impairment existed at October 30, 2005, the time of our latest annual review. We perform our annual test for indicators of goodwill and non-amortizable intangible assets impairment in the fourth quarter of our fiscal year or sooner if indicators of impairment exist.

Intangible assets such as purchased technology are generally recorded in connection with a business acquisition. Values assigned to intangible assets are determined by an independent valuation firm based on estimates and judgments regarding expectations of the success and life cycle of products and technology acquired.

Since the adoption of FAS 142 our valuations have been greater than the carrying value of our goodwill and intangibles. While we believe that our estimates of future cash flows are reasonable, different assumptions regarding such factors as future sales volume, selling price changes, material cost changes, cost savings programs and capital expenditures could significantly affect our valuations. Other changes that may affect our valuations include, but are not limited to product acceptances and regulatory approval. If actual product acceptance differs significantly from the estimates, we may be required to record an impairment charge to write down the assets to their realizable value. A severe decline in market value could result in an unexpected impairment charge to goodwill, which could have a material impact on the results of operations and financial position.

Product liability and workers' compensation costs

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

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

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

Legal contingencies

We are a defendant in numerous legal matters including those involving environmental law and product liability as discussed further in "Business Product liability, environmental and other litigation matters." As required by Financial Accounting Standards Board Statement No. 5

"Accounting for Contingencies" (FAS 5), we determine whether an estimated loss from a loss contingency should be accrued by assessing whether a loss is deemed probable and the loss amount can be reasonably estimated, net of any applicable insurance proceeds. Estimates of potential outcomes of these contingencies are developed in consultation with outside counsel. While this assessment is based upon all available information, litigation is inherently uncertain and the actual liability to fully resolve this litigation cannot be predicted with any assurance of accuracy. Final settlement of these matters could possibly result in significant effects on our results of operations, cash flows and financial position.

Pension benefits

We account for our pension plans in accordance with Financial Accounting Standards Board Statement No. 87 "Employers Accounting for Pensions" (FAS 87). In applying FAS 87, assumptions are made regarding the valuation of benefit obligations and the performance of plan assets. The primary assumptions are as follows:

- Weighted average discount rate this rate is used to estimate the current value of future benefits. This rate is adjusted based on movement in long-term interest rates.

- Expected long-term rate of return on assets this rate is used to estimate future growth in investments and investment earnings. The expected return is based upon a combination of historical market performance and anticipated future returns for a portfolio reflecting the mix of equity, debt and other investments indicative of our plan assets.

- Rates of increase in compensation levels this rate is used to estimate projected annual pay increases, which are used to determine the wage base used to project employees' pension benefits at retirement.

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

Income taxes

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

We recognize deferred taxes for the expected future consequences of events that have been reflected in the consolidated financial statements in accordance with the rules of Financial Accounting Standards Board Statement No. 109 "Accounting for Income Taxes" (FAS 109). Under FAS 109, deferred tax assets and liabilities are determined based on differences between the book values and tax bases of particular assets and liabilities, using tax rates in effect for the years in which the differences are expected to reverse. A valuation allowance is provided to offset any net deferred tax assets if, based upon the available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized. We consider estimated future taxable income and ongoing prudent tax planning strategies in assessing the need for a valuation allowance.

New accounting standards

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements" (SAB 108), which provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. SAB 108 is effective for fiscal years ending after November 15, 2006. We will adopt the provisions of SAB 108 for our annual financial statements for fiscal year 2006. We do not expect the impact of SAB 108 will be material to our consolidated financial statements.

In September 2006, the Financial Accounting Standards Board (FASB) issued FAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106, and 132(R)" (FAS 158), which requires an employer to: (a) recognize in its statement of financial position an asset for a plan's overfunded status or a liability for a plan's underfunded status; (b) measure a plan's assets and its obligations that determine its funded status as of the end of the employer's fiscal year; and (c) recognize changes in the funded status of a defined benefit postretirement plan in the year in which the changes occur. Those changes will be reported in other comprehensive income. The requirement to recognize the funded status of a benefit plan and the disclosure requirements are effective as of the end of the fiscal year ending after December 15, 2006 for companies with publicly traded equity securities. The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008, although earlier adoption is permitted. As a result of the requirement to recognize the funded status of our benefit plans as of December 31, 2006, we expect to record an increase in our pension liability of approximately $8,000,000 and a decrease in stockholders' equity of approximately $5,500,000, net of tax.

In September 2006, the FASB issued FAS No. 157, "Fair Value Measurements" (FAS 157), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. FAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. Earlier application is encouraged provided that the reporting company has not yet issued financial statements for that fiscal year, including financial statements for an interim period within that fiscal year. We do not expect the impact of FAS 157 will be material to our consolidated financial statements.

In July 2006, the FASB issued Financial Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48), which clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes." FIN 48 provides that a tax benefit from an uncertain tax position may be recognized when it is more likely than not that the position will be sustained upon examination, based on the technical merits. This interpretation also provides guidance on measurement, de- recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 will become effective for fiscal years beginning after December 15, 2006. We do not expect that the impact of FIN 48 will be material to our consolidated financial statements.

In March 2006, the FASB issued Financial Accounting Standards Board Statement No. 156, "Accounting for Servicing of Financial Assets an amendment of FASB Statement No. 140" (FAS 156). FAS 156 amends FAS Statement No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," with respect to the accounting for separately recognized servicing assets and servicing liabilities. FAS 156 addresses the recognition and measurement of separately recognized servicing assets and liabilities and provides an approach to simplify efforts to obtain hedge-like (offset) accounting. We are required to adopt the provisions of FAS 156 as of January 1, 2007, although earlier adoption is permitted. We do not expect that the impact of FAS 156 will be material to our consolidated financial statements.

In February 2006, the FASB issued Financial Accounting Standards Board Statement No. 155, "Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140" (FAS 155). FAS 155 amends FAS 133, "Accounting for Derivatives and Hedging Activities," and FAS 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," and allows an entity to remeasure at fair value a hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation from the host, if the holder irrevocably elects to account for the whole instrument on a fair value basis. Subsequent changes in the fair value of the instrument would be recognized in earnings. We are required to adopt the provision of FAS 155 as of January 1, 2007, although earlier adoption is permitted. We do not expect that the impact of FAS 155 will be material to our consolidated financial statements.

In May 2005, the FASB issued Financial Accounting Standards Board Statement No. 154, "Accounting Changes and Error Correction Replacement of APB Opinion No. 20 and FASB Statement No. 3" (FAS 154). FAS 154 replaces APB Opinion No. 20, "Accounting Changes" (APB 20), and FASB Statement No. 3, "Reporting Accounting Changes in Interim Financial Statements," and changes the requirements for the accounting for and reporting of a change in accounting principle. APB 20 previously required that most voluntary changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. FAS 154 requires retrospective application to prior periods' financial statements of changes in accounting principle. FAS 154 defines retrospective application as the application of a different accounting principle to prior accounting periods as if that principle had always been used. FAS 154 also requires that a change in depreciation, amortization, or depletion method for long-lived, non-financial assets be accounted for as a change in accounting estimate affected by a change in accounting principle. We applied the provisions of this statement in January 2006 and the impact was not material to our consolidated financial statements.

In December 2004, the FASB issued Financial Accounting Standards Board Statement No. 153, "Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29, Accounting for Nonmonetary Transactions" (FAS 153). The amendments made by FAS 153 are based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. Further, the amendments eliminate the narrow exception for nonmonetary exchanges of similar productive assets and replace it with a broader exception for exchanges of nonmonetary assets that do not have commercial substance. Previously, Opinion No. 29 required that the accounting for an exchange of a productive asset for a similar productive asset or an equivalent interest in the same or similar productive asset should

be based on the recorded amount of the asset relinquished. The statement is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. Earlier application is permitted for nonmonetary asset exchanges occurring in fiscal periods beginning after the date of issuance. We applied the provisions of this statement prospectively in January 2006 and the impact was not material to our consolidated financial statements.

In November 2004, the FASB issued Financial Accounting Standards Board Statement No. 151, "Inventory Costs" (FAS 151). FAS 151 amends the guidance in Accounting Research Bulletin No. 43, Chapter 4, "Inventory Pricing," to clarify the accounting for inventory costs. The provisions of this statement are effective for fiscal years beginning after June 15, 2005. We applied the provisions of this statement in January 2006, and the impact was not material to our consolidated financial statements.

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.

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

Our foreign subsidiaries transact most business, including certain intercompany transactions, in foreign currencies. Such transactions are principally purchases or sales of materials and are denominated in European currencies or the U.S. or Canadian dollar. We use foreign currency forward exchange contracts to manage the risk related to intercompany purchases that occur during the course of a year and certain open foreign currency denominated commitments to sell products to third parties. For the nine months ended October 1, 2006, the amounts recorded in other income for the change in the fair value of such contracts was immaterial.

We have historically had a very low exposure on the cost of our debt to changes in interest rates. Interest rate swaps are used to mitigate the impact of interest rate fluctuations on certain variable rate debt instruments and reduce interest expense on certain fixed rate instruments. Information about our long-term debt including principal amounts and related interest rates appears in note 11 of notes to consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2005 and in note 10 of notes to consolidated financial statements in our Quarterly Report on Form 10-Q for the quarter ended October 1, 2006.

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

Business

Overview

Watts Regulator Co. was founded by Joseph E. Watts in 1874 in Lawrence, Massachusetts. Watts Regulator Co. started as a small machine shop supplying parts to the New England textile mills of the 19th century and grew into a global manufacturer of products and systems focused on the control, conservation and quality of water and the comfort and safety of the people using it. Watts Water Technologies, Inc. was incorporated in Delaware in 1985 and became the parent company of Watts Regulator Co.

Our competitive strengths

Comprehensive portfolio of leading water-related products. We focus on supplying products for water-related markets, including water quality, water conservation, water safety and water flow control. Our comprehensive portfolio of water-related products provides our customers with purchasing efficiency and ease of service. As wholesale distribution customers have consolidated their vendor base to reduce costs, our broad product offerings have made us more attractive as a single source for their product needs.

Brand preference and leading market positions. We believe our leading product lines of backflow preventers, water pressure regulators, temperature and pressure relief valves, and thermostatic mixing valves have the highest brand name preference and brand name recognition in North America. We further believe end-users of valves and related systems place a high premium on product quality and reliability, and our strength and reputation in these areas have contributed to our leading market positions.

Successful track record of identifying and integrating acquisitions. We have successfully acquired and integrated 30 companies since 1999. Our experience in acquiring businesses has resulted in improved financial performance of the acquired companies, increased our global presence and expanded our product line. We invest in opportunities that enable us to expand our existing product offering, enter new product and geographic markets, and acquire new technology and manufacturing capabilities.

Global manufacturing capabilities. Our sophisticated manufacturing equipment and processes allows us to shift manufacturing of a particular product across our global manufacturing network. We can therefore source our products globally according to costs and customer demand. In addition, we are continuing to source more of our manufacturing from lower-cost majority- or wholly-owned operations in China, Bulgaria and Tunisia.

Technological expertise and new product introductions. We have developed technological expertise in the design and manufacture of water-related products and solutions. For instance, we recently developed and marketed the first line of flexible water supply connectors with a built-in shutoff device. Our FloodSafe auto-shutoff connectors protect homes and businesses from potentially catastrophic water damage resulting from burst or broken water supply connectors. In addition, our Watts Radiant division recently designed Hydronex radiant heating panels. Our Hydronex panels are pre-engineered and manufactured in three typical modular configurations for radiant heating applications, providing installers with an alternative to costly custom-built panels.

Efficient distribution and reduced transaction costs. Over the past five years, we have made significant improvements in our distribution capabilities that have increased the quality of customer service and resulted in reduced transaction costs. We have upgraded our information technology systems, enabling us to increase our level of electronic data interchange transactions, which has improved delivery time and fill rates, allowing our customers to maintain lower inventories.

Experienced management team. Our senior management team has significant experience in the design, manufacturing, distribution, merchandising and sales of products in our industry. Our executive management team has an average of nine years of service with our company. In addition, this team has substantial experience in the acquisition and integration of businesses, aggressive cost management, global operations and efficient manufacturing techniques, all of which are critical to our long-term growth strategy.

Our growth strategy

Our "Water by Watts" strategy is to be the leading provider of water quality, water conservation, water safety and water flow control products for the residential and commercial markets in North America, Europe and China. Our primary objective is to grow earnings by increasing sales within existing markets, expanding into new markets, leveraging our distribution channels and customer base, making selected acquisitions, reducing manufacturing costs and advocating for the development and enforcement of industry standards.

Growing sales within existing markets. We intend to continue to introduce products in existing markets by enhancing our preferred brands, developing new complementary products, promoting plumbing code development to drive sales of safety and water quality products and continually improving merchandising in both the DIY and wholesale distribution channels. For example, with our June 2005 acquisition of the water softener business of Alamo, we broadened our product line in the water purification market by adding a well-known brand of water softeners for both residential and commercial applications.

Expanding into new product and geographic markets. We continually target selected new product and geographic markets based on growth potential, including our ability to leverage our existing distribution channels. For instance, in January 2005, we acquired HF Scientific, Inc., a manufacturer of instrumentation, test kits and chemical reagents used for monitoring water quality, with applications for laboratory and field use. With the acquisition of HF, we entered the water monitoring market, which complements our market for filtration and other water quality products. In addition, with our acquisition of Changsha Valve Works in April 2006, we entered the water works and water distribution markets in China.

Leverage our distribution channel and customer base. We continually leverage our distribution channels through the introduction of new products, as well as the integration of products of our acquired companies. For example, our recent acquisition of ATS Expansion Group based in France will allow us to expand into the DIY market in various European markets. We also intend to introduce ATS' product lines into our existing wholesale distribution channels in other European markets. Another example is our December 2005 acquisition of Dormont Manufacturing Company based in Export, Pennsylvania. Dormont is a leading manufacturer of gas connectors in the United States. Watts has a strong presence in the North American wholesale market, which will allow us to introduce Dormont's line of gas connectors

in a more meaningful way into that distribution channel. We also intend to introduce Watts' line of plumbing and heating safety products into Dormont's commercial food service distribution channel.

Making selected acquisitions. We intend to continue to generate growth by targeting selected acquisitions, both in our core markets as well as new complementary markets. We have completed 30 acquisitions since divesting our industrial and oil and gas business in 1999, including nine acquisitions in 2005 and five acquisitions during the first three quarters of 2006. Our acquisition strategy focuses on businesses that manufacture preferred brand name products that address our themes of water quality, water safety, water conservation, water flow control and related complementary markets. We target businesses that will provide us with one or more of the following: an entry into new markets, an increase in shelf space with existing customers, strong brand names, a new or improved technology or an expansion of the breadth of our Water by Watts offering. In the first nine months of 2006, sales from acquisitions contributed approximately 21.1% to our total sales growth over the comparable period of 2005.

Reducing manufacturing costs. We are committed to reducing our manufacturing costs through a combination of expanding manufacturing in lower-cost countries and consolidating our diverse manufacturing operations in North America and Europe. We have acquired a number of manufacturing facilities in lower-cost regions such as China, Bulgaria and Tunisia, and plan to continue to shift production to these lower-cost regions.

Advocate development and enforcement of standards. We have consistently advocated the development and enforcement of plumbing codes and are committed to providing products to meet these standards, particularly for safety and control valve products. For example, we participated in the effort to include thermostatic scald protection in the American Society of Sanitary Engineers Standard ASSE 1016 and the subsequent adoption of that standard into national and state plumbing codes. These codes serve as a competitive barrier to entry by requiring that products sold in select states meet stringent criteria.

Products

We believe that we have the broadest range of products in terms of design distinction, size and configuration in a majority of our principal product lines. Our principal product lines include:

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

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

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

large diameter butterfly valves for use in China's water infrastructure.

We sell our products to wholesale distributors such as Ferguson Enterprises, Inc. and Hajoca Corp., major DIY chains such as The Home Depot, Inc. and Lowe's Companies, Inc., and OEMs such as Buderus AG, Siemens plc and Rheem Manufacturing Company. Most of our sales are of products that have been approved under regulatory standards incorporated into state and municipal plumbing, heating, building and fire protection codes in North America and Europe. We have consistently advocated the development and enforcement of such codes and remain committed to providing products to meet these standards, in particular, safety and control valve products. We maintain quality control and testing procedures at each of our manufacturing facilities in order to manufacture products in compliance with code requirements. Additionally, a majority of our manufacturing facilities are ISO 9000, 9001 or 9002 certified by the International Organization for Standardization.

Our industry

We estimate the annual global water market to be approximately $365 billion, of which the market that our products address is approximately $60 billion. Within the markets we serve, our sales are relatively balanced between residential and commercial segments, with renovations and remodeling driving a significant portion of demand for our products.

Competition for sales in the water quality, water conservation, water safety and water flow control markets is generally based on brand preference, engineering specifications, plumbing code requirements, price, technological expertise, delivery times and breadth of product offerings. The competitive environment in our industry is characterized by:

Consolidation of manufacturers. Our industry has experienced significant consolidation over the past decade due to the benefits of increased scale and broader product offerings. Many of our competitors have made numerous acquisitions or have been acquired themselves one or more times. Despite the ongoing consolidation, our industry remains highly fragmented, with numerous competitors and continued opportunities for further acquisitions.

Consolidation of North American and European wholesale distributors. The wholesale distribution channels for our products in North America and Europe are becoming more concentrated each year. For example, in March 2006, Home Depot acquired Hughes Supply, Inc., one of the largest wholesale distributors in North America. We believe that our product breadth and ability to act as a single source of supply continues to make us an attractive vendor to wholesale distributors in North America.

Large DIY market. The DIY market in the U.S. is estimated to be approximately $200 billion. We have experienced significant growth in sales of our products in the DIY market since entering that market in 1995, resulting in sales of approximately $165 million in 2005. We believe that our sales in the DIY market have increased primarily due to our development of unique new products and successful merchandising efforts, the expansion of the market with the growth of large national chains, and our ability to fill orders completely and on-time. In

addition, our recent acquisition of ATS in France will allow us to expand into the DIY market in various European markets.

Customers and markets

We sell our products to plumbing, heating and mechanical wholesale distributors, major DIY chains and OEMs.

Wholesalers. Approximately 64% and 63% of our sales in 2005 and 2004, respectively, were to wholesale distributors for both commercial and residential applications. We rely on commissioned manufacturers' representatives, some of which maintain a consigned inventory of our products, to market our product lines.

DIY. Approximately 18% of our sales in both 2005 and 2004 were to DIY customers in North America. Our DIY customers demand less technical products, but are highly receptive to innovative designs and new product ideas. Our DIY sales over the past several years have increased as a result of our development of unique new products and successful merchandising efforts and the expansion of the market with the large national chains. We expect that our DIY sales in Europe will increase significantly as a result of our recent acquisition of ATS.

OEMs. Approximately 18% and 19% of our sales in 2005 and 2004, respectively, were to OEMs in both North America and Europe. In North America, our typical OEM customers are water heater manufacturers, equipment manufacturers needing flow control devices and water systems manufacturers needing backflow preventers. Our sales to OEMs in Europe are primarily to boiler manufacturers and radiant systems manufacturers.

Our largest customer, Home Depot and its subsidiaries, accounted for approximately $98.5 million, or 10.7%, of our total net sales in 2005 and $84.5 million, or 10.3%, of our total net sales in 2004. Our top ten customers accounted for approximately $238.1 million, or 25.8%, of our total net sales in 2005 and $201.7 million, or 24.5%, of our total net sales in 2004. Thousands of other customers constituted the remaining 74.2% of our net sales in 2005 and 75.5% of our net sales in 2004.

Marketing and sales

We rely primarily on commissioned manufacturers' representatives, some of which maintain a consigned inventory of our products. These representatives sell primarily to plumbing and heating wholesalers or service DIY store locations in North America. We also sell products for the residential construction and home repair and remodeling industries through DIY plumbing retailers, national catalog distribution companies, hardware stores, building material outlets and retail home center chains and through plumbing and heating wholesalers. In addition, we sell products directly to certain large OEMs and private label accounts.

Manufacturing

We have integrated and automated manufacturing capabilities, including bronze and iron foundries, machining, plastic injection molding and assembly operations. Our foundry operations include metal pouring systems, automatic core making, yellow brass forging and brass and bronze die-castings. Our machining operations feature computer-controlled machine tools, high-speed chucking machines with robotics and automatic screw machines for machining bronze, brass and steel components. We have invested heavily in recent years to

expand our manufacturing base and to ensure the availability of the most efficient and productive equipment. We are committed to maintaining our manufacturing equipment at a level consistent with current technology in order to maintain high levels of quality and manufacturing efficiencies.

Capital expenditures and depreciation for each of the last three years were as follows:

	Years ended December 31,		
(in millions)	**2003**	**2004**	**2005**
Capital expenditures	$ 20.0	$ 21.0	$ 18.6
Depreciation	$ 20.5	$ 26.3	$ 23.5

For the first nine months of 2006, capital expenditures totaled $35.3 million, and we anticipate spending $40.0 million for all of 2006. The nine-month total for 2006 includes approximately $18.0 million related to the purchase and subsequent sale-leaseback of a building in Italy.

Raw materials

We require substantial amounts of raw materials to produce our products, including bronze, brass, cast iron, steel and plastic, and substantially all of the raw materials we require are purchased from outside sources. We have experienced increases in the costs of certain raw materials, particularly copper. Bronze and brass are copper-based alloys. The spot price of copper increased approximately 89% from September 30, 2005 to September 30, 2006, and approximately 57% from December 31, 2005 to October 26, 2006. In response, we have implemented price increases for some of the products, which have become more expensive to manufacture due to the increases in raw material costs. During the first nine months of 2006, cost increases in raw materials were not completely recovered by increased selling prices or other product cost reductions. We are not able to predict whether or for how long these cost increases will continue. If these cost increases continue and we are not able to reduce or eliminate the effect of the cost increases by reducing production costs or implementing price increases, our profit margins could decrease.

Acquisitions

We have acquired 30 businesses since 1999, including five during the first three quarters of 2006. In acquiring a company, the factors we consider include the following:

- proprietary, preferred brand-name products;
- accretive to earnings in the first year after being acquired;
- product offering expansion and new product opportunities in existing water-related markets;
- expansion into new product and geographic markets;
- strong management team;
- synergies with our existing business units;
- new distribution channels; and

new technology.

We believe our acquisition strategy has been successful for two primary reasons:

Identifying attractive acquisitions. Our acquisition strategy focuses on companies that manufacture preferred brand name products in water-related markets. In addition, while we have discussions with numerous acquisition candidates each year, we consummate only those acquisitions that meet our criteria. Our acquisition criteria are designed to promote long-term profitability and positive cash flow as well as revenue growth.

Successful integration into our company structure. We believe that our experience in acquiring businesses has resulted in improved financial performance through successful integration of acquired businesses. Following the acquisition of a business, we appoint a team composed of individuals from various functional areas in our organization to facilitate the assimilation of the new business and to achieve synergies with other business units. We also implement our financial control system in acquired businesses. This process allows us to implement proven methods more quickly and avoid known problems as we integrate a new business.

Code compliance

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. Standards are established by such industry test and certification organizations as the American Society of Mechanical Engineers (A.S.M.E.), the Canadian Standards Association (C.S.A.), the American Society of Sanitary Engineers (A.S.S.E.), the University of Southern California Foundation for Cross-Connection Control (USC FCC), the International Association of Plumbing and Mechanical Officials (I.A.P.M.O.), Factory Mutual (F.M.), the National Sanitation Foundation (N.S.F.) and Underwriters Laboratory (U.L.). These standards are incorporated into state and municipal plumbing and heating, building and fire protection codes.

National regulatory standards in Europe vary by country. The major standards and/or guidelines which our products must meet are AFNOR (France), DVGW (Germany), UNI/ICIN (Italy), KIWA (Netherlands), SVGW (Switzerland), SITAC (Sweden) and WRAS (United Kingdom). Further, there are local regulatory standards requiring compliance as well.

Together with our commissioned manufacturers' representatives, we have consistently advocated for the development and enforcement of plumbing codes. We maintain stringent quality control and testing procedures at each of our manufacturing facilities in order to manufacture products in compliance with code requirements.

Product development and engineering

We maintain our own product development, design teams, and testing laboratories in North America, Europe and China that continually work to enhance our existing products and develop new products. We maintain sophisticated product development and testing laboratories. Our efforts in this area have been particularly successful in the DIY market, which values innovation in product design. Research and development costs included in selling, general, and administrative expense amounted to $11.6 million, $9.9 million and $9.2 million for the years ended December 31, 2005, 2004 and 2003, respectively.

Competition

The domestic and international markets for water safety and flow control devices are intensely competitive and require us to compete against some companies possessing greater financial, marketing and other resourc