WATTS WATER TECHNOLOGIES INC

FORM 10-Q
(Quarterly Report)

Filed 11/13/2001 For Period Ending 9/30/2001

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

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2001

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
(Address of principal executive offices)	(Zip Code)

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

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 |X| No |_|

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

Class	Outstanding at October 31, 2001
Class A Common, $.10 par value	17,780,704
Class B Common, $.10 par value	8,735,224

WATTS INDUSTRIES, INC. AND SUBSIDIARIES

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WATTS INDUSTRIES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Thousands, except share amounts)

	(Unaudited) Sept. 30, 2001	Dec. 31, 2000
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 15,375	$ 15,235
Trade accounts receivable, less allowance for doubtful accounts of $7,452 at September 30, 2001 and $6,614 at December 31, 2000	100,375	97,718
Inventories:		
Raw materials	40,062	35,483
Work in process	16,366	16,390
Finished goods	63,674	57,078
Total Inventories	120,102	108,951
Prepaid expenses and other assets	7,729	6,850
Deferred income taxes	20,794	20,486
Total Current Assets	264,375	249,240
PROPERTY, PLANT AND EQUIPMENT:		
Property, plant and equipment, at cost	223,732	202,492
Accumulated depreciation	(90,477)	(76,682)
Property, plant and equipment, net	133,255	125,810
OTHER ASSETS:		
Goodwill, net of accumulated amortization of $17,041 at September 30, 2001 and $14,665 at December 31, 2000	127,723	98,179
Other	11,061	8,796
TOTAL ASSETS	$ 536,414	$ 482,025
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 37,006	$ 39,569
Accrued expenses and other liabilities	57,986	59,088
Accrued compensation and benefits	12,498	12,200
Current portion of long-term debt	4,390	1,241
Total Current Liabilities	111,880	112,098
LONG-TERM DEBT, NET OF CURRENT PORTION	140,198	105,377
DEFERRED INCOME TAXES	15,794	15,463
OTHER NONCURRENT LIABILITIES	12,798	9,770
MINORITY INTEREST	7,286	6,775
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: 17,689,615 shares at September 30, 2001 and 17,225,965 shares at December 31, 2000	1,769	1,723
Class B Common Stock, $.10 par value; 25,000,000 shares authorized; 10 votes per share; issued and outstanding: 8,835,224 shares at September 30, 2001 and 9,235,224 shares at December 31, 2000	884	924
Additional paid-in capital	37,170	35,996
Retained earnings	230,901	213,627
Treasury stock	(360)	--
Accumulated other comprehensive income/(loss)	(21,906)	(19,728)
Total Stockholders' Equity	248,458	232,542
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 536,414	$ 482,025

See accompanying notes to consolidated financial statements.

WATTS INDUSTRIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(Thousands, except per share amounts)

(Unaudited)

	Three Months Ended	
	Sept. 30, 2001	Sept. 30, 2000
Net sales	$ 138,009	$ 125,656
Cost of goods sold	91,066	79,800
GROSS PROFIT	46,943	45,856
Selling, general & administrative expenses	32,511	30,759
OPERATING INCOME	14,432	15,097
Other (income) expense:		
Interest income	(264)	(164)
Interest expense	2,587	2,474
Other, net	269	568
Minority interest	59	49
	2,651	2,927
INCOME BEFORE INCOME TAXES	11,781	12,170
Provision for income taxes	3,972	4,500
NET INCOME	$ 7,809	$ 7,670
BASIC EARNINGS PER SHARE		
NET INCOME	$ .29	$ .29
Weighted average number of shares	26,527	26,404
DILUTED EARNINGS PER SHARE		
NET INCOME	$ .29	$ .29
Weighted average number of shares	26,838	26,513
Dividends per common share	$ .0600	$ .0600

See accompanying notes to consolidated financial statements.

WATTS INDUSTRIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(Thousands, except per share amounts)

(Unaudited)

	Nine Months Ended	
	Sept. 30, 2001	Sept. 30, 2000
Net sales	$ 409,496	$ 388,491
Cost of goods sold	269,540	248,032
GROSS PROFIT	139,956	140,459
Selling, general & administrative expenses	98,633	94,517
OPERATING INCOME	41,323	45,942
Other (income) expense:		
Interest income	(518)	(557)
Interest expense	7,395	7,581
Other, net	425	1,593
Minority interest	176	(4)
	7,478	8,613
INCOME BEFORE INCOME TAXES	33,845	37,329
Provision for income taxes	11,728	13,692
NET INCOME	$ 22,117	$ 23,637
BASIC EARNINGS PER SHARE		
NET INCOME	$ .83	$ .90
Weighted average number of shares	26,497	26,395
DILUTED EARNINGS PER SHARE		
NET INCOME	$ .82	$ .89
Weighted average number of shares	26,850	26,585
Dividends per common share	$ .1800	$ .2075

See accompanying notes to consolidated financial statements.

WATTS INDUSTRIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Thousands)

(Unaudited)

	Nine Months Ended	
	Sept. 30, 2001	Sept. 30, 2000
OPERATING ACTIVITIES		
Net income	$ 22,117	$ 23,637
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	14,720	12,769
Amortization	2,676	2,381
Deferred income taxes	--	(160)
Gain / (Loss) on disposal of assets	32	(276)
Equity in undistributed earnings (loss) of affiliates	13	(102)
Changes in operating assets and liabilities, net of effects from acquisitions and dispositions:		
Accounts receivable	2,756	(7,460)
Inventories	403	1,377
Prepaid expenses and other assets	(860)	5,945
Accounts payable, accrued expenses and other liabilities	(8,413)	(158)
Net cash provided by operating activities	33,444	37,953
INVESTING ACTIVITIES		
Additions to property, plant and equipment	(11,539)	(11,390)
Proceeds from sale of property, plant and equipment	85	1,722
Business acquisitions, net of cash acquired	(43,377)	(9,387)
Decrease/(Increase) in other assets	248	(558)
Net cash used in investing activities	(54,583)	(19,613)
FINANCING ACTIVITIES		
Proceeds from long-term borrowings	96,704	51,755
Payments of long-term debt	(68,972)	(63,946)
Proceeds from exercise of stock options	1,180	359
Dividends	(4,842)	(5,517)
Purchase of treasury stock	(360)	--
Net cash provided by (used in) financing activities	23,710	(17,349)
Effect of exchange rate changes on cash and cash equivalents	(915)	(649)
Net cash used in discontinued operations	(1,516)	(2,237)
CHANGE IN CASH AND CASH EQUIVALENTS	140	(1,895)
Cash and cash equivalents at beginning of period	15,235	13,016
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 15,375	$ 11,121
NON CASH INVESTING AND FINANCING ACTIVITIES		
Acquisitions of businesses:		
Fair value of assets acquired	$ 64,146	$ 10,232
Cash Paid	43,377	9,387
Liabilities Assumed	20,769	845
Change in fair market value of derivatives	$ 77	$ --

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements
(Unaudited)

1. In the opinion of management, the accompanying unaudited, consolidated financial statements contain all necessary adjustments, consisting only of adjustments of a normal recurring nature, to present fairly Watts Industries, Inc.'s Consolidated Balance Sheet as of September 30, 2001, its Consolidated Statements of Income for the three and nine months ended September 30, 2001 and 2000, and its Consolidated Statements of Cash Flows for the nine months ended September 30, 2001 and 2000.

The balance sheet at December 31, 2000 has been derived from the audited financial statements at that date. The accounting policies followed by the Company are described in the December 31, 2000 financial statements which are contained in the Company's December 31, 2000 Annual Report on Form 10-K. It is suggested that the financial statements included in this report be read in conjunction with the financial statements and notes included in the December 31, 2000 Annual Report on Form 10-K.

2. The Company's shipping and handling costs included in selling, general and administrative expense amounted to $5,459,000 and $4,663,000 for the three months ended September 30, 2001 and 2000, respectively, and $16,180,000 and $14,260,000 for the nine months ended September 30, 2001 and 2000, respectively.

3. The Company adopted Statement of Financial Accounting Standards No. 133 "Accounting for Derivative Instruments and Hedging Activities" (SFAS 133), as amended by SFAS No. 137 and SFAS No. 138, on January 1, 2001. SFAS No. 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and hedging activities. It requires the recognition of all derivative instruments as assets or liabilities in the Company's balance sheet and measurement of those instruments at fair value. The adoption of SFAS No. 133 on January 1, 2001 did not have a material effect on assets, liabilities, accumulated other comprehensive income or net income.

In the normal course of business, the Company manages risks associated with commodity prices, foreign exchange rates and interest rates through a variety of strategies, including the use of hedging transactions, executed in accordance with its policies. The Company's hedging transactions include, but are not limited to, the use of various derivative financial and commodity instruments. As a matter of policy, the Company does not use derivative instruments unless there is an underlying exposure. Any change in the value of our derivative instruments would be substantially offset by an opposite change in the value of the underlying hedged items. The Company does not use derivative instruments for trading or speculative purposes.

Accounting Policies

Using qualifying criteria defined in SFAS No. 133, derivative instruments are designated and accounted for as either a hedge of a recognized asset or liability (fair value hedge) or a hedge of a forecasted transaction (cash flow hedge). For a fair value hedge, both the effective and ineffective portions of the change in fair value of the derivative instrument, along with an adjustment to the carrying amount of the hedged item for fair value changes attributable to the hedged risk, are recognized in earnings. For a cash flow hedge, changes in the fair value of the derivative instrument that are highly effective are deferred in accumulated other comprehensive income or loss until the underlying hedged item is recognized in earnings. The ineffective portion of fair value changes on qualifying hedges is recognized in earnings immediately. If a fair value or cash flow hedge were to cease to qualify for hedge accounting or be terminated, it would continue to be carried on the balance sheet at fair value until settled, but hedge accounting would be discontinued prospectively. If a forecasted transaction were no longer probable of occurring, amounts previously deferred in accumulated other comprehensive income would be recognized immediately in earnings. On occasion, the Company may enter into a derivative instrument for which hedge accounting is not required because it is entered into to offset changes in the fair value of an underlying transaction which is required to be recognized in earnings (natural hedge). These instruments are reflected in the Consolidated Balance Sheet at fair value with changes in fair value recognized in earnings.

The Company adopted SFAS No. 141 and certain provisions of SFAS No. 142 in connection with the acquisition of the assets of Powers Process Controls. Please refer to the New Accounting Standards Section of Management's Discussion and Analysis for a more complete discussion of SFAS No. 141 and SFAS No. 142.

Foreign Currency Risk

Certain forecasted transactions, primarily intercompany sales between the United States and Canada, and assets are exposed to foreign currency risk. The Company monitors its foreign currency exposures on an ongoing basis to maximize the overall effectiveness of its foreign currency hedge positions. For the nine months ended September 30, 2001, the Company used foreign currency forward contracts as a means of hedging exposure to foreign currency risks. The Company's foreign currency forwards have been designated and qualify as cash flow hedges under the criteria of SFAS 133. SFAS 133 requires that changes in fair value of derivatives that qualify as cash flow hedges be recognized in other comprehensive income, while the ineffective portion of the derivative's change in fair value be recognized immediately in earnings. The net gain on these contracts recorded in other comprehensive income for the three months ended September 30, 2001 was $29,000 and for the nine months ended September 30, 2001 was $55,000.

Interest Rate Risk

The Company uses interest rate swaps as an economic hedge on forecasted interest costs. SFAS 133 requires that unrealized gains and losses on derivatives not qualifying for hedge accounting be recognized currently in earnings. During the quarter ended September 30, 2001, the Company entered into an interest rate swap for its $75,000,000 notes. The Company swapped the fixed interest rate of 8 3/8% to floating LIBOR plus 3.74%. The term of the swap matches the maturity date of the notes (December 2003). The fair value of this swap at September 30, 2001 was approximately $1.5 million. This swap qualifies for hedge accounting treatment. The Company has a swap that converts 10 million Euro of its variable rate debt in Europe to a fixed rate of 4.3%. This swap does not qualify for hedge accounting. For the three months ended September 30, 2001, the Company recorded $52,000 to interest income and for the nine months ended September 30, 2001 recorded $125,000 to interest income to reflect the change in the fair value of its interest rate swaps.

Other Derivatives

The Company also utilizes, on a limited basis, certain commodity derivatives, primarily on copper used in its manufacturing process, to hedge the cost of its anticipated production requirements. The Company did not utilize any commodity derivatives for the nine months ended September 30, 2001.

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

	For the Three Months Ended September 30, 2001		
	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic EPS			
Net Income	$7,809,000	26,527,312	$0.29
Effect of Dilutive Securities			
Common Stock Equivalents	--	310,852	--
Diluted EPS	$7,809,000	26,838,164	$0.29

	For the Three Months Ended September 30, 2000		
	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic EPS			
Net Income	$7,670,000	26,404,463	$0.29
Effect of Dilutive Securities			
Common Stock Equivalents	--	108,567	--
Diluted EPS	$7,670,000	26,513,030	$0.29

Stock options to purchase 758,803 and 1,592,396 shares of common stock were outstanding as of September 30, 2001 and 2000, respectively, but were not included in the computation of diluted earnings per share because the options' exercise price was greater than the average market price of the common shares and therefore, the effect would have been antidilutive.

	For the Nine Months Ended September 30, 2001		
	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic EPS			
Net Income	$22,117,000	26,496,534	$ 0.83
Effect of Dilutive Securities			
Common Stock Equivalents	--	352,972	(0.01)
Diluted EPS	$22,117,000	26,849,506	$ 0.82

	For the Nine Months Ended September 30, 2001		
	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic EPS			
Net Income	$23,637,000	26,395,133	$ 0.90
Effect of Dilutive Securities			
Common Stock Equivalents	--	189,763	(0.01)
Diluted EPS	$23,637,000	26,584,896	$ 0.89

Stock options to purchase 549,933 and 887,938 shares of common stock were outstanding as of September 30, 2001 and 2000, respectively, but were not included in the computation of diluted earnings per share because the options' exercise price was greater than the average market price of the common shares and therefore, the effect would have been antidilutive.

5. Segment Information - the following table presents certain operating segment information:

(Thousands of dollars)

Three months ended September 30, 2001:	North America	Europe	Asia	Other	Corporate/ Consolidated
Net Sales	$103,635	$31,474	$2,900	$ --	$138,009
Operating income	12,631	3,777	118	(2,094)	14,432
Capital Expenditures	1,927	544	131	--	2,602
Depreciation and Amortization	3,895	1,699	185	--	5,779

Three Months Ended September 30, 2000:					
Net Sales	$ 99,557	$23,286	$2,813	$ --	$125,656
Operating income	14,046	3,150	182	(2,281)	15,097
Capital Expenditures	3,281	1,265	1	--	4,547
Depreciation and Amortization	3,612	1,217	184	--	5,013
Nine Months Ended September 30, 2001:					
Net Sales	$310,873	$89,249	$9,374	$ --	$409,496
Operating income	38,054	9,548	415	(6,694)	41,323
Capital Expenditures	8,532	1,623	1,384	--	11,539
Depreciation and Amortization	11,969	4,883	544	--	17,396
Nine Months Ended September 30, 2000:					
Net Sales	$301,275	$77,809	$9,407	$ --	$388,491
Operating income	41,913	10,798	383	(7,152)	45,942
Capital Expenditures	8,860	2,457	73	--	11,390
Depreciation and Amortization	10,708	3,890	552	--	15,150

The above operating segments are presented on a basis consistent with the presentation included in the Company's December 31, 2000 consolidated financial statements. The following table contains additional segment information.

	North America	Europe	Asia	Consolidated
Nine Months Ended September 30, 2001				
Identifiable Assets	$349,395	$162,368	$24,651	$536,414
Twelve Months Ended December 31, 2000				
Identifiable Assets	$332,621	$125,213	$24,191	$482,025

6. The accumulated balances for the components of the Other Comprehensive Income/(Loss) are:

	Foreign Currency Translation	Cash Flow Hedges	Accumulated Other Comprehensive Income/(Loss)
Balance December 31, 1999	(15,199)	--	(15,199)
Change in period	(3,098)	--	(3,098)
Balance March 31, 2000	(18,297)	--	(18,297)
Change in period	(659)	--	(659)
Balance June 30, 2000	(18,956)	--	(18,956)
Change in Period	(4,619)	--	(4,619)
Balance September 30, 2000	(23,575)	--	(23,575)
Balance December 31, 2000	(19,728)	--	(19,728)
Change in period	(5,034)	160	(4,874)
Balance March 31, 2001	(24,762)	160	(24,602)
Change in period	(1,969)	(134)	(2,103)
Balance June 30, 2001	(26,731)	26	(26,705)
Change in period	4,770	29	4,799
Balance September 30, 2001	(21,961)	55	(21,906)

Accumulated other comprehensive income/(loss) in the Consolidated Balance Sheets as of September 30, 2001 and December 31, 2000 consists of cumulative translation adjustments and as of September 30, 2001 changes in the fair value of certain financial instruments which qualify for hedge accounting as required by SFAS 133. The Company's total comprehensive income was as follows:

	Three Months Ended September 30, 2001	2000
Net Income	$ 7,809	$ 7,670
Unrealized Gains Derivative Instruments, Net of Tax	29	--
Foreign Currency Translation Adjustments	4,770	(4,619)
Total Comprehensive Income	$12,608	$ 3,051

	Nine Months Ended September 30, 2001	2000
Net Income	$ 22,117	$ 23,637
Unrealized Gains Derivative Instruments, Net of Tax	55	--
Foreign Currency Translation Adjustments	(2,233)	(8,376)
Total Comprehensive Income	$ 19,939	$ 15,261

7. Acquisitions

On September 28, 2001, a wholly-owned subsidiary of the Company acquired the assets of the Powers Process Controls Division of Mark Controls Corporation, a subsidiary of Crane Co. located in Skokie, Illinois and Mississauga, Ontario, Canada for approximately $13 million in cash. The September 30, 2001 Consolidated Balance Sheet of the Company contains a preliminary purchase price allocation of the Powers acquisition, consistent with the guidelines in SFAS 141 and SFAS 142. Powers designs and manufactures thermostatic mixing valves for personal safety and process control applications in commercial and institutional facilities. It also manufactures control valves and commercial plumbing brass products including shower valves and lavatory faucets. Powers annualized sales prior to the acquisition were approximately $20 million.

On June 13, 2001, a wholly-owned subsidiary of the Company acquired Premier Manufactured Systems, Inc., located in Phoenix, Arizona for approximately $5 million in cash. Premier manufactures water filtration systems for both residential and commercial applications and other filtration products including under-the-counter Ultraviolet filtration as well as a variety of Sediment and Carbon filters. Premier's annualized sales prior to the acquisition were approximately $10 million.

On June 1, 2001, a wholly-owned subsidiary of the Company acquired Fimet S.r.l. (Fabbrica Italiana Manometri e Termometri) located in Milan, Italy and its wholly-owned subsidiary, MTB AD, which is located in Bulgaria for approximately $6 million (U.S.). The acquired business manufactures pressure and temperature gauges for use in the HVAC market. Fimet's annualized sales prior to the acquisition were approximately 10 million Euro.

On January 5, 2001, the Company acquired Dumser Metallbau GmbH & Co. KG located in Landau, Germany for approximately $20 million (U.S.). The main products of Dumser include brass, steel and stainless steel manifolds used as a prime distribution device in hydronic heating systems. Dumser had approximately $24 million (U.S.) in total sales for the twelve months ended December 31, 2000. Dumser has a 51% controlling share of Stern Rubunetti, which had annual sales prior to the acquisition of $4 million (U.S.). Stern Rubunetti is an Italian manufacturing company producing brass components located in Brescia, Italy.

On August 30, 2000, a wholly-owned subsidiary of the Company acquired certain assets of Chiles Power Supply and Bask LLC, doing business as Heatway, located in Springfield, Missouri for approximately $3 million in cash. The acquired business, now operating under the name Watts Radiant, manufactures and distributes a complete line of hydronic and electric radiant heating and snow melting systems. Heatway's annualized sales prior to the acquisition were approximately $11 million.

On May 12, 2000, a wholly-owned subsidiary of the Company acquired McCraney, Inc., located in Santa Ana, California for approximately $7 million in cash. McCraney, doing business as Spacemaker, manufactures a complete line of seismic restraint straps for water heaters as well as water heater stands and enclosures. Spacemaker's twelve months sales prior to the acquisition were approximately $5 million.

8. 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. In June 2001, the Company and the other defendants reached a proposed settlement with one of the municipal entities, the Los Angeles Department of Water and Power ("LADWP") in the James Jones case (Los Angeles Department of Water and Power, ex rel. Nora Amenta v. James Jones Company, et al). A proposed settlement has now been approved by the California Superior Court and submitted to the Los Angeles Board of Water and Power Commissioners for approval. The Company is vigorously contesting this matter. 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 reporting period could have a material effect on the Quarterly or Annual operating results for that period. Also see Part II, Item 1.

Item 2. Management's Discussions and Analysis of Financial Condition and Results

of Operations

Recent Developments

On September 28, 2001, a wholly-owned subsidiary of the Company acquired the assets of the Powers Process Controls Division of Mark Controls Corporation, a subsidiary of Crane Co. located in Skokie, Illinois and Mississauga, Ontario, Canada for approximately $13 million in cash. The September 30, 2001 Consolidated Balance Sheet of the Company contains a preliminary purchase price allocation of the Powers acquisition, consistent with the guidelines in SFAS 141 and SFAS 142. Powers designs and manufactures thermostatic mixing valves for personal safety and process control applications in commercial and institutional facilities. It also manufactures control valves and commercial plumbing brass products including shower valves and lavatory faucets. Powers annualized sales prior to the acquisition were approximately $20 million.

On June 13, 2001, a wholly-owned subsidiary of the Company acquired Premier Manufactured Systems, Inc., located in Phoenix, Arizona for approximately $5 million in cash. Premier manufactures water filtration systems for both residential and commercial applications and other filtration products including under-the-counter Ultraviolet filtration as well as a variety of Sediment and Carbon filters. Premier's annualized sales prior to the acquisition were approximately $10 million.

On June 1, 2001, a wholly-owned subsidiary of the Company acquired Fimet S.r.l. (Fabbrica Italiana Manometri e Termometri) located in Milan, Italy and its wholly-owned subsidiary, MTB AD, which is located in Bulgaria for approximately $6 million (U.S.). The acquired business manufactures pressure and temperature gauges for use in the HVAC market. Fimet's annualized sales prior to the acquisition were approximately 10 million Euro.

On January 5, 2001, the Company acquired Dumser Metallbau GmbH & Co. KG located in Landau, Germany for approximately $20 million (U.S.). The main products of Dumser include brass, steel and stainless steel manifolds used as a prime distribution device in hydronic heating systems. Dumser had approximately $24 million (U.S.) in total sales for the twelve months ended December 31, 2000. Dumser has a 51% controlling share of Stern Rubunetti, which had annual sales prior to the acquisition of $4 million (U.S.). Stern Rubunetti is an Italian manufacturing company producing brass components located in Brescia, Italy.

Three Months Ended September 30, 2001 Compared to
Three Months Ended September 30, 2000

Net sales for the three months ended September 30, 2001 increased $12,353,000 (9.8%) to $138,009,000 compared to the same period in 2000. The increase in net sales is attributable to the following:

Internal Growth	$ (1,831)	(1.5%)
Acquisitions	13,640	10.9%
Foreign Exchange	544	0.4%
Total Change	$ 12,353	9.8%

The decrease in net sales from internal growth is attributable to decreased unit sales to European and North American Plumbing and Heating wholesalers. This is a result of the continued softness in the North American plumbing market and the weakness in the European economies. These decreases were partially offset by increased unit sales to the North American Retail Home Improvement market. The growth in net sales from acquired businesses is due to the inclusion of the net sales from Premier Manufactured Systems of Phoenix, Arizona, acquired on June 13, 2001, Fimet of Milan, Italy, acquired on June 1, 2001, Dumser Metallbau GmbH &

Co. KG of Landau, Germany, acquired on January 5, 2001, the business acquired from Chiles Power Supply and Bask, LLC of Springfield, Missouri, now doing business as Watts Radiant, acquired on August 30, 2000. The increase in foreign exchange is due primarily to the Euro being at a higher rate compared to the same period in 2000.

Watts monitors its net sales in three geographical segments: North America, Europe and Asia. As outlined below, North America, Europe and Asia accounted for 75.1%, 22.8% and 2.1% of net sales, respectively, in the three months ended September 30, 2001 compared to 79.2%, 18.5% and 2.3%, respectively, in the three months ended September 30, 2000. The Company's net sales in these groups for the three months ended September 30, 2001 and 2000 were as follows:

	9/30/01	9/30/00	Change
North America	$103,635	$ 99,557	$ 4,078
Europe	31,474	23,286	8,188
Asia	2,900	2,813	87
Total	$138,009	$125,656	$12,353

The increase in North America's net sales is due to the Premier Manufactured Systems and Watts Radiant acquisitions and increased unit sales to the North American Retail Home Improvement market, partially offset by decreased units sales to Plumbing and Heating wholesalers. The increase in Europe's net sales is due to the acquisitions of Fimet and Dumser, partially offset by decreased unit sales to European Plumbing and Heating wholesalers. Excluding acquisitions, sales in the European market on a local currency basis were 7.1% below the comparable prior year period. The increase in Asia's net sales is due to increased domestic sales.

Gross profit for the three months ended September 30, 2001 increased $1,087,000 (2.4%) and decreased as a percentage of net sales from 36.5% to 34.0%. The increase in gross profit is primarily attributable to the inclusion of the gross profit of acquired companies. Gross profit percentage reductions are attributable to the inclusion of some of the acquired companies, which operate at a lower gross margin than the rest of the Company, and to a less favorable product mix caused by the decreased unit sales to Plumbing and Heating wholesalers.

Selling, general and administrative expenses increased $1,752,000 (5.7%) to $32,511,000. This increase is attributable to the inclusion of the selling, general and administrative expenses of acquired companies.

Operating income for the three months ended September 30, 2001 decreased $665,000 (4.4%) to $14,432,000 compared to the same period in 2000 due to reduced gross profit. The Company's operating income by segment for the three months ended September 30, 2001 and 2000 were as follows:

	9/30/01	9/30/00	Change
North America	$ 12,631	$ 14,046	$(1,415)
Europe	3,777	3,150	627
Asia	118	182	(64)
Corporate/Other	(2,094)	(2,281)	187
Total	$ 14,432	$ 15,097	$ (665)

The decrease in North America operating income is primarily attributable to decreased unit sales to Plumbing and Heating wholesalers, partially offset by the inclusion of operating income from the acquired companies.

Interest expense increased $113,000 in the quarter ended September 30, 2001 compared to the same period in 2000, primarily due to acquisition debt. The Company reduced interest expense by $125,000 in the quarter due to the swap of its $75,000,000 notes at 8.375% fixed to a floating rate of LIBOR plus 3.74%.

The Company's effective tax rate for continuing operations decreased from 37.0% to 33.7%. The decrease is primarily attributable to statutory rate reductions affecting income tax in Canada as well as other tax planning opportunities.

Net income for the three months ended September 30, 2001 increased $139,000 (1.8%) to $7,809,000 or $.29 per common share compared to $.29 per common share for the three months ended September 30, 2000 on a diluted basis.

Nine Months Ended September 30, 2001 Compared to
Nine Months Ended September 30, 2000

Net sales for the nine months ended September 30, 2001 increased $21,005,000 (5.4%) to $409,496,000 compared to the same period in 2000. The increase in net sales is attributable to the following:

Internal Growth	$ (8,254)	(2.1%)
Acquisition	34,030	8.7%
Foreign Exchange	(4,771)	(1.2%)
Total Change	$ 21,005	5.4%

The decrease in net sales from internal growth is attributable to decreased unit sales to North American and European Plumbing and Heating wholesalers resulting from the continued weakness in the North American plumbing market and the weakened European economy. These decreases were partially offset by increased unit sales in the North American Retail Home Improvement market. The growth in net sales from acquired businesses is due to the inclusion of the net sales from Premier Manufactured Systems of Phoenix, Arizona, acquired on June 13, 2001, Fimet of Milan, Italy, acquired on June 1, 2001, Dumser Metallbau GmbH & Co. KG of Landau, Germany, acquired on January 5, 2001, the business acquired from Chiles Power Supply and Bask, LLC of Springfield, Missouri, now doing business as Watts Radiant, acquired on August 30, 2000, and McCraney, Inc. of Santa Ana, California, doing business as Spacemaker, acquired on May 12, 2000. The decrease in foreign exchange is due primarily to the Euro devaluation against the U.S. dollar compared to the same period in 2000.

Watts monitors its net sales in three geographical segments: North America, Europe and Asia. As outlined below, North America, Europe and Asia accounted for 75.9%, 21.8% and 2.3% of net sales, respectively, in the nine months ended September 30, 2001 compared to 77.6%, 20.0% and 2.4%, respectively, in the nine months ended in September 30, 2000. The Company's net sales in these groups for the nine months ended September 30, 2001 and 2000 were as follows:

	9/30/01	9/30/00	Change
North America	$310,873	$301,275	$ 9,598
Europe	89,249	77,809	11,440
Asia	9,374	9,407	(33)
Total	$409,496	$388,491	$ 21,005

The increase in North America's net sales is due to the Premier Manufactured Systems, Watts Radiant, and Spacemaker acquisitions, as well as increased unit sales to the Retail Home Improvement market, partially offset by decreased unit sales to Plumbing and Heating wholesalers. The increase in Europe's net sales is due to the Fimet and Dumser acquisitions, partially offset by decreased unit sales to European Plumbing and Heating wholesalers and the Euro's devaluation against the U.S. dollar. Excluding acquisitions, sales in the European market on a local currency basis were 6.1% below the comparable prior year period.

Gross profit for the nine months ended September 30, 2001 decreased $503,000 (0.4%) and decreased as a percentage of net sales from 36.2% to 34.2%. The decrease in gross profit is primarily attributable to decreased net sales to North American and European Plumbing and Heating wholesalers. Gross profit percentage reductions are attributable to the inclusion of acquired companies, of which some operate at a lower gross profit percentage than the remainder of the Company, and a less favorable product mix caused by decreased sales to the North American and European Plumbing and Heating wholesalers.

Selling, general and administrative expenses increased $4,116,000 (4.4%) to $98,633,000. This increase is attributable to the inclusion of the selling, general and administrative expenses of acquired companies, partially offset by the lower exchange rate of the Euro relative to the U.S. dollar and reduced spending levels.

Operating income for the nine months ended September 30, 2001 decreased $4,619,000 (10.1%) to $41,323,000 compared to the same period in 2000 due to reduced gross profit. The Company's operating income by segment for the nine months ended September 30, 2001 and 2000 were as follows:

	9/30/01	9/30/00	Change
North America	$ 38,054	$ 41,913	$(3,859)
Europe	9,548	10,798	(1,250)
Asia	415	383	32
Corporate/Other	(6,694)	(7,152)	458
Total	$ 41,323	$ 45,942	$(4,619)

The decrease in both North American and European operating income is due to decreased unit sales to plumbing and heating wholesalers. These decreases were partially offset by the operating earnings of acquired companies.

Interest Expense for the nine months ended September 30, 2001 decreased $186,000 (2.5%) compared to the same period in 2000, primarily due to lower interest rates on variable rate indebtedness, despite the increased levels of debt due to acquisitions.

Other income and expense for the nine months ended September 30, 2001 decreased $1,168,000 (73.3%).

The Company's effective tax rate for continuing operations decreased from 36.7% to 34.7%. The decrease is primarily due to statutory rate reductions affecting income tax in Canada and other tax planning opportunities.

Net income for the nine months ended September 30, 2001 decreased $1,520,000 (6.4%) to $22,117,000 or $.82 per common share compared to $.89 per common share for the nine months ended September 30, 2001 on a diluted basis.

Liquidity and Capital Resources

During the nine month period ended September 30, 2001 the Company generated $33,444,000 in cash flow from continuing operations, which was principally used to fund the purchase of $11,539,000 in capital equipment, contribute to the funding of acquisitions, and to pay cash dividends to common shareholders. Capital expenditures were primarily for manufacturing machinery and equipment as part of the Company's commitment to continuously improve its manufacturing capabilities. The Company's capital expenditure budget for the twelve months ended December 31, 2001 is $18,100,000. However, due to the weakness in the markets in which the Company serves, the Company is reducing its capital spending for fiscal 2001 and anticipates that capital spending will be several million dollars less than the originally approved budget.

The Company invested $43,377,000 to acquire businesses during the nine months ended September 30, 2001. These acquisitions were Dumser Metallbau GmbH & Co. KG of Landau, Germany; Fimet S.r.l. of Milan, Italy; and Premier Manufactured Systems, Inc. of Phoenix, Arizona; and Powers Process Control of Skokie, Illinois and Mississauga, Ontario, Canada. The purchase price of these acquisitions was primarily funded through the Company's use of the domestic and foreign revolving lines of credit.

The Company maintains a revolving line of credit facility of $100,000,000, which expires in March 2003, to support the Company's acquisition program, working capital requirements of acquired companies, and for general corporate purposes. As of September 30, 2001 long-term debt included $15,000,000 outstanding on the line of credit and the Company was in compliance with all covenants related to this facility.

As of September 30, 2001, the Company maintained a syndicated credit facility with a group of European banks in the amount of 41,050,000 Euro. This credit facility has several tranches, one of which was reinstated in the current fiscal year, that provides credit to the Company through September, 2004. The purpose of this credit facility is to fund acquisitions in Europe, to support the working capital requirements of acquired companies, and for general corporate purposes. This line of credit was completely utilized as of September 30, 2001.

Working capital as of September 30, 2001 was $152,495,000 compared to $137,142,000 at December 31, 2000. This increase is primarily attributable to the inclusion of working capital of acquired companies. The ratio of current assets to current liabilities was 2.4 to 1 at September 30, 2001 compared to 2.2 to 1 at December 31, 2000. Cash and cash equivalents were $15,375,000 at September 30, 2001 compared to $15,235,000 at December 31, 2000. The increase in long-term debt to $140,198,000 at September 30, 2001 from $105,377,000 at December 31, 2000 was due to the funding of acquisitions of Powers Process Controls, Premier Manufactured Systems, Inc., Fimet, and Dumser. Debt as a percentage of total capital employed (short-term and long-term debt as a percentage of the sum of short-term and long-term debt plus equity) was 36.8% at September 30, 2001 compared to 31.4% at December 31, 2000.

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

The Company from time to time is involved in environmental proceedings and other legal proceedings and incurs costs on an on-going basis related to these matters. The Company has not incurred material expenditures in fiscal 2001 in connection with any of these matters. See Part II, Item 1, Legal Proceedings.

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 Euro affects 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 has experienced 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 is currently able to make and receive payments in Euro and will convert financial and information technology systems to be able to use the Euro as its base currency in relevant markets prior to January 1, 2002.

New Accounting Standards

During 2000, the Financial Accounting Standards Board's Emerging Issues Task Force (EITF) added to its agenda various revenue recognition issues that could impact the income statement classification of certain promotional payments. In May 2000, the EITF reached a consensus on Issue 00-14, Accounting for Certain Sales Incentives. EITF 00-14 addresses the recognition and income statement classification of various sales incentives. Among its requirements, the consensus will require the costs related to consumer coupons currently classified as marketing costs to be classified as a reduction of revenue. The impact of adopting this consensus is not expected to have a material impact on our results of operations. In April 2001, the EITF announced that it would delay the effective date for this consensus to 2002.

In January 2001, the EITF reached a consensus on Issue 00-22, Accounting for "Points" and Certain Other Time-Based or Volume-Based Sales Incentive Offers, and Offers for Free Products or Services to Be Delivered in the Future. Issue 00-22 requires that certain volume-based cash rebates to customers currently recognized as marketing costs be classified as a reduction of revenue. The consensus was effective for the first quarter of 2001 and was not material to our consolidated financial statements.

In April 2001, the EITF reached a consensus on Issue 00-25, Vendor Income Statement Characterization of Consideration to a Purchaser of the Vendor's Products or Services. EITF 00-25 addresses the income statement classification of consideration, other than that directly addressed in Issue 00-14, from a vendor to a reseller, or another party that purchases the vendor's products. Among its requirements, the consensus will require certain of our customer promotional incentives currently classified as marketing costs to be classified as a reduction of revenue. The consensus is effective for fiscal 2002. The Company is currently assessing the impact of adopting Issue 00-25, but anticipates no material change to our consolidated financial statements.

In July 2001, the Financial Standards Accounting Board ("FASB") issued Financial Accounting Standards Board Statement No. 141, Business Combinations ("FAS 141") and Financial Accounting Standards Board Statement No. 142, Goodwill and Other Intangible Assets ("FAS 142"). FAS 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. FAS 141 also specifies the criteria that intangible assets acquired in a purchase method business combination must meet to be recognized and reported apart from goodwill. FAS 142 requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead be tested for impairment, at least annually, in accordance with the provisions of FAS 142. FAS 142 will also require that intangible assets with definite useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with financial Accounting Standards Board Statement No. 121, Accounting for the Impairment of Long-Lived Assets and Long-Lived Assets to be Disposed Of.

The provisions of FAS 141 are effective immediately, except with regard to business combinations initiated prior to July 1, 2001. FAS 142 will be effective as of January 1, 2002. Goodwill and other intangible assets determined to have an indefinite useful life that are acquired in a purchase business combination completed after June 30, 2001 will not be amortized, but will continue to be evaluated for impairment in accordance with appropriate pre-FAS 142 accounting literature. Goodwill and other intangible assets acquired in business combinations completed before July 1, 2001, will continue to be amortized prior to the adoption of FAS 142. The Company is currently evaluating the effect that the adoption of FAS 141 and FAS 142 will have on its results of operations and its financial position.

In August 2001, the FASB issued Financial Accounting Standards Board Statement No. 143, Accounting for Asset Retirement Obligations ("FAS 143") which requires companies to record the fair value of an asset retirement obligation as a liability in the period it incurs a legal obligation associated with the retirement of tangible long-lived assets that result from the acquisition, construction, development and or normal use of the assets. The company must also record a corresponding increase in the carrying value of the related long-lived asset and depreciate that cost over the remaining useful life of the asset. The liability must be increased each period for the passage of time with the offset recorded as an operating expense. The liability must also be adjusted for changes in the estimated future cash flows underlying the initial fair value measurement. Companies must also recognize a gain or loss on the settlement of the liability. The provisions of FAS 143 are effective for fiscal years beginning after June 15, 2002. At the date of the adoption of FAS 143, companies are required to recognize a liability for all existing asset retirement obligations and the associated asset retirement costs. The Company is currently evaluating the effect that the adoption of FAS 143 will have on its results of operations and its financial position.

In August 2001, the FASB issued Financial Accounting Standards Board Statement No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets ("FAS 144") which addresses the accounting and reporting for the impairment or disposal of long-lived assets. FAS 144 supercedes Financial Accounting Standards Board Statement No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-lived Assets to be Disposed Of ("FAS 121") but retains many of the fundamental provisions of FAS 121. FAS 144 also supercedes the accounting and reporting provisions of Accounting Principles Board Opinion No. 30, "Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions" ("APB 30") for the disposal of a segment of a business. However, FAS 144 retains the requirements of APB 30 to report discontinued operations separately and extends that reporting requirement to components of an entity that has either been disposed of or is classified as held for sale. FAS 144 excludes goodwill and other intangibles that are not amortized from its scope. For assets to be held and used, FAS 144 addresses how cash flows should be estimated to test the recoverability of an asset or group of assets, clarifies how an impairment loss should be allocated, and creates a requirement to use an expected present value technique to estimate fair value if market prices are not available and uncertainties exist about the timing and amount of future cash flows. For long-lived assets to be disposed of by sale, FAS 144 establishes the criteria to be met to qualify for this classification, defines the timing of when the related sale must be consummated, eliminates the net realizable value measurement approach for segments of a business and certain acquired assets in a business combination, and defines costs to sell the asset. The provisions of FAS 144 are effective for fiscal years beginning after December 15, 2001 and are generally to be applied prospectively. The Company is currently evaluating the effect that the adoption of FAS 144 will have on its results of operations and its financial position.

Quantitative and Qualitative Disclosures About Market Risk

The Company uses derivative financial instruments primarily to reduce exposure to adverse fluctuations in foreign exchange rates, interest 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 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, which are reported in United States dollars are subject to translation risks 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 purchases or sales of materials and are denominated in European currencies or the U.S. or Canadian dollar. The Company uses foreign currency forward exchange contracts 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.

The Company has historically had a very low exposure to changes in interest rates. Interest rate swaps are used to mitigate the impact of interest rate fluctuations on certain variable rate debt instruments. However, the Company's senior notes and its U.S. revolving line of credit are subject to the impact of changes in interest rates.

The Company purchases significant amounts of bronze ingot, brass rod and cast iron 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.

Other

This report may include statements which are not historical facts and are considered forward looking within the meaning of the Private Securities Litigation Reform Act of 1995. These forward looking statements reflects the Company's current views about future events and financial performance. Investors should not rely on forward looking statements, because they are subject to a variety of risks, uncertainty, and other factors that could cause actual results to differ materially from the Company's expectations and the Company expressly does not undertake any duty to update forward looking statements. These factors include, but are not limited to, the following: 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 plumbing and heating markets, changes in global demand for the Company's products, changes for distribution of the Company's products, interest rates, foreign exchange fluctuations, cyclicality of industries in which the Company markets certain of its products, and general economic factors in markets where the Company's products are sold, manufactured, or marketed, changes in the status of current litigation, including the James Jones case, and other factors discussed in the Company's reports filed with the Securities and Exchange Commission.

This report includes forward looking statements which reflect the Company's current views about future events and financial performance. Forward looking statements do not relate strictly to historical or current facts and may be identified by their use of words like "plan", "believe", "expect", "will", "anticipate", "estimate" and other words of similar meaning. Investors should not rely on forward looking statements because they are subject to a variety of risks, uncertainties, and other factors that could cause actual results to differ materially from our expectations. Some important factors that could cause our actual results to differ materially from those projected in such forward looking statements are discussed in the December 31, 2000 Annual Report on Form 10-K.

PART II

Item 1. Legal Proceedings

The Company 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, Watts Industries, Inc., which formerly owned James Jones, Mueller Co., and Tyco International (U.S.) 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 ("LADWP") intervened. To date, less than half a dozen of the original thirty-four municipalities have subsequently intervened. In December, 2000, the court allowed the Realtor to file a Second Amended Complaint, which added a number of new cities and water districts as plaintiffs and brought the total number of plaintiffs to 161.

The First Amended Complaint alleges that the Company's former subsidiary (James Jones Company) sold products that did not meet contractually specified standards used by the named municipalities for their water systems and falsely certified that 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 LADWP'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 LADWP 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 First Amended Complaint'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, like '81 bronze, 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.

In June, 2001, the Company and the other defendants reached a proposed settlement with the LADWP, one of the plaintiffs, which has now been approved by the California Superior Court and submitted to the Los Angeles Board of Water and Power Commissioners for approval.

On January 19, 2001, the California False Claims Act claims filed by the City of Pomona were dismissed. The California Court of Appeal reversed this dismissal, and the California Supreme Court declined to review this reversal.

After the Company's insurers had denied coverage for the claims in this case, the Company filed a complaint in the California Superior Court against its insurers for coverage. The James Jones Company filed a similar complaint, and on October 30, 2001 the California Superior Court ruled that Zurich American Insurance Company must pay all reasonable defense costs incurred by the Company in the James Jones case since April 23, 1998 as well as the Company's future defense costs in this case until its final resolution. The Company is currently unable to predict the outcome of the litigation relating to insurance coverage.

Based on management's assessment, the Company does not believe that the ultimate outcome of the James Jones case will have a material adverse effect on its liquidity, financial condition or results of operations. The Company intends to continue to contest vigorously the James Jones case and its related litigation.

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 liquidity, financial condition or results of operations due to any changes in federal, state or local environmental laws, regulations or ordinances.

The Company is currently a party to or otherwise involved in various administrative or legal proceedings under federal, state or local environmental laws or regulations involving a limited number of sites. 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 liquidity, 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.

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 liquidity, financial condition or results of operations.

Item 6. Exhibits and Reports on Form 8-K

(a) The exhibits are furnished elsewhere in this report.

(b) Reports filed on Form 8-K during the Quarter ended September 30, 2001.

There were no reports filed on Form 8-K with the Securities and Exchange Commission during the quarter ending September 30, 2001.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

WATTS INDUSTRIES, INC.

Date: November 13, 2001	*By: /s/ Timothy P. Horne* *Timothy P. Horne* *Chairman and Chief Executive Officer*
Date: November 13, 2001	*By: /s/ William C. McCartney* *William C. McCartney* *Chief Financial Officer and Treasurer*

EXHIBIT INDEX

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

Exhibit No.	Description
3.1	Restated Certificate of Incorporation, as amended. (1)
3.2	Amended and Restated By-Laws, as amended May 11, 1999 (2)
11	Computation of Earnings per Share (3)

(1) Incorporated by reference to the relevant exhibit to the Registrant's Annual Report on Form 10-K filed with the Securities and Exchange Commission on September 28, 1995.

(2) Incorporated by reference to the relevant exhibit to the Registrant's Current Report on Form 10-Q for the Quarter ended March 31, 2000.

(3) Incorporated by reference to the Notes to Consolidated Financial Statements, Note 4, of this Report.