

# WATTS WATER TECHNOLOGIES INC

## FORM 10-K405

(Annual Report (Regulation S-K, item 405))

Filed 9/28/1999 For Period Ending 6/30/1999

Address	815 CHESTNUT ST NORTH ANDOVER, Massachusetts 01845
Telephone	978-688-1811
CIK	0000795403
Industry	Misc. Fabricated Products
Sector	Basic Materials
Fiscal Year	12/31

# SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

## FORM 10-K

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934

For the fiscal year ended June 30, 1999

or

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

*Commission file number 0-14787*

### WATTS INDUSTRIES, INC.

(Exact name of registrant as specified in its charter)

Delaware

04-2916536

-----  
(State of incorporation)

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

815 Chestnut Street, North Andover, MA

01845

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(Address of principal executive offices)

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(Zip Code)

Registrant's telephone number, including area code: (978) 688-1811

#### **Securities registered pursuant to Section 12(b) of the Act:**

Class A Common Stock, par value \$.10 per share

Name of exchange on which registered: New York Stock Exchange

**Securities registered pursuant to Section 12(g) of the Act: None**

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

Aggregate market value of the voting stock of the Registrant held by non-affiliates of the Registrant on August 26, 1999 was \$365,276,600.

As of August 26, 1999, 16,472,507 shares of Class A Common Stock, \$.10 par value, and 9,985,247 shares of Class B Common Stock, \$.10 par value, of the Registrant were outstanding.

#### **Documents Incorporated by Reference**

There are no documents incorporated by reference into this Report.

## PART I

### Item 1. BUSINESS.

#### General

Watts Industries, Inc., (the "Company") designs, manufactures and sells an extensive line of valves for the plumbing and heating, water quality, industrial, and oil and gas industries. Watts has focused on the valve industry since its inception in 1874, when it was founded to design and produce steam regulators for New England textile mills. The Company was incorporated in Delaware in 1985. Today, the Company is a leading manufacturer and supplier of plumbing and heating and water quality valve products, which account for approximately 60% of its sales. The Company's growth strategy emphasizes internal development of new valve products and entry into new markets for specialized valves and related products through diversification of its existing business and strategic acquisitions in related business areas, both domestically and abroad.

On December 15, 1998, the Company announced plans to spin-off its industrial, oil and gas businesses into a separate publicly traded company, CIRCOR International, Inc. Under the terms of the planned spin-off transaction, which is expected to be complete on or about October 18, 1999, the Company will distribute one share of CIRCOR common stock to each record shareholder of the Company for every two shares of Company common stock owned as of the record date by that shareholder (the "Distribution"). After the Distribution, the Company will continue to manufacture and distribute plumbing and heating and water quality products through its three geographic business segments: North America, Europe, and Asia.

The Board of Directors and management of the Company have determined that separation of the industrial, oil and gas businesses from the plumbing and heating and water quality business by means of the spin-off of CIRCOR is in the best interests of the Company, CIRCOR and the Company's shareholders. In reaching this conclusion, the Company's Board of Directors and management considered, among other things, that:

- o the separation will allow CIRCOR to raise equity capital in the financial markets to fund its plan for future growth in order to expand its market positions in the instrumentation and fluid regulation and petrochemical industries;
- o the Company's plumbing & heating and water quality business and CIRCOR's instrumentation and fluid regulation and petrochemical businesses are distinct, complex businesses with different challenges, strategies and means of doing business and that the businesses will be better positioned to respond to the opportunities and challenges in their respective industries and thereby achieve their full potential under separate ownership;
- o the separation will permit the management of the Company and CIRCOR to focus on the opportunities and challenges specific to their respective businesses;
- o the separation will allow CIRCOR to offer employee incentives that are more directly linked to the performance of the instrumentation and fluid regulation and petrochemical businesses so that these incentives are better aligned with the interests of CIRCOR shareholders; and
- o the separation will result in two distinct publicly traded equity securities that will enable investors to better understand and evaluate the respective businesses of the Company and CIRCOR.

On May 11, 1999, the Company's Board of Directors voted to amend the Company's By-Laws to change the Company's fiscal year from June 30 of each year to December 31 of each year. The Company will file a report on Form 10-K covering the transition period of July 1, 1999 to December 31, 1999 ("Fiscal 1999.5").

The business description which follows describes the general development of the Company's entire business for the fiscal year ended June 30, 1999, including its plumbing and heating and water quality business and its industrial, oil and gas business. The Company and its plumbing and heating and water quality business intended to be conducted after the Distribution is also described, as appropriate.

The Company's plumbing and heating and water quality product lines include safety pressure relief valves, water pressure regulators, thermostatic mixing valves, ball valves, automatic control valves, water distribution manifolds, zone valves, thermostatic radiator valves, check valves, and valves for water service primarily in residential and commercial environments, and metal and plastic water supply/drainage products including stop valves, tubular brass products, faucets, drains, sink strainers, compression and flare fittings, and plastic tubing and braided metal hose connectors for residential construction and home repair and remodeling, backflow preventers for preventing contamination of potable water caused by reverse flow within water supply lines and fire protection equipment, and drain systems for laboratory drainage and high purity process installations.

The Company's industrial, oil and gas product lines include steam regulators and control devices for industrial, HVAC and naval/marine applications; pneumatic valve and motion switch products for medical, analytical, military and aerospace applications; ball valves, solenoid valves, cryogenic valves, pneumatic and electric actuators, strainers, relief valves, check valves, and butterfly valves for industrial applications; and needle valves, metering valves, plug valves, tube fittings, floating and trunnion ball valves, pipeline closures, specialty gate valves, oil field check valves, and large ball valves for the oil and gas, and chemical and petrochemical industries.

Within a majority of the product lines the Company manufactures and markets, the Company believes that it has one of the broadest product lines in terms of the distinct designs, sizes and configurations of its valves. Products representing a majority of the Company's sales have been approved under regulatory standards incorporated into state and municipal plumbing and heating, building and fire protection codes, and similar approvals from oil and gas industry standards agencies and from various agencies in the European market have been obtained. The Company has consistently advocated the development and enforcement of performance and safety standards, and is currently planning new investments and implementing additional procedures as part of its commitment to meet these standards. The Company maintains quality control and testing procedures at each of its manufacturing facilities in order to produce products in compliance with code requirements. Additionally, a majority of the Company's manufacturing subsidiaries have either acquired or are working to acquire ISO 9000, 9001 or 9002 certification from the International Organization for Standardization (ISO).

On July 22, 1998, a wholly owned subsidiary of the Company acquired Hoke, Inc. ("Hoke") located in Cresskill, New Jersey. Hoke manufactures industrial valves and fittings, consisting of miniaturized pressure regulators, needle valves, metering valves, ball valves, plug valves and its line of Gyrolok(R) tube fittings for instrumentation applications, for the chemical and petrochemical, oil and gas, industrial, OEM, and analytical instrumentation markets. Hoke's sales for the Company's fiscal year ended June 30, 1999 were approximately \$60,000,000. On January 14, 1999, the Company acquired SSI Equipment, Inc. ("SSI") located in Burlington, Ontario. SSI manufactures an extensive line of strainers that are used in commercial and industrial applications. Based on SSI's previous sales, SSI should provide approximately \$4,000,000 of sales to CIRCOR annually. On April 8, 1999, a wholly owned subsidiary of the Company acquired Go Regulator, Inc. ("Go Regulator") located in San Dimas, California. Go Regulator manufactures a complete line of pressure regulators and reducers for the control of either liquid or pneumatic pressure in process, instrumentation, and analytical applications. Go Regulator had sales of approximately \$5,200,000 for its most recent twelve month period. Hoke, SSI, and Go Regulator will be spun-off as part of CIRCOR in the Distribution.

On March 9, 1999 a wholly owned subsidiary of the Company acquired Cazzaniga S.p.A. ("Cazzaniga") located in Biassono, Italy near Milan. Cazzaniga, whose last twelve (12) months sales were approximately \$35 million, is an integrated manufacturer of plumbing and heating products including water distribution manifolds, zone valves, check valves, and their principle line of thermostatic radiator valves. The manufacturing plant features a

yellow brass forging foundry, high speed chucking machines with robotics, German automatic screw machines, and extensive automated assembly contained within a 211,000 square foot facility.

The Company relies primarily on commissioned representative organizations, some of whom maintain a consigned inventory of the Company's products, to market its product lines. These organizations, which accounted for approximately 59% of the Company's net sales in the fiscal year ended June 30, 1999, sell primarily to plumbing and heating wholesalers, DIY Market accounts, and steam, industrial, and oil and gas distributors for resale to end users in the United States and abroad. The Company anticipates that after the Distribution commissioned representative organizations will account for approximately 73% of the Company's net sales. The Company sells metal and plastic water supply/drainage products including valves, tubular brass products, faucets, drains, sink strainers, compression and flare fittings, plastic tubing and braided metal hose connectors for the residential construction and home repair and remodeling industries through do-it-yourself plumbing retailers, national catalog distribution companies, hardware stores, building material outlets and retail home center chains ("DIY Markets") and through the Company's existing plumbing and heating wholesalers. The industrial product line is sold to domestic process industries through distributors and to aerospace and aircraft industries through special distributors and manufacturers' representatives, and the oil and gas product line is sold to domestic oil and gas industries through stocking supply stores and internationally through commissioned agents. The Company also sells products directly to certain large original equipment manufacturers (OEM's) and private label accounts. The Company also maintains direct and indirect sales channels for water valves, steam valves, relief valves, shut-off valves, check valves, butterfly valves, ball valves and flow meters to the power generation, maritime, heating, ventilation and air-conditioning, irrigation, fire protection, and refrigeration industries and utilities. The Company believes that sales to the residential construction and to the oil and gas markets may be subject to cyclical variations to a greater extent than its other targeted markets. During all of fiscal 1999, sales to the oil and gas markets declined as depressed oil and gas prices led producers to spend less on maintenance, repair, exploration, and drilling projects. However, because the Company sells into different geographic areas, and to large and diverse customers, the potential adverse effects from cyclical variations tend to be mitigated. No assurance can be given that the Company will be protected from a broad downturn in the economy. There was no single customer which accounted for more than 10% of the Company's net sales in the fiscal year ended June 30, 1999.

The Company has a fully integrated and highly automated manufacturing capability including foundry operations, machining operations, plastic injection molding and assembly. The Company's foundry operations include metal pouring systems and automatic core making, yellow brass forging, mold making and pouring capabilities. The Company's acquisition of Cazzaniga adds yellow brass forging and machining capabilities to the Company's European operations. The Company's machining operations feature computer-controlled machine tools, high-speed chucking machines with robotics and automatic screw machines for machining bronze, brass, iron and steel components. The Company has invested heavily in recent years to expand its manufacturing base and to ensure the availability of the most efficient and productive equipment. The Company is committed to maintaining its manufacturing equipment at a level consistent with current technology in order to maintain high levels of quality and manufacturing efficiencies. As part of this commitment, the Company has spent a total of \$89,943,000 on capital expenditures over the last three fiscal years. The Company has budgeted \$10,000,000 for Fiscal 1999.5 for plumbing and heating and water quality primarily for manufacturing facilities and equipment. See "Properties" below. The Company is also completing its implementation of an integrated enterprise-wide software system in most of its U.S. and Canadian locations to make operations more efficient and to improve communications with suppliers and customers. Capital expenditures were \$31,031,000, \$29,170,000, and \$29,742,000 for fiscal 1999, 1998, and 1997, respectively. Depreciation and amortization for such periods were \$30,218,000, \$23,185,000, and \$20,828,000, respectively.

Five significant raw materials used in the Company's production processes are bronze ingot, brass rod, stainless steel, cast iron, and carbon steel. While the Company historically has not experienced significant difficulties in obtaining these commodities in quantities sufficient for its operations, there have been significant changes in their prices. The Company's gross profit margins are adversely affected to the extent that the selling

prices of its products do not increase proportionately with increases in the costs of bronze ingot, brass rod, stainless steel, cast iron, and carbon steel. Any significant unanticipated increase or decrease in the prices of these commodities could materially affect the Company's results of operations. However, increased sales volume, an active materials management program, and the diversity of materials used in the Company's production processes have somewhat diminished the impact from changes in the cost of these five raw materials. No assurances can be given that such factors will protect the Company from future changes in the prices for such raw materials.

The domestic and international markets for valves are intensely competitive and include companies possessing greater financial, marketing and other resources than the Company. Management considers product reputation, price, effectiveness of distribution and breadth of product line to be the primary competitive factors. The Company believes that new product development and product engineering are also important to success in the valve industry and that the Company's position in the industry is attributable in significant part to its ability to develop new and innovative products quickly and to adapt and enhance existing products. During fiscal 1999, the Company continued to develop new and innovative products to enhance market position and is continuing to implement manufacturing and design programs to reduce costs. The Company employs approximately 90 engineers and technicians, which does not include engineers working in the Chinese joint ventures, who engage primarily in these activities. Although the Company owns certain patents and trademarks that it considers to be of importance, it does not believe that its business and competitiveness as a whole is dependent on any one or more patents or trademarks or on patent or trademark protection generally.

The Company's financial information by geographic business segment is contained in Note 15 of Notes to Consolidated Financial Statements incorporated herein by reference. From time to time, the Company's results of operations may be adversely affected by fluctuations in foreign exchange rates. Backlog was \$80,541,000 at August 20, 1999 of which \$24,255,000 was from continuing operations and \$98,645,528 at August 14, 1998 of which \$24,711,112 was from continuing operations. The Company does not believe that its backlog at any point in time is indicative of future operating results. Available funds and funds provided from the Company's operations are sufficient to meet anticipated capital requirements. See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations", below as it relates to the impact of foreign exchange rates and capital requirements.

As of June 30, 1999, the Company's domestic and foreign operations employed approximately 4,600 people, plus 900 employees in the Company's joint ventures located in the People's Republic of China. After CIRCOR is spun-off in the Distribution, the Company will employ approximately 2,600 people, plus 840 employees in the Company's joint venture located in the People's Republic of China. There are approximately 165 employees that are covered by collective bargaining agreements in the United States and Canada, but all of these employees are employed by companies of CIRCOR that will be spun-off. The Company believes that its employee relations are excellent.

## Executive Officers

Information with respect to the executive officers of the Company is set forth below:

Name ----	Position -----	Age ---
Timothy P. Horne	Chairman of the Board, Chief Executive Officer and Director	61
David A. Bloss, Sr.	President, Chief Operating Officer and Director	49
Kenneth J. McAvoy	Chief Financial Officer, Treasurer, Secretary and Director	59

Robert T. McLaurin	Corporate Vice President of Asian Operations	68
Michael O. Fifer	Group Vice President	42
William C. McCartney	Vice President of Finance and Corporate Controller	45
Suzanne M. Zabitchuck	Corporate Counsel and Assistant Secretary	44

Timothy P. Horne joined the Company in September 1959 and has been a Director since 1962. Mr. Horne served as the Company's President from 1976 to 1978 and again from 1994 to April 1997. He has served as Chief Executive Officer since 1978 and he became the Company's Chairman of the Board in April 1986.

David A. Bloss, Sr., was appointed President and Chief Operating Officer in April, 1997. He joined the Company as Executive Vice President in July 1993 and has been a Director since January 1994. Prior to joining the Company, Mr. Bloss was for five years associated with the Norton Company, a manufacturer of abrasives and cutting tools, serving most recently as President of the Superabrasives Division. Mr. Bloss will be the Chairman of the Board, Chief Executive Officer and President of CIRCOR.

Kenneth J. McAvoy joined the Company in 1981 as Corporate Controller. He served as the Company's Vice President of Finance from 1984 to 1994. He has been the Chief Financial Officer and Treasurer since June 1986, and has been a Director since January 1994. Mr. McAvoy served as Executive Vice President of European Operations from January 1994 to June 1996. Mr. McAvoy has also served as Secretary or Clerk since January 1985.

Robert T. McLaurin was appointed Corporate Vice President of Asian Operations in August 1994. He served as the Senior Vice President of Manufacturing of Watts Regulator Co. from 1983 to August 1994. He joined Watts Regulator Company as Vice President of Manufacturing in 1978.

Michael O. Fifer joined the Company in May 1994 and was appointed the Company's Vice President of Corporate Development, which title was recently changed to Group Vice President. Prior to joining the Company, Mr. Fifer was Associate Director of Corporate Development with Dynatech Corp., a diversified high-tech manufacturer, from 1991 to April 1994.

William C. McCartney joined the Company in 1985 as Controller. He was appointed the Company's Vice President of Finance in 1994, and he has been Corporate Controller of the Company since April 1988.

Suzanne M. Zabitchuck has been Corporate Counsel of the Company since joining the Company in December 1992. Ms. Zabitchuck was appointed Assistant Secretary in August 1993. Ms. Zabitchuck was associated with The Stride Rite Corporation, a shoe manufacturer, serving as its Associate General Counsel and Clerk immediately prior to joining the Company.

### **Product Liability, Environmental and Other Litigation Matters**

The Company, like other worldwide manufacturing companies, is subject to a variety of potential liabilities connected with its business operations, including potential liabilities and expenses associated with possible product defects or failures and compliance with environmental laws. The Company maintains product liability and other insurance coverage which it believes to be generally in accordance with industry practices. Nonetheless, such insurance coverage may not be adequate to protect the Company fully against substantial damage claims which may arise from product defects and failures.

## **James Jones Litigation**

On June 25, 1997, Nora Armenta sued James Jones Company and its present and past owners, Mueller Co., Tyco International (U.S.) Inc. and Watts Industries, Inc. in the California Superior Court for Los Angeles County with a complaint that sought tens of millions of dollars in damages. By this complaint and an amended complaint filed on November 4, 1998, ("First Amended Complaint") Armenta, a former employee of James Jones, sued on behalf of 34 municipalities as a qui tam plaintiff under the California False Claims Act. Late in 1998, the Los Angeles Department of Water and Power ("DWP") intervened. Of the remaining 33 named municipalities, four (Burbank, Pomona, Santa Monica and South Gate) chose to intervene shortly before the Court-imposed deadline of July 15, 1999. The case will now go forward with the municipalities that have intervened.

The First Amended Complaint alleges that the Company's former subsidiary (James Jones Company) sold products which did not meet contractually specified standards used by the named municipalities for their water systems and falsely certified such standards had been met. Armenta claims that these municipalities were damaged by their purchase of these products, and seeks treble damages, legal costs, attorneys' fees and civil penalties under the False Claims Act.

The DWP's intervention filed on December 9, 1998 adopted the First Amended Complaint and added claims for breach of contract, fraud and deceit, negligent misrepresentation, and unjust enrichment. The DWP seeks past and future reimbursement costs, punitive damages, contract difference in value damages, treble damages, civil penalties under the False Claims Act and costs of the suit.

One of the lawsuit's allegations is the suggestion that because some of the purchased James Jones products are out of specification and contain more lead than the 85 bronze specified, a risk to public health might exist. This contention is predicated on the average difference of about 2% lead content in 81 bronze (6% to 8% lead) and 85 bronze (4% to 6% lead) alloys and the assumption that this would mean increased consumable lead in public drinking water. The evidence and discovery available to date indicate that this is not the case.

In addition, bronze that does not contain more than 8% lead is approved for home plumbing fixtures by the City of Los Angeles, and the Federal Environmental Protection Agency defines metal for pipe fittings with no more than 8% lead as "lead free" under Section 1417 of the Federal Safe Drinking Water Act.

The Company intends to contest this matter vigorously, and discovery is currently under way. Presently, the Company cannot determine whether any loss will result from this litigation. See Note 13 of the Notes to the Consolidated Financial Statements.

## **Product Liability**

Leslie Controls, Inc. and Spence Engineering Company, both subsidiaries of the Company, are involved as third-party defendants in various civil product liability actions pending in the U.S. District Court, Northern District of Ohio. The underlying claims have been filed by present or former employees of various shipping companies for personal injuries allegedly received as a result of exposure to asbestos. The shipping companies contend that they installed in their vessels certain valves manufactured by Leslie Controls and/or Spence Engineering which contained asbestos. The Company maintains product liability and other insurance coverage which it believes to be generally in accordance with industry practices. Nonetheless, such insurance coverage may not be adequate to protect the Company fully against substantial damage claims which may arise from product defects and failures. Coverage with respect to these matters has been disputed by certain of the carriers and, therefore, recovery is questionable, a factor which the Company has considered in its evaluation of these matters. Based on facts presently known to it, the Company does not believe the outcome of these proceedings will have a material adverse effect on its financial condition or results of operations.



## **Environmental**

Certain of the Company's operations generate solid and hazardous wastes, which are disposed of elsewhere by arrangement with the owners or operators of disposal sites or with transporters of such waste. The Company's foundry and other operations are subject to various federal, state and local laws and regulations relating to environmental quality. Compliance with these laws and regulations requires the Company to incur expenses and monitor its operations on an ongoing basis. The Company cannot predict the effect of future requirements on its capital expenditures, earnings or competitive position due to any changes in federal, state or local environmental laws, regulations or ordinances.

The Company is currently a party to or otherwise involved with various administrative or legal proceedings under federal, state or local environmental laws or regulations involving a number of sites, in some cases as a participant in a group of potentially responsible parties ("PRPs"). Three of these sites, the Sharkey and Combe Landfills in New Jersey, and the San Gabriel Valley/El Monte, California water basin site, are listed on the National Priorities List. With respect to the Sharkey Landfill, the Company has been allocated .8144% of the remediation costs, an amount which is not material to the Company. No allocations have been made to date with respect to the Combe Landfill or San Gabriel Valley sites. The EPA has formally notified several entities that they have been identified as being potentially responsible parties with respect to the San Gabriel Valley site. As the Company was not included in this group, its potential involvement in this matter is uncertain at this point given that either the PRPs named to date or the EPA could seek to expand the list of potentially responsible parties. In addition to the foregoing, the Solvent Recovery Service of New England site and the Old Southington landfill site, both in Connecticut, are on the National Priorities List, but, with respect thereto, the Company has resort to indemnification from third parties and based on currently available information, the Company believes it will be entitled to participate in a de minimis capacity.

With respect to the Combe Landfill, the Company recently paid approximately \$414,000 as its share of a \$6.3 million settlement in a CERCLA cost recovery action filed by the U.S. Environmental Protection Agency. The New Jersey Department of Environmental Protection has filed a related claim with respect to the same site for approximately \$5.5 million in the New Jersey Superior Court for Morris County. The state action has more defendants than the settled federal action, and part of the state claim is for future costs which may be subject to negotiation.

During the quarter ending March 31, 1998, the Company received an administrative order from the New Hampshire Department of Environmental Services (the "NH DES") with respect to certain regulatory issues concerning its Franklin, New Hampshire operation. The Company has recently entered into an amended administrative order with the NH DES and has withdrawn its appeal of this matter. The state agency has not as of yet issued any fines or penalties in connection with this matter.

Based on facts presently known to it, the Company does not believe that the outcome of these environmental proceedings will have a material adverse effect on its financial condition or results of operations. Given the nature and scope of the Company's manufacturing operations, there can be no assurance that the Company will not become subject to other environmental proceedings and liabilities in the future which may be material to the Company. See Note 13 of the Notes to the Consolidated Financial Statements.

## **Other Litigation**

Other lawsuits and proceedings or claims, arising from the ordinary course of operations, are also pending or threatened against the Company and its subsidiaries. Based on the facts currently known to it, the Company does not believe that the ultimate outcome of these other litigation matters will have a material adverse effect on its financial condition or results of operation. See Note 13 of the Notes to the Consolidated Financial Statements.

## **Item 2. PROPERTIES.**

The Company maintains 41 facilities worldwide with its corporate headquarters located in North Andover, Massachusetts. The manufacturing operations include four casting foundries, two of which are located in the United States, one in Europe and one at Tianjin Tanggu Watts Valve Company Limited ("Tanggu Watts"), a joint venture located in the People's Republic of China, and it maintains one yellow brass forging foundry located in Italy. Castings and forgings from these foundries and other components are machined and assembled into finished valves at 27 manufacturing facilities located in the United States, Canada, Europe and China. Many of these facilities contain sales offices or warehouses from which the Company ships finished goods to customers and commissioned representative organizations. The vast majority of the Company's operating facilities and the related real estate are owned by the Company. The buildings and land located in (i) Spartanburg, South Carolina and Southington, Connecticut; (ii) Nerviano, Italy and (iii) Tianjin, People's Republic of China and the land located in (iv) Suzhou, People's Republic of China, are leased by Hoke, Pibiviesse S.p.A. ("PBVS"), Tanggu Watts, and Suzhou Watts Valve Co., Ltd. ("Suzhou Watts") respectively, under lease agreements, the terms of which are 10 years and 10 years, 6 years, 30 years, and 30 years, respectively. With the exception of the Tanggu Watts property, the other described leased properties will become part of CIRCOR.

Upon completion of the spin-off of CIRCOR in the Distribution, the Company will maintain 22 facilities worldwide which will include 16 manufacturing facilities, 5 of which include foundries. With the exception of the Tanggu Watts property, the Company will own all of its major facilities. During fiscal 1999, the Company expanded its manufacturing capabilities with the purchase of a building adjacent to its existing facility in Spindale, North Carolina and the Company sold the former Jameco Industries property located in Wyandanch, New York. Certain of the Company's facilities are subject to mortgages and collateral assignments under loan agreements with long-term lenders. In general, the Company believes that its properties, including machinery, tools and equipment, are in good condition, well maintained and adequate and suitable for their intended uses. The Company believes that the manufacturing facilities are currently operating at a level that management considers normal capacity. This utilization is subject to change as a result of increases or decreases in sales.

## **Item 3. LEGAL PROCEEDINGS.**

**Item 3(a). The Company is from time to time involved in various legal and administrative procedures.** See Part I, Item 1, "Product Liability, Environmental and Other Litigation Matters".

**Item 3(b). None.**

## **Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.**

There were no matters submitted during the fourth quarter of the fiscal year covered by this Report to a vote of security holders through solicitation of proxies or otherwise.

### **Annual Meeting of Stockholders and Stockholder Proposals**

On May 11, 1999, the Company's Board of Directors voted to amend the Company's By-Laws to change the Company's fiscal year from June 30 of each year to December 31 of each year. The Company will file a report on Form 10-K covering the transition period of July 1, 1999 to December 31, 1999 ("Fiscal 1999.5"). As a consequence of the Company's decision to change its fiscal year end and on-going activities related to the spin-off of CIRCOR in the Distribution, the Company has elected to postpone and reschedule its 1999 Annual Meeting of Stockholders which would have been held on October 19, 1999. Therefore, the Company intends to hold its next Annual Meeting of Stockholders on or about April 25, 2000.

In order for any stockholder proposal to be included in the proxy statement for the Company's Annual Meeting of Stockholders, such proposal must be received at the principal executive offices of the Company, 815

Chestnut Street, North Andover, MA 01845, not later than December 15, 1999 and must satisfy certain rules of the Securities and Exchange Commission.

Nominations and proposals of stockholders may also be submitted to the Company for consideration at the Annual Meeting if certain conditions set forth in the Company's bylaws are satisfied, but will not be included in the proxy materials unless the conditions set forth in the preceding paragraph are satisfied. Such nominations (or other stockholder proposals) must be delivered to or mailed and received by the Company not less than 75 days nor more than 120 days prior to the Annual Meeting which dates will be February 3, 2000, and December 20, 1999, respectively. Shareholder proposals received by the Company outside of the aforementioned dates will be considered untimely received for consideration at such Annual Meeting. To submit a nomination or other proposal, a stockholder should send the nominee's name or proposal and appropriate supporting information required by the Company's bylaws to the Secretary of the Company at the address set forth above.

## PART II

### Item 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER

#### MATTERS.

##### Market Information

The following tabulation sets forth the high and low sales prices of the Company's Class A Common Stock on the New York Stock Exchange during fiscal 1999 and fiscal 1998 and cash dividends paid per share:

	High ----	Low ---	Dividend -----	High ----	Low ---	Dividend -----
	1999 ----			1998 ----		
First Quarter	24 5/16	16 1/2	\$.0875	\$27 3/4	\$22 5/8	\$.0775
Second Quarter	20 5/8	16	.0875	28 11/16	24 1/2	.0775
Third Quarter	17	12 1/4	.0875	31 3/8	26 1/16	.0875
Fourth Quarter	19 7/8	13 9/16	.0875	30 15/16	20 7/8	.0875

There is no established public trading market for the Class B Common Stock of the Company, which is held exclusively by members of the Horne family and management. The principal holders of such stock are subject to restrictions on transfer with respect to their shares. Each share of Class B Common Stock (10 votes per share) of the Company is convertible into one share of Class A Common Stock (1 vote per share). Aggregate common stock dividend payments for fiscal 1999, 1998, and 1997, were \$9,358,000, \$8,936,000, and \$7,992,000, respectively. While the Company presently intends to continue to pay cash dividends, payment of future dividends necessarily depends upon the Board of Directors' assessment of the Company's earnings, financial condition, capital requirements and other factors. See Note 9 of Notes to Consolidated Financial Statements incorporated herein by reference regarding restrictions on payment of dividends.

The number of record holders of the Company's Class A Common Stock as of August 26, 1999 was 188. The Company believes that the number of beneficial shareholders of the Company's Class A Common Stock was approximately 3,400 as of August 26, 1999. The number of record holders of the Company's Class B Common Stock as of August 26, 1999 was 9.

## Item 6. SELECTED FINANCIAL DATA

The selected financial data set forth below should be read in conjunction with the Company's consolidated financial statements, related Notes thereto and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included herein.

### FIVE YEAR FINANCIAL SUMMARY

(Amounts in thousands, except per share information)

	1999	1998	1997	1996 (1)	1995
	----	----	----	----	----
Selected Data					
Net sales from continuing operations	\$ 474,458	\$ 442,077	\$ 447,235	\$ 411,261	\$ 362,014
Income (loss) from continuing operations	29,454	28,123	26,515	(24,824)	25,255
Net income (loss)	35,956	53,369	51,747	(50,285)	45,738
Total assets	637,742	552,896	526,366	370,454	376,894
Long-term debt	118,916	71,674	94,841	111,715	99,868
Income (loss) per share from continuing operations-diluted	1.10	1.03	0.97	(0.84)	0.85
Net income (loss) per share-diluted	1.34	1.95	1.89	(1.70)	1.54
Cash dividends declared per common share	0.350	0.330	0.295	0.265	0.235

(1) Fiscal 1996 net income includes an after-tax charge of \$92,986,000 related to: restructuring costs of \$25,415,000; an impairment of long-lived assets of \$63,065,000; other charges of \$13,753,000 principally for product liability costs, additional bad debt reserves and environmental remediation costs; and additional inventory valuation reserves of \$9,508,000.

## Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

On December 15, 1998 the Company announced its plan to spin-off its industrial, oil and gas business as a separately traded public company, CIRCOR International, Inc. Under the terms of the spin-off, which is expected to be completed in October 1999, the holders of Watts common stock will receive one share of CIRCOR common stock for every two shares of Watts stock held. The Company's results of operations have been restated to reflect CIRCOR as discontinued operations for all periods presented.

### Results of Operations

12 Months Ended June 1999 Compared to  
12 Months Ended June 1998

Net sales from continuing operations for the twelve months ended June 30, 1999 increased by \$32,381,000, or 7.3%, to \$474,458,000 from \$442,077,000 in the fiscal year ended June 30, 1998. The increase in net sales is attributable to the following:

(Revenue \$'s 1999-1998)

Internal Growth	\$25,455,000	5.7%
Acquisitions	\$10,095,000	2.3%
Divestitures	(\$3,386,000)	(0.8%)
Foreign Exchange	\$217,000	0.1%
-----		
Total Change	\$32,381,000	7.3%
=====		

The increase in net sales from internal growth is primarily attributable to increased unit shipments in the North American segment. The growth in net sales due to acquired companies is primarily attributable to the inclusion of Cazzaniga S.p.A. of Biassono, Italy, which was acquired in March, 1999. Excluding Cazzaniga, shipments in the European segment were consistent with the prior year.

The Company's gross profit increased \$11,788,000, or 7.4%, to \$171,713,000. The increased gross profit is primarily attributable to increased sales. Gross margin remained consistent at 36.2% in both fiscal 1999 and 1998.

Selling general and administrative expenses increased \$7,021,000 (6.2%) to \$119,875,000. This increase is attributable to the inclusion of the expenses of Cazzaniga, and increased variable selling expenses including commissions and freight and marketing costs.

Operating income from continuing operations increased \$4,767,000, or 10.1%, from \$47,071,000 to \$51,838,000 primarily due to increased gross profit.

Other expense from continuing operations increased \$1,256,000 to \$1,688,000. This increase is attributable to the Company's share of losses related to its equity investment in Jameco International LLC. Increased minority interest expense resulting from the improved performance at the Company's joint venture in China also contributed to the increase in other expense.

Income from continuing operations increased \$1,331,000 (4.7%) to \$29,454,000. This increase is primarily attributable to the income generated by acquired companies and increased gross profit from existing companies.

The Company's consolidated results of operations are impacted by the effect that changes in foreign exchange rates have on its international subsidiaries operating results. Changes in foreign exchange rates had an immaterial impact on net income in fiscal 1999.

Income from discontinued operations, net of taxes, decreased \$18,744,000 to \$6,502,000. The Company recognized \$6,166,000 in the current year net after-tax costs to execute the spin-off transaction. These costs include taxes, certain relocation costs, and professional fees. Excluding these costs, income from discontinued operations would have declined \$9,578,000 and diluted earnings per share would have decreased from 92 cents to 59 cents. Net sales from discontinued operations increased \$33,822,000 million (11.7%) to \$321,711,000. The increase is primarily due to the inclusion of net sales from acquired companies. Domestic oil and gas valves experienced a decline of 29.8% in net sales. The competitive aspects resulted in abnormally low pricing while the reduced manufacturing levels caused a loss of overhead absorption of fixed expenses. Net sales of international oil and gas valves decreased 20.9%, as new project awards have significantly slowed due to market conditions.

The Company also recorded a charge to discontinued operations of \$5,000,000 (\$3,000,000 net of tax), for legal expenses associated with the litigation involving James Jones Company. James Jones Company was a subsidiary of the Company in the municipal water works division until September 1996 when it was sold to Tyco International Ltd. See Part I, Item 1, "Product Liability, Environmental and Other Litigation Matters."

## Results of Operations

12 Months Ended June 1998 Compared to  
12 Months Ended June 1997

The Company's net sales from continuing operations for the twelve months ended June 30, 1998 decreased by \$5,158,000 or 1.1%, from \$447,235,000 to \$442,077,000 compared to fiscal year ended June 30, 1997. The decrease in net sales is attributable to the following:

### (Revenue \$'s 1998-1997)

Internal Growth	\$10,133,000	2.3%
Acquisitions	\$15,473,000	3.5%
Divestiture	(\$20,244,000)	(4.5%)
Impact of Foreign Exchange	(\$10,520,000)	(2.4%)
-----		
Total change	(\$5,158,000)	(1.1%)
=====		

The increase in net sales from internal growth is primarily attributable to increased unit shipments in the North American segment. The growth in net sales due to acquired companies is primarily attributable to the inclusion for a full year of the net sales of Ames Company, Inc. ("Ames") of Woodland, CA acquired in January 1997. Fiscal 1997 sales included \$13,415,000 for certain product lines of the Jameco business, imported vitreous china and faucets, in which the Company now owns a 49% minority interest, thereby eliminating these sales from the fiscal 1998 results. The Company also divested three international product lines which impacted fiscal 1998 sales by \$6,829,000. The Company's net sales during fiscal 1998 were also adversely impacted by changes in foreign exchange rates primarily associated with the Company's European operations.

Gross profit from continuing operations increased \$2,651,000, or 1.7%, to \$159,925,000 in fiscal year ended June 30, 1998 and gross margin increased as a percentage of sales from 35.2% to 36.2% compared to fiscal year ended June 30, 1997. This percentage increase is primarily attributable to improved gross margins in the North American segment and the full year inclusion of Ames which operates at a higher gross margin than the Company average. These improvements were partially offset by manufacturing inefficiencies associated with the relocation of the Jameco product line into a Watts Regulator factory in Spindale, North Carolina.

Selling, general and administrative expenses increased \$4,201,000, or 3.9%, to \$112,854,000. This increase is primarily attributable to the inclusion of the expenses of acquired companies and increased variable selling expenses. This increase is partially offset by the effect of the change in foreign exchange rates.

Operating income from continuing operations decreased \$1,550,000 or 3.2%, from \$48,621,000 to \$47,071,000 and decreased as a percentage of sales from 10.9% in fiscal 1997 to 10.7% in fiscal 1998. This decrease is primarily attributable to increased variable selling expenses.

The Company's effective tax rate for continuing operations decreased from 36.5% in fiscal 1997 to 32.0% in fiscal 1998 primarily due to the implementation of tax planning strategies and utilization of net operating loss carryforwards.

Income from continuing operations increased by approximately \$1,608,000, or 6.1%, to \$28,123,000. This increase is primarily attributable to the increased net sales and improved gross margins.

The Company's consolidated results of operations are impacted by the effect that changes in foreign exchange rates have on its international subsidiaries operating results. Changes in foreign exchange rates had an immaterial impact on net income in fiscal 1998.

Net sales from discontinued operations increased \$14,784,000 (5.4%) to \$287,889,000 in the year ended June 30, 1998. This increase is due to the inclusion of net sales from acquisitions and the increased unit shipments of international oil and gas valves as well as increased unit shipments of domestic instrumentation valves. Income from discontinued operations net of taxes increased \$3,222,000 or 14.6% from the period ended June 30, 1997. The increase is due to earnings generated by acquisitions and the increased net sales and gross margins on international oil and gas valves.

## **LIQUIDITY AND CAPITAL RESOURCES**

During the twelve month period ended June 30, 1999 the Company generated \$48,286,000 in cash flow from continuing operations, which was principally used to fund capital expenditures of \$21,532,000 and finance acquisitions. These capital expenditures were primarily for manufacturing machinery and equipment and information technology as part of the Company's commitment to continuously improve its manufacturing capabilities. The Company's capital expenditure budget for the remaining calendar year 1999 is \$10,000,000.

On March 9, 1999, a wholly owned subsidiary of the Company acquired the stock of Cazzaniga S.p.A. whose last twelve (12) months' sales were approximately \$35 million. Cazzaniga, is an integrated manufacturer of plumbing and heating products including water distribution manifolds, zone valves, radiator air purge valves, and their principle line of thermostatic radiator valves. The manufacturing plant features a yellow brass forging foundry, high speed chucking machines with robotics, automatic screw machines, and extensive automated assembly contained within a 211,000 square foot facility.

During the year ended June 30, 1999, the Company entered into a syndicated credit facility with a group of European banks in the amount of 40 million Euros. This credit facility has several tranches which provide credit to the Company for a period up to five (5) years. The purpose of this credit facility is to fund acquisitions in Europe, support the working capital requirements of acquired companies, and for general corporate purposes. As of June 30, 1999, 19,600,000 Euro's (\$20,223,000) were borrowed under this line of credit.

As of June 30, 1999 Watts has an unsecured \$125 million line of credit which will remain in effect until the Company executes the spin-off of CIRCOR. On the effective date of the spin-off, the Company will execute an amended \$100 million line of credit facility to support the Company's acquisition program, working capital

requirements of acquired companies, and for general corporate purposes. At June 30, 1999 the Company had \$104 million outstanding on the line of credit and was in compliance with all banking covenants related to this facility.

In anticipation of the spin-off of CIRCOR from the Company, CIRCOR is negotiating with financial institutions for both lines of credit and private placement debts totaling approximately \$150 million. Proceeds will be used to fund allocated debt from the Company and for future potential strategic activities.

Working capital at June 30, 1999 was \$267,912,000 compared to \$237,373,000 at June 30, 1998. The ratio of current assets to current liabilities was 2.7:1 at both June 30, 1999 and June 30, 1998. Cash and short term investments were \$12,774,000 at June 30, 1999 and \$10,767,000 at June 30, 1998. Debt as a percentage of total capital employed was 38.9% at June 30, 1999 compared to 24.8% at June 30, 1998. This increase is attributable to the borrowings associated with acquisitions.

The Company anticipates that available funds and those funds provided from current operations will be sufficient to meet current operating requirements and anticipated capital expenditures for at least the next 24 months.

The Company from time to time is involved with product liability, environmental proceedings and other litigation proceedings and incurs costs on an ongoing basis related to these matters. The Company has not incurred material expenditures in fiscal 1999 in connection with any of these matters. See Part I, Item 3, "Legal Proceedings."

### **YEAR 2000 Compliance**

The Company has developed a comprehensive program to address its potential exposure to the Year 2000 issue. The Company manages the program by having each subsidiary and operating unit identify their own Year 2000 issues and develop appropriate corrective action steps, while instituting a series of management processes that coordinate and manage the program across the Company. The Company's Corporate Vice President of Administration has been assigned responsibility for the overall coordination and monitoring of the program, including establishment of policies, tracking progress, and leveraging solutions across the Company.

A significant portion of the Company's Year 2000 issues relative to its information technology systems are being addressed as part of the Company-wide initiative to upgrade and replace its information systems which began in fiscal 1997. At June 30, 1999, approximately 90% of the Company's critical information technology systems and approximately 95% of its other information technology systems have been replaced or upgraded and are Year 2000 compliant. The Company expects to complete the replacement or upgrade of the remaining systems in the fall of 1999.

Inventories, assessments and remediation activities for non-information technology systems, including manufacturing equipment, have been completed at June 30, 1999.

The Company has identified critical vendors, suppliers of information processing services, customers, financial institutions and other third parties and surveyed their Year 2000 remediation efforts. Additionally, the Company has contacted all vendors and third party suppliers in this regard. A preponderant majority of vendors responded. Vendors not responding and those determined not to be Year 2000 compliant have been replaced. This vendor survey and review process is complete. The cost of the program was immaterial. The Company did not utilize any independent verification processes to confirm that these vendor responses were reliable. However, the Company's Purchasing Department personnel communicate regularly with its critical vendors. This communication includes Year 2000 compliance confirmation.

The Company has developed contingency plans for those few vendors it considers critical. These are essentially vendors that supply base raw materials and certain component parts. The contingency plans include



increasing levels of on-site and consigned inventory. Additionally, raw materials are readily available and most can be supplied by a number of alternate vendors. These contingency plans for vendors are complete.

In addition, the Company's operations depend on infrastructure in a number of foreign countries in which it operates, and, therefore, a failure of any of those infrastructures could adversely affect its operations. The Company's most significant foreign markets are Canada, China, Germany, Italy, and the United Kingdom. In these countries, the Company is not aware of any significant weaknesses in their infrastructure.

The Company continues to develop detailed contingency plans to deal with unexpected issues which may occur. These plans include the identification of appropriate resources and response teams. Individual business managers at each of the Company's subsidiaries and operating units are responsible to ensure their business functions continue to operate normally. While the specifics vary by operation, the general contingency planning strategies include: increasing the on-hand supply of raw materials and finished goods; identifying alternate suppliers of raw materials; ensuring key personnel (both business and technical) are physically on-site; backing up critical systems just before year-end; and identifying alternative methods of doing business with customers as necessary.

Despite the Company's comprehensive program the Company cannot be completely sure that issues will not develop or events occur that could have material adverse effects on the Company's results of operation or financial condition. Nevertheless, the Company does not expect a material failure. The Company's Year 2000 program is designed to minimize the likelihood of any failure occurring. The most reasonably likely worst case scenario is that a short-term disruption will occur with a small number of customers or suppliers requiring an appropriate response.

Spending for the program is budgeted, expensed as incurred, and not expected to be material.

## **CONVERSION TO THE EURO**

On January 1, 1999, 11 of the 15 member countries of the European Union adopted the Euro as their common legal currency and established fixed conversion rates between their existing sovereign currencies and the Euro. The Euro trades on currency exchanges and is available for non-cash transactions. The introduction of the Euro will affect the Company as the Company has manufacturing and distribution facilities in several of the member countries and trades extensively across Europe. The long-term competitive implications of the conversion are currently being assessed by the Company, however, the Company will experience an immediate reduction in the risks associated with foreign exchange. At this time, the Company is not anticipating that any significant costs will be incurred due to the introduction and conversion to the Euro.

The Company uses foreign currency forward exchange contracts to reduce the impact of currency fluctuations on certain intercompany purchase transactions that will occur within the fiscal year and other known foreign currency exposures. The notional amount of such contracts and the related realized and unrealized gains and losses as of June 30, 1999 are not material.

## **OTHER**

Certain statements contained herein are forward looking. Many factors could cause actual results to differ from these statements, including loss of market share through competition; introduction of competing products by other companies; pressure on prices from competitors, suppliers, and/or customers; regulatory obstacles; lack of acceptance of new products; changes in the plumbing and heating markets; changes in global demand for the Company's products; changes in distribution of the Company's products; interest rates; foreign exchange fluctuations; cyclicalities of industries in which the Company markets certain of its products and general and

economic factors in markets where the Company's products are sold, manufactured or marketed; and other factors discussed in the Company's reports filed with the Securities and Exchange Commission.

In 1998, the Financial Accounting Standards Board issued SFAS 132, "Employers' Disclosure about Pensions and Other Postretirement Benefits," and SFAS 133, "Accounting for Derivative Instruments and Hedging Activities." The Company has adopted SFAS 132. The Company will adopt SFAS 133 on January 1, 2001. The impact of SFAS 133 on the combined financial statements is still being evaluated, but is not expected to be material.

Also in 1998, the American Institute of Certified Public Accountants issued SOP 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use," and SOP 98-5, "Reporting on the Costs of Start-Up Activities." The Company will adopt SOP 98-1 and SOP 98-5 in fiscal 2000. These statements are not expected to have a material effect on the combined financial statements.

#### **Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

The Company uses derivative financial instruments primarily to reduce exposure to adverse fluctuations in foreign exchange rates and prices of certain raw materials used in the manufacturing process. The Company does 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 the Company uses are straightforward instruments with liquid markets.

The Company manages most of its foreign currency exposures on a consolidated basis. The Company identifies all of its known exposures. As part of that process, all natural hedges are identified. The Company then nets these natural hedges from its gross exposures.

The Company's consolidated earnings are subject to fluctuations due to changes in foreign currency exchange rates. However, its overall exposure to such fluctuations is reduced by the diversity of its foreign operating locations which encompass a number of different European locations, Canada, and China.

The Company's foreign subsidiaries transact most business, including certain intercompany transactions, in foreign currencies. Such transactions are principally material purchases or sales and are denominated in European currencies or the U.S. or Canadian dollar. The Company uses foreign currency forward exchange contracts to manage the risk related to intercompany purchases that occur during the course of a fiscal year and certain open foreign currency denominated commitments to sell products to third parties. At June 30, 1999 the Company had forward contracts to buy foreign currencies with a notional value of \$9 million and a fair value of \$8.4 million. At June 30, 1998, there were no significant amounts of open foreign currency forward exchange contracts or related unrealized gains or losses.

The Company has historically had a very low exposure to changes in interest rates. Additionally, the Company historically has strong cash flows, and any amounts of variable rate debt could be paid down through cash generated from operations. At June 30, 1999, the Company was primarily exposed to the Eurodollar interest rate on the outstanding borrowings under its Euro line of credit facility. Information about the Company's long-term debt including principal amounts and related interest rates appears in Note 9 to the consolidated financial statements included herein.

The Company purchases significant amounts of bronze ingot, brass rod, stainless steel, cast iron, and carbon steel which are utilized in manufacturing its many product lines. The Company's operating results can be adversely affected by changes in commodity prices if it is unable to pass on related price increases to its customers. The Company manages this risk by monitoring related market prices, working with its 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 its customers, to the maximum extent possible, when they occur. Additionally, on a

limited basis, the Company uses commodity futures contracts to manage this risk. At June 30, 1999, the Company had outstanding commodity futures contracts with a notional value of \$3.5 million and a fair value of \$3.7 million.

**Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.**

The index to financial statements is included in page 17 of this Report.

**Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.**

None.

**PART III**

**Item 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.**

**Directors**

Information required by this Item 10 will be filed in an amendment to this report not later than 120 days after the Company's fiscal year ended June 30, 1999.

**Executive Officers**

Certain information with respect to the executive officers of the Company is set forth in Item 1 of this report under the caption "Executive Officers".

**Item 11. EXECUTIVE COMPENSATION.**

Information required by this Item 11 will be filed in an amendment to this report not later than 120 days after the Company's fiscal year ended June 30, 1999.

**Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT.**

Information required by this Item 12 will be filed in an amendment to this report not later than 120 days after the Company's fiscal year ended June 30, 1999.

**Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.**

Information required by this Item 13 will be filed in an amendment to this report not later than 120 days after the Company's fiscal year ended June 30, 1999.

**PART IV**

**Item 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K.**

(a)(1) Financial Statements

The following financial statements are included in a separate section of this Report commencing on the page numbers specified below:

Report of Independent Auditors .....	21
Consolidated Statements of Operations for each of the Three Years in the Period Ended June 30, 1999 .....	22
Consolidated Balance Sheets as of June 30, 1999 and 1998 .....	23
Consolidated Statements of Stockholders' Equity for each of the Three Years in the Period Ended June 30, 1999 .....	24
Consolidated Statements of Cash Flows for each of the Three Years in the Period Ended June 30, 1999 .....	25
Notes to Consolidated Financial Statements .....	26
(a)(2) Schedules	
Schedule II - Valuation and Qualifying Accounts for each of the Three Years in the Period Ended June 30, 1999 .....	41
All other schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission are not	

required under the related instructions or are inapplicable, and therefore have been omitted.

#### (a)(3) Exhibits

Exhibits 10.1-10.6, 10.8, 10.22, and 10.29 constitute all of the management contracts and compensation plans and arrangements of the Company required to be filed as exhibits to this Annual Report. Upon written request of any stockholder to the Chief Financial Officer at the Company's principal executive office, the Company will provide any of the Exhibits listed below.

Exhibit No. -----	Description and Location -----
2.1	Distribution Agreement between Watts Industries, Inc. and CIRCOR International, Inc. (20)
3.1	Restated Certificate of Incorporation, as amended. (12)
3.2	Amended and Restated By-Laws, as amended May 11, 1999. (1)
9.1	Horne Family Voting Trust Agreement-1991 dated as of October 31, 1991 (2), Amendments dated November 19, 1996 (18), February 24, 1997 (18), June 5, 1997 (18), August 26, 1997 (18), and October 17, 1997. (21)
9.2	The Amended and Restated George B. Horne Voting Trust Agreement-1997 dated as of September 14, 1999 *. (14)
10.1	Employment Agreement effective as of September 1, 1996 between the Registrant and Timothy P. Horne. (14)
10.2	Supplemental Compensation Agreement effective as of September 1, 1996 between the Registrant and Timothy P. Horne. (14)
10.3	Deferred Compensation Agreement between the Registrant and Timothy P. Horne, as amended. (4)
10.4	1996 Stock Option Plan, dated October 15, 1996. (15)
10.5	1989 Nonqualified Stock Option Plan. (3)
10.6	Watts Industries, Inc. Retirement Plan for Salaried Employees dated December 30, 1994, as amended and restated effective as of January 1, 1994, (12), Amendment No. 1 (14), Amendment No. 2 (14), Amendment No. 3 (14), Amendment No. 4 dated September 4, 1996. (18), Amendment No. 5 dated January 1, 1998 *, Amendment No. 6 dated May 3, 1999, and Amendment No. 7 dated June 7, 1999*.
10.7	Registration Rights Agreement dated July 25, 1986. (5)
10.8	Executive Incentive Bonus Plan, as amended. (12)

- 10.9 Indenture dated as of December 1, 1991 between the Registrant and The First National Bank of Boston, as Trustee, including form of 8-3/8% Note Due 2003. (8)
- 10.10 Loan Agreement and Mortgage among The Industrial Development Authority of the State of New Hampshire, Watts Regulator Co. and Arlington Trust Company dated August 1, 1985. (4)
- 10.11 Amendment Agreement relating to Watts Regulator Co. (Canaan and Franklin, New Hampshire, facilities) financing dated December 31, 1985. (4)
- 10.12 Sale Agreement between Village of Walden Industrial Development Agency and Spence Engineering Company, Inc. dated June 1, 1994. (11)
- 10.13 Letter of Credit, Reimbursement and Guaranty Agreement dated June 1, 1994 by and among the Registrant, Spence Engineering Company, Inc. and First Union National Bank of North Carolina. (11), Amendment No. 1 (14), Amendment No. 2 dated October 1, 1996. (18)
- 10.14 Trust Indenture from Village of Walden Industrial Development Agency to The First National Bank of Boston, as Trustee, dated June 1, 1994. (11)
- 10.15 Loan Agreement between Hillsborough County Industrial Development Authority and Leslie Controls, Inc. dated July 1, 1994. (11)
- 10.16 Letter of Credit, Reimbursement and Guaranty Agreement dated July 1, 1994 by and among the Registrant, Leslie Controls, Inc. and First Union National Bank of North Carolina (11), Amendment No. 1 (14), Amendment No. 2 dated October 1, 1996. (18)
- 10.17 Trust Indenture from Hillsborough County Industrial Development Authority to The First National Bank of Boston, as Trustee, dated July 1, 1994. (11)
- 10.18 Loan Agreement between The Rutherford County Industrial Facilities and Pollution Control Financing Authority and Watts Regulator Company dated September 1, 1994. (12)
- 10.19 Letter of Credit, Reimbursement and Guaranty Agreement dated September 1, 1994 by and among the Registrant, Watts Regulator Company and The First Union National Bank of North Carolina (12), Amendment No. 1 (14), Amendment No. 2 dated October 1, 1996. (18)
- 10.20 Trust Indenture from The Rutherford County Industrial Facilities and Pollution Control Financing Authority to The First National Bank of Boston, as Trustee, dated September 1, 1994. (12)
- 10.21 Amended and Restated Stock Restriction Agreement dated October 30, 1991 (2), Amendment dated August 26, 1997. (18)
- 10.22 Watts Industries, Inc. 1991 Non-Employee Directors' Nonqualified Stock Option Plan (7), Amendment No. 1. (14)
- 10.23 Letters of Credit relating to retrospective paid loss insurance programs. (10)
- 10.24 Form of Stock Restriction Agreement for management stockholders. (5)
- 10.25 Revolving Credit Agreement dated December 23, 1987 between Nederlandse Creditbank NV and Watts Regulator (Nederland) B.V. and related Guaranty of Watts Industries, Inc. and Watts Regulator Co. dated December 14, 1987. (6)
- 10.26 Loan Agreement dated September 1987 with, and related Mortgage to, N.V. Sallandsche Bank. (6)
- 10.27 Agreement of the sale of shares of Intermed, S.p.A., RIAF Holding A.G. and the participations in Multiscope Due S.R.L. dated November 6, 1992. (9)
- 10.28 Amended and Restated Revolving Credit Agreement dated March 27, 1998 between and among Watts Investment Company, certain financial institutions, BankBoston N.A., as Administrative Agent, and the Registrant, as Guarantor. (17)
- 10.29 Watts Industries, Inc. Management Stock Purchase Plan dated October 17, 1995 (13), Amendment No. 1 dated August 5, 1997. (18)
- 10.30 Stock Purchase Agreement dated as of June 19, 1996 by and among Mueller Co., Tyco Valves Limited, Watts Investment Company, Tyco International Ltd. and Watts Industries, Inc. (16)
- 11 Statement Regarding Computation of Earnings per Common Share. (19)
- 21 Subsidiaries. \*
- 23 Consent of KPMG LLP. \*
- 27 Financial Data Schedule-Fiscal 1999. \*
- 27.1 Restated Financial Data Schedule - June 30, 1997. \*
- 27.2 Restated Financial Data Schedule - September 30, 1997. \*

**Incorporated By Reference To:**

- (1) Relevant exhibit to Registrant's Form 10-Q for quarter ended March 31, 1999.
- (2) Relevant exhibit to Registrant's Form 8-K dated November 14, 1991.
- (3) Relevant exhibit to Registrant's Form 10-K for the year ended June 30, 1989.
- (4) Relevant exhibit to Registrant's Form S-1 (No. 33-6515) dated June 17, 1986.
- (5) Relevant exhibit to Registrant's Form S-1 (No. 33-6515) as part of the Second Amendment to such Form S-1 dated August 21, 1986.
- (6) Relevant exhibit to Registrant's Form S-1 (No. 33-27101) dated February 16, 1989.
- (7) Relevant exhibit to Registrant's Amendment No. 1 to Form 10-K for year ended June 30, 1992.
- (8) Relevant exhibit to Registrant's Form 10-K for year ended June 30, 1992.
- (9) Relevant exhibit to Registrant's Amendment No. 2 dated February 22, 1993 to Form 8-K dated November 6, 1992.
- (10) Relevant exhibit to Registrant's Form 10-K for year ended June 30, 1993.
- (11) Relevant exhibit to Registrant's Form 10-K for year ended June 30, 1994.
- (12) Relevant exhibit to Registrant's Form 10-K for year ended June 30, 1995.
- (13) Relevant exhibit to Registrant's Form S-8 (No. 33-64627) dated November 29, 1995.
- (14) Relevant exhibit to Registrant's Form 10-K for year ended June 30, 1996.
- (15) Relevant exhibit to Registrant's Form S-8 (No. 333-32685) dated August 1, 1997.
- (16) Relevant exhibit to Registrant's Form 8-K dated September 4, 1996.
- (17) Relevant exhibit to Registrant's Form 10-Q for quarter ended March 31, 1998.
- (18) Relevant exhibit to Registrant's Form 10-K for year ended June 30, 1997.
- (19) Notes to Consolidated Financial Statements, Note 2 of this Report.
- (20) Exhibit 2.1 to CIRCOR International, Inc. Amendment No. 1 to its registration statement on Form 10 filed on September 22, 1999. (File No. 000-26961).
- (21) Relevant exhibit to Registrant's Form 10-K for year ended June 30, 1998.

\* Filed as an exhibit to this Report with the Securities and Exchange Commission

(b) Reports on Form 8-K.

The Registrant did not file any reports on Form 8-K during the fourth quarter of the period covered by this Annual Report.

## SIGNATURES

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

### WATTS INDUSTRIES, INC.

By: /s/ Timothy P. Horne  
-----  
Timothy P. Horne  
Chairman of the Board and  
Chief Executive Officer

DATED: September 27, 1999

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature -----	Title -----	Date -----
/s/ Timothy P. Horne ----- Timothy P. Horne	Chairman of the Board and Chief Executive Officer (Principal Executive Officer) and Director	September 27, 1999
/s/ Kenneth J. McAvoy ----- Kenneth J. McAvoy	Chief Financial Officer and Treasurer (Principal Financial and Accounting Officer), Secretary, and Director	September 27, 1999
/s/ David A. Bloss, Sr. ----- David A. Bloss, Sr.	President and Chief Operating Officer, and Director	September 27, 1999
/s/ Gordon W. Moran ----- Gordon W. Moran	Director	September 27, 1999
/s/ Daniel J. Murphy, III ----- Daniel J. Murphy, III	Director	September 27, 1999
/s/ Roger A. Young ----- Roger A. Young	Director	September 27, 1999

## Independent Auditors' Report

The Board of Directors and Stockholders  
Watts Industries, Inc.:

We have audited the accompanying consolidated balance sheets of Watts Industries, Inc. and subsidiaries as of June 30, 1999 and 1998, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the years in the three-year period ended June 30, 1999. In connection with our audits of the consolidated financial statements, we also audited the accompanying financial statement schedule of valuation and qualifying accounts. These consolidated financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and schedule based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Watts Industries, Inc. and subsidiaries as of June 30, 1999 and 1998, and the results of their operations and their cash flows for the each of the years in the three-year period ended June 30, 1999, in conformity with generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

*/s/ KPMG LLP*

*Boston, Massachusetts  
August 13, 1999*



Watts Industries, Inc. and Subsidiaries  
Consolidated Statements of Operations  
(Amounts in thousands, except per share information)

	Fiscal Year Ended June 30		
	1999	1998	1997
Net sales .....	\$ 474,458	\$ 442,077	\$ 447,235
Cost of goods sold .....	302,745	282,152	289,961
GROSS PROFIT .....	171,713	159,925	157,274
Selling, general and administrative expenses .....	119,875	112,854	108,653
OPERATING INCOME .....	51,838	47,071	48,621
Other (income) expense:			
Interest income .....	(923)	(1,228)	(616)
Interest expense .....	6,150	6,514	7,072
Other .....	1,688	432	420
	6,915	5,718	6,876
INCOME FROM CONTINUING OPERATIONS			
BEFORE INCOME TAXES .....	44,923	41,353	41,745
Provision for income taxes .....	15,469	13,230	15,230
INCOME FROM CONTINUING OPERATIONS .....	29,454	28,123	26,515
Income from discontinued operations, net of taxes .....	6,502	25,246	22,024
Gain on disposal of discontinued operations, net of taxes ..	--	--	3,208
INCOME FROM DISCONTINUED OPERATIONS, NET OF TAX .....	6,502	25,246	25,232
NET INCOME .....	\$ 35,956	\$ 53,369	\$ 51,747
	=====	=====	=====
Basic EPS			
Income per share:			
Continuing operations .....	\$ 1.10	\$ 1.04	\$ 0.97
Discontinued operations .....	0.24	0.93	0.93
NET INCOME .....	\$ 1.34	\$ 1.97	\$ 1.90
	=====	=====	=====
Weighted average number of shares .....	26,736	27,109	27,181
	=====	=====	=====
Diluted EPS			
Income per share:			
Continuing operations .....	\$ 1.10	\$ 1.03	\$ 0.97
Discontinued operations .....	0.24	0.92	0.92
NET INCOME .....	\$ 1.34	\$ 1.95	\$ 1.89
	=====	=====	=====
Weighted average number of shares .....	26,799	27,423	27,347
	=====	=====	=====
Dividends per share .....	\$ 0.350	\$ 0.330	\$ 0.295
	=====	=====	=====

The accompanying notes are an integral part of these consolidated financial statements.

Watts Industries, Inc. and Subsidiaries  
Consolidated Balance Sheets  
(Amounts in thousands, except share information)

	June 30	
	1999	1998
	-----	-----
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents .....	\$ 12,774	\$ 10,767
Trade accounts receivable, less allowance for doubtful		
accounts of \$7,747 in 1999 and \$6,821 in 1998 .....	89,315	77,325
Inventories .....	110,552	104,198
Prepaid expenses and other assets .....	10,193	9,857
Deferred income taxes .....	21,271	17,963
Net current assets of discontinued operations .....	122,971	100,844
	-----	-----
Total Current Assets .....	367,076	320,954
PROPERTY, PLANT AND EQUIPMENT, NET .....	129,163	105,487
OTHER ASSETS:		
Goodwill, net of accumulated amortization		
of \$10,921 in 1999 and \$8,389 in 1998 .....	96,285	79,837
Other .....	9,027	9,765
Net noncurrent assets of discontinued operations .....	36,191	36,853
	-----	-----
TOTAL ASSETS .....	\$ 637,742	\$ 552,896
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable .....	\$ 35,579	\$ 28,327
Accrued expenses and other liabilities .....	48,843	37,100
Accrued compensation and benefits .....	12,692	11,150
Income taxes payable .....	--	1,993
Current portion of long-term debt .....	2,050	5,011
	-----	-----
Total Current Liabilities .....	99,164	83,581
LONG-TERM DEBT, NET OF CURRENT PORTION .....	118,916	71,647
DEFERRED INCOME TAXES .....	13,070	9,209
OTHER NONCURRENT LIABILITIES .....	11,450	6,798
MINORITY INTEREST .....	7,487	7,646
STOCKHOLDERS' EQUITY:		
Preferred Stock, \$.10 par value; 5,000,000 shares		
authorized; no shares issued or outstanding .....	--	--
Class A Common Stock, \$.10 par value; 80,000,000 shares		
authorized; 1 vote per share; issued and outstanding, 16,158,807		
shares in 1999 and 16,859,027 shares in 1998 .....	1,616	1,686
Class B Common Stock, \$.10 par value; 25,000,000 shares		
authorized; 10 votes per share; issued and outstanding, 10,285,247		
shares in 1999 and 10,296,827 shares in 1998 .....	1,029	1,030
Additional paid-in capital .....	36,069	47,647
Retained earnings .....	364,089	337,565
Treasury stock, at cost, 100,000 shares in 1998 .....	--	(2,583)
Accumulated Other Comprehensive Income (Loss) .....	(15,148)	(11,330)
	-----	-----
Total Stockholders' Equity .....	387,655	374,015
	-----	-----
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY .....	\$ 637,742	\$ 552,896
	=====	=====

The accompanying notes are an integral part of these consolidated financial statements.

Watts Industries, Inc. and Subsidiaries  
Consolidated Statements of Stockholders' Equity  
(Amounts in thousands, except share information)

	Class A Common Stock		Class B Common Stock		Additional Paid-In Capital	Retained Earnings
	Shares	Amount	Shares	Amount		
Balance at June 30, 1996 .....	16,856,838	\$1,686	11,365,627	\$1,136	67,930	\$249,415
Comprehensive income:						
Net income .....						51,747
Cumulative translation adjustment .....						
Comprehensive income .....						
Shares of Class B Common Stock converted to Class A Common Stock .....	150,000	15	(150,000)	(15)		
Shares of Class A Common Stock issued upon the exercise of stock options .....	111,922	11			2,145	
Purchase and retirement of treasury stock .....	(1,321,300)	(132)			(25,432)	
Common Stock cash dividends .....						(7,992)
Balance at June 30, 1997 .....	15,797,460	1,580	11,215,627	1,121	44,643	293,170
Comprehensive income:						
Net income .....						53,369
Cumulative translation adjustment .....						
Comprehensive income .....						
Shares of Class B Common Stock converted to Class A Common Stock .....	918,800	91	(918,800)	(91)		
Shares of Class A Common Stock issued upon the exercise of stock options .....	153,400	16			2,998	
Shares of Class A Common Stock exchanged upon the exercise of stock options and retired. ....	(10,633)	(1)			(265)	
Purchase of treasury stock, 100,000 shares @ cost ...						
Net change in restricted stock units .....					271	
Common Stock dividends .....						(8,974)
Balance at June 30, 1998 .....	16,859,027	1,686	10,296,827	1,030	47,647	337,565
Comprehensive income:						
Net income .....						35,956
Cumulative translation adjustment .....						
Comprehensive income .....						
Shares of Class B Common Stock converted to Class A Common Stock .....	11,580	1	(11,580)	(1)		
Shares of Class A Common Stock issued upon the exercise of stock options .....	3,700	1			60	
Purchase of treasury stock, 615,500 shares @ cost ...						
Retirement of treasury stock .....	(715,500)	(72)			(11,926)	
Net change in restricted stock units .....					288	
Common Stock dividends .....						(9,432)
Balance at June 30, 1999 .....	16,158,807	\$1,616	10,285,247	\$1,029	\$ 36,069	\$364,089

	Accumulated Other Comprehensive Income	Treasury Stock	Total Stockholders' Equity
Balance at June 30, 1996 .....	\$ (584)	\$ --	\$319,583
Comprehensive income:			
Net income .....			51,747
Cumulative translation adjustment .....	(6,291)		(6,291)
Comprehensive income .....			45,456
Shares of Class B Common Stock converted to Class A Common Stock .....			
Shares of Class A Common Stock issued upon the exercise of stock options .....			2,156
Purchase and retirement of treasury stock .....			(25,564)
Common Stock cash dividends .....			(7,992)
Balance at June 30, 1997 .....	(6,875)	--	333,639
Comprehensive income:			
Net income .....			53,369
Cumulative translation adjustment .....	(4,455)		(4,455)
Comprehensive income .....			48,914
Shares of Class B Common Stock converted to Class A Common Stock .....			

Shares of Class A Common Stock issued upon the exercise of stock options .....			3,014
Shares of Class A Common Stock exchanged upon the exercise of stock options and retired. ....			(266)
Purchase of treasury stock, 100,000 shares @ cost ...	(2,583)		(2,583)
Net change in restricted stock units .....			271
Common Stock dividends .....			(8,974)
Balance at June 30, 1998 .....	(11,330)	(2,583)	374,015
Comprehensive income:			
Net income .....			35,956
Cumulative translation adjustment .....	(3,818)		(3,818)
Comprehensive income .....			32,138
Shares of Class B Common Stock converted to Class A Common Stock .....			
Shares of Class A Common Stock issued upon the exercise of stock options .....			61
Purchase of treasury stock, 615,500 shares @ cost ...	(9,415)		(9,415)
Retirement of treasury stock .....	11,998		
Net change in restricted stock units .....			288
Common Stock dividends .....			(9,432)
Balance at June 30, 1999 .....	\$(15,148)	\$ --	\$387,655

The accompanying notes are an integral part of these consolidated financial statements.

Watts Industries, Inc. and Subsidiaries  
Consolidated Statements of Cash Flows  
(Amounts in thousands)

	Fiscal Year Ended June 30		
	1999	1998	1997
	-----	-----	-----
OPERATING ACTIVITIES			
Income from continuing operations .....	\$ 29,454	\$ 28,123	\$ 26,515
Adjustments to reconcile net income from continuing operations to net cash provided by continuing operating activities:			
Depreciation .....	14,745	12,908	11,570
Amortization .....	2,711	2,433	2,104
Deferred income taxes (benefit) .....	(2,823)	884	3,874
Gain on disposal of property, plant and equipment .....	(19)	(1,152)	(2,796)
Equity in undistributed earnings (loss) of affiliates .....	712	(192)	(5)
Changes in operating assets and liabilities, net of effects from business acquisitions:			
Accounts receivable .....	(876)	(2,493)	(5,567)
Inventories .....	(532)	(8,959)	9,721
Prepaid expenses and other assets .....	(1,050)	408	(208)
Accounts payable, accrued expenses and other liabilities ....	5,964	6,275	(13,510)
	-----	-----	-----
Net cash provided by discontinued operations .....	48,286	38,235	31,698
	-----	-----	-----
Net cash provided by operating activities .....	16,794	19,660	21,064
	-----	-----	-----
	65,080	57,895	52,762
	-----	-----	-----
INVESTING ACTIVITIES			
Additions to property, plant and equipment .....	(21,532)	(23,056)	(24,285)
Proceeds from sale of property, plant and equipment .....	2,337	7,253	1,715
Increase in other assets .....	(415)	(578)	(1,097)
Business acquisitions, net of cash acquired .....	(28,422)	(1,129)	(36,772)
Discontinued operations:			
Business acquisitions, net of cash acquired .....	(74,176)	(22,503)	(933)
Proceeds from disposal of discontinued operations .....	--	146	88,164
Additions to property, plant and equipment .....	(9,499)	(6,115)	(3,135)
	-----	-----	-----
Net cash provided by (used in) investing activities .....	(131,707)	(45,982)	23,657
	-----	-----	-----
FINANCING ACTIVITIES			
Proceeds from long-term borrowings .....	81,121	68,779	105,412
Payments of long-term debt .....	(47,138)	(85,971)	(128,720)
Proceeds from exercise of stock options .....	61	2,715	1,935
Dividends .....	(9,358)	(8,936)	(7,992)
Purchase of treasury stock .....	(9,415)	(2,583)	(25,564)
Discontinued operations:			
Proceeds from long-term borrowings .....	79,289	25,484	934
Payments of long-term debt .....	(28,546)	(19,084)	(11,942)
	-----	-----	-----
Net cash provided by (used in) financing activities .....	66,014	(19,596)	(65,937)
	-----	-----	-----
Effect of exchange rate changes on cash and cash equivalents .....	2,620	(207)	739
	-----	-----	-----
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS .....	2,007	(7,890)	11,221
Cash and cash equivalents at beginning of year .....	10,767	18,657	7,436
	-----	-----	-----
CASH AND CASH EQUIVALENTS AT END OF YEAR .....	\$ 12,774	\$ 10,767	\$ 18,657
	=====	=====	=====

The accompanying notes are an integral part of these consolidated financial statements.

## **Watts Industries, Inc. and Subsidiaries**

### **Notes to Consolidated Financial Statements**

#### **(1) Description of Business**

The Company designs, manufactures and sells an extensive line of valves for the plumbing and heating and water quality markets located predominately in North America, Europe, and Asia. On December 15, 1998, the Company announced its intention to spin-off its businesses that produce valves for the industrial, oil and gas markets as a separate publicly traded company.

#### **(2) Accounting Policies**

##### **Principles of Consolidation**

The consolidated financial statements include the accounts of Watts Industries, Inc. and its majority and wholly-owned subsidiaries (the Company). Upon consolidation, all significant intercompany accounts and transactions are eliminated. The financial statements of the Company have been restated to reflect the industrial, oil and gas businesses as discontinued operations as a result of the planned spin-off transaction.

##### **Cash Equivalents**

Cash equivalents consist of highly liquid investments with maturities of three months or less at the date of original issuance.

##### **Inventories**

Inventories are stated at the lower of cost (first-in, first-out method) or market.

##### **Goodwill**

Goodwill represents the excess of cost over the fair value of net assets of businesses acquired. This balance is amortized over 40 years using the straight-line method. The Company assesses the recoverability of this intangible asset by determining whether the amortization of the goodwill balance over its remaining life can be recovered through undiscounted future operating cash flows of the acquired operation. The amount of goodwill impairment, if any, is measured based on projected discounted future operating cash flows using a discount rate reflecting the Company's average cost of funds.

##### **Property, Plant and Equipment**

Property, plant and equipment are recorded at cost. Depreciation is provided on a straight-line basis over the estimated useful lives of the assets, which range from 10 to 40 years for buildings and improvements and 3 to 15 years for machinery and equipment.

##### **Long-Lived Assets**

Impairment losses are recorded on long-lived assets used in operations when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amount. In such instances, the carrying value of long-lived assets is reduced to their estimated fair value, as determined using an appraisal or a discounted cash flow approach, as appropriate.

##### **Income Taxes**

Deferred income taxes are recognized for temporary differences between financial statement and income tax bases of assets and liabilities.

(Continued)

**Notes to Consolidated Financial Statements**

**Foreign Currency Translation**

Balance sheet accounts of foreign subsidiaries are translated into United States dollars at fiscal year-end exchange rates. Operating accounts are translated at weighted average exchange rates for each year. Net translation gains or losses are adjusted directly to a separate component of stockholders' equity. The Company does not provide for U.S. income taxes on foreign currency translation adjustments since it does not provide for such taxes on undistributed earnings of foreign subsidiaries.

**Stock Based Compensation**

As allowed under Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation, the Company accounts for its stock-based employee compensation plans in accordance with the provisions of APB Opinion No. 25, Accounting for Stock Issued to Employees.

**Earnings Per Share**

Basic net income per common share is calculated by dividing net income by the weighted average number of common shares outstanding. Diluted earnings per share assumes the conversion of all dilutive securities (see Note 11).

Net income and shares used to compute net income per share from continuing operations, basic and assuming full dilution, are reconciled below:

	Year Ending June 30,								
	1999			1998			1997		
	Income from continuing operations	Shares	Per Share Amount	Income from continuing operations	Shares	Per Share Amount	Income from continuing operations	Shares	Per Share Amount
Basic EPS	\$29,454	26,736	\$1.10	\$28,123	27,109	\$1.04	\$26,515	27,181	\$0.97
Dilutive securities, principally common stock options		63			314			166	
Diluted EPS	\$29,454	26,799	\$1.10	\$28,123	27,423	\$1.03	\$26,515	27,347	\$0.97

**Derivative Financial Instruments**

The Company uses financial instruments, principally forward contracts and options to hedge foreign currency and commodity exposures. These contracts hedge transactions and balances for periods consistent with their committed exposures, and do not constitute investments independent of these exposures. The Company does not hold or issue financial instruments for trading purposes, nor is it a party to any leveraged contracts.

Realized and unrealized foreign exchange gains and losses on financial instruments are recognized and offset foreign exchange gains and losses on the underlying exposures. Any gain or loss from a financial instrument that ceases to be an effective hedge is recognized in the income statement.

**Estimates**

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

(Continued)

**Notes to Consolidated Financial Statements**

**New Accounting Standards**

In 1998, the Financial Accounting Standards Board issued SFAS 132, "Employers' Disclosure about Pensions and Other Postretirement Benefits," and SFAS 133, "Accounting for Derivative Instruments and Hedging Activities." The Company has adopted SFAS 132. The Company will adopt SFAS 133 on January 1, 2001. The impact of SFAS 133 on the consolidated financial statements is still being evaluated, but is not expected to be material.

Also in 1998, the American Institute of Certified Public Accountants issued SOP 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use," and SOP 98-5, "Reporting on the Costs of Start-Up Activities." The Company will adopt SOP 98-1 and SOP 98-5 in fiscal 2000. These statements are not expected to have a material affect on the consolidated financial statements.

**(3) Discontinued Operations**

On December 15, 1998, the Company announced that it plans to spin-off its industrial, oil and gas businesses as a separate publicly traded company, CIRCOR International, Inc. ("CIRCOR"). Under the terms of the planned spin-off transaction, which is expected to be completed in October 1999, the Company will distribute to the holders of its common stock one share of CIRCOR common stock for every two shares of Watts common stock. In connection with this transaction, the Company will enter into several agreements with CIRCOR that will cover such matters as technology transfers and transition services. Additionally, the Company expects to enter into a tax sharing agreement with CIRCOR effectively providing that the Company will be responsible for the United States tax liability of CIRCOR for the years CIRCOR was included in the Company's consolidated United States tax returns.

In September of 1996, the Company divested itself of its municipal water group of businesses, which included Henry Pratt Company, James Jones Company and Edward Barber & Company Ltd. by selling the stock of each entity and realizing a \$3.2 million after tax gain.

The historical operating results of these businesses are shown net of tax as discontinued operations in the consolidated statements of operations. Net assets of discontinued operations in the consolidated balance sheet include those assets and liabilities attributable to the CIRCOR businesses.

The historical operating results of the discontinued operations include an allocation of the Company's interest expense based on an allocation of the Company's debt to discontinued operations. Income taxes have been allocated to discontinued operations based on their pretax income and calculated on a separate company basis pursuant to the requirements of Statement of Financial Accounting Standards No. 109.

(Continued)



# Watts Industries, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements

Condensed historical balance sheet and operating statement data of the discontinued operations is summarized below:

	June 30,	
	1999	1998
	-----	-----
	(in thousands)	
Balance Sheet:		
Total current assets	\$ 185,028	\$ 157,847
Total current liabilities	(62,057)	(57,003)
	-----	-----
Net current assets	\$ 122,971	\$ 100,844
	=====	=====
Total non-current assets	\$ 178,153	\$ 99,067
Total non-current liabilities	(141,962)	(62,214)
	-----	-----
Net non-current assets	\$ 36,191	\$ 36,853
	=====	=====
	Year ended June 30,	
	-----	-----
	1999	1998
	-----	-----
	(in thousands)	
Statement of Operations:		
Net sales:		
Municipal Water Group	\$ --	\$ --
CIRCOR	321,711	287,889
	-----	-----
Total net sales	321,711	287,889
	-----	-----
Costs and expenses:		
Municipal Water Group	5,000	--
CIRCOR	299,385	248,161
	-----	-----
Total costs and expenses	304,385	248,161
	-----	-----
Income before income taxes	17,326	39,728
Provision for income taxes	10,824	14,482
	-----	-----
Income from discontinued operations, net of taxes	\$ 6,502	\$ 25,246
	=====	=====

Costs and expenses related to the Municipal Water Group for 1999 relate to legal costs associated with the State of California litigation (see Note 13).

### (4) Business Acquisitions

On July 22, 1998, Watts acquired Hoke, Inc., a multinational manufacturer of industrial valves and fittings, for \$85 million, including assumption of debt. As allowed in the purchase agreement, the Company has initiated arbitration proceedings against the former shareholders of Hoke to recover a portion of the purchase price. At this time, the Company cannot determine how much, if any, of the purchase price will be recovered. Hoke is included as part of the industrial, oil and gas businesses which are being spun off into a separate publicly traded company, CIRCOR. Any amounts recovered as a result of the arbitration proceedings will go to CIRCOR.

(Continued)

## Watts Industries, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements

During fiscal 1999, the Company also acquired SSI Equipment, Inc. of Burlington, Ontario, Canada; Go Regulator, Inc. of San Dimas, California and Cazzaniga S.p.A. located in Biassono, Italy. In fiscal 1998, the Company acquired Telford Valve and Specialties, Inc. of Edmonton, Alberta, Canada, Atkomatic Valve Company, located in Indianapolis, Indiana and Aerodyne Controls Corp. of Ronkonkoma, New York. All of these acquired companies are valve manufacturers and the aggregate purchase price of these acquisitions, including Hoke, was approximately \$102.6 million. The goodwill which resulted from these acquisitions is being amortized on a straight-line basis over a 40 year period.

All acquisitions have been accounted for under the purchase method and the results of operations of the acquired businesses have been included in the consolidated financial statements from the date of acquisition. Had these acquisitions occurred at the beginning of fiscal year 1999, 1998 or 1997, the effect on operating results would not have been material.

(5) Inventories

Inventories consist of the following:

	June 30,	
	1999	1998
	----	----
	(in thousands)	
Raw materials	\$ 36,901	\$ 34,057
Work in process	7,493	6,128
Finished goods	66,158	64,013
	-----	-----
	\$ 110,552	\$ 104,198
	=====	=====

(6) Property, Plant and Equipment

Property, plant and equipment consists of the following:

	June 30,	
	1999	1998
	----	----
	(in thousands)	
Land	\$ 7,964	\$ 5,582
Building and improvements	53,867	48,676
Machinery and equipment	148,952	128,339
Construction in progress	7,932	10,861
	-----	-----
	218,715	193,458
Accumulated depreciation	(89,552)	(87,971)
	-----	-----
	\$ 129,163	\$ 105,487
	=====	=====

(Continued)

# Watts Industries, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements

### (7) Income Taxes

The significant components of the Company's deferred income tax liabilities and assets are as follows:

	June 30,	
	1999	1998
	(in thousands)	
Deferred income tax liabilities:		
Excess tax over book depreciation	\$ 11,386	\$ 5,809
Inventory	1,027	1,991
Other	657	1,409
Total deferred income tax liabilities	13,070	9,209
Deferred income tax assets:		
Accrued expenses	13,037	9,120
Net operating loss carryforward	10,918	12,625
Other	3,441	3,979
Total deferred income tax assets	27,396	25,724
Valuation allowance for deferred income tax assets	(6,125)	(7,761)
Net deferred income tax assets	21,271	17,963
Net deferred income tax asset	\$ 8,201	\$ 8,754

The provision for income taxes from continuing operations is based on the following pre-tax income:

	Fiscal Year Ended June 30,		
	1999	1998	1997
	(in thousands)		
Domestic	\$ 33,787	\$ 34,609	\$ 31,323
Foreign	11,136	6,744	10,422
	\$ 44,923	\$ 41,353	\$ 41,745

The provision for income taxes from continuing operations consists of the following:

	Fiscal Year Ended June 30,		
	1999	1998	1997
	(in thousands)		
Current tax expense (benefit):			
Federal	\$ 12,698	\$ 10,551	\$ 10,497
Foreign	2,820	2,164	(57)
State	385	1,416	(146)
	15,903	14,131	10,294
Deferred tax expense (benefit):			
Federal	(577)	(129)	1,013
Foreign	212	(750)	3,746
State	(69)	(22)	177
	(434)	(901)	4,936
	\$ 15,469	\$ 13,230	\$ 15,230



Notes to Consolidated Financial Statements

Actual income taxes reported from continuing operations are different than would have been computed by applying the federal statutory tax rate to income from continuing operations before income taxes. The reasons for this difference are as follows:

	Fiscal Year Ended June 30,		
	1999	1998	1997
	----	----	----
	(in thousands)		
Computed expected federal income tax expense	\$ 15,723	\$ 14,474	\$ 14,612
State income taxes, net of federal tax benefit	366	1,614	202
Nondeductible goodwill and amortization	1,058	714	584
Foreign tax rate and regulation differential	(664)	(1,830)	(568)
Other, net	(1,014)	(1,742)	400
	-----	-----	-----
	\$ 15,469	\$ 13,230	\$ 15,230
	=====	=====	=====

At June 30, 1999, the Company has foreign net operating loss carryforwards of \$16.4 million for income tax purposes that expire in fiscal years 2000 through 2003. In addition, foreign net operating losses of \$10.7 million can be carried forward indefinitely. Undistributed earnings of the Company's foreign subsidiaries amounted to approximately \$45 million, \$33 million and \$28 million at June 30, 1999, 1998 and 1997, respectively. Those earnings are considered to be indefinitely reinvested and, accordingly, no provision for U.S. federal and state income taxes has been recorded thereon. Upon distribution of those earnings, in the form of dividends or otherwise, the Company will be subject to both U.S. income taxes (subject to an adjustment for foreign tax credits) and withholding taxes payable to the various foreign countries. Determination of the amount of U.S. income tax liability that would be incurred is not practicable because of the complexities associated with its hypothetical calculation; however, unrecognized foreign tax credits would be available to reduce some portion of any U.S. income tax liability. Withholding taxes of approximately \$5.4 million would be payable upon remittance of all previously unremitted earnings at June 30, 1999.

The Company made income tax payments of \$24.8 million, \$17.2 million and \$20.2 million in fiscal years 1999, 1998 and 1997, respectively.

(8) Accrued Expenses and Other Liabilities

Accrued expenses and other liabilities consist of the following:

	June 30,	
	1999	1998
	----	----
	(in thousands)	
Commissions and sales incentives payable	\$11,401	\$ 8,990
Accrued insurance costs	10,801	9,394
Professional fees	6,154	908
Other	20,487	17,808
	-----	-----
	\$48,843	\$37,100
	=====	=====

(Continued)

# Watts Industries, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements

### (9) Financing Arrangements

Long-term debt consists of the following:

	June 30,	
	1999	1998
	-----	-----
	(in thousands)	
8-3/8% Notes, due December 2003	\$ 75,000	\$ 75,000
\$125 million revolving line of credit, accruing interest at a variable rate (5.37% and 6.79% at June 30, 1999 and 1998, respectively) of either Eurodollar rate plus .185%, Prime Rate or a competitive money market rate to be specified by the Lender, and expiring March 2003	104,000	19,000
40 million Euro line of Credit, accruing interest at a variable rate of EURIBOR plus .75% (3.7% at June 30, 1999), and expiring September 2004	20,223	--
Industrial Revenue Bonds, maturing September 2002 accruing interest at a variable rate based on weekly tax-exempt interest rates (3.96% and 3.60% at June 30, 1999 and 1998, respectively)	5,000	5,400
Other	13,740	8,217
Allocation to discontinued operations	(96,997)	(30,959)
	-----	-----
	120,966	76,658
Less: current portion	2,050	5,011
	-----	-----
	\$ 118,916	\$ 71,647
	=====	=====

At the time of the distribution for the spin-off transaction, CIRCOR will repay intercompany loans and advances from Watts based on a formula which allocates borrowings between Watts and CIRCOR based on their relative levels of business acquisition activity. The amount received from CIRCOR will be used to reduce outstanding borrowings under the revolving credit facility. Based on this methodology, borrowings amounting to \$96,997 and \$30,959 have been allocated to discontinued operations at June 30, 1999 and 1998, respectively.

On March 1, 1999, a wholly owned subsidiary of the Company entered into a syndicated revolving credit facility with a group of European banks that provides for borrowings up to 40 million Euro at an interest rate of EURIBOR plus 75 basis points. This credit facility expires on September 1, 2004.

Principal payments during each of the next five fiscal years are due as follows (in thousands): 2000 - \$2,050; 2001 - \$1,303; 2002 - \$5,763; 2003 - \$184,358; and 2004 - \$19. Interest paid for all periods presented in the accompanying combined financial statements approximates interest expense.

Certain of the Company's loan agreements contain covenants that require, among other items, the maintenance of certain financial ratios and net worth, and limit the Company's ability to enter into secured borrowing arrangements. Under its most restrictive loan covenant, which requires the Company to maintain a net worth of not less than the sum of \$295 million and 50% of cumulative consolidated net income for complete fiscal years subsequent to June 30, 1996, the Company had \$22.1 million available at June 30, 1999 for the payment of dividends.

(Continued)

Notes to Consolidated Financial Statements

(10) Common Stock

Since 1997, the Company's Board of Directors has authorized the repurchase of 3,880,200 shares of the Company's common stock in the open market and through private purchases. Since the inception of this repurchase program, 3,495,700 shares of the Company's common stock have been repurchased and retired.

The Class A Common Stock and Class B Common Stock have equal dividend and liquidation rights. Each share of the Company's Class A Common Stock is entitled to one vote on all matters submitted to stockholders and each share of Class B Common Stock is entitled to ten votes on all such matters. Shares of Class B Common Stock are convertible into shares of Class A Common Stock, on a one-to-one basis, at the option of the holder. The Company has reserved a total of 5,998,308 shares of Class A Common Stock for issuance under its stock-based compensation plans and 10,285,247 shares for conversion of Class B Stock to Class A Common Stock.

(11) Stock-Based Compensation

The Company has several stock option plans under which key employees and outside directors have been granted incentive (ISOs) and nonqualified (NSOs) options to purchase the Company's Class A common stock. Generally, options become exercisable over a five-year period at the rate of 20% per year and expire ten years after the date of grant. ISOs and NSOs granted under the plans have exercise prices of not less than 100% and 50% of the fair market value of the common stock on the date of grant, respectively. At June 30, 1999, 4,517,514 shares of Class A common stock were authorized for future grants of options under the Company's stock option plans.

The following is a summary of stock option activity and related information:

(Options in thousands)	Fiscal Year Ended June 30,					
	1999		1998		1997	
	Options	Weighted average exercise price	Options	Weighted average exercise price	Options	Weighted average exercise price
Outstanding at beginning of year	1,362	\$ 21.08	1,348	\$ 20.01	1,137	\$ 21.04
Granted	201	18.36	284	25.12	378	16.38
Canceled	(78)	21.39	(117)	20.72	(55)	21.79
Exercised (a)	(4)	16.38	(153)	19.43	(112)	17.28
Outstanding at end of year	1,481	\$ 20.71	1,362	\$ 21.08	1,348	\$ 20.01
Exercisable at end of year	808	\$ 20.52	619	\$ 20.19	552	\$ 20.39

(a) Includes 13,100 options in 1998 exercised in exchange for 10,633 shares of outstanding Class A common shares which were contributed to Treasury and subsequently retired.

(Continued)

# Watts Industries, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements

The following table summarizes information about options outstanding at June 30, 1999:

(Options in thousands) Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number outstanding	Weighted average remaining contractual life (years)	Weighted average exercise price	Number exercisable	Weighted average exercise price
\$10.69 - \$11.38	13	1.4	\$ 10.84	13	\$ 10.84
\$14.25 - \$16.38	317	6.6	16.18	159	16.64
\$16.60 - \$18.44	363	6.4	17.86	170	17.21
\$22.13 - \$25.38	788	6.0	23.98	466	23.52
	-----			-----	
\$10.69 - \$25.38	1,481	5.1	20.71	808	20.52
	=====			=====	

The Company has a Management Stock Purchase Plan which allows for the granting of Restricted Stock Units (RSUs) to key employees to purchase up to 1,000,000 shares of Class A common stock at 67% of the fair market value on the date of grant. RSUs vest annually over a three-year period from the date of grant. The difference between the RSU price and fair market value at the date of award is amortized to compensation expense ratably over the vesting period. At June 30, 1999, 178,688 RSUs were outstanding. Dividends declared for RSU's which remain unpaid at June 30, 1999 total \$107,000.

Pro forma information regarding net income and net income per share is required by SFAS No. 123 for awards granted after June 30, 1995 as if the Company had accounted for its stock-based awards to employees under the fair value method of SFAS 123. The weighted average grant date fair value of options granted during fiscal years 1999, 1998 and 1997 was \$3.82, \$5.52 and \$3.72, respectively. The fair value of the Company's stock-based awards to employees was estimated using a Black-Scholes option pricing model and the following assumptions:

	1999	1998	1997
	----	----	----
Expected life (years)	5.0	5.0	5.0
Expected stock price volatility	15.0%	15.0%	15.0%
Expected dividend yield	1.9%	1.3%	1.8%
Risk-free interest rate	5.92%	5.54%	6.56%

The Company's pro forma information follows:

	Fiscal Year Ended June 30,		
	1999	1998	1997
	----	----	----
	(in thousands, except per share information)		
Net income - as reported	\$35,956	\$53,369	\$51,747
Net income - pro forma	34,863	52,443	51,132
Basic EPS - as reported	1.34	1.97	1.90
Basic EPS - pro forma	1.30	1.93	1.88
Diluted EPS - as reported	1.34	1.95	1.89
Diluted EPS - pro forma	1.30	1.91	1.87

Because SFAS 123 is applicable only to awards granted subsequent to June 30, 1995, its pro forma effect will not be fully reflected until fiscal year 2000.

(Continued)



## Notes to Consolidated Financial Statements

## (12) Employee Benefit Plans

The Company sponsors defined benefit pension plans covering substantially all of its domestic non-union employees. Benefits are based primarily on years of service and employees' compensation. The funding policy of the Company for these plans is to contribute annually the maximum amount that can be deducted for federal income tax purposes.

The components of net pension expense follow:

	Fiscal Year Ended June 30,		
	1999	1998	1997
	(in thousands)		
Change in projected benefit obligation			
Balance at beginning of year	\$ 31,786	\$ 24,026	\$ 22,060
Service costs	1,485	953	798
Interest costs	2,221	2,081	1,812
Actuarial loss / (gain)	(904)	5,244	416
Amendments / curtailments	--	764	(97)
Benefits paid	(1,068)	(1,281)	(964)
Balance at end of year	\$ 33,520	\$ 31,787	\$ 24,025
Change in fair value of plan assets			
Balance at beginning of year	\$ 29,446	\$ 23,230	\$ 21,611
Actual return on assets	933	5,703	1,811
Employer contributions	476	1,794	770
Benefits paid	(1,068)	(1,281)	(964)
Fair value of plan assets at end of year	\$ 29,787	\$ 29,446	\$ 23,228
Funded Status			
Unrecognized transition asset	\$ (1,322)	\$ (1,594)	\$ (1,856)
Unrecognized prior service cost	1,388	1,535	919
Unrecognized net actuarial loss / (gain)	1,604	870	(526)
Accrued benefit cost	(2,072)	(1,528)	(2,258)
Net accrued pension cost included in consolidated balance sheets			
Accrued minimum liability	\$ (446)	\$ (862)	\$ (203)
Intangible asset	446	862	203
Accrued benefit cost	(2,072)	(1,528)	(2,258)
Weighted Average Assumptions used			
Discount rate	7.00%	7.00%	8.00%
Expected return on plan assets	9.00%	9.00%	8.00%
Rate of compensation	5.00%	5.00%	5.00%

The Company sponsors a 401(k) Savings Plan for substantially all domestic non-union employees. Under the Plan, the Company matches a specified percentage of employee contributions, subject to certain limitations. Company expense incurred in connection with this plan was \$214,828, \$222,174 and \$161,708 in fiscal years 1999, 1998 and 1997, respectively.

(Continued)

**Notes to Consolidated Financial Statements**

Subsequent to the spin-off of CIRCOR which is expected to take place in October 1999, CIRCOR will become liable for the payment of all pension plan benefits earned by CIRCOR employees prior to and following the spin-off who retire after the spin-off. The Watts pension plan will transfer assets to the CIRCOR International pension plan and the amount of the assets will be calculated based on the relative percentage of the Projected Benefit Obligation. Such amount may be adjusted to comply with the asset allocation methodology set forth in section 4044 of the Employee Retirement Income Security Act of 1974, as amended, if necessary.

**(13) Contingencies and Environmental Remediation**

**Contingencies**

In April 1998, the Company became aware of a complaint that was filed under seal in the State of California alleging violations of the California False Claims Act. The complaint alleges that a former subsidiary of the Company sold products utilized in municipal water systems which failed to meet contractually specified standards and falsely certified that such standards had been met. The complaint further alleges that the municipal entities have suffered tens of millions of dollars in damages as a result of defective products and seeks treble damages, reimbursement of legal costs and penalties. The Company intends to vigorously contest this matter but cannot presently determine whether any loss will result from it. Other lawsuits and proceedings or claims, arising from the ordinary course of operations, are also pending or threatened against the Company and its subsidiaries.

The Company has established reserves which it presently believes are adequate in light of probable and estimable exposure to pending and threatened litigation of which it has knowledge. However, resolution of any such matters during a specific period could have a material effect on quarterly or annual operating results for that period.

**Environmental Remediation**

The Company has been named a potentially responsible party with respect to identified contaminated sites. The level of contamination varies significantly from site to site as do the related levels of remediation efforts. Environmental liabilities are recorded based on the most probable cost, if known, or on the estimated minimum cost of remediation. The Company's accrued estimated environmental liabilities are based on assumptions which are subject to a number of factors and uncertainties. Circumstances which can affect the reliability and precision of these estimates include identification of additional sites, environmental regulations, level of cleanup required, technologies available, number and financial condition of other contributors to remediation and the time period over which remediation may occur. The Company recognizes changes in estimates as new remediation requirements are defined or as new information becomes available. The Company estimates that its accrued environmental remediation liabilities will likely be paid over the next five to ten years.

(Continued)

Notes to Consolidated Financial Statements

(14) Financial Instruments

Fair Value

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

The fair value of the Company's 8-3/8% notes, due December 2003, is based on quoted market prices. The fair value of the Company's variable rate debt approximates its carrying value. The carrying amount and the estimated fair market value of the Company's long-term debt, including the current portion and amounts allocated to discontinued operations, are as follows:

	June 30,	
	1999	1998
	-----	-----
	(in thousands)	
Carrying amount	\$217,963	\$107,617
Estimated fair value	222,441	114,907

Derivative Instruments

The Company uses foreign currency forward exchange contracts to reduce the impact of currency fluctuations on certain anticipated intercompany purchase transactions that are expected to occur within the fiscal year and certain other foreign currency transactions. Related gains and losses are recognized when the contracts expire, which is generally in the same period as the underlying foreign currency denominated transaction. These contracts do not subject the Company to significant market risk from exchange movement because they offset gains and losses on the related foreign currency denominated transactions. At June 30, 1999, the Company had forward contracts to buy foreign currencies with a face value \$9 million. These contracts mature on various dates between July 1999 and January 2000 and have a fair market value of \$8.4 million at June 30, 1999. The counterparties to these contracts are major financial institutions. The risk of loss to the Company in the event of non-performance by a counterparty is not significant.

The Company uses commodity futures contracts to fix the price on a certain portion of certain raw materials used in the manufacturing process. These contracts highly correlate to the actual purchases of the commodity and the contract values are reflected in the cost of the commodity as it is actually purchased. At June 30, 1999, the Company had outstanding commodity futures contracts with a notional value of \$3.5 million and a fair value of \$3.7 million.

(Continued)

# Watts Industries, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements

### (15) Segment Information

The following table presents certain operating segment information:

(Thousands of dollars)	North America -----	Europe -----	Asia ----	Corporate Adjustments -----	Consolidated -----
1999					
Net Sales	\$369,193	\$ 92,247	\$13,018	\$ --	\$474,458
Operating income	38,536	11,228	1,608	466	51,838
Identifiable assets	484,784	133,720	22,374	(3,136)	637,742
Capital expenditures	17,987	3,471	74	--	21,532
Depreciation and amortization	12,851	3,921	684	--	17,456
1998					
Net Sales	345,346	82,837	13,894	--	442,077
Operating income	36,754	8,258	1,984	75	47,071
Identifiable assets	443,224	87,463	23,719	(1,510)	552,896
Capital expenditures	19,839	2,621	596	--	23,056
Depreciation and amortization	11,491	3,182	668	--	15,341
1997					
Net Sales	336,568	94,359	16,308	--	447,235
Operating income	36,539	10,641	1,717	(276)	48,621
Identifiable assets	411,736	93,696	22,519	(1,585)	526,366
Capital expenditures	19,274	3,842	1,169	--	24,285
Depreciation and amortization	9,458	3,623	593	--	13,674

Each operating segment is individually managed and has separate financial results that are reviewed by the Company's chief operating decision-maker.

All intercompany transactions have been eliminated, and intersegment revenues are not significant.

(Continued)

# Watts Industries, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements

### (16) Quarterly Financial Information (Unaudited)

	First Quarter -----	Second Quarter -----	Third Quarter -----	Fourth Quarter -----
	(in thousands, except per share information)			
Fiscal year ended June 30, 1999:				
Net sales	\$ 113,269	\$114,310	\$116,972	\$129,907
Gross profit	41,086	40,833	41,888	47,906
Net income from continuing operations	7,893	7,332	6,905	7,324
Net income	12,388	11,256	6,905	5,407
Per common share:				
Basic				
Income from continuing operations	.29	.27	.26	.27
Net income	.46	.42	.26	.20
Diluted				
Income from continuing operations	.29	.27	.26	.27
Net income	.46	.42	.26	.20
Dividends per common share	.0875	.0875	.0875	.0875
Fiscal year ended June 30, 1998:				
Net sales	\$ 111,839	\$111,844	\$108,166	\$110,228
Gross profit	41,163	40,496	39,028	39,238
Net income from continuing operations	7,326	7,613	7,259	5,925
Net income	13,620	13,609	14,041	12,099
Per common share:				
Basic				
Income from continuing operations	.27	.28	.27	.22
Net income	.50	.50	.52	.45
Diluted				
Income from continuing operations	.27	.28	.26	.22
Net income	.50	.50	.51	.44
Dividends per common share	.0775	.0775	.0875	.0875

(Continued)

## Schedule II-Valuation and Qualifying Accounts Watts Industries, Inc. Continuing Operations

(Dollar amounts in thousands)

Column A	Column B	Column C	Column D	Column E	
Additions					
Description	Balance at Beginning of Period	Charged to Costs and Expenses	Charged to Other Accounts--Describe	Deductions-- Describe(1)	Balance at End of Period
Year ended June 30, 1999					
Deducted from asset account:					
Allowance for doubtful accounts	\$6,821	\$1,728	\$747 (2)	\$1,549	\$7,747
Year ended June 30, 1998					
Deducted from asset account:					
Allowance for doubtful accounts	\$6,236	\$2,201		\$1,616	\$6,821
Year ended June 30, 1997					
Deducted from asset account:					
Allowance for doubtful accounts	\$6,862	\$2,191	\$30 (2)	\$2,847	\$6,236

(1) Uncollectible accounts written off, net of recoveries.

(2) Balance acquired in connection with acquisition of Cazzaniga in 1999 and Ames in 1997.

(Continued)

## EXHIBIT INDEX

Exhibit No. -----	Description and Location -----
2.1	Distribution Agreement between Watts Industries, Inc. and CIRCOR International, Inc. (20)
3.1	Restated Certificate of Incorporation, as amended. (12)
3.2	Amended and Restated By-Laws, as amended May 11, 1999. (1)
9.1	Horne Family Voting Trust Agreement-1991 dated as of October 31, 1991 (2), Amendments dated November 19, 1996 (18), February 24, 1997 (18), June 5, 1997 (18), August 26, 1997 (18), and October 17, 1997. (21)
9.2	The Amended and Restated George B. Horne Voting Trust Agreement-1997 dated as of September 14, 1999 *.
10.1	Employment Agreement effective as of September 1, 1996 between the Registrant and Timothy P. Horne. (14)
10.2	Supplemental Compensation Agreement effective as of September 1, 1996 between the Registrant and Timothy P. Horne. (14)
10.3	Deferred Compensation Agreement between the Registrant and Timothy P. Horne, as amended. (4)
10.4	1996 Stock Option Plan, dated October 15, 1996. (15)
10.5	1989 Nonqualified Stock Option Plan. (3)
10.6	Watts Industries, Inc. Retirement Plan for Salaried Employees dated December 30, 1994, as amended and restated effective as of January 1, 1994, (12), Amendment No. 1 (14), Amendment No. 2 (14), Amendment No. 3 (14), Amendment No. 4 dated September 4, 1996. (18), Amendment No. 5 dated January 1, 1998 *, Amendment No. 6 dated May 3, 1999, and Amendment No. 7 dated June 7, 1999 *.
10.7	Registration Rights Agreement dated July 25, 1986. (5)
10.8	Executive Incentive Bonus Plan, as amended. (12)

- 10.9 Indenture dated as of December 1, 1991 between the Registrant and The First National Bank of Boston, as Trustee, including form of 8-3/8% Note Due 2003. (8)
- 10.10 Loan Agreement and Mortgage among The Industrial Development Authority of the State of New Hampshire, Watts Regulator Co. and Arlington Trust Company dated August 1, 1985. (4)
- 10.11 Amendment Agreement relating to Watts Regulator Co. (Canaan and Franklin, New Hampshire, facilities) financing dated December 31, 1985. (4)
- 10.12 Sale Agreement between Village of Walden Industrial Development Agency and Spence Engineering Company, Inc. dated June 1, 1994. (11)
- 10.13 Letter of Credit, Reimbursement and Guaranty Agreement dated June 1, 1994 by and among the Registrant, Spence Engineering Company, Inc. and First Union National Bank of North Carolina. (11), Amendment No. 1 (14), Amendment No. 2 dated October 1, 1996. (18)
- 10.14 Trust Indenture from Village of Walden Industrial Development Agency to The First National Bank of Boston, as Trustee, dated June 1, 1994. (11)
- 10.15 Loan Agreement between Hillsborough County Industrial Development Authority and Leslie Controls, Inc. dated July 1, 1994. (11)
- 10.16 Letter of Credit, Reimbursement and Guaranty Agreement dated July 1, 1994 by and among the Registrant, Leslie Controls, Inc. and First Union National Bank of North Carolina (11), Amendment No. 1 (14), Amendment No. 2 dated October 1, 1996. (18)
- 10.17 Trust Indenture from Hillsborough County Industrial Development Authority to The First National Bank of Boston, as Trustee, dated July 1, 1994. (11)
- 10.18 Loan Agreement between The Rutherford County Industrial Facilities and Pollution Control Financing Authority and Watts Regulator Company dated September 1, 1994. (12)
- 10.19 Letter of Credit, Reimbursement and Guaranty Agreement dated September 1, 1994 by and among the Registrant, Watts Regulator Company and The First Union National Bank of North Carolina (12), Amendment No. 1 (14), Amendment No. 2 dated October 1, 1996. (18)
- 10.20 Trust Indenture from The Rutherford County Industrial Facilities and Pollution Control Financing Authority to The First National Bank of Boston, as Trustee, dated September 1, 1994. (12)
- 10.21 Amended and Restated Stock Restriction Agreement dated October 30, 1991 (2), Amendment dated August 26, 1997. (18)
- 10.22 Watts Industries, Inc. 1991 Non-Employee Directors' Nonqualified Stock Option Plan (7), Amendment No. 1. (14)
- 10.23 Letters of Credit relating to retrospective paid loss insurance programs. (10)
- 10.24 Form of Stock Restriction Agreement for management stockholders. (5)
- 10.25 Revolving Credit Agreement dated December 23, 1987 between Nederlandse Creditbank NV and Watts Regulator (Nederland) B.V. and related Guaranty of Watts Industries, Inc. and Watts Regulator Co. dated December 14, 1987. (6)
- 10.26 Loan Agreement dated September 1987 with, and related Mortgage to, N.V. Sallandsche Bank. (6)
- 10.27 Agreement of the sale of shares of Intermed, S.p.A., RIAF Holding A.G. and the participations in Multiscope Due S.R.L. dated November 6, 1992. (9)
- 10.28 Amended and Restated Revolving Credit Agreement dated March 27, 1998 between and among Watts Investment Company, certain financial institutions, BankBoston N.A., as Administrative Agent, and the Registrant, as Guarantor. (17)
- 10.29 Watts Industries, Inc. Management Stock Purchase Plan dated October 17, 1995 (13), Amendment No. 1 dated August 5, 1997. (18)
- 10.30 Stock Purchase Agreement dated as of June 19, 1996 by and among Mueller Co., Tyco Valves Limited, Watts Investment Company, Tyco International Ltd. and Watts Industries, Inc. (16)
- 11 Statement Regarding Computation of Earnings per Common Share. (19)
- 21 Subsidiaries. \*
- 23 Consent of KPMG LLP. \*
- 27 Financial Data Schedule-Fiscal 1999. \*
- 27.1 Restated Financial Data Schedule - June 30, 1997. \*
- 27.2 Restated Financial Data Schedule - September 30, 1997. \*



**Incorporated By Reference To:**

- (1) Relevant exhibit to Registrant's Form 10-Q for quarter ended March 31, 1999.
- (2) Relevant exhibit to Registrant's Form 8-K dated November 14, 1991.
- (3) Relevant exhibit to Registrant's Form 10-K for the year ended June 30, 1989.
- (4) Relevant exhibit to Registrant's Form S-1 (No. 33-6515) dated June 17, 1986.
- (5) Relevant exhibit to Registrant's Form S-1 (No. 33-6515) as part of the Second Amendment to such Form S-1 dated August 21, 1986.
- (6) Relevant exhibit to Registrant's Form S-1 (No. 33-27101) dated February 16, 1989.
- (7) Relevant exhibit to Registrant's Amendment No. 1 to Form 10-K for year ended June 30, 1992.
- (8) Relevant exhibit to Registrant's Form 10-K for year ended June 30, 1992.
- (9) Relevant exhibit to Registrant's Amendment No. 2 dated February 22, 1993 to Form 8-K dated November 6, 1992.
- (10) Relevant exhibit to Registrant's Form 10-K for year ended June 30, 1993.
- (11) Relevant exhibit to Registrant's Form 10-K for year ended June 30, 1994.
- (12) Relevant exhibit to Registrant's Form 10-K for year ended June 30, 1995.
- (13) Relevant exhibit to Registrant's Form S-8 (No. 33-64627) dated November 29, 1995.
- (14) Relevant exhibit to Registrant's Form 10-K for year ended June 30, 1996.
- (15) Relevant exhibit to Registrant's Form S-8 (No. 333-32685) dated August 1, 1997.
- (16) Relevant exhibit to Registrant's Form 8-K dated September 4, 1996.
- (17) Relevant exhibit to Registrant's Form 10-Q for quarter ended March 31, 1998.
- (18) Relevant exhibit to Registrant's Form 10-K for year ended June 30, 1997.
- (19) Notes to Consolidated Financial Statements, Note 2 of this Report.
- (20) Exhibit 2.1 to CIRCOR International, Inc. Amendment No. 1 to its registration statement on Form 10 filed on September 22, 1999. (File No. 000-26961).
- (21) Relevant exhibit to Registrant's Form 10-K for year ended June 30, 1998.

\* Filed as an exhibit to this Report with the Securities and Exchange Commission

**THE AMENDED AND RESTATED GEORGE B. HORNE  
VOTING TRUST AGREEMENT - 1997**

THIS AGREEMENT, amended and restated as of the 14 day of September, 1999 (this "Agreement"), by and among Timothy P. Horne, as trustee (together with his successors in trust as provided herein, the "Trustees"), WATTS INDUSTRIES, INC., a Delaware corporation (the "Company"), Timothy P. Horne, individually, Timothy P. Horne, as Trustee of the George B. Horne Trust - 1982, as currently republished, Timothy P. Horne, as Trustee of the Daniel W. Horne Trust - 1980, Timothy P. Horne, as Trustee of the Deborah Horne Trust - 1976, Timothy P. Horne, as Trustee of the George B. Horne Grandchildren's Trust - 1995 F/B/O Tara V. Horne, Timothy P. Horne, as Trustee of the George B. Horne Grandchildren's Trust - 1995 F/B/O Tiffany Horne, Tara V. Horne, Judith Rae Horne, as Trustee of the Tiffany Horne Trust - 1984 and Judith Rae Horne as custodian for Tiffany Horne (together with any other person or persons who hereafter might deposit shares in this voting trust and thereby become holders of voting trust certificates hereunder, individually as a "Depositor" and collectively as the "Depositors"), and GEORGE B. HORNE individually (in such capacity hereinafter sometimes referred to, together with the Depositors and any other person or persons who are or hereafter become parties hereto as "Beneficiaries" hereunder or subject hereto as holders of voting trust certificates, individually as a "Beneficiary" and collectively as the "Beneficiaries").

**WITNESSETH:**

WHEREAS, the parties hereto entered into the George B. Horne Voting Trust Agreement-1997 dated as of August 26, 1997, as amended by the Amendment (the "First Amendment") to The George B. Horne Voting Trust Agreement-1997 dated as of October 30, 1997 (the "Existing Agreement"), with a view toward promoting and enhancing the long-term stability and growth of the Company; and

WHEREAS, the Trustees and the registered holders of greater than a majority of voting trust certificates outstanding under the Voting Trust Agreement, desire to amend and restate the Voting Trust Agreement to incorporate the First Amendment and to further amend the Voting Trust Agreement to provide, among other things, that any capital stock or other equity interest of a corporation or other entity, other than the Company, received by a Beneficiary as a result of a dividend or other distribution or issuance in respect of any capital stock of the Company held by such Beneficiary will become subject to the Voting Trust Agreement; and

WHEREAS, the parties hereto agree that, pursuant to this Agreement and on the terms and conditions set forth herein, the Trustees shall be granted the sole and exclusive voting power in all matters with respect to those shares of capital stock of the Company and other securities which are subject to this Agreement as set forth herein, together with the other rights and powers specified herein; and

WHEREAS, the parties hereto intend that this Agreement will satisfy the requirements of Section 218(a) of the Delaware General Corporation Law, as amended (the "DGCL"), and be treated as a voting trust thereunder; and

WHEREAS, the Trustees have consented to act under this Agreement for the purposes hereinafter provided.

NOW, THEREFORE, in consideration of the mutual covenants herein contained and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto mutually promise, covenant, undertake and agree as follows:

1. Transfer of Stock to Trustees. The Depositor is, contemporaneously with the execution of this Agreement, depositing with the Trustees one or more certificates representing that number of shares of the Class B Common Stock of the Company held by such Depositor as set forth opposite such Depositor's name on Schedule A attached hereto, and each Beneficiary shall deposit with the Trustees immediately upon receipt certificates representing (a) any shares of capital stock of the Company having voting powers, (b) any shares of capital stock or other equity interest or rights of a corporation (other than the Company) or other entity having voting powers that are issued as a result of a dividend or other distribution or issuance in respect of any shares of capital stock of the Company (such corporation or other entity, an "Additional Issuer") and (c) any shares of capital stock or other equity interest or rights of an Additional Issuer having voting powers that are issued as a result of a dividend or other distribution or issuance in respect of any shares of capital stock or other equity interest of such Additional Issuer, in each case which shares or other equity interest or rights are acquired or received by such Beneficiary during the term of this Agreement other than (i) shares of Class A Common Stock of the Company or shares of capital stock or other equity interest of an Additional Issuer acquired by such Beneficiary under any stock purchase, savings, option, bonus, stock appreciation, profit-sharing, thrift, incentive, pension or similar plan of the Company or an Additional Issuer, or acquired by such Beneficiary in any open market purchase, (ii) any shares of Class B Common Stock listed on Schedule A as not being held pursuant to and subject to this Agreement, if any, and (iii) shares of capital stock or other equity interest of the Company or an Additional Issuer issued as a stock dividend or pursuant to a stock split in respect of any shares of capital stock or other equity interest of the Company or an Additional Issuer held by such Beneficiary which are not subject to this Agreement. All such stock certificates shall be so endorsed, or accompanied by such instruments of transfer, as to enable the Trustees to cause such certificates to be transferred into the names of the Trustees after the filing of this Agreement as required by law, which the Trustees shall forthwith cause to be done as hereinafter provided. Upon receipt by the Trustees of the certificates for any such shares of stock and the transfer of the same into the names of the Trustees, the Trustees shall hold the same subject to the terms of this Agreement and shall issue and deliver to the depositors of shares of stock hereunder voting trust certificates representing their interests in such stock deposited pursuant to this Agreement. Except as specifically provided in this Agreement, and without limitation of the voting rights of the Trustees including in

connection with any merger or other sale of the Company or any Additional Issuer, the Trustees shall not sell, assign, donate, pledge, encumber, grant any security interest with respect to, hypothecate, or otherwise transfer or dispose of any of the capital stock or other equity interest of the Company or any Additional Issuer held pursuant to this Agreement.

During the term of this Agreement, no shares subject to this voting trust may be withdrawn except in the manner provided below in this Section 1. Any such withdrawal by a registered holder of voting trust certificates shall be effected only by a written amendment to this Agreement in the form of Schedule B attached hereto executed by the requisite number of Trustees then serving as such hereunder then required to take action under Section 10. The Trustee having the Determination Power shall have the right to consent to such amendment and withdrawal in his sole discretion and approval by such Trustee having the Determination Power with respect to such amendment and withdrawal shall be deemed to constitute approval of all Trustees at any time serving. If TIMOTHY P. HORNE is not then serving as a Trustee hereunder, then consent to such amendment and withdrawal shall be by the holders of at least a majority vote of the outstanding voting trust certificates issued in respect of capital stock or other securities of the Company or any Additional Issuer, as the case may be, as to which the proposed withdrawal relates. Upon the surrender by such holder to the Trustees of the voting trust certificate or certificates designated in such amendment, the Trustees are authorized to deliver or cause to be delivered to such holder (i) a certificate or certificates for the shares of the capital stock or other equity interest of the Company or the Additional Issuer so withdrawn, with any appropriate restrictive legends, and (ii) a new voting trust certificate in respect of the remaining shares held hereunder, if any signed in the manner contemplated by the terms of this Agreement. Shares withdrawn from this voting trust, when so withdrawn, shall be free of any restrictions imposed by this Agreement, but shall remain subject to any and all restrictions imposed by other agreements or by law. Nothing in this Section 1 or in any such amendment shall modify, amend, limit or terminate any other restrictions contained in, or be construed as a consent to any transfer of shares subject to this Agreement under, any other agreement or instrument, unless such amendment specifically refers to such other agreement or instrument and satisfies all requirements for amendment or waiver thereof (including execution and delivery by appropriate parties).

The other provisions of this Section 1 notwithstanding, removal of shares from this Voting Trust shall be required if the removal and liquidation of such shares is needed to enable the Estate of a deceased holder of voting trust certificates to pay its federal and/or state death or estate tax, and the other assets of such estate are insufficient to pay such tax.

Any depositor may request that he or she be allowed to withdraw one or more shares of stock from the trust by filing a written request for withdrawal with the Trustee of the Trust. Such written request shall set forth the number of shares that the depositor wishes to withdraw from the trust and shall state the intended purpose for the requested withdrawal of shares from the trust. Any request for withdrawal of shares may be

approved by the Trustee, within the Trustee's absolute discretion, provided that the Trustee in his discretion shall have determined that approval of the request for withdrawal shall not be adverse to the best interests of Watts Industries, Inc. ("Watts") or its successors or the Additional Issuer or its successors, as applicable, and provided that the Trustee shall have determined that a request for withdrawal of any shares of Class B Common Stock of Watts, if approved, shall be in the best interests of the Class B Stockholders of Watts. Shares of Class B Common Stock of Watts so withdrawn for any reason in accordance with these provisions shall be subject to any restrictions imposed upon the said shares of Class B Common Stock of Watts in accordance with any Stock Restriction Agreement entered by or on behalf of such Holder during his or her lifetime.

2. Agreement. Copies of this Agreement and of every agreement supplemental hereto or amendatory hereof shall be provided to the Trustees, the Company, and any Additional Issuer and shall, prior to the issuance of voting trust certificates hereunder, be filed with and maintained in the registered office of the Company in Delaware, in the registered office of any Additional Issuer in its state of incorporation or organization and at such other place as the Trustees shall designate, and shall be open to inspection daily during business hours by any Beneficiary. All voting trust certificates shall be issued, received and held subject to all of the terms of this Agreement. All persons and entities who accept a voting trust certificate issued hereunder shall be bound by the provisions of this Agreement with the same effect as if they were parties to this Agreement.

All certificates for the Company's or any Additional Issuer's capital stock or other equity interest transferred and delivered to the Trustees pursuant hereto shall be surrendered by the Trustees to the Company or such Additional Issuer, as applicable, and canceled and new certificates therefor shall be issued to and held by the Trustees in their own names in their capacities as Trustees hereunder and shall bear a legend indicating that the shares represented by such certificate are subject to this Agreement (which fact shall also be stated in the stock ledger of the Company or the Additional Issuer, as applicable).

3. Voting Trust Certificates. Each voting trust certificate to be issued and delivered by the Trustees in respect of the capital stock or other equity interest of the Company or any Additional Issuer, as hereinbefore provided, shall state the number of shares which it represents, shall be signed by the Trustees then in office, and shall be in substantially the form of Schedule C attached hereto and bear the restrictive legend set forth thereon, it being understood that during any period in which a Trustee has the Determination Power (as hereinafter defined), voting trust certificates issued hereunder may be signed by that Trustee alone and such Trustee's signature shall be deemed for all purposes to constitute the signature and authorization of all Trustees hereunder and to evidence conclusively that the issuance of the related certificate is the act of all Trustees then serving. In connection with the issuance of voting trust certificates in respect of shares of capital stock or other equity interest in an Additional Issuer, the voting trust certificate may include changes to the form of certificate included herewith as Schedule C to reflect such Additional Issuer.

4. Transfer of Certificates; Restrictions. The transfer of any voting trust certificate (including without limitation any sale, assignment, donation, pledge, encumbrance, grant of a security interest, hypothecation or other transfer or disposition) (a) shall be effected only with the written consent of all of the Trustees then serving hereunder (acting together, or, if all such Trustees do not agree, by the Trustee, if any, having the Determination Power with respect to such transfer under Section 10 hereof) and (b) shall be subject to any restrictions, conditions and other provisions to the extent applicable to it or to the stock which it represents, whether imposed by law, specified on the relevant certificate or specified in the Restated Certificate of Incorporation of the Company, as amended (the "Restated Certificate") (provided that any transfer of voting trust certificates without a transfer of the underlying stock held in this voting trust shall in no way affect the voting rights of such underlying stock, consistent with the terms of the Restated Certificate), the Certificate of Incorporation or other organizational documents of the applicable Additional Issuer, as in effect from time to time, this Agreement or any other agreement, including without limitation the Stock Restriction Agreement dated as of August 28, 1986, as the same may have been or may hereafter be amended and/or restated, among parties hereto. Any attempted transfer in violation of such restrictions, conditions and other provisions shall be void ab initio and the Trustees shall not register such transfer or recognize the intended transferee as the holder of the voting trust certificate for any purpose. To the extent permitted by law, voting trust certificates shall not be subject to attachment, garnishment, judicial order, levy, execution or similar process, however instituted, for satisfaction of a judgment or otherwise.

Subject to the foregoing provisions, the voting trust certificates shall be transferable on the books of the Trustees, at such office as the Trustees may designate, by the registered owner thereof, either in person or by attorney duly authorized, upon surrender thereof, according to the rules established for that purpose by the Trustees, and the Trustees may treat the registered holder as the owner thereof for all purposes whatsoever, but they shall not be required to deliver new voting trust certificates hereunder without the surrender of such existing voting trust certificates for cancellation by the Trustees at the time of their issuance of new voting trust certificates.

If a voting trust certificate is lost, stolen, mutilated or destroyed, the Trustees, in their discretion, may issue a duplicate of such certificate upon receipt of (a) evidence of such fact satisfactory to them; (b) indemnity satisfactory to them; (c) the existing certificate, if mutilated; and (d) their reasonable fees and expenses in connection with the issuance of a new trust certificate.

5. Termination Procedure. Upon the termination of the voting trust at any time, as hereinafter provided, the Trustees shall mail written notice of such termination to the registered owners of the outstanding voting trust certificates at the address appearing on the transfer books of the Trustees. From the date specified in any such notice (which date shall be fixed by the Trustees) the voting trust certificates shall cease to have any effect, and the holders of such voting trust certificates shall have no further rights under this voting trust other than to receive certificates for shares of stock of

the Company or any Additional Issuer or other property distributable under the terms hereof upon the surrender of such voting trust certificates.

Within 30 days after the termination of this voting trust, the Trustees shall deliver to the registered holders of all voting trust certificates outstanding as of the date of such termination, stock certificates for the number of shares of such class or classes of the Company's or any Additional Issuer's capital stock or other equity interest represented thereby as to which they shall be entitled upon the surrender for cancellation of such voting trust certificates, properly endorsed or accompanied by properly endorsed instruments of transfer, if appropriate, at the place designated by the Trustees, and after payment, if the Trustees so require, by the persons entitled to receive such stock certificates, of a sum sufficient to cover any stamp tax or governmental charge in respect of the transfer or delivery of such stock certificates. Such certificates or shares shall bear such legend referring to the restrictions on transfer of such shares as may be required by this Agreement, by law or otherwise. Thereupon, all liability of the Trustees for delivery of such certificates of shares shall terminate, and the voting trust certificates representing the beneficial interest in the shares so delivered by the Trustees shall be null and void.

If upon such termination, one or more registered holders of outstanding voting trust certificates shall fail to surrender such voting trust certificates, or the Trustees for any reason shall be unable to comply with the provisions of the preceding paragraph, the Trustees may, at any time subsequent to 30 days after the termination of this Agreement, deposit (x) with the Company stock certificates representing the number of shares of capital stock or other equity interest represented by such voting trust certificates, together with written instructions authorizing the Company to deliver to the applicable registered holder such stock certificates representing stock in the Company in exchange for voting trust certificates representing a like interest in the capital stock of the Company and (y) with each Additional Issuer stock certificates representing the number of shares of capital stock or other equity interest in such Additional Issuer represented by such voting trust certificates, together with written instructions authorizing such Additional Issuer to deliver to the applicable registered holder such stock certificates representing capital stock or other equity interest in such Additional Issuer in exchange for voting trust certificates representing a like interest in the capital stock or other equity interest of such Additional Issuer; and upon such deposit, all further liability of the Trustees for the delivery of such stock certificates and the delivery or payment of dividends upon surrender of the voting trust certificates shall cease, and the Trustees shall not be required to take any further actions hereunder.

Notwithstanding anything herein to the contrary, upon any extension of this voting trust as contemplated by Section 13 hereof, the shares of stock held herein with respect to which this voting trust is being extended shall continue to be held by the Trustees and/or their successor Trustees rather than being transferred to the registered holders of voting trust certificates in respect thereof for recontribution, and in such event no transfer of such shares shall be deemed to have occurred for any purpose.

6. Dividends. If any dividend in respect of the stock deposited with the Trustee is paid, in whole or in part, in stock of the Company or an Additional Issuer having voting powers, the Trustees shall likewise hold, subject to the terms of this Agreement, the stock certificates which are received by them on account of such dividend, and the holder of each outstanding voting trust certificate representing stock on which such dividend has been paid shall be entitled to receive a voting trust certificate issued under this Agreement for the number of shares and class of stock received as such dividend with respect to the shares represented by such voting trust certificate. Holders entitled to receive the voting trust certificates issued in respect of such dividends shall be those registered as such on the transfer books of the Trustees at the close of business on the record date for such dividend.

If any dividend in respect of the stock deposited with the Trustees is paid other than in capital stock or other equity interest having voting powers of the Company or any Additional Issuer, then the Trustees shall promptly distribute the same to the holders of outstanding voting trust certificates registered as such at the close of business on the record date for such distribution. Such distribution shall be made to such holders of voting trust certificates ratably, in accordance with the number of shares represented by their respective voting trust certificates.

In lieu of receiving cash dividends upon the capital stock or other equity interest of the Company or any Additional Issuer deposited with the Trustees and paying the same to the holders of outstanding voting trust certificates pursuant to the preceding paragraph, the Trustees may instruct the Company or the Additional Issuer in writing to pay such dividends directly to the holders of the voting trust certificates specified by the Trustees. Such instructions are deemed given hereby and until receipt of written instructions to the contrary from the Trustees, the Company or the applicable Additional Issuer agrees to pay such dividends directly to the holders of the voting trust certificates. The Trustees may at any time revoke such instructions and by written notice to the Company or the applicable Additional Issuer direct it to make dividend payments to the Trustees. Neither the Company nor any Additional Issuer shall be liable to any holder of a voting trust certificate or any person claiming to be entitled to any such dividends by reason of adhering to any written instructions of the Trustees.

7. Subscription Rights. If any stock or other equity interest of the Company or any Additional Issuer are offered for subscription to all of the holders of any class of the Company's or such Additional Issuer's capital stock or other equity interest deposited hereunder, the Trustees promptly, upon receipt of notice of such offer, shall mail a copy thereof to each registered holder of the outstanding voting trust certificates representing such class of capital stock or other equity interest. Upon receipt by the Trustees, at least five days prior to the last day fixed by the Company or such Additional Issuer, as applicable, for subscription and payment, of a request for any such registered holder of voting trust certificates to subscribe for such shares on behalf of such registered holder, accompanied by the sum of money required to pay for such stock or other equity interest, the Trustees shall make such subscription and payment, and upon receipt from the Company or such Additional Issuer, as applicable of the certificates for shares or



other equity interest so subscribed for, shall issue to such registered holder a voting trust certificate representing such shares if the same be stock of the Company or such Additional Issuer, as applicable, having voting powers, but if the same be shares or securities other than stock having voting powers, the Trustees shall mail or deliver such securities to the voting trust certificate holder in whose behalf the subscription was made, or may instruct the Company or such Additional Issuer, as applicable to make delivery directly to the voting trust certificate holder entitled thereto.

8. Dissolution of the Company. In the event of the dissolution or total or partial liquidation of the Company or an Additional Issuer (other than in the event of a transaction described in Section 9 below), whether voluntary or involuntary, the Trustees shall receive the moneys, securities, rights or property to which the holders of outstanding shares of the Company's or such Additional Issuer's capital stock or other equity interest, as applicable, deposited hereunder are entitled, and shall distribute the same among the registered holders of voting trust certificates in proportion to their interests, as shown by the transfer books of the Trustees, or the Trustees may in their discretion deposit such moneys, securities, rights or property with any bank or trust company with authority and instructions to distribute the same as above provided, and upon such deposit, all further obligations or liabilities of the Trustee in respect of such moneys, securities, rights or property so deposited shall cease.

9. Reorganization or Sale of the Company. In the event that there occurs (i) any merger or consolidation transaction involving the Company or an Additional Issuer and one or more other entities, or a transaction in which all or substantially all of the assets of the Company or an Additional Issuer are transferred to another entity or (ii) a transaction in which stockholders of the Company or an Additional Issuer transfer or exchange shares held by them wholly or partially for capital stock or other equity interest of another entity having voting powers, and in any such transaction securities of such entity having voting powers are received by the Trustees in respect of the shares subject to this voting trust, it being understood that in connection with any such transaction or otherwise all voting powers in respect of shares subject to this voting trust shall be exercised by the Trustees in accordance with the terms hereof and that shares may be removed from this voting trust only in accordance with Section 1, thus giving the Trustees all power and authority to vote all shares subject hereto in connection with any such transaction, then (x) in connection with any such transaction involving the Company the term "Company" for all purposes of this Agreement shall include the successor entity to the Company, (y) in connection with any such transaction involving an Additional Issuer the term "Additional Issuer" for all purposes of this Agreement shall include the successor entity to such Additional Issuer and (z) the Trustees shall receive and hold under this Agreement any such capital stock or other equity interest of such successor entity received on account of the ownership, as Trustees hereunder, of the stock held hereunder immediately prior to such transaction. Voting trust certificates issued and outstanding under this Agreement at the time of such transaction may remain outstanding or the Trustees may, in their discretion, substitute for such voting trust certificates new voting trust certificates in appropriate form and with appropriate modifications to reflect the number of shares of other securities then held, and the terms, "stock" and "capital

stock" as used herein shall be taken to include any securities, including any other type of equity interest, which may be received by the Trustees in lieu of all or any part of the capital stock or other securities of the Company or an Additional Issuer, as applicable.

In the event that there occurs any transaction described in the preceding paragraph and in connection therewith the Trustees receive assets other than capital stock or other equity interest having voting powers, the Trustees shall distribute such assets to the registered holders of the outstanding voting trust certificates hereunder pro rata on the basis of their respective interests in the shares held hereunder and, if such consideration shall consist wholly of such assets, this Agreement shall thereafter terminate.

10. Rights, Powers and Duties of Trustees. Until the actual delivery to the holders of voting trust certificates issued hereunder of stock certificates in exchange therefor, and until the surrender of such voting trust certificates for cancellation, in each case in accordance with the terms of this Agreement, title to all of the Company's and each Additional Issuer's stock deposited hereunder shall be vested in the Trustees, who shall be deemed the holders of record of such shares for all purposes, and the Trustees shall have the sole and exclusive right, acting as hereinafter provided and subject to such limitations as are set forth herein, to exercise, in person or by their nominees or proxies, all of the rights and powers in respect of all stock deposited hereunder, including the right to vote such stock and to take part in or consent to any corporate or stockholders' action of any kind whatsoever, whether ordinary or extraordinary, subject to the provisions hereinafter set forth. The right to vote shall include the right to vote in connection with the election of directors and other resolution or proposed action of any character whatsoever which may be presented at any meeting or require the consent of stockholders of the Company or any Additional Issuer. It is expressly understood and agreed that the holders of voting trust certificates in their capacities as such shall not have any right, either under said voting trust certificates or under this Agreement, or under any agreement or doctrine or concept of law, express or implied, or otherwise, with respect to any shares held by the Trustees hereunder to vote such shares or to take part in or consent to any corporate action, or to do or perform any other act or thing which the holders of the Company's or any Additional Issuer's common stock of any class are now or may hereafter become entitled to do or perform.

No Trustee shall incur any responsibility in his capacity as trustee, individually or otherwise, in voting the shares held hereunder or in any matter or act committed or omitted to be done under or in connection with this Agreement, or for any vote or act committed or omitted to be done by any predecessor or successor Trustee, except for such Trustee's willful malfeasance.

The Trustees shall at all times keep, or cause to be kept, complete and accurate records of all stock deposited with them hereunder, the identity, addresses and ownership of the Depositors and Beneficiaries, and all voting trust certificates issued by the Trustee. Such records shall be open to inspection by any Depositor or Beneficiary under this Agreement on reasonable notice given to the Trustees at their usual place of business during their normal business hours.

Whenever action is required of the Trustees, such action may be taken by written consent signed by the requisite number of Trustees or by vote of the requisite number of Trustees at a meeting of the Trustees. So long as there are two (2) or more Trustees hereunder, the concurrence of both (if there are two

(2) Trustees) or a majority (if there are more than two (2) Trustees) of the Trustees then serving shall be necessary and sufficient for the validity of any action taken by the Trustees, and if at any time there is one Trustee hereunder (subject to Section 11) such Trustee's action shall be necessary and sufficient for the validity of any action taken by the Trustees. Notwithstanding the foregoing, if at any time TIMOTHY P. HORNE and or any other person shall serve as co-Trustees hereunder, and if for any reason the Trustees shall fail to concur with respect to any action proposed to be taken by the Trustees under or pursuant to this Agreement (including without limitation any voting decision, any amendment in connection with the withdrawal of shares as contemplated by

Section 1, any other trust amendment or trust termination), then TIMOTHY P. HORNE, for so long as he is serving as a Trustee hereunder, shall have the power (such power being herein called the "Determination Power") to determine in his sole discretion, whether or not such proposed action is to be taken and upon his approval such action when and if taken shall have the same force and effect as if both or all of the Trustees had agreed with respect thereto. Any and all documents or instruments executed by or on behalf of the Trustees hereunder (including without limitation voting trusting certificates) may be executed by Timothy P. Horne alone and his signature shall evidence conclusively the authorization and all of the Trustees hereunder.

In the event that TIMOTHY P. HORNE shall cease to serve as a Trustee hereunder, then no Trustee hereunder shall have the Determination Power, except in accordance with a duly-published amendment to this Agreement adopted in accordance with the terms hereof, provided, however, that the foregoing shall not be deemed to limit the authority of any person serving as a sole Trustee under and in accordance with this Agreement.

11. Remaining Trustees; Successor Trustees, Successors' Determination Power. At least one (1) individual shall serve as a Trustee hereunder during any period in which TIMOTHY P. HORNE serves as a Trustee hereunder. The said TIMOTHY P. HORNE shall have full discretionary authority to serve as the sole Trustee until such time as he shall determine that he is unwilling or unable to so serve and shall have resigned by written instrument, or until his death or permanent incapacity or disability. During any period following TIMOTHY P. HORNE's service as a Trustee hereunder (subject to the further provisions of this Section 11 as set forth in the second paragraph hereof), there shall be at least two (2) Trustees hereunder. Notwithstanding the preceding two sentences or any other provisions of this Agreement or otherwise to the contrary, if at any time no Trustee shall be serving hereunder for any reason (as a result, for example, of the deaths of the Trustees), then this Agreement and the voting trust created hereby shall nevertheless remain in existence and in full force and effect until a new Trustee shall be appointed in accordance with this Section 11. All Trustees hereunder shall be individuals. Trustees shall in no event be subject to removal for any reason and any Trustee hereunder shall serve until his or her resignation, death,

permanent disability or incapacity (as hereinafter defined). Any Trustee hereunder may resign by a signed instrument delivered to the remaining Trustee or Trustees, if any, or otherwise to the registered holders of the outstanding voting trust certificates.

The following provisions shall govern the succession of Trustees hereunder. In the event TIMOTHY P. HORNE shall cease to serve as a Trustee hereunder, then Attorney WALTER J. FLOWERS, Attorney DAVID F. DIETZ and DANIEL J. MURPHY, III shall thereupon become Co-Trustees hereunder if they are then living and willing and able to serve as such. In the event that any of WALTER J. FLOWERS, DAVID F. DIETZ or DANIEL J. MURPHY, III shall be unwilling or unable to serve as a Co-Trustee, then a Primary Designee or a Secondary Designee (as defined hereinbelow) shall be appointed to serve in the stead of any such named Co-Trustee who shall be unwilling or unable to serve in that capacity. In the event that any of WALTER J. FLOWERS, DAVID F. DIETZ or DANIEL J. MURPHY, III or any Primary Designee or Secondary Designee is unable or unwilling or shall otherwise fail to serve as a Trustee hereunder at the time he would otherwise become such, or after becoming a Co-Trustee shall cease to serve as such for any reason, then there shall continue to be two (2) trustees hereunder, and a person or the persons indicated below (if available) shall become a Co-Trustee or Co-Trustees in accordance with the following line of succession in order that there will ultimately be three (3) Co-Trustees to serve in such office in accordance with the terms of this Trust:

- (1) First, any individual designated as the "Primary Designee" in accordance with the following paragraph of this Section 11;
- (2) Next, any individual designated as the "Secondary Designee" in accordance with the following paragraph of this Section 11; and
- (3) Then, one (1) or two (2) individuals (as applicable) appointed by the holders of a majority in interest of the voting trust certificates issued in respect of capital stock of the Company then outstanding

such that in the event the individual or individuals contemplated to serve as a Trustee or Trustee(s) hereunder for any reason fail or are unable to serve as such at the time they would otherwise be a Trustee or Trustees hereunder or thereafter cease to serve as such for any reason, or if no designation of a Primary Designee and/or a Secondary Designee shall be in effect, then the next available individual in the line of succession shall become a Trustee hereunder, provided, however, that if for any reason there shall ever be a single Trustee hereunder during any period following Timothy P. Horne's service as a Trustee hereunder, then such sole Trustee shall be authorized to take all actions on behalf of the Trustee until such time as another Trustee shall be appointed, provided that the party or parties authorized to designate a successor or successors shall endeavor to do so promptly. In the event of any disagreement between the Co-Trustees with regard to any issue involving the Trust, the majority vote of the Trustees then in office shall be determinative of any issue which shall be considered by the Trustees.

At any time TIMOTHY P. HORNE, if then living and not then subject to any incapacity (as hereinafter defined) may by written instrument signed and filed with the registered office of the Company in Delaware and with the registered office of each Additional Issuer in its state of incorporation or organization, designate (i) an individual to serve as Primary Designee in the line of succession contemplated by this Section 11 (the "Primary Designee"), and (ii) if he so elects, an additional individual to succeed, or to serve in lieu of or with the Primary Designee as a trustee hereunder (the "Secondary Designee") as also contemplated by this Section 11. Any such designation shall also be revocable by a written instrument signed by TIMOTHY P. HORNE if then living and not then subject to any incapacity (as hereinafter defined), and filed with the registered office of the Company in Delaware and with the registered office of each Additional Issuer in its state of incorporation or organization at any time prior to the time at which a designated successor becomes a Trustee hereunder. It is understood that the provisions of this Section 11 are intended to permit the designation of up to two individuals to become Trustees in accordance with the line of succession as Trustees hereunder, and while designations of particular individuals may be revoked and a new individual designated in his or her place (such as in the case of a designee's death, for example), no more than two individuals may become Trustees hereunder pursuant to a designation as a Primary or Secondary Designee absent an amendment to this Agreement, it being understood that in event a Secondary Designee becomes a Trustee hereunder because a Primary Designee shall have failed to serve as a Trustee hereunder, then the individual who becomes a Trustee hereunder shall be deemed the Primary Designee and the individuals so empowered in this paragraph may thereafter name a new Secondary Designee in accordance with the terms hereof. In the event that TIMOTHY P. HORNE dies or becomes subject to any incapacity (as hereinafter defined), the power designated in this paragraph shall become personal to and may be exercised only by the individuals named in this paragraph in accordance with the terms hereof. The provisions of this paragraph are intended to be permissive and shall authorize, but not require, the appointment of a Primary or Secondary Designee.

In the event of the permanent disability or incapacity of a Trustee, he shall cease to serve in that capacity as provided in this paragraph. For purposes of this Agreement, "permanent disability" shall mean any physical or mental disability or incapacitation that precludes a Trustee from performing his responsibilities under this Agreement and which is not capable of cure or correction, and "incapacity" shall mean any mental state by reason of which the individual in question would not be deemed competent under the law of his state of principal residence. If permanent disability or incapacity is claimed with respect to a Trustee or other person, said permanent disability or incapacity shall be evidenced by a written certification (a "Certification") signed by two doctors attending such Trustee or other person, which doctors shall be licensed to practice medicine in the state of the relevant person's principal residence, and , in the case of a Trustee, such Trustee shall cease to serve in such capacity upon receipt by a co-Trustee, successor Trustee or the registered holders of the voting trust certificates then outstanding, as the case may be, of a Certification. Absent a Certification, the individual in question shall be presumed to be not subject to any permanent disability or incapacity and he shall be recognized as a duly-appointed Trustee of this Trust.

The rights, powers and privileges of each of the Trustees named hereunder shall be possessed by any successor Trustee with the same effect as though such successor had originally been a party to this Agreement; provided, however, that no Trustee or successor Trustee hereunder shall possess the Determination Power referred to in Section 10 unless it is specifically conferred upon such Trustee pursuant to the provisions hereof.

In any other circumstance, no Trustee hereunder other than TIMOTHY P. HORNE shall have the Determination Power. In the event that there shall be more than one Trustee serving at any time, and in the event that the Trustees shall not concur on matters not specifically contemplated by the terms of this Agreement, the Trustees shall consider such matter and they shall vote among them to determine the disposition of the issue among them, (bearing in mind the relative interests of the Shareholders, the Company, and the Depositors into this Trust). The majority vote of the Trustees shall be determinative and shall resolve the matter after giving due consideration to the purposes of this Trust.

Each Trustee shall affix his signatures to this Agreement and each successor Trustee appointed pursuant to this Section 11 shall accept appointment or election hereunder by affixing his signature to this Agreement at the time he becomes a Trustee hereunder. By affixing their signatures to this Agreement, the Trustees and each successor Trustee agree to be bound by the terms hereof.

Reference in this Agreement to "Trustees" means the Trustee or Trustees at the time acting in that capacity, whether an original Trustee or any additional or successor Trustee, as the context requires.

12. Compensation and Reimbursement of Trustees. Each Trustee shall serve without compensation. The Trustees shall have the right to incur and to pay such reasonable expenses and charges and to employ and pay such agents, attorneys and counsel as they may deem necessary and proper. Any such expenses or charges incurred by and due to the Trustees may be deducted from the dividends, proceeds or other moneys or property received by the Trustees in respect of the stock deposited hereunder or may be payable by the Company or any Additional Issuer in their discretion. Nothing herein contained shall disqualify any Trustee or any successor Trustee, including without limitation any person named as a Primary or Secondary Designee, or any firm in which he is interested, from serving the Company, any Additional Issuer or any of their respective subsidiaries as an officer or director or in any other capacity (including without limitation as legal counsel, financial adviser or lender), holding any class of stock in the Company or any Additional Issuer, becoming a creditor of the Company or any Additional Issuer or otherwise dealing with it in good faith, depositing his stock in trust pursuant to this Agreement, voting for himself as a director of the Company or any Additional Issuer in any election thereof, or taking any other action as a Trustee hereunder in connection with any matter in which such Trustee has any direct or indirect interest. The provisions of the foregoing notwithstanding, each Trustee shall be entitled to be fully indemnified by the assets of the voting trust and the holders of outstanding voting trust certificates, pro rata in accordance with their interests at the time of the relevant payment, against all costs,

charges, expenses, loss, liability and damage (except for damage caused by his own willful malfeasance) incurred by him in the administration of this trust or in the exercise of any power conferred upon the Trustees by this Agreement.

13. Amendment, Termination. This Agreement may be amended by a written amendment signed by the number of Trustees authorized to take action at the relevant time under Section 10, or, if the Trustees (if more than one) do not concur with respect to any proposed amendment at any time when any Trustee holds the Determination Power, then by the Trustee having the Determination Power, which approval shall constitute approval of all of the Trustees then serving and, except as contemplated by Section 1, by registered holders of at least a majority vote of the outstanding voting trust certificates issued in respect of capital stock or other equity interest of the Company or any Additional Issuer, as the case may be, as to which the matter relates; provided, however, that no such amendment shall modify or amend the provisions of the following two paragraphs without the written consent of each individual Depositor or the Trustee of each Trust Depositor who is living at the time of such proposed amendment. For all purposes of this Agreement, references to percentages of voting trust certificates outstanding shall refer to, (x) in the case of a matter relating to the Company, the number of votes represented by the shares of stock of the Company represented by voting trust certificates issued in respect of shares of stock of the Company and, (y) in the case of a matter relating to an Additional Issuer, the number of votes represented by the shares of stock of the applicable Additional Issuer represented by voting trust certificates issued in respect of the capital stock or other equity interest of such Additional Issuer.

This Agreement may be terminated only by a written instrument signed by the number of Trustees authorized to take action at the relevant time under

Section 1 or, if the Trustees (if more than one) do not concur with respect to any proposed termination at any time when any Trustee holds the Determination Power, then by the Trustee having the Determination Power, which approval shall constitute approval of all of the Trustees, the registered holders of a majority of the voting trust certificates issued in respect of the capital stock of the Company then outstanding and each individual Depositor or the Trustee of each Trust Depositor who is living at the time of the proposed termination.

If not previously terminated in accordance with the terms hereof

(including under the circumstances contemplated by the provisions of Section 9)

this Agreement shall terminate on August 26, 2021; provided, however, that at any time within two (2) years prior to such date (or prior to any subsequent date of termination fixed in accordance with the provisions hereof and of applicable law), one or more of the persons designated in the following provisions of this Section 13 may, by written agreement, extend the duration of this Agreement for an additional term not exceeding twenty-four (24) years from the expiration date as originally fixed or as last extended. The foregoing right of extension shall be exercisable in respect of particular shares subject hereto by (i) the individual Depositor who originally deposited the relevant shares, if the Depositor is then living and is not subject to any incapacity at the time of the proposed extension, and if so exercised such extension shall be binding upon any and all holders of voting trust certificates in respect of the shares deposited hereunder by such individual Depositor, (ii) the trustee of

any trust Depositor which deposited the relevant shares, including without limitation any trust Depositor which is a revocable trust, which trustee is then living and not subject to any incapacity at the time of the proposed extension, and regardless of whether such trust is then still in existence, and if so exercised shall be binding upon any and all holders of voting trust certificates in respect of shares deposited hereunder by such trust Depositor and any and all beneficiaries thereof or successors in interest thereto, and (iii) the holder of any voting trust certificate representing shares not covered by either of the preceding clauses (i) or (ii), and if so exercised shall be effective with respect to all shares represented by such voting trust certificate, it being understood that the provisions only of clauses (i) or (ii) of this paragraph and not of clause (iii) shall govern any extension with respect to shares referred to therein if and to the extent a Depositor referred to therein is available to consent to such extension. Any such action to extend this Agreement shall be binding upon the Trustees and Depositor and upon all holders of the related voting trust certificates (including without limitation trustees, officers, beneficiaries and owners of any trust or other entity which is such a holder thereof) and any and all successors in interest of any of the foregoing (including without limitation any holder of voting trust certificates representing shares deposited by any Depositor consenting or on whose behalf consent is given by the relevant trustee to such extension in the manner provided above, and any Beneficiary or successor of a Beneficiary of any trust Depositor. Extensions in accordance with this Section 13 (i) shall not be deemed to constitute the commencement of a new voting trust for purposes of the DGCL or the law governing the incorporation or organization of any Additional Issuer, (ii) shall be filed with the registered offices of the Company in Delaware and with the registered offices of each Additional Issuer in its state of incorporation or organization, as provided by law, and (iii) shall not involve or require any transfer of shares as contemplated by the last provisions of Section 5.

14. Notices, Distributions. Unless otherwise specifically provided in this Agreement, any notice to or communication with any holder of any voting trust certificate or other party hereunder shall be deemed to be sufficiently given or made if mailed, postage prepaid, to such holder at his or her address appearing on the books of the trust, which shall in all cases be deemed to be the address of such holder for all purposes under this Agreement, without regard to what other or different addresses of which the Trustees may have notice. Every notice so given shall be effective, whether or not received, and the date of mailing shall be the date such notice is deemed given for all purposes.

Any notice to any Trustee hereunder shall be sufficient if mailed, postage prepaid, by certified or registered mail to him, with a copy sent to the Company at Watts Industries, Inc., Route 114 and Chestnut Street, North Andover, Massachusetts 01845.

Subject to Section 6 hereof, all distributions of cash, securities, or other property hereunder by the Trustees to the holders of voting trust certificates may be made, in the discretion of the Trustees, by mail (regular, registered or certified mail, as the Trustees may deem advisable), in the same manner as hereinabove provided for the giving of notices to the holders of voting trust certificates.



15. Construction. This Agreement is to be construed as a Delaware contract, is to take effect as a sealed instrument, and is binding upon and inures to the benefit of the parties hereto and their heirs, executors, administrators, representatives, successors and permitted assigns. In case any one or more of the provisions or parts of a provisions contained in this Agreement or in any voting trust certificate hereunder shall for any reason be held to be invalid, illegal or unenforceable in any respect, such invalidity, illegality or unenforceability shall not affect any other provision or part of a provision hereof or thereof, but this Agreement and such voting trust certificates shall be construed as if such invalid or illegal or unenforceable provision or part of a provision had never been contained herein, and the parties will use their best efforts to substitute a valid, legal and enforceable provision which, insofar as practicable, implements the purposes and intents thereof.

16. Gender. Words used in this Agreement, regardless of the number and gender specifically used, shall be deemed and construed to include any other number, singular or plural (and all references to the `Trustees' shall refer to the Trustee then serving if only one Trustee is then serving), and any other gender, masculine, feminine, or neuter, as the context requires.

17. Execution. This Agreement may be executed in any number of counterparts, each of which, when executed, shall be deemed to be an original and all of which together shall constitute but one and the same instrument. Any Additional Issuer shall become a party to this Agreement by executing a counterpart signature page hereto and shall file a copy of this Agreement with the Secretary of State or other appropriate office of its state of incorporation or organization.

IN WITNESS WHEREOF, the parties hereof have executed this Agreement under seal, all as of this day and year first above written.

**Timothy P. Horne, as Trustee**

Timothy P. Horne, individually

Timothy P. Horne, as Trustee of the  
George B. Horne Trust--1982

Timothy P. Horne, as Trustee of the  
Deborah Horne Trust--1976

Timothy P. Horne, as Trustee of the  
Daniel W. Horne Trust--1980

Timothy P. Horne, as Trustee of the  
Grandchildren's Trust f/b/o  
Tara V. Horne

Timothy P. Horne, as Trustee of the  
Grandchildren's Trust f/b/o  
Tiffany R. Horne

## SCHEDULE A

Depositor (if any)	No. of Shares Subject to Trust	No. of Shares Not Subject to Trust
Timothy P. Horne as Trustee of The George B. Horne Trust - 1982 as Currently Published	2,124,600	
Timothy P. Horne	2,751,220	
Timothy P. Horne as Trustee of the Daniel W. Horne Trust - 1980	1,335,840	
Timothy P. Horne as Trustee of the Deborah Horne Trust - 1980	1,335,840	
Tara V. Horne	40,000	
Timothy P. Horne as Trustee of The George B. Horne Grandchildren's Trust - 1995 f/b/o Tara V. Horne	30,200	
Timothy P. Horne as Trustee of The George B. Horne Grandchildren's Trust - 1995 f/b/o Tiffany Horne	22,600	
Judith Rae Horne as Trustee of The Tiffany Horne Trust - 1984	163,520	
Judith Rae Horne as Custodian for Tiffany Horne	44,220	

## **SCHEDULE B**

### **AMENDMENT TO VOTING TRUST AGREEMENT**

WHEREAS, [\_\_\_\_\_] and [\_\_\_\_\_] ] are Trustees under a Voting Trust Agreement dated as of August 1997, such Voting Trust Agreement, being referred to herein as the "Agreement"); and

WHEREAS, [\_\_\_\_\_] desires to withdraw [\_\_\_\_\_] (\_\_\_\_\_) [shares of Class B Common Stock of Watts Industries, Inc., a Delaware corporation/shares of common stock of [Additional Issuer] (the "Company")]

WHEREAS, the Trustees and the holders of not less than a majority in interest of the voting trust certificates issued in respect of the capital stock or other equity interest of the Company outstanding hereunder desire to consent and agree to the above-described transactions.

NOW, THEREFORE, the parties hereto do hereby agree as follows: The parties hereto do hereby consent to the withdrawal of such shares and to amend Schedule A to the Agreement by amending and restating Schedule A in its entirety to read as follows:

## SCHEDULE A

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Class B Stock Name Number of Shares Certificate No.

---

**Name of Registered Holder**

---

**Name of Registered Holder**

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2. Except as hereinabove provided, the parties ratify and confirm the Agreement in all respects.

The parties hereto have executed this Amendment to the Agreement in one or more counterparts under seal as of the \_\_\_\_ day of \_\_\_\_\_, 19\_\_.

[Signatures to be added per the terms of the Agreement]

## **SCHEDULE C**

### **FORM OF VOTING TRUST CERTIFICATE**

This Voting Trust Certificate has not been registered under the Securities Act of 1933, as amended, and may not be sold or otherwise transferred unless (a) covered by an effective registration statement under the Securities Act of 1933, as amended, or (b) the trustees and the Company have been furnished with an opinion of counsel satisfactory to them to the effect that no registration is legally required for such transfer.

This Voting Trust Certificate has been issued under, and is subject to, a certain Voting Trust Agreement, dated as of August 26, 1997, by and among the Company and Timothy P. Horne as Trustee, and certain other persons, (as identified on Schedule A of said Agreement as amended), a copy of which will be furnished by the Company to the holder of this Voting Trust Certificate upon written request and without charge, and this Voting Trust Certificate can only be transferred subject to, and in accordance with, such Agreement.

This Voting Trust Certificate is subject to restrictions on transfer contained in the Company's Restated Certificate of Incorporation, as amended, a copy of which restrictions will be provided to the holder of this Voting Trust Certificate upon request and without charge.

The shares represented by this Voting Trust Certificate are subject to restrictions on transfer pursuant to a Stock Restriction Agreement, a copy of which will be furnished by the Company to the holder of this Voting Trust Certificate upon written request and without charge.

No. Shares:

This certificate that the undersigned trustee has received a certificate or certificates in the name of evidencing ownership of shares of the [Class B Common Stock of Watts Industries, Inc., a Delaware corporation (the "Company"),/Additional Issuer] and that said shares are held subject to all of the terms and conditions of a certain Voting Trust Agreement dated as of the day of August, 1997 (the "Agreement"), and are entitled to all of the benefits set forth in the Agreement. Copies of the Agreement and of every amendment and supplement thereto are on file at the office of the Company and shall be available for the inspection of every Beneficiary thereof or party thereto during normal business hours. The holder of this Certificate, which is issued, received and held under the Agreement, by acceptance hereof, assents to and is bound by the Agreement with the same effect as if the Agreement has been signed by him in person.

The shares of stock represented by this Certificate bear the legend:

"These shares are subject to a certain Voting Trust Agreement, dated as of August 26, 1997, by and among the Company and Timothy P. Horne as trustee, and certain other persons, [as amended] a copy of which will be furnished by the Company to the holder of this Certificate upon written request and without charge, and these shares can only be transferred subject to, and in accordance with, such Agreement."

Subject to the provisions of the foregoing and the Agreement, this Certificate is transferable only on the books of the Trustees by the registered holder in person or his duly authorized attorney, and the holder hereof, by accepting this certificate, manifests his consent that the trustees may treat the registered holder hereof as the true owner for all purposes, except the delivery of stock certificates, which delivery shall not be made without the surrender of this certificate or otherwise pursuant to the Agreement.

IN WITNESS WHEREOF, \_\_\_\_\_ [and \_\_\_\_\_], trustee,  
[have] [has] executed this certificate as of this \_\_\_\_ day of \_\_\_\_\_, 19\_\_.

**, as Trustee**

**AMENDMENT NUMBER FIVE**

**WATTS INDUSTRIES, INC.**

**RETIREMENT PLAN FOR SALARIED EMPLOYEES**

WHEREAS, Watts Industries, Inc. (the "Sponsoring Employer") established the Watts Industries, Inc. Retirement Plan For Salaried Employees (the "Plan") for the benefit of its eligible Employer which was most recently restated effective as of January 1, 1994;

WHEREAS, pursuant to Section 13.01 of the Plan, the Sponsoring Employer reserved the right to amend the Plan; and

WHEREAS, the Sponsoring Employer desires to amend the Plan to clarify and reflect certain administrative matters and to reflect certain legislative changes.

NOW, THEREFORE, the Plan is hereby amended as follows:

1. Effective January 1, 1998, Sections 1.02(d) and (e) are revised to make certain clarifying changes as follows:

"(d) For purposes of Section 8.05, the Actuarial Equivalent will be determined as follows:

(i) for annuity starting dates commencing prior to October 1, 1995, by using the rates and mortality table described in (c) above, except that the interest rate for immediate annuities set by the Pension Benefit Guaranty Corporation for the month of payment will be used; and

(ii) for annuity starting dates commencing on or after October 1, 1995 and ending on or before December 31, 1995 by using mortality rates based on a fixed blend of 50% of the male mortality rates and 50% of the female mortality rates from the 1983 Group Annuity Mortality Table and by using an interest rate specified in (A) or (B), whichever results in a greater benefit:

(A) the interest rate on 30-year Treasury Constant Maturities for the month of November, 1994 or

(B) the interest rate on 30-year Treasury Constant Maturities for the month which is two months prior to the month in which the Participant's annuity starting date occurs;



(iii) for annuity starting dates commencing on or after January 1, 1996 and ending on or before September 30, 1996, by using mortality rates based on a fixed blend of 50% of the male mortality rates and 50% of the female mortality rates from the 1983 Group Annuity Mortality Table and by using an interest rate specified in (C) or (D) whichever results in a greater benefit:

(C) the interest rate on 30-year Treasury Constant Maturities for the month of November, 1995 or

(D) the interest rate on 30-year Treasury Constant Maturities for the month in which the Participant's annuity starting date occurs;

(iv) for annuity starting dates commencing on or after October 1, 1996 by using mortality rates based on a fixed blend of 50% of the male mortality rates and 50% of the female mortality rates from the 1983 Group Annuity Mortality Table and by using the interest rate on 30-year Treasury Constant Maturities for the month of November prior to the Plan Year in which the annuity starting date occurs.

(e) For purposes of Section 12.01 (except as provided in (g) below), the Actuarial Equivalent will be determined as follows:

(i) for annuity starting dates commencing prior to October 1, 1995, by using the interest rate and mortality table described in (c) above, except for lump sum payments the interest rate for immediate annuities set by the Pension Benefit Guaranty Corporation for the month of payment will be used;

(ii) for annuity starting dates commencing on or after October 1, 1995 and ending on or before December 31, 1995 by using mortality rates based on a fixed blend of 50% of the male mortality and 50% of the female mortality rates from the 1983 Group Annuity Mortality Table and by using an interest rate specified in (A) or (B), whichever results in a greater benefit:

(A) the interest rate on 30-year Treasury Constant Maturities for the month of November, 1994 or

(B) the interest rate on 30-year Treasury Constant Maturities for the month which is two months prior to the month in which the Participant's annuity starting date occurs;

(iii) for annuity starting dates commencing on or after January 1, 1996 and ending on or before September 30, 1996, by using mortality rates based on a fixed blend of 50% of the male mortality rates and 50% of the female

mortality rates from the 1983 Group Annuity Mortality Table and by using an interest rate specified in (C) or (D) whichever results in a greater benefit:

(C) the interest rate on 30-year Treasury Constant Maturities for the month of November, 1995 or

(D) the interest rate on 30-year Treasury Constant Maturities for the month in which the Participant's annuity starting date occurs;

(iv) for annuity starting dates commencing on or after October 1, 1996 by using mortality rates based on a fixed blend of 50% of the male mortality rates and 50% of the female mortality rates from the 1983 Group Annuity Mortality Table and by using the interest rate on 30-year Treasury Constant Maturities for the month of November prior to the Plan Year in which the annuity starting date occurs."

2. Effective January 1, 1998, Section 1.02 is amended to rename "subsection (f)" as subsection (g) and to add a new subsection (f) as follows:

"(f) For purposes of subsections (d) and (e) above, the term annuity starting date means the date as of which an amount is paid, except with respect to payments under Section 12.01, in which case, it means the first day of the month following the month in which the Participant terminates employment."

3. Effective January 1, 1997, Section 1.09 is amended to delete the fourth paragraph in its entirety.

4. Effective January 1, 1997, Section 1.20 of is amended to read as follows:

"1.20 "Highly Compensated Employee" means any Employee who performed services for the Employer or an Affiliated Employer during the Determination Year and who:

(a) was a 5% owner (within the meaning of Section 416(i)(1)(B)(i) of the Code at any time during the Determination Year or the Look-Back Year; or

(b) received compensation from the Employer or an Affiliated Employer in excess of \$80,000 (as adjusted pursuant to 415(d) of the Code) during the Look-Back Year, and was among the top 20% of Employees when ranked on the basis of compensation paid during the Look-Back Year.

For purpose of determining an Employee's compensation under this Section 1.20, compensation shall mean the Employee's total compensation reportable on Form W-2,

plus all contributions made on behalf of the Employee by the Employer or an Affiliated Employer pursuant to a salary deferral agreement maintained by the Employer or an Affiliated Employer under any cash or deferred arrangement described in Section 401(k) of the Code or any salary reduction agreement pursuant to a cafeteria plan established under Section 125 of the Code by the Employer or Affiliated Employer.

For purposes of this Section, the "Look-Back Year" means the period of the twelve consecutive months immediately preceding the Determination Year. Also for purposes of this Section, "Determination Year" means the Plan Year that is being tested for purposes of determining if an Employee is a Highly Compensated Employee."

5. Effective January 1, 1998, Section 1.22 is amended to read as follows:

"1.22 "Maximum Offset Allowance" means at Social Security Retirement Age, (i), (ii), or (iii) below, whichever is applicable, (i) if a Participant's Social Security Retirement Age is 65, .0075 of his Social Security Compensation; (ii) if a Participant's Social Security Retirement Age is 66, .0068 of his Social Security Compensation; or (iii) if a Participant's Social Security Retirement Age is 67 or higher, .00625 of his Social Security Compensation, multiplied by his years of Benefit Service (up to a maximum of 25 years)."

Notwithstanding the foregoing, the Maximum Offset Allowance shall not exceed 1/2 of the benefit determined without regard to the offset, based on the lesser of Social Security Compensation or Final Average Compensation."

6. Effective as of January 1, 1998, Section 2.02 is amended to read as follows:

#### **"2.02 CREDITING OF SERVICE ON OR AFTER JANUARY 1, 1985**

An Employee must accumulate at least 1,000 Hours of Service during a 12-month computation period in order to be credited with a year of Service. The 12-month computation period for purposes of determining a year of Service for vesting under Section 6.02 is the Plan Year. The 12-month computation period for purposes of determining a Year of service for eligibility under Section 3.01 is the 12-month period beginning when the Employee first performs an Hour of Service and the subsequent computation periods shall be the Plan Year beginning with the Plan Year that includes the first anniversary of the date the Participant first performs an Hour of Service. The 12-month computation period for purposes of determining a year of Service for Benefit Service purposes as set forth in Section 2.05 is the Plan Year. During any computation period during which an Employee's Hours of Service cannot be determined, the Employee shall be credited with 190 Hours of Service for each month during such period in which he or she completes one Hour of Service."

7. Effective as of January 1, 1998, Section 2.022 is deleted and Section 2.023 is renumbered as Section 2.022.

8. Effective as of the January 1, 1998 , Section 2.05 is amended in its entirety to make certain clarifications as follows:

**"2.05 BENEFIT SERVICE ON OR AFTER JANUARY 1, 1985**

With respect to employment on and after January 1, 1985, Benefit Service, for purposes of determining a Participant's benefit under the Plan means his years of Service earned as an Eligible Employee excluding any service prior to such Eligible Employee's twenty first birthday. For purposes of this Section 2.05, a year of Service is any Plan Year in which the Participant is credited with 1000 Hours of Service. During any computation period in which an Eligible Employee's Hours of Service cannot be determined, the Eligible Employee shall be credited with 190 Hours of Service for each month during such period in which he or she completes one Hour of Service.

However, if an Eligible Employee does not have 1,000 Hours of Service in a Plan Year because he or she enters or, following a Break in Service, re-enters employment with the Employer after the first day of a Plan Year or terminates his or her employment or retires prior to the end of a Plan Year, he or she shall be deemed to have accrued a partial year of service for such Plan Year equal to the ratio that his or her credited Hours of Service for such Plan Year bears to 1,000."

9. Effective December 12, 1994, Article 2 is amended to add the following provision as Section 2.06:

**"2.06 VETERAN'S BENEFITS**

Notwithstanding any provision of this Plan to the contrary, contributions, benefits and service credit with respect to qualified military service will be provided in accordance with Section 414(u) of the Internal Revenue Code."

10. Effective April 1, 1998, Section 3.01 is amended to add the following subparagraph (x) to subsection (b) thereof:

"(x) Effective April 1, 1998, an employee of Aerodyne Controls Corporation who became an Eligible Employee of Circle Seal Corporation on January 5, 1998 shall be eligible to participate in the Plan on the first day of the month coinciding with or next following the date he attains age 21 and completes one year of Service. Service with Aerodyne Controls Corporation prior to January 5, 1998 shall be taken into account for eligibility and vesting purposes. However, such Eligible Employee's Benefit Service shall be taken into account only with regard to service with the Employer commencing April 1, 1998."

11. Effective January 1, 1997, Section 5.03 is amended to add subsection (f) as follows:

"(f) This subsection (f) shall apply to any Participant who had his retirement benefit determined under Part B of the Plan and who after January 1, 1997, transferred to Regtrol Inc. (hereinafter referred to as a "Transferred Jameco Participant").

A Transferred Jameco Participant's Normal Retirement Benefit shall be an amount based on a maximum of 25 years of "Combined Total Benefit Service" and equal to the sum of (i) and (ii) where:

(i) is the Transferred Jameco Participant's accrued benefit based on the formula under Part B of the Plan in effect as of the transfer date and determined based upon (1) his years of Service under Part B of the Plan as of the transfer date and

(2) his Average Monthly Compensation under Section 1.05 of Part B and his Covered Compensation under Section 1.16 of Part B as of his retirement or termination date.

(ii) is the Transferred Jameco Participant's accrued benefit, if any, determined in accordance with Section 5.03(c) for years of Benefit Service earned on or after transfer date.

For purposes of this Section 5.03(f), "Combined Total Benefit Service" means benefit service earned under Part B of this Plan and Benefit Service earned under subsection (ii) above. In the event a Participant's Combined Total Benefit Service exceeds twenty-five (25) on his date of retirement or termination of employment with the Employer, the Transferred Jameco Participant's retirement benefit shall be determined by decreasing his years of service under subsection (i) by the number of years of service which exceeds twenty-five and substituting such benefit service with years of Benefit Service under subsection (ii).

However, in no event shall a Transferred Jameco Participant's accrued benefit be less than his accrued benefit based upon his years of benefit Service as of his transfer date as calculated under

Part B."

12. Effective January 1, 1998, Section 5.06(b) is amended to read as follows:

"(b) The Deferred Retirement Benefit payable to a Participant who attains age 70 1/2 and who continues to be an Employee shall be equal to the Participant's accrued benefit determined as of the last day of the Plan Year in which the Participant attains age 70 1/2. The Deferred Retirement Benefit payable under this paragraph (b) shall be determined in accordance with Section 5.03 or 5.031, whichever is applicable, and shall be payable in the form of a single life annuity. The Deferred

Retirement Benefit shall commence no later than the January 1 immediately following the Plan Year in which the Participant attains age 70 1/2.

The monthly benefit of a Participant who has begun receiving benefits and who continues to be an Employee after his attainment of age 70 1/2 shall be adjusted, effective on the January 1 following the Plan Year in which the Participant's benefit commenced and on each succeeding January 1 prior to the Participant's Deferred Retirement Date, to reflect the effect of changes in the Participant's accrued benefit since the previous January 1. The final adjustment shall be made as of the Participant's Deferred Retirement Date. Adjustments required by this paragraph shall include a reduction equal to the Actuarial Equivalent of any benefit payments already made with respect to the Participant. In no event, however, will the benefit payable to the Participant be reduced as a result of this paragraph. Furthermore, the operation of this paragraph will not affect the form of benefit payment previously elected by the Participant.

Upon such Participant's actual Deferred Retirement Date, he shall then be eligible to make the election as described in Section 5.022."

13. Effective January 1, 1998, Article 5 is amended to renumber existing "Section 5.11" as Section 5.12 and to add a new Section 5.11 as follows:

#### **"5.11 DISABILITY RETIREMENT BENEFIT**

In the event a Participant becomes disabled while employed with the Employer so that he is receiving disability benefits under the Employer's long term disability program and is eligible for and is receiving disability benefits under Title II of the Social Security Act, such Participant shall continue to be credited with years of Service for vesting and years of Benefit Service for the period he remains disabled and such crediting shall cease upon the earlier of the Participant's recovery from disability, death, election of Early Retirement or Normal Retirement Date. During the period of disability such Participant's shall be credited with Compensation equal to the greater of his Compensation credited in the Plan Year he becomes disabled or the Compensation credited for the immediately preceding Plan Year. In addition, such disabled Participant's Maximum Offset Allowance shall be determined as of the date he becomes disabled. If a Participant's disability continues until his Normal Retirement Date, his Normal Retirement Benefit shall commence as of the date elected by the Participant in accordance with the normal form of benefit described as Section 5.01 or 5.02, whichever is applicable, or the optional retirement benefit, if elected by the Participant, as set forth in Article 5."

14. Effective January 1, 1998, Section 7.04(c) is amended to read as follows:

"(c) If a Participant dies after attaining his Normal Retirement Age but before his Deferred Retirement Date, the Spouse Joint and Survivor Annuity as

described in Section 5.02 shall be deemed to be in effect on behalf of such Participant, provided he has not made an election under Section 5.022 to receive his benefits under another form of payment."

15. Effective January 1, 1998, Section 12.01 of Part A is amended to read as follows:

**"12.01 PAYMENT OF SMALL AMOUNTS**

In the event that the Actuarial Equivalent of the Participant's accrued benefit is \$3,500 or less on the determination date, the accrued benefit shall be automatically paid in a lump sum. Notwithstanding this above, if the Actuarial Equivalent of the Participant's accrued benefit derived from Employer contributions is \$3,500 or less, after distribution of the Participant's Accumulated Contribution Account, a Participant may elect to receive distribution of his remaining Employer provided accrued benefit provided the appropriate spousal consent as set forth in Section 5.024 is obtained.

No distribution may be made under this Section 12.01 after a Participant's Benefit Commencement Date, unless the Participant and the Participant's spouse, or where the Participant has died, the surviving spouse consents in writing to such distribution."

IN WITNESS WHEREOF, Watts Industries, Inc. has caused this Amendment to be executed by its authorized officer and its seal affixed hereto this \_\_\_\_\_ day of \_\_\_\_\_, 1998.

**WATTS INDUSTRIES, INC.**

By: \_\_\_\_\_

Title: \_\_\_\_\_

(Seal)

**AMENDMENT NUMBER SIX**

**WATTS INDUSTRIES, INC.**

**RETIREMENT PLAN FOR SALARIED EMPLOYEES**

WHEREAS, Watts Industries, Inc. (the "Sponsoring Employer") established the Watts Industries, Inc. Retirement Plan for Salaried Employees (the "Plan") for the benefit of its eligible employees which was most recently amended and restated effective as of January 1, 1994;

WHEREAS, pursuant to Section 13.01 of the Plan, the Sponsoring Employer reserved the right to amend the Plan; and

WHEREAS, the Sponsoring Employer desires to amend the Plan to reflect the inclusion of certain eligible employees;

NOW, THEREFORE, the Plan is hereby amended as follows:

1. Effective January 1, 1997, Section 3.01(b) is amended to add the following subsection (xi) as follows:

"(xi) Effective January 1, 1997, an employee of Consolidated Precision Corp. who became an employee of Circle Seals Controls shall become an Eligible Employee for purposes of the Plan and shall become a Participant in the Plan as of the later of January 1, 1997 or the date the Eligible Employee meets the requirements of Section 3.01(a). An Eligible Employee's service with Consolidated Precision Corp. prior to its acquisition by the Employer shall be taken into account for eligibility and vesting purposes. However, such Eligible Employee's Benefit Service shall be taken into account only with regard to service with the Employer commencing January 1, 1997."

2. Effective January 1, 1998, Section 3.01(b) is amended to add the following subsection (xii) as follows:

"(xii) Effective January 1, 1998, an employee of Ames Company, Inc. shall become an Eligible Employee under this Plan and shall become a Participant in the Plan as of the later of January 1, 1998 or the date the Eligible Employee meets the requirements of Section 3.01(a). Such Eligible Employee's service with Ames Company, Inc. prior to its acquisition by the Employer shall be taken into account for eligibility and vesting. However, such Eligible Employee's Benefit Service shall be taken into account only with regard to service with the Employer commencing January 1, 1998."



IN WITNESS WHEREOF, Watts Industries, Inc. has caused this Amendment to be executed by its duly authorized officer and its seal affixed hereto this \_\_\_\_\_ day of \_\_\_\_\_, 19\_\_.

**WATTS INDUSTRIES, INC.**

By: \_\_\_\_\_

Title: \_\_\_\_\_

[Seal]

**AMENDMENT NUMBER SEVEN**

**WATTS INDUSTRIES, INC.**

**RETIREMENT PLAN FOR SALARIED EMPLOYEES**

WHEREAS, Watts Industries, Inc. (the "Sponsoring Employer") established the Watts Industries, Inc. Retirement Plan for Salaried Employees (the "Plan") for the benefit of its eligible employees which was most recently amended and restated effective as of January 1, 1994;

WHEREAS, pursuant to Section 13.01 of the Plan, the Sponsoring Employer reserved the right to amend the Plan; and

WHEREAS, the Sponsoring Employer desires to amend the Plan to reflect the inclusion of certain eligible employees and certain employers;

NOW, THEREFORE, the Plan is hereby amended as follows:

1. Effective January 1, 1998, Section 1.16 is amended to add the following sentence:

"Effective January 1, 1998, the term "Employer" includes "Ames Company, Inc.""

2. Effective August 31, 1995, Section 3.01(b) is amended to add the following subsection (xiii) as follows:

"(xiii) A salaried employee of Keane Controls Corporation who became an employee of Circle Seal Controls, Inc. shall become an Eligible Employee for purposes of the Plan and shall become a Participant in the Plan as of the later of August 31, 1995 or the date such Eligible Employee meets the requirements of Section 3.01(a). An Eligible Employee's service with Keane Controls Corporation, prior to its acquisition by the Employer, shall be taken into account for eligibility and vesting purposes. However, such Eligible Employee's Benefit Service shall be taken into account only with regard to service with the Employer commencing August 31, 1995."

3. Effective March 17, 1998, Section 3.01(b) is amended to add the following subsection (xiv) as follows:

"(xiv) A salaried employee of Atkomatic Valve Company who became an employee of Circle Seal Controls, Inc. shall become an Eligible Employee for purposes of the Plan and shall become a Participant in the Plan as of the later of March 17, 1998 or the date the Eligible Employee meets the requirements of Section 3.01(a). An Eligible Employee's service with Atkomatic Valve Company, prior to its acquisition by the Employer, shall be taken into account for eligibility and vesting. However, such Eligible Employee's .Benefit Service shall be taken into account only with regard to service with the Employer commencing March 17, 1998."

IN WITNESS WHEREOF, Watts Industries, Inc. has caused this Amendment to be executed by its duly authorized officer and its seal affixed hereto this \_\_\_\_\_ day of \_\_\_\_\_, 1999.

**WATTS INDUSTRIES, INC.**

By: \_\_\_\_\_

Title: \_\_\_\_\_

[Seal]

## Exhibit 21

### DIRECT AND INDIRECT SUBSIDIARIES OF WATTS INDUSTRIES, INC.

#### DOMESTIC:

Watts Finance Company [Delaware]  
Watts International Sales Corp. [Massachusetts] Watts Investment Company [Delaware]  
Watts Regulator Company [Massachusetts]  
Watts Securities Corp. [Massachusetts]  
Circle Seal Controls, Inc. [Delaware]  
Green County Castings, Inc. [Oklahoma]  
KF Industries, Inc. [Oklahoma]  
KF Sales Corp. [Delaware]  
Rudolph Labranche, Inc. [New Hampshire]  
Leslie Controls, Inc. [New Jersey]  
Spence Engineering Company, Inc. [Delaware] Watts Drainage Products, Inc. [Delaware] [formerly Ancon U.S.A.] Anderson-Barrows Metals Corp. [California] Circle Seal Corporation [Delaware][formerly Jameco Acquisition] Jameco Industries, Inc. [New York]  
Webster Valve, Inc. [New Hampshire]  
Ames Holdings, Inc. [Delaware]  
Ames Company, Inc. [California]  
Yolo-Ames Leasing Company, Inc. [California] Hoke, Inc. [New York]  
Ajax Screw Machine Co., Inc. [Connecticut] Hoke-International, Ltd. [New York]  
Go-Regulator, Inc. [California]  
SSI Equipment, Inc. [New York]

#### INTERNATIONAL:

IOG Canada, Inc. [Canada]  
SSI Equipment, Inc. [Canada]  
Watts Industries (Canada) Inc. [Canada]  
Watts Investment Company Canada Ltd. [Canada] Hoke Controls, Limited [Canada]  
Watts Cazzaniga S.p.A. [Italy]  
Cazzaniga Immobiliare S.r.l.  
Watts Industries Europe B.V. [the Netherlands] Watts Industries France S.A. [France]  
Watts Industries Germany GmbH [Germany]

Hoke Handelsgesellschaft, GmbH [Germany] Hoke Overseas Sales Corp. [U.S. Virgin Islands] Wattsco International [U.S. Virgin Islands]  
Watts Ocean BV [the Netherlands]  
Watts Eurotherm SA [France]  
Watts UK Ltd. [United Kingdom]  
Watts G.R.C. SA [Spain]  
Watts Interme AG [Switzerland]  
Watts Interme GmbH [Austria]  
Watts Interme SpA [Italy]  
\*Interme UK Ltd [United Kingdom]  
Watts Europe Services BV [the Netherlands] Leslie International V.I. [Virgin Islands] Watts M.T.R. GmbH [Germany]  
Anderson Barrows B.V. [the Netherlands]  
Pibiviesse SpA [Italy]  
B.V. Philabel [the Netherlands]  
Watts AG [Switzerland]  
Watts Ocean NV [Belgian]  
WIG Armaturen Vertriebs, GmbH [Germany]  
WSA Heizungs und Sanitartechnik GmbH [Germany] WIC Verwaltungs und Beteiligungs GmbH [Germany] WLI S.r.L. [Italy][formerly ISI SpA]  
Watts Londa SpA [Italy][formerly Watts ISI SpA]

In addition to the foregoing, the Company holds and 80% interest in De Martin Srl [Italy], a 60% interest in Tianjin Tanggu Watts Valve Company Limited, a Chinese joint venture, and a 60% interest in Suzhou Watts Valve Co., Ltd., a Chinese joint venture. The Company also holds a 49% interest in Jameco International LLC.

\* dissolution pending

## **INDEPENDENT AUDITORS' CONSENT**

The Board of Directors and Stockholders  
Watts Industries, Inc.

We consent to the incorporation by reference in the following registration statements of Watts Industries, Inc. and any amendments thereto (1) No. 333-32685 on Form S-8, (2) No. 33-37926 on Form S-8, (3) No. 33-69422 on Form S-8, (4) No. 33-64627 on Form S-8, (5) No. 33-30377 on Form S-8 of our report dated August 13, 1999, relating to the consolidated balance sheet of Watts Industries, Inc. and subsidiaries as of June 30, 1999 and 1998, the related consolidated statements of operations, stockholders' equity and cash flows for each of the years in the three-year period ended June 30, 1999, and the Valuation and Qualifying Account Schedule, which reports appear in the June 30, 1999 annual report on Form 10-K of Watts Industries, Inc.

Boston, Massachusetts  
September 22, 1999

**ARTICLE 5**

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM JUNE 30, 1999 FINANCIAL STATEMENTS AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.

MULTIPLIER: 1,000

PERIOD TYPE	12 MOS	
FISCAL YEAR END	JUN 30 1999	
PERIOD END	JUN 30 1999	
CASH	10,682	
SECURITIES	2,092	
RECEIVABLES	97,062	
ALLOWANCES	7,747	
INVENTORY	110,552	
CURRENT ASSETS	367,076	
PP&E	218,715	
DEPRECIATION	89,552	
TOTAL ASSETS	637,742	
CURRENT LIABILITIES	99,164	
BONDS	120,966	<a href="#">1</a>
COMMON	2,645	
PREFERRED MANDATORY	0	
PREFERRED	0	
OTHER SE	385,010	
TOTAL LIABILITY AND EQUITY	637,742	
SALES	474,458	
TOTAL REVENUES	474,458	
CGS	302,745	
TOTAL COSTS	422,620	<a href="#">2</a>
OTHER EXPENSES	6,915	<a href="#">3</a>
LOSS PROVISION	1,728	
INTEREST EXPENSE	6,150	
INCOME PRETAX	44,923	
INCOME TAX	15,469	
INCOME CONTINUING	29,454	
DISCONTINUED	6,502	
EXTRAORDINARY	0	
CHANGES	0	
NET INCOME	35,956	
EPS BASIC	1.34	
EPS DILUTED	1.34	

[1](#) INCLUDES LONG TERM DEBT AND CURRENT PORTION

[2](#) INCLUDES ONLY COST OF GOODS SOLD AND OPERATING EXPENSES.

[3](#) INCLUDES INTEREST EXPENSE AND LOSS PROVISION SHOWN BELOW.

**ARTICLE 5**

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM JUNE 30, 1997 FINANCIAL STATEMENTS AND IS QUALIFIED IN ITS ENTIRETY BY SUCH FINANCIAL STATEMENTS. THIS SCHEDULE HAS BEEN RESTATED TO REFLECT THE ACCOUNTING CHANGES TO DISCONTINUED OPERATIONS

MULTIPLIER: 1,000

PERIOD TYPE	12 MOS	
FISCAL YEAR END	JUN 30 1997	
PERIOD END	JUN 30 1997	
CASH	18,139	
SECURITIES	518	
RECEIVABLES	85,169	
ALLOWANCES	6,237	
INVENTORY	99,097	
CURRENT ASSETS	308,803	
PP&E	174,525	
DEPRECIATION	76,543	
TOTAL ASSETS	533,328	
CURRENT LIABILITIES	84,100	
BONDS	94,842	<sup>1</sup>
COMMON	2,701	
PREFERRED MANDATORY	0	
PREFERRED	0	
OTHER SE	330,938	
TOTAL LIABILITY AND EQUITY	533,328	
SALES	447,235	
TOTAL REVENUES	447,235	
CGS	289,960	
TOTAL COSTS	398,613	<sup>2</sup>
OTHER EXPENSES	6,876	<sup>3</sup>
LOSS PROVISION	581	
INTEREST EXPENSE	7,072	
INCOME PRETAX	41,476	
INCOME TAX	15,230	
INCOME CONTINUING	26,517	
DISCONTINUED	22,022	
EXTRAORDINARY	3,208	
CHANGES	0	
NET INCOME	51,747	
EPS BASIC	1.89	
EPS DILUTED	1.89	

<sup>1</sup> INCLUDES LONG TERM DEBT AND CURRENT PORTION

<sup>2</sup> INCLUDES ONLY COST OF GOODS SOLD AND OPERATING EXPENSES.

<sup>3</sup> INCLUDES INTEREST EXPENSE AND LOSS PROVISION SHOWN BELOW.



## ARTICLE 5

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM SEPTEMBER 30, 1997 FINANCIAL STATEMENTS AND IS QUALIFIED IN ITS ENTIRETY BY SUCH FINANCIAL STATEMENTS. THIS SCHEDULE HAS BEEN RESTATED TO REFLECT THE ACCOUNTING CHANGES RELATED TO DISCONTINUED OPERATIONS

MULTIPLIER: 1,000

PERIOD TYPE	3 MOS	
FISCAL YEAR END	JUN 30 1998	
PERIOD END	SEP 30 1997	
CASH	10,198	
SECURITIES	11,641	
RECEIVABLES	90,745	
ALLOWANCES	6,980	
INVENTORY	105,567	
CURRENT ASSETS	326,353	
PP&E	179,051	
DEPRECIATION	79,196	
TOTAL ASSETS	579,011	
CURRENT LIABILITIES	89,290	
BONDS	117,469	1
COMMON	2,704	
PREFERRED MANDATORY	0	
PREFERRED	0	
OTHER SE	343,006	
TOTAL LIABILITY AND EQUITY	579,011	
SALES	111,839	
TOTAL REVENUES	111,839	
CGS	70,676	
TOTAL COSTS	98,366	2
OTHER EXPENSES	2,475	3
LOSS PROVISION	240	
INTEREST EXPENSE	1,727	
INCOME PRETAX	10,998	
INCOME TAX	3,672	
INCOME CONTINUING	7,326	
DISCONTINUED	6,294	
EXTRAORDINARY	0	
CHANGES	0	
NET INCOME	13,620	
EPS BASIC	.50	
EPS DILUTED	.50	

<sup>1</sup> INCLUDES LONG TERM DEBT AND CURRENT PORTION

<sup>2</sup> INCLUDES ONLY COST OF GOODS SOLD AND OPERATING EXPENSES.

<sup>3</sup> INCLUDES INTEREST EXPENSE AND LOSS PROVISION SHOWN BELOW.

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