WATTS WATER TECHNOLOGIES INC

FORM 10-Q
(Quarterly Report)

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Address	815 CHESTNUT ST
	NORTH ANDOVER, Massachusetts 01845
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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 March 31, 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 April 30, 2001
Class A Common, $.10 par value	17,457,498
Class B Common, $.10 par value	9,035,224

WATTS INDUSTRIES, INC. AND SUBSIDIARIES

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

ASSETS	(Unaudited) March 31, 2001	Dec. 31, 2000
CURRENT ASSETS:		
Cash and cash equivalents	$ 11,801	$ 15,235
Trade accounts receivable, less allowance for doubtful accounts of $7,025 at March 31, 2001 and $6,614 at December 31, 2000	97,614	97,718
Inventories, net:		
Raw materials	37,668	35,483
Work in process	17,594	16,390
Finished goods	61,215	57,078
Total Inventories	116,477	108,951
Prepaid expenses and other assets	8,094	6,850
Deferred income taxes	20,937	20,486
Total Current Assets	254,923	249,240
PROPERTY, PLANT AND EQUIPMENT:		
Property, plant and equipment, at cost	207,614	202,492
Accumulated depreciation	(80,016)	(76,682)
Property, plant and equipment, net	127,598	125,810
OTHER ASSETS:		
Goodwill, net of accumulated amortization of $15,428 at March 31, 2001 and $14,665 at December 31, 2000	109,080	98,179
Other	9,369	8,796
TOTAL ASSETS	$ 500,970	$ 482,025

LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 39,926	$ 39,569
Accrued expenses and other liabilities	59,941	59,088
Accrued compensation and benefits	12,136	12,200
Current portion of long-term debt	1,913	1,241
Total Current Liabilities	113,916	112,098
LONG-TERM DEBT, NET OF CURRENT PORTION	121,123	105,377
DEFERRED INCOME TAXES	15,282	15,463
OTHER NONCURRENT LIABILITIES	9,789	9,770
MINORITY INTEREST	7,111	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: 17,398,035 shares at March 31, 2001 and 17,225,965 shares at December 31, 2000	1,740	1,723
Class B Common Stock, $.10 par value; 25,000,000 shares authorized; 10 votes per share; issued and outstanding: shares 9,085,224 at March 31, 2001 and 9,235,224 shares at December 31, 2000	909	924
Additional paid-in capital	36,411	35,996
Retained earnings	219,291	213,627
Accumulated other comprehensive income	(24,602)	(19,728)
Total Stockholders' Equity	233,749	232,542
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 500,970	$ 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	
	March 31, 2001	March 31, 2000
Net sales	$ 135,925	$ 131,651
Cost of goods sold	89,261	84,277
GROSS PROFIT	46,664	47,374
Selling, general & administrative expenses	32,845	32,061
OPERATING INCOME	13,819	15,313
Other (income) expense:		
Interest income	(140)	(178)
Interest expense	2,417	2,591
Other, net	201	479
Minority interest	53	(6)
	2,531	2,886
INCOME BEFORE INCOME TAXES	11,288	12,427
Provision for income taxes	4,015	4,487
NET INCOME	$ 7,273	$ 7,940
BASIC EARNINGS PER SHARE		
NET INCOME	$ .27	$ .30
Weighted average number of shares	26,464	26,388
DILUTED EARNINGS PER SHARE		
NET INCOME	$ .27	$ .30
Weighted average number of shares	26,819	26,700
Dividends per common share	$ .0600	$ .0875

See accompanying notes to consolidated financial statements.

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

(Unaudited)

	Three Months Ended March 31, 2001	Three Months Ended March 31, 2000
OPERATING ACTIVITIES		
Net income	$ 7,273	$ 7,940
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	5,066	4,304
Amortization	863	791
Deferred income taxes	(336)	61
Gain on disposal of assets	(3)	(35)
Equity in undistributed earnings (loss) of affiliates	13	(18)
Changes in operating assets and liabilities, net of effects from acquisitions and dispositions:		
Accounts receivable	(764)	(4,091)
Inventories	(3,476)	(3,434)
Prepaid expenses and other assets	(1,502)	3,053
Accounts payable, accrued expenses and other liabilities	1,235	(2,890)
Net cash provided by operating activities	8,369	5,681
INVESTING ACTIVITIES		
Additions to property, plant and equipment	(3,441)	(4,226)
Proceeds from sale of property, plant and equipment	95	56
Business acquisitions, net of cash acquired	(18,960)	--
Increase in other assets	(90)	(138)
Net cash used in investing activities	(22,396)	(4,308)
FINANCING ACTIVITIES		
Proceeds from long-term borrowings	35,362	12,000
Payments of long-term debt	(23,244)	16,381)
Proceeds from exercise of stock options	417	293
Dividends	(1,609)	(2,313)
Net cash provided by (used in) financing activities	10,926	(6,401)
Effect of exchange rate changes on cash and cash equivalents	335	(366)
Net cash used in discontinued operations	(668)	(1,088)
CHANGE IN CASH AND CASH EQUIVALENTS	(3,434)	(6,482)
Cash and cash equivalents at beginning of period	15,235	13,016
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 11,801	$ 6,534
NON CASH INVESTING AND FINANCING ACTIVITIES		
Acquisitions of businesses:		
Fair value of assets acquired	$ 28,045	$ --
Cash Paid	18,960	--
Liabilities Assumed	9,085	--
Change in fair market value of derivatives	$ 160	$ --

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 March 31, 2001, its Consolidated Statements of Income for the three months ended March 31, 2001 and 2000, and its Consolidated Statements of Cash Flows for the three months ended March 31, 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 $5,526,000 and $4,724,000 for the three months ended March 31, 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, we manage 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 our policies. Our hedging transactions include, but are not limited to, the use of various derivative financial and commodity instruments. As a matter of policy, we do 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. We do 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, we 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.

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. During the quarter ended March 31, 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 reorganized in other comprehensive income while the ineffective portion of the derivative's change in fair value be reorganized immediately in earnings. The net gain on these contracts recorded in other comprehensive income during the quarter ended March 31, 2001 was $160,000. The ineffective amounts had no effect on earnings for the quarter.

Interest Rate Risk

The Company uses interest rate swaps as an economic hedge on forcasted interest costs by converting variable rate debt obligations into fixed rate obligations. The Company's interest rate swaps did not meet the criteria of SFAS 133 to qualify for hedge accounting. SFAS 133 requires that unrealized gains and losses on derivatives not qualifying for hedge accounting be reorganized currently in earnings. During the quarter ended March 31, 2001, the Company recorded a charge of $98,000 to interest expense to reflect the change in the fair value of the interest rate swap.

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 during the quarter ended March 31, 2001.

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

	For the Three Months Ended March 31, 2001		
	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic EPS			
Net Income	$7,273,000	26,464,058	$0.27
Effect of Dilutive Securities			
Common Stock Equivalents	--	355,072	--
Diluted EPS	$7,273,000	26,819,130	$0.27

	For the Three Months Ended March 31, 2000		
	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic EPS			
Net Income	$7,940,000	26,387,795	$0.30
Effect of Dilutive Securities			
Common Stock Equivalents	--	312,220	--
Diluted EPS	$7,940,000	26,700,015	$0.30

Stock options to purchase 519,863 shares and 928,173 shares of common stock were outstanding at March 31, 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)	North America	Europe	Asia	Corporate/ Other	Consolidated
Three months ended March 31, 2001:					
Net Sales	$102,200	$30,540	$3,185	$ --	$135,925
Operating income	13,396	3,052	70	(2,699)	13,819
Three months ended March 31, 2000:					
Net Sales	$99,517	$28,720	$3,414	$ --	$131,651
Operating income	14,294	4,117	19	(3,117)	15,313

The above operating segments are presented on a basis consistent with the presentation included in the Company's December 31, 2000 financial statements. There have been no material changes in the identifiable assets of the individual segments since December 31, 2000.

6. Accumulated other comprehensive income in the consolidated balance sheets as of March 31, 2001 and December 31, 2000 consists of cumulative translation adjustments and as of March 31, 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 March 31, 2001	2000
Net Income	$ 7,273	$ 7,940
Unrealized Gain on Derivative Instruments, Net of Tax	160	--
Foreign Currency Translation Adjustments	(5,034)	(3,098)
Total Comprehensive Income	$ 2,399	$ 4,842

7. Acquisitions

On January 5, 2001, the Company acquired Dumser Metallbau GmbH & Co. KG located in Landau, Germany for approximately $20 million. 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, a $4 million 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, located in Springfield, Missouri for approximately $3 million. The acquired business, now operating under the name Watts Heatway, 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. 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 last twelve months sales 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. During the quarter ended December 31, 2000, the Company made an offer to settle all of the claims of the Los Angeles Department of Water and Power in the James Jones case (Los Angeles Department of Water and Power, ex rel. Nora Amenta v. James Jones Company, et al). The Los Angeles Department of Water and Power has indicated that it views this offer favorably and that it intends to seek its approval. On January 19, 2001, the California False Claims Act claims filed by the City of Pomona were dismissed. The City of Pomona has filed for appellate review of this order, and the Company is currently unable to predict the outcome of any appeal. On the present record, the vast majority of the other cities named in this lawsuit are subject to a legal challenge similar to that which resulted in the dismissal of Pomona's False Claims Act case. 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 Discussion and Analysis of Financial Condition and Results of Operations

Results of Operations
Three Months Ended March 31, 2001 Compared to Three Months Ended March 31, 2000

Net sales for the three months ended March 31, 2001 increased $4,274,000 (3.2%) to $135,925,000 compared to the same period in 2000. The increase in net sales is attributable to the following:

Internal Growth	($2,205)	(1.7%)
Acquisitions	9,508	7.2%
Foreign Exchange	(3,029)	(2.3%)
	-------	-----
Total Change	$4,274	3.2%
	=======	=====

The decrease in net sales from internal growth is attributable to decreased unit sales to North American plumbing and heating wholesalers resulting from the continued soft North American housing market, and a reduction in unit sales in Italy. These decreases were partially offset by increased unit sales to the Do-It-Yourself market. The growth in net sales from acquired businesses is due to the inclusion of net sales from Dumser Metalbau GmbH KG, of Landau, Germany, which was acquired on January 5, 2001, the business acquired from Chiles Power Supply and Bask LLC of Springfield, Missouri, now doing business as Watts Heatway, which was acquired on

August 30, 2000 and McCraney, Inc. of Santa Ana, California, doing business as Spacemaker, which was acquired May 12, 2000. The decrease in foreign exchange is due primarily to the Euro's devaluation against the US 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 75.2%, 22.5%, and 2.3% of net sales, respectively, in the three months ended March 31, 2001 compared to 75.6%, 21.8%, and 2.6% respectively in the three months ended March 31, 2000. The Company's net sales in these groups for the three months ended March 31, 2001 and 2000 were as follows:

	3/31/01	3/31/00	Change
North America	$102,200	$99,517	$2,683
Europe	30,540	28,720	1,820
Asia	3,185	3,414	(229)
Total	$135,925	$131,651	$4,274

The increase in North America's net sales is due to the Watts Heatway and Spacemaker acquisitions, partially offset by decreased unit sales to plumbing and heating wholesalers and the Canadian dollar's devaluation against the US dollar compared to the same period in 2000. The increase in Europe's net sales is due to the Dumser acquisition, partially offset by decreased unit sales in Italy and the Euro's devaluation against the US dollar. Sales in the European market on a local currency basis were 2.0% below the comparable prior year period. The decrease in Asia's net sales is due to reduced demand in the North American export market.

Gross profit for the three months decreased $710,000 (1.5%) and decreased as a percentage of net sales from 36.0% to 34.3%. The decrease in gross profit is primarily attributable to decreased net sales to our plumbing and heating wholesalers in North America and Italy. Gross profit percentage reductions are attributable to a less favorable product mix caused by increased unit sales to the Do-It-Yourself market and decreased unit sales to plumbing and heating wholesalers.

Selling, general and administrative expenses increased $784,000 (2.4%) to $32,845,000. This increase is attributable the inclusion of selling, general, and administrative expenses of Watts Heatway, Spacemaker and Dumser partially offset by decreased variable selling expenses.

Operating income for the three months ended March 31, 2001 decreased $1,494,000 (9.8%) to $13,819,000 compared to the same period in 2000 due to reduced gross profit and increased selling, general and administrative expenses.

The Company's operating income by segment for the three months ended March 31, 2001 and 2000 were as follows:

	3/31/01	3/31/00	Change
North America	$13,396	$14,294	($898)
Europe	3,052	4,117	(1,065)
Asia	70	19	51
Corporate /Other	(2,699)	(3,117)	418
Total	$13,819	$15,313	($1,494)

The decrease in North America is due to reduced gross profit. The decrease in Europe is due to decreased unit sales to plumbing and heating wholesalers in Italy and the Euro's devaluation against the US dollar compared to the prior year, partially offset by income from the Dumser acquisition.

Interest expense decreased $174,000 in the quarter ended March 31, 2001, compared to the same period in 2000, primarily due to lower interest rates on variable rate indebtedness.

The Company's effective tax rate for continuing operations decreased from 36.1% to 35.6%. The decrease is primarily attributable to due to statutory rate reductions affecting income taxed in Canada and Germany.

Net income for the three months ended March 31, 2001 decreased $667,000 (8.4%) to $7,273,000 or $ .27 per common share compared to $.30 per common share for the three months ended March 31, 2000 on a diluted basis.

Liquidity and Capital Resources

During the three month period ended March 31, 2001, the Company generated $8,369,000 in cash flow, from continuing operations, which was principally used to fund the purchase of $3,441,000 in capital equipment, pay cash dividends to common shareholders and pay down long term debt. 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.

The Company generated $3,319,000 in free cash flow (cash provided by continuing operations less dividends and capital expenditures) during the three months ended March 31, 2001 versus negative free cash of $858,000 in the comparable prior year period. The increase is attributable to an increase in cash from operations over 2000, lower capital expenditures and a reduced dividend rate to reflect the Company's current size.

The Company maintains a revolving line of credit facility of $100,000,000, which expires March 2003, to support the Company's acquisition program, working capital requirements of acquired companies, and for general corporate purposes. At March 31, 2001, the Company had

$6,000,000 outstanding on the line of credit and was in compliance with all banking covenants related to this facility.

As of March 31, 2001, the Company maintained a syndicated credit facility with a group of European banks in the amount of 40,000,000 Euros. This credit facility has several tranches, one of which was reinstated during the quarter ended March 31, 2001, that provide 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. As of March 31, 2001, 33,424,000 Euros ($29,436,000) were borrowed under this line of credit.

Working capital at March 31, 2001 was $141,007,000 compared to $137,142,000 at December 31, 2000. The ratio of current assets to current liabilities was 2.2 to 1 at March 31, 2001 and at December 31, 2000. Cash and cash equivalents were $11,801,000 at March 31, 2001, compared to $15,235,000 at December 31, 2000. The increase in long-term debt to $121,123,000 at March 31, 2001 from $105,377,000 at December 31, 2000 was due to the Dumser acquisition. 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 34.5% at March 31, 2001 compared to 31.4% at December 31, 2000.

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 environmental proceedings and other legal proceedings and incurs costs on an ongoing 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 Euros 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 will require that certain volume-based cash rebates to customers currently recognized as marketing costs be classified as a reduction of revenue. The consensus is 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 and bottler payments currently classified as marketing costs to be classified as a reduction of revenue. We are currently assessing the impact of adopting Issue 00-25 but expect that the majority of our promotional expenses will be required to be classified as a reduction of revenue.

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 Watts Industries' 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 Watts Industries expectations and Watts Industries 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 litigations, including the James Jones case, and other factors discussed in the Company's report filed with the Securities and Exchange Commission.

This report includes forward looking statements which reflect Watts Industries' 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
Environmental and Other Litigation Matters

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 ("DWP") intervened. To date, less than half a dozen of the original thirty-four municipalities have subsequently intervened.

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 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 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 December 2000, the court allowed the Relator 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. During the quarter ended December 31, 2000, the Company and the other defendants made an offer to settle all of the claims of the DWP in this case. The DWP has indicated that it views this offer favorably and that it intends to seek the offer's approval. On January 19, 2001, the California False Claims Act claims filed by the City of Pomona were dismissed. The City of Pomona has filed for appellate review of this order, and the Company is currently unable to predict the outcome of any appeal. On the present record, the vast majority of other cities named in this lawsuit are subject to a legal challenge similar to that which resulted in the dismissal of Pomona's False Claims Act case. As a result of these developments and management's current assessment of the case, the Company recorded a charge of $7,170,000 after tax in the quarter ended December 31, 2000, which represents the after tax impact of the Company's current estimate of the cost to bring the entire case to resolution. This charge is reported as a loss from discontinued operations. While this charge represents the after tax impact of the Company's current estimate based on all available information, litigation is inherently uncertain and the actual liability to the Company to fully resolve the litigation could be materially higher than this estimate.

The Company intends to continue to contest this matter vigorously.

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 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 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 financial condition or results of operation.

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 March 31, 2001.

Current report on 8-K filed on February 6, 2001, containing the press release date February 6, 2001 announcing earnings for the quarter and year ended December 31, 2000 and certain developments in the James Jones case.

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:	*May 11, 2001*	*By: /s/ Timothy P. Horne* *Timothy P. Horne* *Chairman and Chief Executive Officer*
Date:	*May 11, 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.