

Mueller Water Products, Inc.
Form 10-Q
May 09, 2007

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2007.

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

Commission File Number 333-131536

MUELLER WATER PRODUCTS, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

20-3547095
(I.R.S. Employer
identification No.)

1200 Abernathy Road
Atlanta, GA 30328

(Address of principal executive offices)

(770) 206-4200

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer

Accelerated Filer

Non-accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

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There were 114,766,327 shares of common stock of the Registrant outstanding as of May 1, 2007, composed of 28,921,407 shares of Series A common stock and 85,844,920 shares of Series B common stock.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

MUELLER WATER PRODUCTS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

	March 31, 2007	September 30, 2006
	(dollars in millions)	
Assets		
Cash and cash equivalents	\$ 69.2	\$ 81.4
Receivables, net of allowance for doubtful accounts of \$4.9 million and \$4.8 million at March 31, 2007 and September 30, 2006, respectively	274.3	322.9
Inventories	510.8	454.6
Deferred income taxes	42.3	42.6
Prepaid expenses	35.7	33.7
Total current assets	932.3	935.2
Property, plant and equipment, net	343.7	337.0
Deferred financing fees and other long-term assets	13.7	16.8
Identifiable intangible assets, net	834.0	835.4
Goodwill	865.6	865.5
Total assets	\$ 2,989.3	\$ 2,989.9
Liabilities		
Current portion of long-term debt	\$ 8.9	\$ 9.0
Accounts payable	115.4	129.9
Accrued expenses and other current liabilities	89.0	116.3
Total current liabilities	213.3	255.2
Long-term debt	1,119.5	1,118.3
Accrued pension liability, net	45.7	43.7
Accumulated postretirement benefits obligation	44.7	46.3
Deferred income taxes	284.1	278.5
Other long-term liabilities	20.9	20.9
Total liabilities	1,728.2	1,762.9
Shareholders Equity		
Common stock, \$0.01 par value per share:		
Class A 400,000,000 shares authorized. 28,916,736 and 28,750,000 shares issued at March 31, 2007 and September 30, 2006, respectively	0.3	0.3
Class B 200,000,000 shares authorized and 85,844,920 shares issued at March 31, 2007 and September 30, 2006	0.8	0.8
Capital in excess of par value	1,418.7	1,417.5
Accumulated deficit	(138.1)	(173.0)
Accumulated other comprehensive loss	(20.6)	(18.6)
Total shareholders equity	1,261.1	1,227.0
Total liabilities and shareholders equity	\$ 2,989.3	\$ 2,989.9

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

MUELLER WATER PRODUCTS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three months ended	
	March 31,	
	2007	2006
	(dollars in millions)	
Net sales	\$ 459.7	\$ 434.9
Cost of sales	341.9	340.3
Gross profit	117.8	94.6
Operating expenses:		
Selling, general and administrative	64.9	60.8
Related party corporate charges		2.0
Facility rationalization, restructuring and related costs		4.3
Total operating expenses	64.9	67.1
Income from operations	52.9	27.5
Interest expense, net of interest income	21.1	30.1
Income (loss) before income taxes	31.8	(2.6)
Income tax expense (benefit)	13.9	(0.8)
Net income (loss)	\$ 17.9	\$ (1.8)
Basic and diluted income (loss) per share	\$ 0.16	\$ (0.02)

	Six months ended	
	March 31,	
	2007	2006
	(dollars in millions)	
Net sales	\$ 871.6	\$ 915.3
Cost of sales	646.1	777.2
Gross profit	225.5	138.1
Operating expenses:		
Selling, general and administrative	122.0	117.9
Related party corporate charges	1.6	3.8
Facility rationalization, restructuring and related costs		28.4
Total operating expenses	123.6	150.1
Income (loss) from operations	101.9	(12.0)
Interest expense, net of interest income	41.5	62.3
Income (loss) before income taxes	60.4	(74.3)
Income tax expense (benefit)	25.5	(23.7)
Net income (loss)	\$ 34.9	\$ (50.6)
Basic and diluted income (loss) per share	\$ 0.30	\$ (0.59)

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

MUELLER WATER PRODUCTS, INC.
CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDER S EQUITY
AND COMPREHENSIVE INCOME
FOR THE SIX MONTHS ENDED MARCH 31, 2007
(UNAUDITED)

	Common Stock	Capital in Excess of Par Value	Accumulated Deficit	Comprehensive Income	Accumulated Other Comprehensive Loss	Total
	(dollars in millions)					
Balance at September 30, 2006	\$ 1.1	\$ 1,417.5	\$ (173.0)	\$	\$ (18.6)	\$ 1,227.0
Dividend paid, \$0.0175 per share		(4.0)				(4.0)
Share-based compensation		5.2				5.2
Comprehensive income						
Net income			34.9	34.9		34.9
Unrealized loss on derivative instruments				(0.8)	(0.8)	(0.8)
Foreign currency translation adjustments				(1.2)	(1.2)	(1.2)
Comprehensive income				\$ 32.9		
Balance at March 31, 2007	\$ 1.1	\$ 1,418.7	\$ (138.1)		\$ (20.6)	\$ 1,261.1

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

MUELLER WATER PRODUCTS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Six months ended	
	March 31,	
	2007	2006
	(dollars in millions)	
Operating Activities		
Net income (loss)	\$ 34.9	\$ (50.6)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation	35.0	34.4
Amortization of intangibles	14.5	13.6
Amortization of deferred financing fees	1.3	2.5
Accretion on debt	5.4	6.6
Share-based compensation expense	5.2	0.3
Impairments of property, plant and equipment		21.3
Provision (credit) for deferred income taxes	6.6	(26.1)
Other, net	2.6	(0.8)
Changes in assets and liabilities, net of the effects of acquisitions:		
Receivables	53.1	23.4
Inventories	(50.8)	62.1
Prepaid expenses and other current assets	(1.5)	1.8
Pension and other long-term liabilities	0.1	3.5
Accrued expenses and other current liabilities	(49.7)	(28.9)
Net cash provided by operating activities	56.7	63.1
Investing Activities		
Additions to property, plant and equipment	(42.5)	(30.9)
Acquisitions of businesses, net of cash acquired	(22.5)	(15.5)
Decrease in amounts due to Walter		(15.6)
Net cash used in investing activities	(65.0)	(62.0)
Financing Activities		
Increase in dollar value of bank checks outstanding	3.9	9.7
Proceeds from short-term borrowings		55.9
Retirement of short-term debt		(55.9)
Proceeds from long-term debt		1,050.0
Retirement of long-term debt	(4.3)	(617.9)
Payment of deferred financing fees		(21.6)
Dividend to shareholders	(4.0)	(444.5)
Dividend to Walter for acquisition costs		(12.0)
Walter contribution of Predecessor Mueller's cash		76.3
Net cash (used in) provided by financing activities	(4.4)	40.0
Effect of exchange rate changes on cash	0.5	
Net (decrease) increase in cash and cash equivalents	(12.2)	41.1
Cash and cash equivalents at beginning of period	81.4	
Cash and cash equivalents at end of period	\$ 69.2	\$ 41.1

MUELLER WATER PRODUCTS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
(UNAUDITED)

Schedule of non-cash investing and financing activities:

On October 3, 2005, the Company's former parent, Walter Industries, Inc., purchased all the outstanding common stock of Predecessor Mueller in the Acquisition (as defined in Note 1. to the Condensed Consolidated Financial Statements).

	(dollars in millions)
Contribution of Predecessor Mueller by Walter	\$ 932.9
Less: Cash of Predecessor Mueller received	(76.3)
Total net assets received excluding cash	\$ 856.6

Subsequent to the Acquisition, the Company's former parent, Walter Industries, Inc., forgave an intercompany receivable with U.S. Pipe of \$443.6 million.

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

MUELLER WATER PRODUCTS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
AS OF AND FOR THE THREE AND SIX MONTHS ENDED
MARCH 31, 2007 AND MARCH 31, 2006
(UNAUDITED)

Note 1. Organization

The registrant is Mueller Water Products, Inc., a Delaware corporation (*Mueller Water* or the *Company*). The Company is the surviving corporation of the merger on February 2, 2006 of Mueller Water Products, LLC (Commission File Number: 333-116590) and Mueller Water Products Co-Issuer, Inc. with and into Mueller Holding Company, Inc., a Delaware corporation. On June 1, 2006, Mueller Water completed its initial public offering of its Series A common stock (NYSE: MWA). On December 14, 2006, Walter Industries, Inc. (*Walter*), a diversified New York Stock Exchange traded company (NYSE:WLT), distributed all of the Company's outstanding Series B common stock (NYSE: MWA.B) to its shareholders.

On October 3, 2005, through a series of transactions (the *Acquisition*), Walter, through a wholly-owned subsidiary, acquired all outstanding shares of capital stock of Mueller Water Products, Inc. (*Predecessor Mueller*), which immediately was converted into Mueller Water Products, LLC, a Delaware limited liability company, and contributed United States Pipe and Foundry Company, LLC (*U.S. Pipe*) to the acquired company. The results of operations of Predecessor Mueller are included in the Condensed Consolidated Statements of Operations beginning October 3, 2005.

The Company was originally organized as United States Pipe and Foundry Company, Inc. (*Inc.*) and was a wholly-owned subsidiary of Walter. On September 23, 2005, *Inc.* was dissolved, United States Pipe and Foundry Company, LLC was organized in the state of Alabama, and the operations of *Inc.* were conducted under the form of a limited liability company. The Company has three operating segments, which are named after its leading brands in each segment: Mueller Co., U.S. Pipe and Anvil.

The condensed consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America, which require management to make certain estimates and assumptions that affect the reported amounts of assets, liabilities, sales and expenses for the reporting periods. Actual results could differ from those estimates. All significant intercompany balances and transactions have been eliminated. In the opinion of management, all normal and recurring adjustments that are considered necessary for a fair financial statement presentation have been made. The condensed balance sheet data as of September 30, 2006 was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

Note 2. Related Party Transactions

Related Party Transactions The Company purchases foundry coke from Sloss Industries, Inc., which was an affiliate until December 14, 2006, for an amount that approximates the market value of comparable transactions. Costs included in cost of sales related to purchases from Sloss Industries, Inc. were \$4.5 million and \$5.4 million for the three months ended March 31, 2007 and 2006, respectively, and \$9.0 million and \$10.8 million for the six months ended March 31, 2007 and 2006, respectively.

Other services that Sloss Industries, Inc. provides to the Company include the delivery of electrical power to one of the Company's facilities, rail car switching and the leasing of a distribution facility. Charges for such services were immaterial for the three months ended March 31, 2007, \$0.4 million for the

three months ended March 31, 2006, and \$0.3 million and \$0.8 million for the six months ended March 31, 2007 and 2006, respectively.

Related Party Allocations Certain costs incurred by Walter such as insurance, executive salaries, professional service fees, human resources, transportation, healthcare and other centralized business functions were allocated to its subsidiaries. Certain costs that were considered directly related to the U.S. Pipe segment were charged to the Company and included in selling, general and administrative expenses. As of December 15, 2006, Walter is no longer considered a related party. These costs were approximately \$0.5 million, \$0.6 million and \$1.0 million for the six months ended March 31, 2007 and the three months and six months ended March 31, 2006, respectively. Costs incurred by Walter that could not be directly attributed to its subsidiaries were allocated based on estimated annual revenues. Such costs were allocated to the Company and are recorded as related party corporate charges in the accompanying Condensed Consolidated Statements of Operations. There were no charges during the three months ended March 31, 2007 and \$2.0 million of such charges for the three months ended March 31, 2006. Allocated expenses were \$1.6 million and \$3.8 million for the six months ended March 31, 2007 and 2006, respectively. While the Company considers the allocation of such costs to be reasonable, the cost of performing such services on its own behalf may vary from historically allocated amounts.

Certain of the Company's employees had been granted Walter restricted stock units and stock options under Walter's share-based compensation plans. In connection with Walter's distribution of all the Company's Series B common stock to its shareholders on December 14, 2006, Walter cancelled these instruments. The Company had no expenses related to this share-based compensation allocated from Walter for the three months ended March 31, 2007 and expensed \$0.2 million for the three months ended March 31, 2006, and \$0.5 million and \$0.2 million for the six months ended March 31, 2007 and 2006, respectively.

Note 3. Acquisitions

Fast Fabricators, Inc.

On January 4, 2007, the Company acquired the assets of Fast Fabricators, Inc., a ductile iron pipe fabricator headquartered in Bloomfield, Connecticut, for \$22.5 million in cash, net of cash acquired. In March 2007, the Company accrued an additional amount due of \$0.5 million based on the final net asset value, adjusting the purchase price to \$23.0 million. This accrued amount was paid in April 2007. The purchase price may increase by up to \$1.5 million for an earnout holdback. The earnout holdback will be settled by March 15, 2008, based on the 2007 calendar year EBITDA as defined in the purchase agreement with the seller. The Company has deposited \$1.5 million into escrow, which is included in cash and cash equivalents in the accompanying Condensed Consolidated Balance Sheet, for the Earnout Holdback. The Company cannot access these funds until the earnout, if any, has been paid.

The estimated fair values of the assets acquired and liabilities assumed are as follows (dollars in millions):

Current assets	\$ 10.5
Identified intangibles	13.1
Goodwill	0.5
Plant, property, and equipment and other noncurrent assets	1.8
Accounts payable and accrued liabilities	(2.9)
Net assets acquired	\$ 23.0

Acquisition of Predecessor Mueller by Walter Industries

On October 3, 2005, pursuant to the agreement dated June 17, 2005, Walter acquired all of the outstanding common stock of Predecessor Mueller for \$944.0 million and assumed \$1.05 billion of indebtedness. Predecessor Mueller was converted into a limited liability company on October 3, 2005 and was merged with and into the Company on February 2, 2006. In conjunction with the acquisition, U.S. Pipe was contributed in a series of transactions to Mueller Group, LLC (Mueller Group or Group), a wholly-owned subsidiary of the Company, on October 3, 2005. On February 23, 2006, Walter received \$10.5 million based on the final closing cash and working capital, adjusting the purchase price to \$933.5 million.

Walter's acquisition of Predecessor Mueller has been accounted for as a business combination with U.S. Pipe considered the acquirer for accounting purposes. The total purchase price is comprised of (dollars in millions):

Acquisition of the outstanding common stock of Predecessor Mueller	\$ 918.1
Acquisition-related transaction costs	15.4
Total purchase price	\$ 933.5

Acquisition-related transaction costs include investment banking, legal and accounting fees and other external costs directly related to the Acquisition.

The excess of the purchase price over the net tangible and identifiable intangible assets is recorded as goodwill. Based on current fair values, the purchase price was allocated as follows (dollars in millions):

Receivables, net	\$ 177.4
Inventory	373.2
Property, plant and equipment	214.2
Identifiable intangible assets	856.9
Goodwill	801.7
Net other assets	350.7
Net deferred tax liabilities	(267.9)
Debt	(1,572.7)
Total purchase price allocation	\$ 933.5

Note 4. Facility Rationalization, Restructuring and Related Costs

On October 26, 2005 Walter announced plans to close U.S. Pipe's Chattanooga, Tennessee plant and transfer the valve and hydrant production of that plant to Mueller Co.'s Chattanooga, Tennessee and Albertville, Alabama plants. The plant closed in 2006, resulting in the termination of approximately 340 employees. Exit costs totaled \$49.9 million of which approximately \$28.6 million was related to severance and fixed asset write-offs and qualified as restructuring and impairment charges. The remaining exit costs of \$21.3 million were comprised of an inventory write-down totaling \$11.4 million, a \$9.0 million write-off of unabsorbed overhead costs and \$0.9 million of other related costs, which were recognized in cost of sales during the year ended September 30, 2006. The Company paid \$0.1 million and \$0.4 million of the above-mentioned severance in the three and six months ended March 31, 2007, respectively.

On January 26, 2006, the Company announced the closure of the Henry Pratt valve manufacturing facility in Dixon, Illinois, which is included in the Company's Mueller Co. segment. The eventual closure of the facility is expected to occur in fiscal year 2007, resulting in the termination of approximately 100 employees. Total estimated costs related to this closure are \$3.7 million, including termination benefits of \$1.0 million and property impairment charges of \$1.7 million, which were recorded as adjustments to

goodwill in the year ended September 30, 2006. These restructuring costs were recorded to goodwill as the overall plan to close the facility was identified prior to the Acquisition. The remaining estimated costs of \$1.0 million are for the transfer and installation of equipment and temporary outsourcing of manufacturing and will be expensed when incurred. The Company paid \$0.1 million and \$0.5 million of the above-mentioned severance in the three and six months ended March 31, 2007, respectively.

On November 18, 2006, the Company announced the relocation of pipe nipple and merchant coupling production in the Canvil manufacturing facility in Ontario, Canada to the Beck facility in Pennsylvania, both of which are included in the Company's Anvil segment. The consolidation of these product lines in the Beck Facility was completed during the quarter ended March 31, 2007, resulting in the termination of approximately 60 employees. Termination benefits of \$1.8 million were recorded as adjustments to goodwill in the year ended September 30, 2006. These restructuring costs were recorded to goodwill as the overall plan to close the facility was identified prior to the Acquisition. In the current fiscal year, the Company revised its severance estimate, and decreased the goodwill balance and accrued severance by \$0.4 million. The Company paid \$0.5 million of the above-mentioned severance in the three and six months ended March 31, 2007.

Activity in accrued restructuring and other severance for the three and six months ended March 31, 2007 was as follows (dollars in millions):

	For the three months ended March 31, 2007	For the six months ended March 31, 2007
Beginning balance	\$ 4.2	\$ 5.3
Adjustments to accruals allocated to goodwill for plant closures identified prior to the Acquisition		(0.4)
Restructuring and other severance payments	(1.2)	(1.9)
Ending balance	\$ 3.0	\$ 3.0

Note 5. Share-Based Compensation Plans

Certain of the Company's employees had been granted Walter restricted stock units and stock options under Walter's share-based compensation plans. The Company has expensed \$0.5 million related to the share-based compensation costs allocated from Walter for the six months ended March 31, 2007. In connection with Walter's distribution of all the Company's Series B common stock to its shareholders on December 14, 2006, Walter cancelled these outstanding instruments and the Company replaced them with restricted stock units and options to acquire shares of the Company's Series A common stock. These equity awards were designed to provide intrinsic value and terms equal to the Walter cancelled instruments as follows:

	Number of instruments (millions)	Range of exercise prices	Weighted average exercise price	Total compensation (dollars in millions)
Restricted stock units	0.4			