WATTS WATER TECHNOLOGIES INC
Form 10-Q
August 06, 2014
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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 June 29, 2014

or

o 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 001-11499

WATTS WATER TECHNOLOGIES, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	**04-2916536** (I.R.S. Employer Identification No.)
815 Chestnut Street, North Andover, MA (Address of Principal Executive Offices)	**01845** (Zip Code)

Registrant s Telephone Number, Including Area Code: **(978) 688-1811**

(Former Name, Former Address and Former Fiscal year, if changed since last report.)

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 o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

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 August 4, 2014
Class A Common Stock, $0.10 par value	28,589,504
Class B Common Stock, $0.10 par value	6,479,290

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WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Amounts in millions, except share information)

(Unaudited)

	June 29, 2014	December 31, 2013
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	**$ 244.3**	$ 267.9
Trade accounts receivable, less allowance for doubtful accounts of $10.2 million at June 29, 2014 and $9.7 million at December 31, 2013	**234.9**	212.9
Inventories, net:		
Raw materials	**115.2**	111.3
Work in process	**20.3**	19.1
Finished goods	**182.9**	179.8
Total Inventories	**318.4**	310.2
Prepaid expenses and other assets	**33.8**	35.0
Deferred income taxes	**28.4**	29.8
Asset held for sale	**1.3**	1.3
Total Current Assets	**861.1**	857.1
PROPERTY, PLANT AND EQUIPMENT:		
Property, plant and equipment, at cost	**543.4**	539.2
Accumulated depreciation	**(331.1)**	(319.3)
Property, plant and equipment, net	**212.3**	219.9
OTHER ASSETS:		
Goodwill	**511.5**	514.8
Intangible assets, net	**124.1**	132.4
Deferred income taxes	**4.8**	3.8
Other, net	**12.9**	12.2
TOTAL ASSETS	$ **1,726.7**	$ 1,740.2
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ **133.1**	$ 145.6
Accrued expenses and other liabilities	**134.9**	135.2
Accrued compensation and benefits	**43.6**	43.9
Current portion of long-term debt	**2.1**	2.2
Total Current Liabilities	**313.7**	326.9
LONG-TERM DEBT, NET OF CURRENT PORTION	**304.5**	305.5
DEFERRED INCOME TAXES	**44.0**	45.9
OTHER NONCURRENT LIABILITIES	**55.9**	59.8
STOCKHOLDERS EQUITY:		
Preferred Stock, $0.10 par value; 5,000,000 shares authorized; no shares issued or outstanding		
	2.9	2.9

Class A Common Stock, $0.10 par value; 80,000,000 shares authorized; 1 vote per share; issued and outstanding 28,637,866 shares at June 29, 2014 and 28,824,779 shares at December 31, 2013				
Class B Common Stock, $0.10 par value; 25,000,000 shares authorized; 10 votes per share; issued and outstanding, 6,479,290 shares at June 29, 2014 and 6,489,290 shares at December 31, 2013		**0.6**		0.6
Additional paid-in capital		**483.8**		473.5
Retained earnings		**517.6**		513.1
Accumulated other comprehensive income		**3.7**		12.0
Total Stockholders Equity		**1,008.6**		1,002.1
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$	**1,726.7**	$	1,740.2

See accompanying notes to consolidated financial statements.

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WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(Amounts in millions, except per share information)

(Unaudited)

	Second Quarter Ended		Six Months Ended	
	June 29, 2014	**June 30, 2013**	**June 29, 2014**	**June 30, 2013**
Net sales	$ **396.0**	$ 366.8	**$ 761.2**	$ 725.7
Cost of goods sold	**257.0**	234.0	**488.9**	464.0
GROSS PROFIT	**139.0**	132.8	**272.3**	261.7
Selling, general and administrative expenses	**99.8**	95.2	**203.1**	193.3
Restructuring and other charges, net	**2.6**	2.0	**6.8**	4.2
OPERATING INCOME	**36.6**	35.6	**62.4**	64.2
Other (income) expense:				
Interest income	**(0.2)**	(0.2)	**(0.3)**	(0.3)
Interest expense	**4.9**	5.5	**9.8**	11.5
Other expense (income), net	**(0.1)**	1.4	**0.3**	1.4
Total other expense	**4.6**	6.7	**9.8**	12.6
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	**32.0**	28.9	**52.6**	51.6
Provision for income taxes	**10.7**	10.0	**17.2**	16.4
NET INCOME FROM CONTINUING OPERATIONS	**21.3**	18.9	**35.4**	35.2
Loss from discontinued operations, net of tax				(0.2)
NET INCOME	$ **21.3**	$ 18.9	**$ 35.4**	$ 35.0
BASIC EPS				
Net income (loss) per share:				
Continuing operations	**$ 0.60**	$ 0.53	**$ 1.00**	$ 0.99
Discontinued operations				(0.01)
NET INCOME	**$ 0.60**	$ 0.53	**$ 1.00**	$ 0.99
Weighted average number of shares	**35.3**	35.5	**35.3**	35.5
DILUTED EPS				
Net income (loss) per share:				
Continuing operations	**$ 0.60**	$ 0.53	**$ 1.00**	**$** 0.99
Discontinued operations				(0.01)
NET INCOME	**$ 0.60**	$ 0.53	**$ 1.00**	$ 0.98
Weighted average number of shares	**35.4**	35.6	**35.4**	35.6
Dividends per share	**$ 0.15**	$ 0.13	**$ 0.28**	$ 0.24

See accompanying notes to consolidated financial statements.

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WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Amounts in millions)

(Unaudited)

	Second Quarter Ended		Six Months Ended	
	June 29, 2014	**June 30, 2013**	**June 29, 2014**	**June 30, 2013**
Net income	**$ 21.3**	$ 18.9	**$ 35.4**	$ 35.0
Other comprehensive income, net of tax:				
Foreign currency translation adjustments	**(4.3)**	7.5	**(8.6)**	(12.4)
Defined benefit pension plans:				
Amortization of net losses included in net periodic pension cost	**0.1**	0.1	**0.3**	0.3
Other comprehensive income (loss), net of tax	**(4.2)**	7.6	**(8.3)**	(12.1)
Comprehensive income	**$ 17.1**	$ 26.5	**$ 27.1**	$ 22.9

See accompanying notes to consolidated financial statements.

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WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in millions)

(Unaudited)

	Six Months Ended	
	June 29, 2014	June 30, 2013
OPERATING ACTIVITIES		
Net income	$ **35.4**	$ 35.0
Less: Loss from discontinued operations, net of taxes		(0.2)
Net income from continuing operations	**35.4**	35.2
Adjustments to reconcile net income from continuing operations to net cash provided by continuing operating activities:		
Depreciation	**16.6**	16.9
Amortization of intangibles	**7.4**	7.4
Gain on disposal and impairment of goodwill, property, plant and equipment and other		(0.2)
Stock-based compensation	**3.4**	3.9
Deferred income tax benefit	**(1.3)**	(1.7)
Changes in operating assets and liabilities, net of effects from business acquisitions and divestures:		
Accounts receivable	**(23.2)**	(16.4)
Inventories	**(10.7)**	(17.3)
Prepaid expenses and other assets	**2.5**	(3.7)
Accounts payable, accrued expenses and other liabilities	**(11.7)**	(2.3)
Net cash provided by continuing operations	**18.4**	21.8
INVESTING ACTIVITIES		
Additions to property, plant and equipment	**(10.6)**	(18.0)
Proceeds from the sale of property, plant and equipment	**0.2**	1.4
Proceeds from the sale of securities		2.1
Net cash used in investing activities	**(10.4)**	(14.5)
FINANCING ACTIVITIES		
Payments of long-term debt	**(0.9)**	(76.1)
Payment of capital leases and other	**(2.5)**	(3.2)
Proceeds from share transactions under employee stock plans	**4.7**	3.9
Tax benefit of stock awards exercised	**1.3**	0.7
Payments to repurchase common stock	**(20.0)**	(10.0)
Debt issuance costs	**(2.0)**	
Dividends	**(9.9)**	(8.5)
Net cash used in financing activities	**(29.3)**	(93.2)
Effect of exchange rate changes on cash and cash equivalents	**(2.3)**	(3.5)
Net cash used in operating activities of discontinued operations		(0.6)
DECREASE IN CASH AND CASH EQUIVALENTS	**(23.6)**	(90.0)
Cash and cash equivalents at beginning of year	**267.9**	271.3
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ **244.3**	$ 181.3
NON-CASH INVESTING AND FINANCING ACTIVITIES		
Acquisitions of fixed assets under financing agreement	$	$ 0.4
Issuance of stock under management stock purchase plan	$ **0.2**	$ 0.8

CASH PAID FOR:				
Interest	**$**	**9.5**	**$**	11.7
Income taxes	**$**	**15.5**	$	17.7

See accompanying notes to consolidated financial statements.

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WATTS WATER TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included in the Watts Water Technologies, Inc. (the Company) Consolidated Balance Sheet as of June 29, 2014, the Consolidated Statements of Operations for the second quarters and six months ended June 29, 2014 and June 30, 2013, the Consolidated Statements of Comprehensive Income for the second quarters and six months ended June 29, 2014 and June 30, 2013, and the Consolidated Statements of Cash Flows for the six months ended June 29, 2014 and June 30, 2013.

The consolidated balance sheet at December 31, 2013 has been derived from the audited consolidated financial statements at that date. The accounting policies followed by the Company are described in the Company s Annual Report on Form 10-K for the year ended December 31, 2013. The financial statements included in this report should be read in conjunction with the consolidated financial statements and notes included in the Annual Report on Form 10-K for the year ended December 31, 2013. Operating results for the interim periods presented are not necessarily indicative of the results to be expected for the year ending December 31, 2014.

The Company operates on a 52-week fiscal year ending on December 31st. Any quarterly data contained in this Quarterly Report on Form 10-Q generally reflect the results of operations for a 13-week period or 26-week period, respectively.

2. Accounting Policies

Estimates

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

Goodwill and Long-Lived Assets

The changes in the carrying amount of goodwill by geographic segment are as follows:

	June 29, 2014							
	Gross Balance				Accumulated Impairment Losses			Net Goodwill
	Balance January 1, 2014	Acquired During the Period	Foreign Currency Translation and Other	Balance June 29, 2014	Balance January 1, 2014	Impairment Loss During the Period	Balance June 29, 2014	June 29, 2014
	(in millions)							
Americas	$ 224.7	$	$ (0.1)	$ 224.6	$ (24.5)	$	$ (24.5)	$ 200.1
Europe, Middle East and Africa (EMEA)	301.3		(2.8)	298.5				298.5
Asia-Pacific	13.3		(0.4)	12.9				12.9
Total	$ 539.3	$	$ (3.3)	$ 536.0	$ (24.5)	$	$ (24.5)	$ 511.5

	June 30, 2013							
	Gross Balance				Accumulated Impairment Losses			Net Goodwill
	Balance January 1, 2013	Acquired During the Period	Foreign Currency Translation and Other	Balance June 30, 2013	Balance January 1, 2013	Impairment Loss During the Period	Balance June 30, 2013	June 30, 2013
	(in millions)							
Americas	$ 225.6	$	$ (0.7)	$ 224.9	$ (24.2)	$	$ (24.2)	$ 200.7
EMEA	289.7		(4.0)	285.7				285.7
Asia-Pacific	12.9			12.9				12.9
Total	$ 528.2	$	$ (4.7)	$ 523.5	$ (24.2)	$	$ (24.2)	$ 499.3

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Goodwill and indefinite-lived intangible assets are tested for impairment at least annually or more frequently if events or circumstances indicate that it is more likely than not that they might be impaired, such as from a change in business conditions. The Company performs its annual goodwill and indefinite-lived intangible assets impairment assessment in the fourth quarter of each year.

Intangible assets with estimable lives and other long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable. Recoverability of intangible assets with estimable lives and other long-lived assets are measured by a comparison of the carrying amount of an asset or asset group to future net undiscounted pretax cash flows expected to be generated by the asset or asset group. If these comparisons indicate that an asset is not recoverable based on the future net undiscounted pretax cash flows, the impairment loss recognized is the amount by which the carrying amount of the asset or asset group exceeds the related estimated fair value. Estimated fair value is based on either discounted future pretax operating cash flows or appraised values, depending on the nature of the asset. The Company determines the discount rate for this analysis based on the weighted average cost of capital based on the market and guideline public companies for the related business, and does not allocate interest charges to the asset or asset group being measured. Judgment is required to estimate future operating cash flows.

Intangible assets include the following:

	June 29, 2014			December 31, 2013		
	Gross Carrying Amount	**Accumulated Amortization**	**Net Carrying Amount**	**Gross Carrying Amount**	**Accumulated Amortization**	**Net Carrying Amount**
			(in millions)			
Patents	**$ 16.4**	**$ (12.9)**	**$ 3.5**	$ 16.6	$ (12.6)	$ 4.0
Customer relationships	**132.6**	**(81.8)**	**50.8**	133.0	(76.4)	56.6
Technology	**26.8**	**(11.9)**	**14.9**	26.9	(10.9)	16.0
Trade Names	**13.6**	**(3.6)**	**10.0**	13.7	(3.0)	10.7
Other	**8.8**	**(5.7)**	**3.1**	8.8	(5.6)	3.2
Total amortizable intangibles	**198.2**	**(115.9)**	**82.3**	199.0	(108.5)	90.5
Indefinite-lived intangible assets	**41.8**		**41.8**	41.9		41.9
Total	**$ 240.0**	**$ (115.9)**	**$ 124.1**	$ 240.9	$ (108.5)	$ 132.4

Aggregate amortization expense for amortizable intangible assets for both the second quarters of 2014 and 2013 was $3.7 million. Additionally, future amortization expense for the next five years on amortizable intangible assets is expected to be approximately $7.4 million for the remainder of 2014, $14.6 million for 2015, $14.2 million for 2016, $13.8 million for 2017 and $9.7 million for 2018. Amortization expense is recorded on a straight-line basis over the estimated useful lives of the intangible assets. The weighted-average remaining life of total amortizable intangible assets is 8.1 years. Patents, customer relationships, technology, trade names and other amortizable intangibles have weighted-average remaining lives of 5.3 years, 5.1 years, 11.1 years, 10.5 years and 38.8 years, respectively. Indefinite-lived intangible assets primarily include trademarks and trade names.

Stock-Based Compensation

The Company maintains one stock incentive plan, the 2004 Stock Incentive Plan. Under this plan, key employees have been granted nonqualified stock options to purchase the Company s Class A common stock. Options typically become exercisable over a four-year period at the rate of 25% per year and expire ten years after the grant date. However, most options granted in 2014 become exercisable over a three-year period at the rate of one-third per year. Options granted under the plans may have exercise prices of not less than 100% of the fair market value of the Class A common stock on the date of grant. The Company s current practice is to grant all options at fair market value on the grant date. The Company issued 4,808 and 9,500 stock options during the first six months of 2014 and 2013, respectively.

The Company grants shares of restricted stock and deferred shares to key employees and stock awards to non-employee members of the Company s Board of Directors under the 2004 Stock Incentive Plan. Stock awards to non-employee members of the Company s Board of Directors are fully vested upon grant. Employees restricted stock awards and deferred shares typically vest over a three-year period at the rate of one-third per year, except that most restricted stock awards and deferred shares granted in 2014 vest over a two-year period at the rate of 50% per year. The restricted stock awards and deferred shares are amortized to expense on a straight-line basis over the vesting period. The Company issued 41,885 and 3,167 shares of restricted stock in the first six months of 2014 and 2013, respectively.

Beginning in 2014, the Company also granted performance stock units to key employees under the 2004 Stock Incentive Plan. Performance stock units vest at the end of a three-year performance period. Upon vesting, the number of shares of the Company s Class A common stock awarded to each performance stock unit recipient will be determined based on the Company s performance relative to certain performance goals set at the time the performance stock units were granted. The performance goals for the 2014 performance stock units are based on the compound annual growth rate of the Company s revenue over the three-year performance

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period and the Company s return on invested capital (ROIC) for the third year of the performance period. The performance period for the 2014 performance stock units is January 1, 2014 through December 31, 2016. The 2014 performance stock units also provide an overall minimum ROIC threshold, which the Company must exceed in order for any shares of the Company s Class A common stock to be earned. The number of shares of Class A common stock that may be earned by a performance stock unit recipient ranges from 0% to 200% of a target number of shares designated for each recipient at the time of grant. The performance stock units are amortized to expense over the vesting period based on the Company s performance relative to the performance goals. If such goals are not met, no compensation expense is recognized and previously recognized compensation expense is reversed. The Company issued 20,069 shares of performance stock units in the second quarter of 2014 under the 2004 Stock Incentive Plan.

The Company has a Management Stock Purchase Plan that allows for the purchase of restricted stock units (RSUs) by key employees. On an annual basis, key employees may elect to receive a portion of their annual incentive compensation in RSUs instead of cash. Each RSU represents one share of Class A common stock and is purchased by the employee at 67% of the fair market value of the Company s Class A common stock on the date of grant. RSUs vest either annually over a three-year period from the grant date or upon the third anniversary of the grant date and receipt of the shares underlying RSUs is deferred for a minimum of three years or such greater number of years as is chosen by the employee. An aggregate of 2,000,000 shares of Class A common stock may be issued under the Management Stock Purchase Plan. The Company granted 30,561 RSUs and 44,777 RSUs in the first six months of 2014 and 2013, respectively.

The fair value of each RSU issued under the Management Stock Purchase Plan is estimated on the date of grant using the Black-Scholes-Merton Model based on the following weighted average assumptions:

	2014	**2013**
Expected life (years)	**3.0**	3.0
Expected stock price volatility	**31.2%**	34.1%
Expected dividend yield	**0.9%**	0.9%
Risk-free interest rate	**0.7%**	0.4%

The above assumptions were used to determine the weighted average grant-date fair value of RSUs of $22.57 and $18.05 in 2014 and 2013, respectively.

A more detailed description of each of these plans can be found in Note 12 of Notes to Consolidated Financial Statements in the Company s Annual Report on Form 10-K for the year ended December 31, 2013.

Shipping and Handling

The Company s shipping and handling costs included in selling, general and administrative expenses were $15.8 million for the second quarters of 2014 and 2013, and were $30.5 million and $29.7 million for the first six months of 2014 and 2013, respectively. The 2013 shipping and handling costs disclosed have been updated to include handling costs in order to be comparable with the current quarter.

Research and Development

Research and development costs included in selling, general and administrative expenses were $5.6 million and $5.5 million for the second quarters of 2014 and 2013, respectively, and were $11.9 million and $10.9 million for the first six months of 2014 and 2013, respectively.

Taxes, Other than Income Taxes

Taxes assessed by governmental authorities on sale transactions are recorded on a net basis and excluded from sales in the Company s consolidated statements of operations.

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

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New Accounting Standards

In June of 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-12, Compensation Stock Compensation: Accounting for Share Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period . ASU 2014-12 clarifies that performance targets that could be achieved after the requisite period should be treated as performance conditions. Those performance conditions would not be reflected in estimating the grant date fair value of the award, but instead would be accounted for when the achievement of the performance condition becomes probable. ASU 2014-12 is effective in the first quarter of 2016 for public companies with calendar year ends, with early adoption permitted. The adoption of this guidance is not expected to have a material impact on the Company s financial statements.

In May of 2014, FASB issued ASU 2014-09, Revenue from Contracts with Customers . ASU 2014-09 converges revenue recognition under U.S. GAAP and IFRS. For U.S. GAAP, the standard generally eliminates transaction and industry-specific revenue recognition guidance. This includes current guidance on long-term construction-type contracts, software arrangements, real estate sales, telecommunication arrangements, and franchise sales. Under the new standard, revenue is recognized based on a five-step model. ASU 2014-09 is effective in the first quarter of 2017 for public companies with calendar year ends, and early adoption is not permitted for public companies under U.S. GAAP. The Company is assessing the impact of this standard on the Company s financial statements.

In April 2014, the FASB issued ASU 2014-08, Presentation of Financial Statements and Property, Plant, and Equipment: Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity . ASU 2014-08 will change the definition of discontinued operations and limit discontinued operations presentation to disposals of components representing a strategic shift that will have a major effect on the operations and financial results of the issuer. ASU 2014-08 is effective in the first quarter of 2015 for public companies with calendar year ends, with early adoption permitted. The adoption of this guidance is not expected to have a material impact on the Company s financial statements.

3. Discontinued Operations

On August 1, 2013, the Company completed the sale of all of the outstanding shares of an indirectly wholly-owned subsidiary, Watts Insulation GmbH (Austroflex), receiving net cash proceeds of $7.9 million. The loss after tax on disposal of the business was approximately $2.2 million. The Company does not have a substantial continuing involvement in Austroflex s operations and cash flows, therefore Austroflex s results of operations have been presented as discontinued operations and all periods presented have been adjusted in the consolidated interim financial statements to reflect Austroflex s results as discontinued operations. Austroflex s pretax loss included in discontinued operations for the six months ended June 30, 2013 was $0.2 million. Austroflex s revenues reported in discontinued operations were $4.5 million and $7.7 million for the three and six month periods ended June 30, 2013, respectively.

4. Financial Instruments and Derivative Instruments

The Company measures certain financial assets and liabilities at fair value on a recurring basis, including deferred compensation plan assets and related liability, and contingent consideration. There were no designated cash flow hedges as of June 29, 2014 and December 31, 2013. The fair values of these certain financial assets and liabilities were determined using the following inputs at June 29, 2014 and December 31, 2013:

	Total	Fair Value Measurements at June 29, 2014 Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(in millions)		
Assets				
Plan asset for deferred compensation(1)	$ 4.2	$ 4.2	$	$
Total assets	$ 4.2	$ 4.2	$	$
Liabilities				
Plan liability for deferred compensation(2)	$ 4.2	$ 4.2	$	$
Contingent consideration(3)	2.2			2.2
Total liabilities	$ 6.4	$ 4.2	$	$ 2.2

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	Fair Value Measurements at December 31, 2013 Using:			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(in millions)			
Assets				
Plan asset for deferred compensation(1)	$ 4.6	$ 4.6	$	$
Total assets	$ 4.6	$ 4.6	$	$
Liabilities				
Plan liability for deferred compensation(2)	$ 4.6	$ 4.6	$	$
Contingent consideration(3)	4.4			4.4
Total liabilities	$ 9.0	$ 4.6	$	$ 4.4

(1) Included on the Company s consolidated balance sheet in other assets (other, net).

(2) Included on the Company s consolidated balance sheet in accrued compensation and benefits.

(3) Included on the Company s consolidated balance sheet in accrued expenses and other liabilities as of June 29, 2014 and in other noncurrent liabilities and accrued expenses and other liabilities as of December 31, 2013.

The table below provides a summary of the changes in fair value of all financial assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the period December 31, 2013 to June 29, 2014.

	Balance December 31, 2013	Purchases, sales, settlements, net	Total realized and unrealized (gains) losses included in: Net earnings adjustments	Comprehensive income	Balance June 29, 2014
	(in millions)				
Contingent consideration	$ 4.4	$ (2.2)	$	$	$ 2.2

On January 31, 2012, the Company completed the acquisition of tekmar Control Systems (tekmar) in a share purchase transaction. The initial purchase price paid was CAD $18.0 million, with post-closing adjustments related to working capital and an earnout based on the attainment of certain future earnings levels. A contingent liability of $5.1 million was recognized as the estimate of the acquisition date fair value of the contingent consideration. This liability was classified as Level 3 under the fair value hierarchy as it was based on the probability of achievement of a future performance metric as of the date of the acquisition, which was not observable in the market. The contingent liability was increased by $1.0 million during 2013 based on a revised estimate of the fair value of the contingent consideration. A portion of the contingent consideration was paid out during the first quarter of 2014 and the second quarter of 2013, in the amount of $2.2 million and $1.2 million, respectively, based on performance metrics achieved. The earnout will be completed based on fiscal year 2014 earnings and final payment made in 2015.

Cash equivalents consist of instruments with remaining maturities of three months or less at the date of purchase and consist primarily of money market funds, for which the carrying amount is a reasonable estimate of fair value.

The Company uses financial instruments from time to time to enhance its ability to manage risk, including foreign currency and commodity pricing exposures, which exist as part of its ongoing business operations. The use of derivatives exposes the Company to counterparty credit risk for nonperformance and to market risk related to changes in currency exchange rates and commodity prices. The Company manages its exposure to counterparty credit risk through diversification of counterparties. The Company s counterparties in derivative transactions are substantial commercial banks with significant experience using such derivative instruments. The impact of market risk on the fair value and cash flows of the Company s derivative instruments is monitored and the Company restricts the use of derivative financial instruments to hedging activities. The Company does not enter into contracts for trading purposes nor does the Company enter into any contracts for speculative purposes. The use of derivative instruments is approved by senior management under written guidelines.

The Company has exposure to a number of foreign currency rates, including the Canadian dollar, the euro, the Chinese yuan and the British pound sterling. To manage this risk, the Company has in the past used a layering methodology and entered into forward

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exchange contracts which hedged approximately 50% of the projected intercompany purchase transactions for the next twelve months. The Company presently does not have any open forward exchange contracts.

Fair Value

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

The fair values of the Company s 5.85% senior notes due 2016, and 5.05% senior notes due 2020, are based on a discounted cash flow model using comparable industrial companies, the Company s credit metrics, the Company s size, as well as current market interest rates quoted in active markets and are classified within Level 2 of the valuation hierarchy. The fair value of the Company s variable rate debt approximates its carrying value. The carrying amount and the estimated fair market value of the Company s long-term debt, including the current portion, are as follows:

	June 29, 2014	December 31, 2013
	(in millions)	
Carrying amount	**$ 306.6**	$ 307.7
Estimated fair value	**$ 330.8**	$ 333.4

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5. Restructuring and Other Charges, Net

The Company s Board of Directors approves all major restructuring programs that involve the discontinuance of significant product lines or the shutdown of significant facilities. From time to time, the Company takes additional restructuring actions, including involuntary terminations that are not part of a major program. The Company accounts for these costs in the period that the individual employees are notified or the liability is incurred. These costs are included in restructuring and other charges in the Company s consolidated statements of operations.

2013 Actions

On July 30, 2013, the Board of Directors authorized a restructuring program with respect to the Company s EMEA segment to reduce its European manufacturing footprint, improve organizational and operational efficiency and better align costs with expected revenues in response to changing market conditions. The restructuring program is expected to include a pre-tax charge to earnings totaling approximately $14.7 million, approximately $10.9 million of which is expected to be recorded through fiscal 2014 and the remainder recorded during fiscal 2015. Total expected pre-tax charges increased as of the second quarter of 2014 from $14.0 to $14.7 million due to additional expected severance costs. The total charge will include costs for severance benefits, relocation, site clean-up, professional fees and certain asset write-downs. The total net after-tax charge for the restructuring program is expected to be approximately $10.3 million. The restructuring program is expected to be completed by the end of the fourth quarter of fiscal 2015. Certain aspects of the restructuring program are subject to further analysis and determinations by local management and consultation and negotiation with various works councils. The net after-tax charge incurred in the second quarter and first six months of 2014 was $1.4 million and $1.7 million, respectively.

Other Actions

The Company also periodically initiates other actions which are not part of a major program. In 2013 and 2014, the Company initiated restructuring activities in EMEA to relocate certain manufacturing activities and in EMEA and the Americas to reduce costs through a reduction-in-force. There are no remaining expected costs relating to these actions.

A summary of the pre-tax cost by restructuring program is as follows:

	Second Quarter Ended		Six Months Ended	
	June 29, 2014	**June 30, 2013**	**June 29, 2014**	**June 30, 2013**
		(in millions)		
Restructuring costs:				
2013 Actions	$ **2.1**	$	$ **2.5**	$
Other Actions	**0.5**	2.0	**4.3**	4.2
Total restructuring and other charges, net	**$ 2.6**	$ 2.0	**$ 6.8**	$ 4.2

The Company recorded pre-tax restructuring and other charges, net in its business segments as follows:

	Second Quarter Ended June 29, 2014	Second Quarter Ended June 30, 2013	Six Months Ended June 29, 2014	Six Months Ended June 30, 2013
	(in millions)			
Americas	**$ 0.4**	$ 0.1	**$ 2.3**	$ 0.3
EMEA	**2.2**	1.9	**3.7**	3.9
Corporate			**0.8**	
Total	**$ 2.6**	$ 2.0	**$ 6.8**	$ 4.2

Details of the Company s 2013 European footprint program reserve, which for the six months ended June 29, 2014 relates only to severance, is as follows:

	Six Months Ended June 29, 2014 (in millions)
Balance at December 31, 2013	$ 2.0
Net pre-tax restructuring charges	0.4
Utilization and foreign currency impact	(0.3)
Balance at March 30, 2014	$ 2.1
Net pre-tax restructuring charges	**2.1**
Utilization and foreign currency impact	**(1.4)**
Balance at June 29, 2014	**$ 2.8**

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The following table summarizes total expected, incurred and remaining pre-tax costs for 2013 European footprint program actions by type, and all attributable to the EMEA reportable segment:

	Severance	Legal and consultancy	Asset write-downs	Facility exit and other	Total
			(in millions)		
Expected costs	$ 13.0	$ 1.3	$ 0.2	$ 0.2	$ 14.7
Costs incurred 2013	(4.1)				(4.1)
Costs incurred first quarter 2014	(0.1)		(0.2)	(0.1)	(0.4)
Costs incurred second quarter 2014	**(2.0)**	**(0.1)**			**(2.1)**
Remaining costs at June 29, 2014	**$ 6.8**	**$ 1.2**	**$**	**$ 0.1**	**$ 8.1**

6. Earnings per Share

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

	For the Second Quarter Ended June 29, 2014			For the Second Quarter Ended June 30, 2013		
	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)	Per Share Amount
	(amounts in millions, except per share amounts)					
Basic EPS:						
Net income	**$ 21.3**	**35.3**	**$ 0.60**	$ 18.9	35.5	$ 0.53
Effect of dilutive securities						
Common stock equivalents		**0.1**			0.1	
Diluted EPS:						
Net income	**$ 21.3**	**35.4**	**$ 0.60**	$ 18.9	35.6	$ 0.53

Options to purchase 0.3 million and 0.4 million shares of Class A common stock were outstanding during the second quarters of 2014 and 2013, respectively, but were not included in the computation of diluted EPS because to do so would be anti-dilutive.

	For the First Six Months Ended June 29, 2014			For the First Six Months Ended June 30, 2013		
	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)	Per Share Amount
	(amounts in millions, except per share amounts)					
Basic EPS						
Net income:						
Continuing operations	**$ 35.4**	**35.3**	**$ 1.00**	$ 35.2	35.5	$ 0.99
Discontinued operations				(0.2)		(0.01)
Net income	**$ 35.4**		**$ 1.00**	$ 35.0		$ 0.99
Effect of dilutive securities						
Common stock equivalents		**0.1**			0.1	
Diluted EPS						
Net income:						
Continuing operations	**$ 35.4**		**$ 1.00**	$ 35.2		$ 0.99

Discontinued operations							(0.2)			(0.01)
Net income	**$**	**35.4**	**35.4**	**$**	**1.00**	$	35.0	35.6	$	0.98

Options to purchase 0.3 million and 0.4 million shares of Class A common stock were outstanding during each of the first six months of 2014 and 2013, respectively, but were not included in the computation of diluted EPS because to do so would be anti-dilutive.

On April 30, 2013, the Company s Board of Directors authorized the repurchase of up to $90 million of the Company s Class A common stock from time to time on the open market or in privately negotiated transactions. The timing and number of any shares repurchased will be determined by the Company s management based on its evaluation of market conditions. Repurchases may also

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be made under a Rule 10b5-1 plan, which would permit shares to be repurchased when the Company might otherwise be precluded from doing so under insider trading laws. The repurchase program may be suspended or discontinued at any time, subject to the terms of any Rule 10b5-1 plan the Company may enter into with respect to the repurchase program. During the second quarter ended June 29, 2014, the Company repurchased approximately 186,000 shares of Class A common stock at a cost of approximately $10.6 million. During the first six months of 2014, the Company repurchased approximately 347,000 shares of Class A common stock at a cost of approximately $20.0 million. During the quarter ended and six months ended June 30, 2013, the Company repurchased approximately 213,000 shares of Class A common stock at a cost of approximately $10.0 million.

7. Segment Information

The Company operates in three geographic segments: Americas, EMEA, and Asia-Pacific. Each of these operating segments is managed separately and has separate financial results that are reviewed by the Company s chief operating decision-maker. All intercompany sales transactions have been eliminated. Sales by region are based upon location of the entity recording the sale. The accounting policies for each segment are the same as those described in the summary of significant accounting policies.

As of January 1, 2014, the Company began allocating certain expenses to its three operating segments that had previously been recorded as Corporate expenses. These expenses primarily include stock compensation, legal expenses and audit expenses that are directly attributable to and benefit the three operating segments. The 2013 results have been retrospectively revised for comparative purposes.

The following is a summary of the Company s significant accounts and balances by segment, reconciled to the consolidated totals:

	Second Quarter Ended		Six Months Ended	
	June 29, 2014	**June 30, 2013**	**June 29, 2014**	**June 30, 2013**
		(in millions)		
Net Sales				
Americas	**$ 241.8**	$ 224.4	**$ 460.9**	$ 437.4
EMEA	**143.9**	134.1	**283.0**	273.3
Asia-Pacific	**10.3**	8.3	**17.3**	15.0
Consolidated net sales	**$ 396.0**	$ 366.8	**$ 761.2**	$ 725.7
Operating income (loss)				
Americas	**$ 29.0**	$ 30.7	**$ 51.6**	$ 52.8
EMEA	**13.1**	9.8	**22.0**	20.7
Asia-Pacific	**2.1**	2.4	**3.0**	5.3
Subtotal reportable segments	**44.2**	42.9	**76.6**	78.8
Corporate (*)	**(7.6)**	(7.3)	**(14.2)**	(14.6)
Consolidated operating income	**36.6**	35.6	**62.4**	64.2
Interest income	**0.2**	0.2	**0.3**	0.3
Interest expense	**(4.9)**	(5.5)	**(9.8)**	(11.5)
Other income (expense), net	**0.1**	(1.4)	**(0.3)**	(1.4)
Income from continuing operations before income taxes	**$ 32.0**	$ 28.9	**$ 52.6**	$ 51.6

Capital Expenditures								
Americas	**$**	**2.7**	$	4.6	**$**	**4.9**	$	12.8
EMEA		**2.6**		2.1		**5.1**		4.3
Asia-Pacific		**0.3**		0.3		**0.6**		0.9
Consolidated capital expenditures	**$**	**5.6**	$	7.0	**$**	**10.6**	$	18.0
Depreciation and Amortization								
Americas	**$**	**4.9**	$	5.1	**$**	**9.7**	$	10.1
EMEA		**6.8**		6.4		**13.4**		12.9
Asia-Pacific		**0.4**		0.6		**0.9**		1.3
Consolidated depreciation and amortization	**$**	**12.1**	$	12.1	**$**	**24.0**	$	24.3
Identifiable Assets (at end of period)								
Americas					**$**	**768.2**	$	743.0
EMEA						**877.9**		800.2
Asia-Pacific						**80.6**		80.1
Discontinued operations								12.5
Consolidated identifiable assets					**$**	**1,726.7**	$	1,635.8
Property, plant and equipment, net (at end of period)								
Americas					**$**	**84.0**	$	86.0
EMEA						**114.7**		119.5
Asia-Pacific						**13.6**		14.6
Consolidated property, plant and equipment, net					**$**	**212.3**	$	220.1

* Corporate expenses are primarily for administrative compensation expense, compliance costs, professional fees, including corporate-related legal and audit expenses, shareholder services and benefit administration costs.

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Apart from the change noted above resulting from allocating certain expenses to its operating segments, the above operating segments are presented on a basis consistent with the presentation included in the Company s December 31, 2013 consolidated financial statements included in its Annual Report on Form 10-K.

The U.S. property, plant and equipment of the Company s Americas segment was $79.5 million and $81.0 million at June 29, 2014 and June 30, 2013, respectively. The following includes U.S. net sales of the Company s Americas segment:

	Second Quarter Ended		Six Months Ended	
	June 29, 2014	June 30, 2013	June 29, 2014	June 30, 2013
	(in millions)			
U.S. net sales	**$ 222.1**	$ 201.6	**$ 423.7**	$ 394.4

The following includes intersegment sales for Americas, EMEA and Asia-Pacific:

	Second Quarter Ended		Six Months Ended	
	June 29, 2014	June 30, 2013	June 29, 2014	June 30, 2013
	(in millions)			
Intersegment Sales				
Americas	**$ 1.9**	$ 1.3	**$ 3.1**	$ 2.6
EMEA	**3.8**	2.4	**7.4**	5.1
Asia-Pacific	**41.4**	47.5	**80.4**	89.1
Intersegment sales	**$ 47.1**	$ 51.2	**$ 90.9**	$ 96.8

8. Accumulated Other Comprehensive Income (Loss)

Accumulated other comprehensive income (loss) consists of the following:

	Foreign Currency Translation	Pension Adjustment	Accumulated Other Comprehensive Income (Loss)
		(in millions)	
Balance December 31, 2013	**$ 37.9**	**$ (25.9)**	**$ 12.0**
Change in period	**(4.3)**	**0.2**	**(4.1)**
Balance March 30, 2014	**$ 33.6**	**$ (25.7)**	**$ 7.9**
Change in period	**(4.3)**	**0.1**	**(4.2)**
Balance June 29, 2014	**$ 29.3**	**$ (25.6)**	**$ 3.7**
Balance December 31, 2012	$ 14.4	$ (25.2)	$ (10.8)

Change in period	(19.9)	0.2	(19.7)
Balance March 31, 2013	$ (5.5)	$ (25.0)	$ (30.5)
Change in period	7.5	0.1	7.6
Balance June 30, 2013	$ 2.0	$ (24.9)	$ (22.9)

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9. Debt

On February 18, 2014, the Company terminated its prior credit agreement and entered into a new Credit Agreement (the Credit Agreement) among the Company, certain subsidiaries of the Company who become borrowers under the Credit Agreement, JPMorgan Chase Bank, N.A., as Administrative Agent, Swing Line Lender and Letter of Credit Issuer, and the other lenders referred to therein. The Credit Agreement provides for a $500 million, five-year, senior unsecured revolving credit facility which may be increased by an additional $500 million under certain circumstances and subject to the terms of the Credit Agreement. The Credit Agreement has a sublimit of up to $100 million in letters of credit. The Credit Agreement matures on February 18, 2019.

Borrowings outstanding under the Credit Agreement bear interest at a fluctuating rate per annum equal to an applicable percentage equal to (1) in the case of Eurocurrency rate loans, the British Bankers Association LIBOR rate plus an applicable percentage, ranging from 0.975% to 1.45%, determined by reference to the Company s consolidated leverage ratio, or (2) in the case of base rate loans and swing line loans, the highest of (a) the federal funds rate plus 0.5%, (b) the rate of interest in effect for such day as announced by JPMorgan Chase Bank, N.A. as its prime rate, and (c) the British Bankers Association LIBOR rate plus 1.0%, plus an applicable percentage, ranging from 0.00% to 0.45%, determined by reference to the Company s consolidated leverage ratio. In addition to paying interest under the Credit Agreement, the Company is also required to pay certain fees in connection with the credit facility, including, but not limited to, an unused facility fee and letter of credit fees. Under the Credit Agreement, the Company is required to satisfy and maintain specified financial ratios and other financial condition tests. The Company may repay loans outstanding under the Credit Agreement from time to time without premium or penalty, other than customary breakage costs, if any, and subject to the terms of the Credit Agreement. As of June 29, 2014, the Company was in compliance with all covenants related to the Credit Agreement and had $476.4 million of unused and available credit under the Credit Agreement and $23.6 million of stand-by letters of credit outstanding on the Credit Agreement. The Company did not have any borrowings outstanding under the Credit Agreement at June 29, 2014.

The Company is a party to several note agreements as further detailed in Note 10 of Notes to Consolidated Financial Statements of the Annual Report on Form 10-K for the year ended December 31, 2013. These note agreements require the Company to maintain a fixed charge coverage ratio of consolidated EBITDA plus consolidated rent expense during the period to consolidated fixed charges. Consolidated fixed charges are the sum of consolidated interest expense for the period and consolidated rent expense. As of June 29, 2014, the Company was in compliance with all covenants regarding these note agreements.

10. Contingencies and Environmental Remediation

Accrual and Disclosure Policy

The Company is a defendant in numerous legal matters arising from its ordinary course of operations, including those involving product liability, environmental matters and commercial disputes.

The Company reviews its lawsuits and other legal proceedings on an ongoing basis and follows appropriate accounting guidance when making accrual and disclosure decisions. The Company establishes accruals for matters when the Company assesses that it is probable that a loss has been incurred and the amount of the loss can be reasonably estimated. The Company does not establish accruals for such matters when the

Company does not believe both that it is probable that a loss has been incurred and the amount of the loss can be reasonably estimated. The Company s assessment of whether a loss is probable is based on its assessment of the ultimate outcome of the matter following all appeals.

Under the FASB issued ASC 450 Contingencies , an event is reasonably possible if the chance of the future event or events occurring is more than remote but less than likely and an event is remote if the chance of the future event or events occurring is slight . Thus, references to the upper end of the range of reasonably possible loss for cases in which the Company is able to estimate a range of reasonably possible loss mean the upper end of the range of loss for cases for which the Company believes the risk of loss is more than slight.

There may continue to be exposure to loss in excess of any amount accrued. When it is possible to estimate the reasonably possible loss or range of loss above the amount accrued for the matters disclosed, that estimate is aggregated and disclosed. The Company

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records legal costs associated with its legal contingencies as incurred, except for legal costs associated with product liability claims which are included in the product liability accrual.

As of June 29, 2014, the Company estimates that the aggregate amount of reasonably possible loss in excess of the amount accrued for its legal contingencies is approximately $10.3 million, pre-tax. With respect to the estimate of reasonably possible loss, management has estimated the upper end of the range of reasonably possible loss based on (i) the amount of money damages claimed, where applicable, (ii) the allegations and factual development to date, (iii) available defenses based on the allegations, and/or (iv) other potentially liable parties. This estimate is based upon currently available information and is subject to significant judgment and a variety of assumptions, and known and unknown uncertainties. The matters underlying the estimate will change from time to time, and actual results may vary significantly from the current estimate. In the event of an unfavorable outcome in one or more matters, the ultimate liability may be in excess of amounts currently accrued, if any, and may be material to the Company s operating results or cash flows for a particular quarterly or annual period. However, based on information currently known to it, management believes that the ultimate outcome of all matters, as they are resolved over time, is not likely to have a material adverse effect on the financial condition of the Company, though the outcome could be material to the Company s operating results for any particular period depending, in part, upon the operating results for such period.

Trabakoolas et al., v, Watts Water Technologies, Inc., et al.,

On March 8, 2012, Watts Water Technologies, Inc., Watts Regulator Co., and Watts Plumbing Technologies Co., Ltd., among other companies, were named as defendants in a putative nationwide class action complaint filed in the U.S. District Court for the Northern District of California seeking to recover damages and other relief based on the alleged failure of toilet connectors. The complaint sought among other items, damages in an unspecified amount, replacement costs, injunctive relief, and attorneys fees and costs.

On December 12, 2013, the Company reached an agreement in principle to settle all claims. The total settlement amount is $23.0 million, of which the Company would be responsible for $14.0 million after insurance proceeds of $9.0 million. The settlement was subject to review by the Court at a preliminary approval hearing held on February 12, 2014. The Court granted preliminary approval on February 14, 2014. On July 18, 2014, the Court granted final approval of the class settlement at a fairness hearing, and issued a subsequent written order formalizing the approval on August 5, 2014. The order will become final unless an appeal is taken within thirty days. The Company will vigorously contest any appeal that is taken. If the order becomes final without an appeal, the litigation will be terminated.

During the fourth quarter of 2013, the Company recorded a liability of $22.6 million related to the Trabakoolas matter, of which $12.7 million was included in current liabilities and $9.9 million in other noncurrent liabilities. In addition, a $9.0 million receivable was recorded in current assets related to insurance proceeds due under a separate settlement agreement if the class action settlement is approved and becomes final. The liability was reduced by $1.3 million for notice and claims administrator payments made during the first half of 2014 and as of June 29, 2014, the remaining total liability was $21.3 million.

Product Liability

The Company is subject to a variety of potential liabilities in connection with product liability cases. The Company maintains product liability and other insurance coverage, which the Company believes to be generally in accordance with industry practices. For product liability cases in the U.S., management establishes its product liability accrual, which includes legal costs associated with accrued claims, by utilizing third-party actuarial valuations which incorporate historical trend factors and the Company s specific claims experience derived from loss reports provided by third-party claims administrators. Changes in the nature of claims, legal costs, or the actual settlement amounts could affect the adequacy of this estimate and require changes to the accrual. Because the liability is an estimate, the ultimate liability may be more or less than reported. In other countries, the Company maintains insurance coverage with relatively high deductible payments, as product liability claims tend to be smaller than those experienced in the U.S.

Environmental Remediation

The Company has been named as a potentially responsible party with respect to a limited number of identified contaminated sites. The levels of contamination vary significantly from site to site as do the related levels of remediation efforts. Environmental liabilities are recorded based on the most probable cost, if known, or on the estimated minimum cost of remediation. Accruals are not discounted to their present value, unless the amount and timing of expenditures are fixed and reliably determinable. The Company accrues estimated environmental liabilities based on assumptions, which are subject to a number of factors and uncertainties. Circumstances that can affect the reliability and precision of these estimates include identification of additional sites, environmental regulations, level of cleanup required, technologies available, number and financial condition of other contributors to remediation and the time period over which remediation may occur. The Company recognizes changes in estimates as new remediation requirements are defined or as new information becomes available. Environmental liabilities as of the second quarter ended 2014 and 2013 were not considered material.

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Asbestos Litigation

The Company is defending 47 lawsuits in different jurisdictions, alleging injury or death as a result of exposure to asbestos. The complaints in these cases typically name a large number of defendants and do not identify any particular Company products as a source of asbestos exposure. To date, the Company has obtained a dismissal in every case before it has reached trial because discovery has failed to yield evidence of substantial exposure to any Company products.

Other Litigation

Other lawsuits and proceedings or claims, arising from the ordinary course of operations, are also pending or threatened against the Company.

11. Defined Benefit Plans

For the majority of its U.S. employees, the Company sponsors a funded non-contributing defined benefit pension plan, the Watts Water Technologies, Inc. Pension Plan (the Pension Plan), and an unfunded non-contributing defined benefit pension plan, the Watts Water Technologies, Inc. Supplemental Employees Retirement Plan (the SERP). Benefits are based primarily on years of service and employees compensation. The funding policy of the Company for these plans is to contribute an annual amount that does not exceed the maximum amount that can be deducted for federal income tax purposes. On October 31, 2011, the Company s Board of Directors voted to cease accruals effective December 31, 2011 under both the Company s Pension Plan and the SERP. On April 28, 2014, the Company s Board of Directors voted to terminate the Company s Pension Plan and the SERP.

The Pension Plan was terminated effective July 31, 2014. Distribution of plan assets pursuant to the termination will not be made until the plan termination satisfies the regulatory requirements prescribed by the Internal Revenue Service and the Pension Benefit Guaranty Corporation, which is expected to occur in late 2015. The SERP was terminated effective May 15, 2014. The Company will settle all liabilities under the SERP in accordance with Section 409A of the Internal Revenue Code by paying lump sums to plan participants at least twelve and no more than twenty four months following the termination date. The Board of Directors authorized the Company to make such contributions to the Pension Plan and SERP as may be necessary to make the plans sufficient to settle all plan liabilities.

The components of net periodic benefit cost are as follows:

	Second Quarter Ended		Six Months Ended	
	June 29, 2014	**June 30, 2013**	**June 29, 2014**	**June 30, 2013**
		(in millions)		
Service cost administrative costs	$ **0.1**	$ 0.1	$ **0.3**	$ 0.2
Interest costs on benefits obligation	**1.5**	1.4	**3.0**	2.8
Expected return on assets	**(1.5)**	(1.7)	**(3.0)**	(3.4)

Net actuarial loss amortization		**0.2**		0.2		**0.5**		0.4
Net periodic benefit cost	**$**	**0.3**	$		**$**	**0.8**	$	

The information related to the Company s pension funds cash flow is as follows:

	Six Months Ended			
	June 29, 2014		**June 30, 2013**	
	(in millions)			
Employer contributions	**$**	**0.4**	$	0.4

The Company expects to contribute approximately $0.4 million to its pension plans for the remainder of 2014.

12. Subsequent Events

Dividend Declared

On July 29, 2014, the Company declared a quarterly dividend of fifteen cents ($0.15) per share on each outstanding share of Class A common stock and Class B common stock payable on August 29, 2014 to stockholders of record at the close of business on August 18, 2014.

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Item 2. Management s Discussion And Analysis Of Financial Condition And Results Of Operations

Overview

The following discussion and analysis are provided to increase understanding of, and should be read in conjunction with, the accompanying unaudited consolidated financial statements and notes. In this quarterly report on Form 10-Q, references to the Company, Watts, we, us or ou refer to Watts Water Technologies, Inc. and its consolidated subsidiaries.

We operate on a 52-week calendar year ending on December 31. Any quarterly data contained in this Quarterly Report on Form 10-Q generally reflect the results of operations for a 13-week period or 26-week period, respectively.

We are a leading supplier of products for use in the water quality, water safety, water flow control and water conservation markets in both the Americas and EMEA (Europe, Middle East and Africa), with a growing presence in Asia-Pacific. For 140 years, we have designed and manufactured products that promote comfort and safety of people and the quality and conservation of water used in commercial and residential applications. We earn revenue and income almost exclusively from the sale of our products. Our principal product lines are:

- Residential & commercial flow control products includes products typically sold into plumbing and hot water applications such as backflow preventers, water pressure regulators, temperature and pressure relief valves, and thermostatic mixing valves.

- HVAC & gas products includes hydronic and electric heating systems for under-floor radiant applications, hydronic pump groups for boiler manufacturers and alternative energy control packages, and flexible stainless steel connectors for natural and liquid propane gas in commercial food service and residential applications. HVAC is an acronym for heating, ventilation and air conditioning.

- Drains & water re-use products includes drainage products and engineered rain water harvesting solutions for commercial, industrial, marine and residential applications.

- Water quality products includes point-of-use and point-of-entry water filtration, conditioning and scale prevention systems for both commercial and residential applications.

Our business is reported in three geographic segments: Americas, EMEA and Asia-Pacific. We distribute our products through three primary distribution channels: wholesale, do-it-yourself (DIY) and original equipment manufacturers (OEMs). Interest rates, the unemployment rate and credit availability have an indirect effect on the demand for our products due to the effect such rates have on the number of new residential and commercial construction starts and remodeling projects. All of these activities have an impact on our levels of sales and earnings. An additional factor that has an effect on our sales and operating income is fluctuation in foreign currency exchange rates, as approximately 44% of our sales in the second quarter ended June 29, 2014, and certain portions of our costs, assets and liabilities are denominated in currencies other than the U.S. dollar.

During the second quarter of 2014, sales increased $29.2 million as compared to the second quarter of 2013, primarily from an organic increase in sales of $23.7 million and a favorable foreign exchange movement of $5.5 million. The foreign exchange impact was primarily due to the appreciation of the euro against the U.S. dollar, partially offset by the weakening of the Canadian dollar against the U.S. dollar. Organic sales increased by 6.5% compared to last year s comparable period, primarily from increased sales in the Americas. Organic sales in the second quarter of 2014 increased in the Americas by $18.7 million, or 8.3%, an increase in EMEA of $3.1 million, or 2.3%, and an increase in Asia-Pacific by $1.9 million, or 22.9%. Organic sales growth excludes the impacts of acquisitions, divestitures and foreign exchange from year-over-year comparisons. We believe this provides investors with a more complete understanding of underlying sales trends by providing sales growth on a consistent basis. Gross margin decreased in the second quarter of 2014 as compared to 2013 by 1.1 percentage points. The decrease is due primarily to lower absorption, higher production costs and increased customer rebate expense in the Americas partially offset by production efficiencies, favorable material prices and cost containment in EMEA. Operating income of $36.6 million increased by 2.8% in the second quarter of 2014 as compared to the second quarter of 2013, driven primarily by cost control efforts in EMEA offset by increased selling, general and administrative expenses and restructuring costs. Included in selling, general and administrative expenses for the quarter was $1.6 million of EMEA transformation deployment costs.

The EMEA transformation program began in the fourth quarter of 2013 and is designed to realign our European operating strategy from being country specific to pan European focused. Under this initiative, we intend to (1) develop better sales capabilities through improved product management and enhanced product cross-selling efforts, (2) drive more efficient sourcing and logistics, and (3) enhance our focus on emerging market opportunities. We plan to align our legal and tax structure in accordance with our business structure and take advantage of favorable tax rates where possible. We expect this project to be ongoing through 2016. We incurred non-recurring deployment costs of approximately $1.6 million and $5.1 million in the three and six month periods ended June 29, 2014, respectively, and $6.3 million for the project to date. These non-recurring costs consist primarily of external consulting and IT related costs, and are exclusive of restructuring expense. A more detailed description of this program can be found in the Company s Annual Report on Form 10-K for the year ended December 31, 2013.

We believe that the factors relating to our future growth include the demand for clean water around the world, a healthy economic environment regulatory requirements relating to the quality and conservation of water, continued enforcement of plumbing and building codes, our ability to grow organically in select attractive market segments and geographic regions and the successful completion of selective acquisitions. Our acquisition strategy focuses on businesses that manufacture preferred brand name or specified products that address our themes of water quality, water conservation, water safety, water flow control, HVAC and related complementary markets and geographies. We target businesses that will provide us with one or more of the following: an entry into new markets and geographies, an increase in business with existing customers, a new or improved technology or an expansion of the breadth of our water quality, water conservation, water safety and water flow control and HVAC products for the residential, commercial and light industrial markets. We have completed 36 acquisitions since 1999.

Products representing a majority of our sales are subject to regulatory standards and code enforcement, which typically require that these products meet stringent performance criteria. Together with our commissioned manufacturers representatives, we have consistently advocated for the development and enforcement of such plumbing codes. We are focused on maintaining stringent quality control and testing procedures at each of our manufacturing facilities in order to manufacture products in compliance with code requirements and take advantage of the resulting demand for compliant products.

Historically, we have faced a risk relating to our ability to respond to raw material cost fluctuations. We manage this risk by monitoring related market prices, working with our suppliers to achieve the maximum level of stability in their costs and related pricing, seeking alternative supply sources when necessary, purchasing forward commitments for raw materials, when available, implementing cost reduction programs and passing increases in costs to our customers in the form of price increases.

Another risk we face in all areas of our business is competition. We consider brand preference, engineering specifications, code requirements, price, technological expertise, delivery times, quality and breadth of product offerings to be the primary competitive factors. We believe that product development, product testing capability, breadth of product offerings and investment in plant and equipment needed to manufacture products in compliance with code requirements represent a competitive advantage for us. We expect to spend approximately $25 to $28 million during 2014 for purchases of capital equipment to continue to improve our manufacturing capabilities.

Recent Events

Dividend Declared

On July 29, 2014, we declared a quarterly dividend of fifteen cents ($0.15) per share on each outstanding share of Class A common stock and Class B common stock payable on August 29, 2014 to stockholders of record at the close of business on August 18, 2014.

Termination of Pension Plans

On April 28, 2014, our Board of Directors voted to terminate the Watts Water Technologies, Inc. Pension Plan (the Pension Plan) and the Watts Water Technologies, Inc. Supplemental Employees Retirement Plan (the SERP). These terminations follow amendments to the Pension Plan and SERP to cease (or freeze) benefit accruals for eligible employees under those plans effective December 31, 2011.

The Pension Plan was terminated effective July 31, 2014. Distribution of plan assets pursuant to the termination will not be made until the plan termination satisfies the regulatory requirements prescribed by the Internal Revenue Service and the Pension Benefit Guaranty Corporation, which is expected to occur in late 2015. The SERP was terminated effective May 15, 2014. We will settle all liabilities under the SERP in accordance with Section 409A of the Internal Revenue Code by paying lump sums to plan participants at least twelve and no more than twenty four months following the termination date. The Board of Directors authorized us to make such contributions to the Pension Plan and SERP as may be necessary to make the plans sufficient to settle all plan liabilities.

Trabakoolas et al., v, Watts Water Technologies, Inc., et al.,

On March 8, 2012, Watts Water Technologies, Inc., Watts Regulator Co., and Watts Plumbing Technologies Co., Ltd., among other companies, were named as defendants in a putative nationwide class action complaint filed in the U.S. District Court for the Northern District of California seeking to recover damages and other relief based on the alleged failure of toilet connectors. The complaint seeks among other items, damages in an unspecified amount, replacement costs, injunctive relief, and attorneys fees and costs.

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On December 12, 2013, we reached an agreement in principle to settle all claims. The total settlement amount is $23.0 million, of which we would be responsible for $14.0 million after insurance proceeds of $9.0 million. The settlement was subject to review by the Court at a preliminary approval hearing held on February 12, 2014. The Court granted preliminary approval on February 14, 2014. On July 18, 2014, the Court granted final approval of the class settlement at a fairness hearing, and issued a subsequent written order formalizing the approval on August 5, 2014. The order will become final unless an appeal is taken within thirty days.

Results of Operations

Second Quarter Ended June 29, 2014 Compared to Second Quarter Ended June 30, 2013

Net Sales. Our business is reported in three geographic segments: Americas, EMEA and Asia-Pacific. Our net sales in each of these segments for each of the second quarters of 2014 and 2013 were as follows:

	Second Quarter Ended June 29, 2014		Second Quarter Ended June 30, 2013			% Change to Consolidated
	Net Sales	% Sales	Net Sales	% Sales	Change	Net Sales
			(dollars in millions)			
Americas	**$ 241.8**	**61.1%**	$ 224.4	61.2%	$ 17.4	4.7%
EMEA	**143.9**	**36.3**	134.1	36.5	9.8	2.7
Asia-Pacific	**10.3**	**2.6**	8.3	2.3	2.0	0.6
Total	**$ 396.0**	**100.0%**	$ 366.8	100.0%	$ 29.2	8.0%

The change in net sales was attributable to the following:

					Change As a % of Consolidated Net Sales				Change As a % of Segment Net Sales		
	Americas	EMEA	Asia-Pacific	Total	Americas	EMEA	Asia-Pacific	Total	Americas	EMEA	Asia-Pacific
							(dollars in millions)				
Organic	$ 18.7	$ 3.1	$ 1.9	$ 23.7	5.1%	0.9%	0.5%	6.5%	8.3%	2.3%	22.9%
Foreign exchange	(1.3)	6.7	0.1	5.5	(0.4)	1.8	0.1	1.5	(0.5)	5.0	1.2
Total	$ 17.4	$ 9.8	$ 2.0	$ 29.2	4.7%	2.7%	0.6%	8.0%	7.8%	7.3%	24.1%

Our products are sold to wholesalers, DIY chains, and OEMs. The change in organic net sales by channel was attributable to the following:

					Change As a % of Prior Year Sales		
	Wholesale	DIY	OEMs	Total	Wholesale	DIY	OEMs
				(dollars in millions)			
Americas	$ 17.5	$ 1.3	$ (0.1)	$ 18.7	10.9%	2.9%	(0.5)%

EMEA	(1.4)	(0.4)	4.9	3.1	(2.0)	(10.3)	8.2
Asia-Pacific	1.9			1.9	22.9		
Total	$ 18.0	$ 0.9	$ 4.8	$ 23.7			

Organic net sales in the Americas wholesale and DIY markets increased in the second quarter of 2014, compared to the second quarter of 2013, mainly due to increased sales in residential and commercial flow product lines.

Organic net sales in the EMEA wholesale market decreased as compared to the second quarter of 2013 primarily due to a general wholesale market decline including slower Italian and Middle East markets and a slight decrease in the drains market. These decreases were offset by increased sales in the German OEM market and our electronic controls business.

Organic net sales in the Asia-Pacific wholesale market increased as compared to the second quarter of 2013 primarily due to increased sales in residential valve and heating products.

The net increase in sales due to foreign exchange was primarily due to the appreciation of the euro and the Chinese yuan against the U.S. dollar offset partially by the depreciation of the Canadian dollar against the U.S. dollar. We cannot predict whether foreign currencies will appreciate or depreciate against the U.S. dollar in future periods or whether future foreign exchange rate fluctuations will have a positive or negative impact on our net sales.

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Gross Profit. Gross profit and gross profit as a percent of net sales (gross margin) for the second quarters of 2014 and 2013 were as follows:

	Second Quarter Ended	
	June 29, 2014 (dollars in millions)	June 30, 2013
Gross profit	**$ 139.0**	$ 132.8
Gross margin	**35.1%**	36.2%

Americas gross margin decreased compared to the second quarter of 2013 due primarily to higher production costs mainly in our lead free foundry and increased customer rebates. EMEA s gross margin increased primarily due to production efficiencies, favorable material prices and cost containment.

Selling, General and Administrative Expenses. Selling, general and administrative, or SG&A, expenses for the second quarter of 2014 increased $4.6 million, or 4.8%, compared to the second quarter of 2013. The increase in SG&A expenses was attributable to the following:

	(in millions)	% Change
Organic	$ 3.3	3.5%
Foreign exchange	1.3	1.3
Total	$ 4.6	4.8%

The organic increase in SG&A expenses was primarily due to EMEA transformation non-recurring deployment costs of $1.6 million, increased commission and freight costs of $1.2 million associated with increased sales, increased personnel costs of $0.8 million, and increased product liability and workers compensation costs of $0.6 million, partially offset by a decrease in legal expense of $0.7 million due to fewer ongoing legal matters. The non-recurring EMEA deployment costs of $1.6 million consist primarily of external consulting and IT related costs. The increase in SG&A expenses from foreign exchange was primarily due to the appreciation of the euro against the U.S. dollar in 2014. Total SG&A expenses, as a percentage of sales, were 25.2% in the second quarter of 2014 and 26.0% in the second quarter of 2013.

Restructuring and Other Charges, Net. In the second quarter of 2014, we recorded a net charge of $2.6 million primarily for involuntary terminations and other costs incurred as part of our EMEA restructuring plans and a reduction-in-force in the Americas, as compared to $2.0 million of restructuring charges for the second quarter of 2013. For a more detailed description of our current restructuring plans, see Note 5 of Notes to Consolidated Financial Statements.

Operating Income. Operating income (loss) by geographic segment for the second quarters of 2014 and 2013 were as follows:

	Second Quarter Ended			% Change to Consolidated Operating Income
	June 29, 2014	June 30, 2013 (dollars in millions)	Change	

Americas	$	**29.0**	$	30.7	$	(1.7)	(4.8)%
EMEA		**13.1**		9.8		3.3	9.2
Asia-Pacific		**2.1**		2.4		(0.3)	(0.8)
Corporate		**(7.6)**		(7.3)		(0.3)	(0.8)
Total	$	**36.6**	$	35.6	$	1.0	2.8%

The increase (decrease) in operating income (loss) is attributable to the following:

						Change As a % of Consolidated Operating Income					Change As a % of Segment Operating Income			
	Americas	**EMEA**	**Asia-Pacific**	**Corporate**	**Total**	**Americas**	**EMEA**	**Asia-Pacific**	**Corporate**	**Total**	**Americas**	**EMEA**	**Asia-Pacific**	**Corporate**
								(dollars in millions)						
Organic	$ (1.1)	$ 2.7	$ (0.3)	$ (0.3)	$ 1.0	(3.1)%	7.5%	(0.8)%	(0.8)%	2.8%	(3.6)%	27.5%	(12.5)%	(4.1)%
Foreign exchange	(0.2)	0.8			0.6	(0.6)	2.3			1.7	(0.6)	8.2		
Restructuring, impairment charges and other	(0.4)	(0.2)			(0.6)	(1.1)	(0.6)			(1.7)	(1.3)	(2.0)		
Total	$ (1.7)	$ 3.3	$ (0.3)	$ (0.3)	$ 1.0	(4.8)%	9.2%	(0.8)%	(0.8)%	2.8%	(5.5)%	33.7%	(12.5)%	(4.1)%

The increase in consolidated operating income was due primarily to increased gross profit partially offset by an increase in SG&A expenses and restructuring and other charges. The decrease in Americas organic operating income was driven by higher production

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costs and increased restructuring expenses. The EMEA organic operating income increase was due to increased sales volumes, production efficiencies and SG&A expense reductions offset by the EMEA transformation deployment costs of $1.6 million.

Interest Expense. Interest expense decreased $0.6 million, or 10.9%, for the second quarter of 2014 as compared to the second quarter of 2013 primarily due to the retirement in mid-May 2013 of $75 million in unsecured senior notes and lower borrowing rates on our stand-by letters of credit.

Other expense (income), net. Other expense, net decreased $1.5 million for the second quarter of 2014 as compared to the second quarter of 2013 primarily due to fewer net foreign currency transaction losses.

Income Taxes. Our effective income tax rate for continuing operations decreased to 33.4% in the second quarter of 2014 from 34.6% for the second quarter of 2013. The decrease was largely due to worldwide earnings mix as a result of Europe contributing a larger portion of worldwide earnings in 2014 than in 2013 and certain tax adjustments in the second quarter of 2013 that did not repeat in 2014.

Net Income. Net income from continuing operations for the second quarter of 2014 was $21.3 million, or $0.60 per common share, compared to $18.9 million, or $0.53 per common share, for the second quarter of 2013. Results for the second quarter of 2014 include after-tax charges of $1.8 million, or $0.05 per common share, for restructuring and other charges, EMEA transformation deployment costs of $1.2 million or $0.04 per common share, compared to $1.5 million, or $0.04 per common share, for restructuring and other charges for the second quarter of 2013.

Six Months Ended June 29, 2014 Compared to Six Months Ended June 30, 2013

Net Sales. Our business is reported in three geographic segments: Americas, EMEA and Asia-Pacific. Our net sales in each of these segments for each of the first six months of 2014 and 2013 were as follows:

	Six Months Ended June 29, 2014		Six Months Ended June 30, 2013			% Change to Consolidated
	Net Sales	% Sales	Net Sales	% Sales	Change	Net Sales
			(dollars in millions)			
Americas	**$ 460.9**	**60.5%**	$ 437.4	60.3%	$ 23.5	3.3%
EMEA	**283.0**	**37.2**	273.3	37.6	9.7	1.3
Asia-Pacific	**17.3**	**2.3**	15.0	2.1	2.3	0.3
Total	**$ 761.2**	**100.0%**	$ 725.7	100.0%	$ 35.5	4.9%

The change in net sales was attributable to the following:

					Change As a % of Consolidated Net Sales				Change As a % of Segment Net Sales		
	Americas	EMEA	Asia-Pacific	Total	Americas	EMEA	Asia-Pacific	Total	Americas	EMEA	Asia-Pacific
							(dollars in millions)				
Organic	$ 26.5	$ (1.8)	$ 2.0	$ 26.7	3.7%	(0.3)%	0.3%	3.7%	6.1%	(0.7)%	13.3%
Foreign exchange	(3.0)	11.5	0.3	8.8	(0.4)	1.6		1.2	(0.7)	4.2	2.0
Total	$ 23.5	$ 9.7	$ 2.3	$ 35.5	3.3%	1.3%	0.3%	4.9%	5.4%	3.5%	15.3%

Our products are sold to wholesalers, DIY chains, and OEMs. The change in organic net sales by channel was attributable to the following:

					Change As a % of Prior Year Sales		
	Wholesale	DIY	OEMs	Total	Wholesale	DIY	OEMs
				(dollars in millions)			
Americas	$ 25.0	$ 1.4	$ 0.1	$ 26.5	8.0%	1.6%	0.3%
EMEA	(3.4)	(1.2)	2.8	(1.8)	(2.4)	(15.0)	2.3
Asia-Pacific	2.0			2.0	13.3		
Total	$ 23.6	$ 0.2	$ 2.9	$ 26.7			

Organic net sales in the Americas wholesale, DIY and OEM markets increased in the first six months of 2014, compared to the first six months of 2013, mainly due to increased sales volume and pricing in residential and commercial flow product lines.

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Organic net sales in the EMEA wholesale market decreased as compared to the first six months of 2013 primarily due to softening in the German wholesale market and a slight decrease in the drains and Middle East markets. These decreases were partially offset by increases in the EMEA OEM market by increased sales in the German OEM market and our electronic controls business.

Organic net sales in the Asia-Pacific wholesale market increased as compared to the second quarter of 2013 primarily due to increased sales in residential valve and heating products

The net increase in sales due to foreign exchange was primarily due to the appreciation of the euro and the Chinese yuan against the U.S. dollar offset partially by the depreciation of the Canadian dollar against the U.S. dollar. We cannot predict whether foreign currencies will appreciate or depreciate against the U.S. dollar in future periods or whether future foreign exchange rate fluctuations will have a positive or negative impact on our net sales.

Gross Profit. Gross profit and gross profit as a percent of net sales (gross margin) for the first six months of 2014 and 2013 were as follows:

	Six Months Ended			
	June 29, 2014		**June 30, 2013**	
	(dollars in millions)			
Gross profit	**$**	**272.3**	$	261.7
Gross margin		**35.8%**		36.1%

Americas gross margin decreased compared to the first six months of 2013 due primarily to higher production costs mainly in our lead free foundry and increased customer rebates more than offsetting the favorable product mix. EMEA s gross margin increased primarily due to production efficiencies, favorable material prices and cost reductions. Asia-Pacific s gross margin decreased slightly primarily due to reduced volume driven by lower intercompany sales.

Selling, General and Administrative Expenses. Selling, general and administrative, or SG&A, expenses for the first six months of 2014 increased $9.8 million, or 5.1%, compared to the first six months of 2013. The increase in SG&A expenses was attributable to the following:

		(in millions)	**% Change**
Organic	$	7.8	4.1%
Foreign exchange		2.0	1.0
Total	$	9.8	5.1%

The organic increase in SG&A expenses was primarily due to EMEA transformation non-recurring deployment costs of $5.1 million, a $1.9 million accrual for additional U.S. import duties and fees pertaining to activities during the previous five years, increased commission and freight costs of $2.8 million associated with increased sales, and increased product liability and workers compensation costs of $0.7 million, partially offset by decreased legal expenses of $2.4 million due to fewer ongoing legal matters and a favorable legal settlement of $1.5 million. The non-recurring EMEA deployment costs of $5.1 million consist primarily of external consulting and IT related costs. The increase in SG&A expenses from foreign exchange was primarily due to the appreciation of the euro against the U.S. dollar offset partially by the depreciation of the Canadian dollar against the U.S. dollar in 2014. Total SG&A expenses, as a percentage of sales, were 26.7% in the first six months of 2014 and 26.6% in the first six months of 2013.

Restructuring and Other Charges, Net. In the first six months of 2014, we recorded a net charge of $6.8 million primarily for involuntary terminations and other costs incurred as part of our EMEA restructuring plans and a reduction-in-force in the Americas and Corporate, as compared to $4.2 million of restructuring charges for the first six months of 2013. For a more detailed description of our current restructuring plans, see Note 5 of Notes to Consolidated Financial Statements.

Operating Income. Operating income (loss) by geographic segment for the first six months of 2014 and 2013 were as follows:

	Six Months Ended			% Change to Consolidated Operating Income
	June 29, 2014	**June 30, 2013**	**Change**	
		(dollars in millions)		
Americas	**$ 51.6**	$ 52.8	$ (1.2)	(1.8)%
EMEA	**22.0**	20.7	1.3	2.0
Asia-Pacific	**3.0**	5.3	(2.3)	(3.6)
Corporate	**(14.2)**	(14.6)	0.4	0.6
Total	**$ 62.4**	$ 64.2	$ (1.8)	(2.8)%

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The increase (decrease) in operating income (loss) is attributable to the following:

						Change As a % of Consolidated Operating Income					Change As a % of Segment Operating Income			
	Americas	EMEA	Asia-Pacific	Corporate	Total	Americas	EMEA	Asia-Pacific	Corporate	Total	Americas	EMEA	Asia-Pacific	Corporate
						(dollars in millions)								
Organic	$ 1.4	$ (0.3)	$ (2.3)	$ 1.2	$	2.2%	(0.5)%	(3.6)%	1.9%	%	2.6%	(1.4)%	(43.4)%	(8.2)%
Foreign exchange	(0.5)	1.3			0.8	(0.7)	2.0			1.3	(0.9)	6.3		
Restructuring, impairment charges and other	(2.1)	0.3		(0.8)	(2.6)	(3.3)	0.5		(1.3)	(4.1)	(4.0)	1.4		5.5
Total	$ (1.2)	$ 1.3	$ (2.3)	$ 0.4	$ (1.8)	(1.8)%	2.0%	(3.6)%	0.6%	(2.8)%	(2.3)%	6.3%	(43.4)%	(2.7)%

The decrease in consolidated operating income was due primarily to an increase in SG&A expenses and restructuring and other charges. The increase in Americas organic operating income was driven by higher sales volume offset by production inefficiencies and increased restructuring expenses. The EMEA organic operating income decrease was due to EMEA transformation deployment costs of $5.1 million offset by productivity efficiencies and SG&A expense reductions. Asia-Pacific s organic operating income decreased primarily due to the impact on gross margins from reduced absorption driven by lower intercompany sales.

Interest Expense. Interest expense decreased $1.7 million, or 14.8%, for the first six months of 2014 as compared to the first six months of 2013 primarily due to the retirement in mid-May 2013 of $75 million in unsecured senior notes and lower borrowing rates on our stand-by letters of credit.

Other expense (income), net. Other expense (income), net decreased $1.1 million for the first six months of 2014 as compared to the first six months of 2013, primarily due to fewer net foreign currency transaction losses.

Income Taxes. Our effective income tax rate for continuing operations increased to 32.7% in the first six months of 2014 from 31.8% for the first six months of 2013. The lower rate in 2013 can be attributed to the benefit of the 2012 U.S. research credit which was recorded in early 2013 when the law was re-enacted. The tax rate is slightly higher in 2014 due to the Americas earnings mix, with the U.S. contributing a larger portion of worldwide earnings in 2014 than in 2013.

Net Income. Net income from continuing operations for the first six months of 2014 was $35.4 million, or $1.00 per common share, compared to $35.0 million, or $0.99 per common share, for the first six months of 2013. Results for the first six months of 2014 include after-tax charges of $4.5 million, or $0.13 per common share, for restructuring and other charges, EMEA transformation deployment costs of $3.7 million or $0.11 per common share, compared to $3.0 million, or $0.08 per common share, for restructuring and other charges for the first six months of 2013.

Liquidity and Capital Resources

We generated $18.4 million of net cash from operating activities in the first six months of 2014 as compared to $21.8 million in the first six months of 2013. This decrease is primarily due to the net change in working capital driven by increased sales and accounts receivable balances and higher inventory levels to support the lead free conversion. Working capital (defined as current assets less current liabilities) as of June 29, 2014 was $547.4 million compared to $476.1 million as of June 30, 2013.

We used $10.4 million of net cash for investing activities for the first six months of 2014 for the purchase of capital equipment. For the remainder of fiscal year 2014, we expect to invest approximately $15 to $18 million in capital equipment as part of our ongoing commitment to improve our operating capabilities.

We used $29.3 million of net cash for financing activities for the first six months of 2014 primarily for the payments to repurchase approximately 347 thousand shares of Class A common stock at a cost of approximately $20.0 million and payment of dividends of $9.9 million. For the remainder of fiscal year 2014, we expect to invest approximately $20 million in our stock repurchase program.

On February 18, 2014, we terminated a prior credit agreement and entered into a new Credit Agreement (the Credit Agreement) among the Company, certain subsidiaries of the Company who become borrowers under the Credit Agreement, JPMorgan Chase Bank, N.A., as Administrative Agent, Swing Line Lender and Letter of Credit Issuer, and the other lenders referred to therein. The Credit Agreement provides for a $500 million, five-year, senior unsecured revolving credit facility which may be increased by an additional $500 million under certain circumstances and subject to the terms of the Credit Agreement. The Credit Agreement has a sublimit of up to $100 million in letters of credit. The Credit Agreement matures on February 18, 2019.

Borrowings outstanding under the Credit Agreement bear interest at a fluctuating rate per annum equal to an applicable percentage equal to (1) in the case of Eurocurrency rate loans, the British Bankers Association LIBOR rate plus an applicable percentage, ranging from 0.975% to 1.45%, determined by reference to the Company s consolidated leverage ratio, or (2) in the case of base rate loans and swing line loans, the highest of (a) the federal funds rate plus 0.5%, (b) the rate of interest in effect for such day as announced by

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JPMorgan Chase Bank, N.A. as its prime rate, and (c) the British Bankers Association LIBOR rate plus 1.0%, plus an applicable percentage, ranging from 0.00% to 0.45%, determined by reference to our consolidated leverage ratio. In addition to paying interest under the Credit Agreement, we are also required to pay certain fees in connection with the credit facility, including, but not limited to, an unused facility fee and letter of credit fees. Under the Credit Agreement, we are required to satisfy and maintain specified financial ratios and other financial condition tests. We may repay loans outstanding under the Credit Agreement from time to time without premium or penalty, other than customary breakage costs, if any, and subject to the terms of the Credit Agreement. As of June 29, 2014, we had $23.6 million of stand-by letters of credit outstanding under the Credit Agreement. As of June 29, 2014, we were in compliance with all covenants related to the Credit Agreement and had $476.4 million of unused and available credit under the Credit Agreement.

Working capital as of June 29, 2014 was $547.4 million compared to $530.2 million as of December 31, 2013. The increase is primarily due to an increase in accounts receivable and inventory, a decrease in accounts payable, offset by a decrease in cash and cash equivalents. Cash and cash equivalents decreased to $244.3 million as of June 29, 2014, compared to $267.9 million as of December 31, 2013, primarily driven by the repurchase of stock. The ratio of current assets to current liabilities was 2.7 to 1 as of June 29, 2014 and 2.6 to 1 as of December 31, 2013.

Our Pension Plan was terminated effective July 31, 2014. The plan termination must first satisfy the regulatory requirements prescribed by the Internal Revenue Service and the Pension Benefit Guaranty Corporation, which is expected to occur in late 2015. Once the requirements are met, distribution of plan assets pursuant to the termination is expected to occur within four months. Our SERP was terminated effective May 15, 2014. We will settle all liabilities under the SERP in accordance with Section 409A of the Internal Revenue Code by paying lump sums to plan participants at least twelve and no more than twenty four months following the termination date. Based on our third party actuary s estimate using preliminary assumptions, our estimated cash outflow is approximately $30-40 million. This estimated range is subject to change based on the fair value of the plan assets at distribution, market interest rates and annuity purchase rates at distribution and elected forms of payment.

As of June 29, 2014, we held $244.3 million in cash and cash equivalents. Of this amount, approximately $217.0 million of cash and cash equivalents was held by foreign subsidiaries. Our ability to fund U.S. operations from this balance could be limited by possible tax implications of moving proceeds across jurisdictions. Our U.S. operations currently generate sufficient cash flows to meet our domestic obligations. We also have the ability to borrow funds at reasonable interest rates or utilize the committed funds under our Credit Agreement. However, if amounts held by foreign subsidiaries were needed to fund operations in the United States, we could be required to accrue and pay taxes to repatriate these funds. Such charges may include a federal tax of up to 35.0% on dividends received in the U.S., potential state income taxes and an additional withholding tax payable to foreign jurisdictions of up to 10.0%. However, our intent is to permanently reinvest undistributed earnings of foreign subsidiaries through operations or acquisitions, and there are no current plans to repatriate the undistributed earnings to fund operations in the United States.

Non-GAAP Financial Measures

We believe free cash flow to be an appropriate supplemental measure of our operating performance because it provides investors with a measure of our ability to generate cash, repay debt, pay dividends, repurchase stock and fund acquisitions. Other companies may define free cash flow differently. Free cash flow does not represent cash generated from operating activities in accordance with U.S. Generally Accepted Accounting Principles (GAAP). Therefore it should not be considered an alternative to net cash provided by operations as an indication of our performance. The cash conversion rate of free cash flow to net income is also a measure of our performance in cash flow generation.

A reconciliation of net cash provided by operating activities to free cash flow and calculation of our cash conversion rate is provided below:

	Six Months Ended			
		June 29, 2014		June 30, 2013
	(in millions)			
Net cash provided by operating activities	**$**	**18.4**	$	21.8
Less: additions to property, plant, and equipment		**(10.6)**		(18.0)
Plus: proceeds from the sale of property, plant, and equipment		**0.2**		1.4
Free cash flow	**$**	**8.0**	$	5.2
Net income from continuing operations	**$**	**35.4**	$	35.2
Cash conversion rate of free cash flow to net income from continuing operations		**22.6%**		14.8%

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Our free cash flow increased in the second quarter of 2014 when compared to the second quarter of 2013 primarily due to higher capital expenditure in 2013 related to our lead free foundry.

Our net debt to capitalization ratio (a non-GAAP financial measure) at June 29, 2014 was 5.8%, compared to 3.8% at December 31, 2013. The increase in net debt to capitalization ratio is due to an increase in net debt primarily driven by a reduction in cash and cash equivalents at June 29, 2014. Management believes the net debt to capitalization ratio is an appropriate supplemental measure because it helps investors understand our ability to meet our financing needs and serves as a basis to evaluate our financial structure. Our computation may not be comparable to other companies that may define their net debt to capitalization ratios differently.

A reconciliation of long-term debt (including current portion) to net debt and our net debt to capitalization ratio is provided below:

		June 29, 2014		**December 31, 2013**
		(in millions)		
Current portion of long-term debt	**$**	**2.1**	$	2.2
Plus: long-term debt, net of current portion		**304.5**		305.5
Less: cash and cash equivalents		**(244.3)**		(267.9)
Net debt	**$**	**62.3**	$	39.8

		June 29, 2014		**December 31, 2013**
		(in millions)		
Net debt	**$**	**62.3**	$	39.8
Plus: total stockholders equity		**1,008.6**		1,002.1
Capitalization	**$**	**1,070.9**	$	1,041.9
Net debt to capitalization ratio		**5.8%**		3.8%

We maintain letters of credit that guarantee our performance or payment to third parties in accordance with specified terms and conditions. Amounts outstanding were approximately $23.6 million as of June 29, 2014 and at December 31, 2013. Our letters of credit are primarily associated with insurance coverage and, to a lesser extent, foreign purchases and generally expire within one year of issuance. These instruments may exist or expire without being drawn down; therefore they do not necessarily represent future cash flow obligations.

Off-Balance Sheet Arrangements

Except for operating lease commitments, we have no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors.

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Application of Critical Accounting Policies and Key Estimates

The preparation of our consolidated financial statements in accordance with GAAP requires management to make judgments, assumptions and estimates that affect the amounts reported. A critical accounting estimate is an assumption about highly uncertain matters and could have a material effect on the consolidated financial statements if another, also reasonable, amount were used, or, a change in the estimate is reasonably likely from period to period. We base our assumptions on historical experience and on other estimates that we believe are reasonable under the circumstances. Actual results could differ significantly from these estimates. There were no changes in accounting policies or significant changes in accounting estimates during the first six months of 2014.

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

Revenue recognition

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

Allowance for doubtful accounts

The allowance for doubtful accounts is established to represent our best estimate of the net realizable value of the outstanding accounts receivable. The development of our allowance for doubtful accounts varies by region but in general is based on a review of past due amounts, historical write-off experience, as well as aging trends affecting specific accounts and general operational factors affecting all accounts. In addition, factors are developed in certain regions utilizing historical trends of sales and returns and allowances and cash discount activities to derive a reserve for returns and allowances and cash discounts.

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

Inventory valuation

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

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

Goodwill and other intangibles

We have made numerous acquisitions over the years which included the recognition of a significant amount of goodwill. Goodwill is tested for impairment annually or more frequently if an event or circumstance indicates that an impairment loss may have been incurred. Application of the goodwill impairment test requires judgment, including the identification of reporting units, assignment of assets and liabilities to reporting units, and determination of the fair value of each reporting unit. We estimate the fair value of our reporting units using an income approach based on the present value of estimated future cash flows, and when appropriate, guideline public company and guideline transaction market approach. We have eight reporting units in continuing operations, including Residential and Commercial, Dormont, Drains & Water Re-use, Water Quality, EMEA, Blücher, BRAE and Asia-Pacific. Our Water Quality and BRAE reporting units have no goodwill.

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We review goodwill for impairment as of October month end, or earlier if there is a triggering event or circumstance that indicates that an impairment loss may have been incurred. Accounting guidance allows us to review goodwill for impairment utilizing either qualitative or quantitative analyses. We have the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events and circumstances, we determine it is more likely than not that the fair value of a reporting unit is greater than its carrying amount, then performing the two-step (quantitative) impairment test is unnecessary.

We first identify those reporting units that we believe could pass a qualitative assessment to determine whether further impairment testing is necessary. For each reporting unit identified, our qualitative analysis includes:

1) A review of the most recent fair value calculation to identify the extent of the cushion between fair value and carrying amount, to determine if a substantial cushion existed.

2) A review of events and circumstances that have occurred since the most recent fair value calculation to determine if those events or circumstances would have affected our previous fair value assessment. Items identified and reviewed include macroeconomic conditions, industry and market changes, cost factor changes, events that affect the reporting unit, financial performance against expectations and the reporting unit s performance relative to peers.

We then compile this information and make our assessment of whether it is more likely than not that the fair value of the reporting unit is less than its carrying amount. If we determine it is not more likely than not, then no further quantitative analysis is required.

The second analysis for goodwill impairment involves a quantitative two-step process. The first step of the impairment test requires a comparison of the fair value of each of our reporting units to the respective carrying value. If the carrying value of a reporting unit is less than its fair value, no indication of impairment exists and a second step is not performed. If the carrying amount of a reporting unit is higher than its fair value, there is an indication that impairment may exist and a second step must be performed. In the second step, the impairment is computed by comparing the implied fair value of the reporting unit s goodwill with the carrying amount of the goodwill. If the carrying amount of the reporting unit s goodwill is greater than the implied fair value of its goodwill, an impairment loss must be recognized for the excess and charged to operations.

Inherent in our development of the present value of future cash flow projections are assumptions and estimates derived from a review of our operating results, business plans, expected growth rates, cost of capital and tax rates. We also make certain assumptions about future economic conditions and other market data. We develop our assumptions based on our historical results including sales growth, operating profits, working capital levels and tax rates.

We believe that the discounted cash flow model is sensitive to the selected discount rate. We use third-party valuation specialists to help develop appropriate discount rates for each reporting unit. We use standard valuation practices to arrive at a weighted average cost of capital based on the market and guideline public companies. The higher the discount rate, the lower the discounted cash flows. While we believe that our estimates of future cash flows are reasonable, different assumptions could significantly affect our valuations and result in impairments in the future.

Intangible assets such as trademarks and trade names are generally recorded in connection with a business acquisition. Values assigned to intangible assets are determined by an independent valuation firm based on our estimates and judgments regarding expectations of the success and life cycle of products and technology acquired. Revised accounting guidance issued in 2012 allows us to perform a qualitative impairment assessment of indefinite-lived intangible assets consistent with the goodwill guidance noted previously. For our 2013 impairment assessment, we performed quantitative assessments for all indefinite-lived intangible assets. The methodology we employed was the relief from royalty method, a subset of the income approach. Similar to goodwill, we review indefinite-lived intangible assets for impairment as of October month end, or earlier if there is a triggering event or circumstance that indicate that an impairment loss may have been incurred.

Product liability and workers compensation costs

Because of retention requirements associated with our insurance policies, we are generally self-insured for potential product liability claims and for workers compensation costs associated with workplace accidents. We are subject to a variety of potential liabilities in connection with product liability cases and we maintain product liability and other insurance coverage, which we believe to be generally in accordance with industry practices. For product liability cases in the U.S., management establishes its product liability accrual, which includes legal costs associated with accrued claims, by utilizing third-party actuarial valuations that incorporate historical trend factors and our specific claims experience derived from loss reports provided by third-party claims administrators. Changes in the nature of claims, legal costs, or the actual settlement amounts could affect the adequacy of this estimate and require changes to the accrual. Because the liability is an estimate, the ultimate liability may be more or less than reported. In other countries, we maintain insurance coverage with relatively high deductible payments, as product liability claims tend to be smaller than those experienced in the U.S.

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

We determine the trend factors for product liability and workers compensation liabilities based on consultation with outside actuaries.

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

Legal contingencies

We are a defendant in numerous legal matters including those involving environmental law and product liability as discussed in more detail in Part I, Item 1, Business - Product Liability, Environmental and Other Litigation Matters, of our Annual Report on Form 10-K for the year ended December 31, 2013. As required by GAAP, we determine whether an estimated loss from a loss contingency should be accrued by assessing whether a loss is deemed probable and the loss amount can be reasonably estimated. When it is possible to estimate reasonably possible loss or range of loss above the amount accrued, that estimate is aggregated and disclosed. Estimates of potential outcomes of these contingencies are developed in consultation with outside counsel. While this assessment is based upon all available information, litigation is inherently uncertain and the actual liability to fully resolve this litigation cannot be predicted with any assurance of accuracy. In the event of an unfavorable outcome in one or more legal matters, the ultimate liability may be in excess of amounts currently accrued, if any, and may be material to our operating results or cash flows for a particular quarterly or annual period.

Pension benefits

We account for our pension plans in accordance with GAAP, which involves recording a liability or asset based on the projected benefit obligation and the fair value of plan assets. Assumptions are made regarding the valuation of benefit obligations and the performance of plan assets. The primary assumptions are as follows:

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

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

We determine these assumptions based on consultation with outside actuaries and investment advisors. Any variance in these assumptions could have a significant impact on future recognized pension costs, assets and liabilities. On October 31, 2011, our Board of Directors voted to cease accruals of additional benefits effective December 31, 2011 under both the Pension Plan and Supplemental Employees Retirement Plan. On April 28, 2014, the Company s Board of Directors voted to terminate the Company s Pension Plan and Supplemental Employees Retirement Plan. The Pension Plan was terminated effective July 31, 2014. Distribution of plan assets pursuant to the termination will not be made until the plan termination satisfies the regulatory requirements prescribed by the Internal Revenue Service and the Pension Benefit Guaranty Corporation, which is expected to occur in late 2015. The SERP was terminated effective May 15, 2014. The Company will settle all liabilities under the SERP in accordance with Section 409A of the Internal Revenue Code by paying lump sums to plan participants at least twelve and no more than twenty four months following the termination date. The Board of Directors authorized the Company to make such contributions to the Pension Plan and SERP as may be necessary to make the plans sufficient to settle all plan liabilities. Refer to Note 11 in Item 1. Financial Statement, for further details.

Income taxes

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

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We recognize deferred taxes for the expected future consequences of events that have been reflected in the consolidated financial statements. Deferred tax assets and liabilities are determined based on differences between the book values and tax bases of particular assets and liabilities, using tax rates in effect for the years in which the differences are expected to reverse. A valuation allowance is provided to offset any net deferred tax assets if, based upon the available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized. We consider estimated future taxable income and ongoing prudent tax planning strategies in assessing the need for a valuation allowance.

New Accounting Standards

In June of 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-12, Compensation Stock Compensation: Accounting for Share Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period . ASU 2014-12 clarifies that performance targets that could be achieved after the requisite period should be treated as performance conditions. Those performance conditions would not be reflected in estimating the grant date fair value of the award, but instead would be accounted for when the achievement of the performance condition becomes probable. ASU 2014-12 is effective in the first quarter of 2016 for public companies with calendar year ends, with early adoption permitted. The adoption of this guidance is not expected to have a material impact on our financial statements.

In May of 2014, FASB issued ASU 2014-09, Revenue from Contracts with Customers . ASU 2014-09 converges revenue recognition under U.S. GAAP and IFRS. For U.S. GAAP, the standard generally eliminates transaction- and industry-specific revenue recognition guidance. This includes current guidance on long-term construction-type contracts, software arrangements, real estate sales, telecommunication arrangements, and franchise sales. Under the new standard, revenue is recognized based on a five-step model. ASU 2014-09 is effective in the first quarter of 2017 for public companies with calendar year ends, and early adoption is not permitted for public companies under U.S. GAAP. We are assessing the impact of this standard on the Company s financial statements.

In April 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-08, Presentation of Financial Statements and Property, Plant, and Equipment: Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity . ASU 2014-08 will change the definition of discontinued operations and limit discontinued operations presentation to disposals of components representing a strategic shift that will have a major effect on the operations and financial results of the issuer. ASU 2014-08 is effective in the first quarter of 2015 for public companies with calendar year ends, with early adoption permitted. The adoption of this guidance is not expected to have a material impact on our financial statements.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We may use derivative financial instruments primarily to reduce exposure to adverse fluctuations in foreign exchange rates, interest rates and costs of certain raw materials used in the manufacturing process. We do not enter into derivative financial instruments for trading purposes. As a matter of policy, all derivative positions are used to reduce risk by hedging underlying economic exposure. The derivatives we use are instruments with liquid markets.

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

Our foreign subsidiaries transact most business, including certain intercompany transactions, in foreign currencies. Such transactions are principally purchases or sales of materials and are denominated in European currencies or the U.S. or Canadian dollar. We use foreign currency forward exchange contracts to manage the risk related to intercompany purchases that occur during the course of a year and certain open foreign currency denominated commitments to sell products to third parties. Realized and unrealized gains and losses on the contracts we recognized in other (income) expense are not material.

We have historically had a low exposure on the cost of our debt to changes in interest rates. Information about our long-term debt, including principal amounts and related interest rates, appears in Notes 4 and 9 of this report and in Note 10 of Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2013.

We purchase significant amounts of bronze ingot, brass rod, cast iron, steel and plastic, which are utilized in manufacturing our many product lines. Our operating results can be adversely affected by changes in commodity prices if we are unable to pass on related price increases to our customers. We manage this risk by monitoring related market prices, working with our suppliers to achieve the maximum level of stability in their costs and related pricing, seeking alternative supply sources when necessary, purchasing forward commitments for raw materials, when available, implementing cost reduction programs, value engineering, and passing increases in costs onto our customers in the form of price increases.

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Item 4. Controls and Procedures

As required by Rule 13a-15(b) under the Securities Exchange Act of 1934, as amended, or Exchange Act, as of the end of the period covered by this report, we carried out an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer (our principal executive officer and principal financial officer, respectively), of the effectiveness of our disclosure controls and procedures. In designing and evaluating our disclosure controls and procedures, we recognize that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and our management necessarily applies its judgment in evaluating and implementing possible controls and procedures. The effectiveness of our disclosure controls and procedures is also necessarily limited by the staff and other resources available to us and the geographic diversity of our operations. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective, in that they provide reasonable assurance that information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms and are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act are accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

There was no change in our internal control over financial reporting that occurred during the quarter ended June 29, 2014, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. In connection with these rules, we will continue to review and document our disclosure controls and procedures, including our internal control over financial reporting, and may from time to time make changes aimed at enhancing their effectiveness and to ensure that our systems evolve with our business.

Part II. OTHER INFORMATION

Item l. Legal Proceedings

As disclosed in Part I, Item 1, Product Liability, Environmental and Other Litigation Matters of our Annual Report on Form 10-K for the year ended December 31, 2013, we are party to certain litigation. Except as included in Part I. Financial Statement Note 10 under Trabakoolas et al., v, Watts Water Technologies, Inc., et al., there have been no material developments with respect to our contingencies and environmental remediation proceedings during the quarter ended June 29, 2014.

Item 1A. Risk Factors

This report may include statements that 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 reflect our current views about future results of operations and other forward-looking information. In some cases you can identify these statements by forward-looking words such as anticipate, believe, could, estimate, expect, intend, may, should and would or similar words. You should not rely on forward-looking statements because our actual may differ materially from those indicated by these forward-looking statements as a result of a number of important factors. These factors include, but are not limited to, the following: the effectiveness of our operational excellence initiatives and cost recovery actions; the effectiveness of our ongoing restructuring and transformation projects; the current economic and financial condition, which can affect levels of housing starts and remodeling, and affect the markets where our products are sold, manufactured, or marketed; production inefficiencies related to our lead free foundry; shortages in and pricing of raw materials and supplies; loss of market share through competition; introduction of competing products by other companies; pressure on prices from competitors, suppliers, and/or customers; changes in variable interest rates on our borrowings; identification and disclosure of material weaknesses in our internal control over financial reporting; failure to expand our markets through acquisitions; failure or delay in developing new products; lack of acceptance of new products; failure to manufacture products that meet required performance and safety standards; foreign exchange rate fluctuations; cyclicality of industries, such as plumbing and heating wholesalers and home improvement retailers, in which we market certain of our products; environmental compliance costs; product liability risks; the results and timing of our restructuring plans; changes in the status of current litigation, including successful appeal of the approved settlement in Trabakoolas v. Watts; and other risks and uncertainties discussed in Part I, Item 1A. Risk Factors and in Note 14 of the Notes to the Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2013 filed with the Securities Exchange Commission, and in other reports we file from time to time with the Securities and Exchange Commission.

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Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

We satisfy the minimum withholding tax obligation due upon the vesting of shares of restricted stock and the conversion of restricted stock units into shares of Class A common stock by automatically withholding from the shares being issued a number of shares with an aggregate fair market value on the date of such vesting or conversion that would satisfy the withholding amount due.

The following table includes information with respect to shares of our Class A common stock withheld to satisfy withholding tax obligations during the three-month period ended June 29, 2014.

	Issuer Purchases of Equity Securities			
Period	**(a) Total Number of Shares (or Units) Purchased**	**(b) Average Price Paid per Share (or Unit)**	**(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs**	**(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs**
March 31, 2014 April 27, 2014		$		
April 28, 2014 May 25, 2014	1,303	$ 57.98		
May 26, 2014 June 29, 2014	266	$ 54.27		
Total	1,569	$ 57.35		

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The following table includes information with respect to repurchases of our Class A common stock during the three-month period ended June 29, 2014 under our stock repurchase program.

	Issuer Purchases of Equity Securities					
Period	**(a) Total Number of Shares (or Units) Purchased (1)**		**(b) Average Price Paid per Share (or Unit)**	**(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs**		**(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs**
March 31, 2014 April 27, 2014	54,575	$	58.14	54,575	$	54,473,499
April 28, 2014 May 25, 2014	61,986	$	54.61	61,986	$	51,088,594
May 26, 2014 June 29, 2014	69,404	$	58.62	69,404	$	47,020,234
Total	185,965	$	57.14	185,965		

(1) On April 30, 2013, the Board of Directors authorized a stock repurchase program of up to $90 million of the Company s Class A common stock to be purchased from time to time on the open market or in privately negotiated transactions. The timing and number of any shares repurchased will be determined by the Company s management based on its evaluation of market conditions. During the quarter ended June 29, 2014, we repurchased approximately $10.6 million of common stock.

Item 6. Exhibits

The exhibits listed in the Exhibit Index immediately preceding the exhibits are filed as part of this Quarterly Report on Form 10-Q and such Exhibit Index is incorporated herein by reference.

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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 WATER TECHNOLOGIES, INC.	
Date: August 6, 2014	By:	/s/ Robert J. Pagano, Jr. Robert J. Pagano, Jr. Chief Executive Officer (principal executive officer)
Date: August 6, 2014	By:	/s/ Dean P. Freeman Dean P. Freeman Chief Financial Officer (principal financial officer)
Date: August 6, 2014	By:	/s/ Kenneth S. Korotkin Kenneth S. Korotkin Chief Accounting Officer (principal accounting officer)

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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 (2)
10.1	Watts Water Technologies, Inc. Executive Severance Plan (3)
10.2	Form of Restricted Stock Agreement between Watts Water Technologies, Inc. and Robert J. Pagano, Jr. (4)
10.3	Form of Performance Stock Unit Award Agreement between Watts Water Technologies, Inc. and Robert J. Pagano, Jr. (4)
10.4	Form of 2014 Performance Stock Unit Award Agreement under the Watts Water Technologies, Inc. Second Amended and Restated 2004 Stock Incentive Plan (5)
10.5	Form of 2014 Restricted Stock Award Agreement under the Watts Water Technologies, Inc. Second Amended and Restated 2004 Stock Incentive Plan
10.6	Form of 2014 Stock Option Agreement under the Watts Water Technologies, Inc. Second Amended and Restated 2004 Stock Incentive Plan
31	Certification of Principal Executive Officer and Principal Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended
32	Certification of Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. 1350
101.INS*	XBRL Instance Document.
101.SCH*	XBRL Taxonomy Extension Schema Document.
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document.

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* Attached as Exhibit 101 to this report are the following formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Balance Sheets at June 29, 2014 and December 31, 2013, (ii) Consolidated Statements of Operations for the Second Quarters Ended June 29, 2014 and June 30, 2013 and the Six Months Ended June 29, 2014 and June 30, 2013, (iii) Consolidated Statements of Comprehensive Income (Loss) for the Second Quarters Ended June 29, 2014 and June 30, 2013 and the Six Months Ended June 29, 2014 and June 30, 2013, (iv) Consolidated Statements of Cash Flows for the First Six Months Ended June 29, 2014 and June 30, 2013, and (v) Notes to Consolidated Financial Statements.

(1) Incorporated by reference to the Registrant s Quarterly Report on Form 10-Q (File No. 001-11499) for the quarter ended July 3, 2005.

(2) Incorporated by reference to the Registrant s Current Report on Form 8-K (File No. 001-11499) dated April 29, 2013.

(3) Incorporated by reference to the Registrant s Current Report on Form 8-K (File No. 001-11499) dated May 26, 2014.

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(4) Incorporated by reference to the Registrant s Current Report on Form 8-K (File No. 001-11499) dated May 4, 2014.

(5) Incorporated by reference to the Registrant s Quarterly Report on Form 10-Q (File No. 001-11499) for the quarter ended March 30, 2014.

om: Black 1pt solid">Six Months Ended September 30, 2013Risk free interest rate 0.02% - 0.62%Average expected life 0.25 – 3 yearsExpected volatility 78.9% - 104.5%Expected dividends None

The table below sets forth a summary of changes in the fair value of our Level 3 financial instruments for the six months ended September 30, 2014:

	April 1, 2014	Recorded New Derivative Liabilities	Change in estimated fair value recognized in results of operations	Reclassification of Derivative Liability to Paid in capital	September 30, 2014
Derivative liabilities	$10,679,067	$ –	$ –	$ (10,679,067)	$ –

The table below sets forth a summary of changes in the fair value of our Level 3 financial instruments for the six months ended September 30, 2013:

	April 1, 2013	Recorded New Derivative Liabilities	Change in estimated fair value recognized in results of operations	Reclassification of Derivative Liability to Paid in capital	September 30, 2013
Derivative liabilities	$3,588,239	$ –	$2,382,877	$ (106,501)	$5,864,615

10. STOCK COMPENSATION

The following table breaks out the components of our share-based compensation expenses relating to shares and options granted and the effect on basic and diluted loss per common share during the three and six months ended September 30, 2014 and 2013.

	Three Months Ended September 30, 2014	Three Months Ended September 30, 2013	Six Months Ended September 30, 2014	Six Months Ended September 30, 2013
Vesting of stock options	89,793	73,856	260,680	124,243
Incremental fair value of option modifications	–	957	–	1,914
Vesting expense associated with CEO restricted stock grant	–	–	–	64,444
Total share-based compensation expense	$89,793	$74,813	$260,680	$190,601
Total share-based compensation expense included in net loss	$89,793	$73,856	$260,680	$190,601
Weighted average number of common shares outstanding – basic and diluted	259,369,911	187,643,582	243,494,916	182,004,220
Basic and diluted loss per common share	$(0.00)	$(0.00)	$(0.00)	$(0.00)

All of the stock-based compensation expense recorded during the six months ended September 30, 2014 and 2013, which totaled $260,680 and $190,601, respectively, is included in payroll and related expense in the accompanying condensed consolidated statements of operations. Stock-based compensation expense recorded during the six months ended September 30, 2014 and 2013 had no impact on basic and diluted loss per common share.

We review share-based compensation on a quarterly basis for changes to the estimate of expected award forfeitures based on actual forfeiture experience. The cumulative effect of adjusting the forfeiture rate for all expense amortization is recognized in the period the forfeiture estimate is changed. The effect of forfeiture adjustments for the three and six month periods ended September 30, 2014 was insignificant.

On June 6, 2014, our Board of Directors approved the following grants of options to certain officers and directors of the Company:

o To Mr. James A. Joyce, an option to acquire an aggregate of 1,500,000 shares of our common stock at an exercise price of $0.19 per share, the closing price of our common stock on the date of grant. The fair value of this stock option at the date of grant was $246,000. The option vested as to 500,000 shares on the grant date for a vesting expense of $82,000 and will vest as to an additional 500,000 shares on each of the first two anniversaries of the grant date. Unless earlier exercised or terminated, the option will expire June 6, 2024.

o To Mr. Rodney S. Kenley, an option to acquire an aggregate of 250,000 shares of our common stock at an exercise price of $0.19 per share, the closing price of our common stock on the date of grant. The fair value of this stock option at the date of grant was $41,000. The option vested as to 83,333 shares on the grant date for a vesting expense of $13,667 and will vest as to an additional 83,333 shares on the first anniversary of the grant date and 83,334 shares on the second anniversary of the grant date. Unless earlier exercised or terminated, the option will expire June 6, 2024.

o To Mr. James B. Frakes, an option to acquire an aggregate of 250,000 shares of our common stock at an exercise price of $0.19 per share, the closing price of our common stock on the date of grant. The fair value of this stock option at the date of grant was $41,000. The option vested as to 83,333 shares on the grant date for a vesting expense of $13,667 and will vest as to an additional 83,333 shares on the first anniversary of the grant date and 83,334 shares on the second anniversary of the grant date. Unless earlier exercised or terminated, the option will expire June 6, 2024.

o To Dr. Richard H. Tullis, an option to acquire an aggregate of 50,000 shares of our common stock at an exercise price of $0.19 per share, the closing price of our common stock on the date of grant. The fair value of this stock option at the date of grant was $8,200. The option vested as to 16,667 shares on the grant date for a vesting expense of $2,733 and will vest as to an additional 16,667 shares on the first anniversary of the grant date and 16,666 shares on the second anniversary of the grant date. Unless earlier exercised or terminated, the option will expire June 6, 2024.

In addition to the above grants to our officers, on June 6, 2014, our Board of Directors also approved the grant of options to five employees to acquire an aggregate of 370,000 shares of our common stock at an exercise price of $0.19 per share, the closing price of our common stock on the date of grant. The aggregate fair value of those stock options at the date of grant was $60,680. Those options vested as to 123,333 shares on the grant date for a vesting expense of $20,227 and will vest as to an additional 123,333 shares on the first anniversary of the grant date and 123,334 shares on the second anniversary of the grant date. Unless earlier exercised or terminated, the option will expire June 6, 2024.

In addition to the share-based compensation expense for the specific stock option grants noted above, our total share-based compensation expense for the three and six months ended September 30, 2014 includes ongoing vesting expense associated with stock grants from prior periods.

Changes to 2012 Board Compensation Program

In July 2012, the Board approved a Board Compensation Program (the "2012 Program"), which modified and superseded the 2005 Directors Compensation Program that had been in effect previously. On June 6, 2014, the Board approved certain changes to the 2012 Program. Under the modified 2012 Program, in which only non-employee Directors may participate, a new eligible Director will receive an initial grant of $50,000 worth of options to acquire shares of common stock, with such grant being valued at the exercise price based on the average of the closing bid prices of our common stock for the five trading days preceding the first day of the fiscal year. These options will have a term of ten years and will vest 1/3 upon grant and 1/3 upon each of the first two anniversaries of the date of grant.

At the beginning of each fiscal year, each existing Director eligible to participate in the 2012 Program also will receive a grant of $35,000 worth of options valued at the exercise price based on the average of the closing bid prices of the Common Stock for the five trading days preceding the first day of the fiscal year. Such options will vest on the first anniversary of the date of grant. In lieu of per meeting fees, under the 2012 Program eligible Directors will receive an annual Board retainer fee of $30,000. The modified 2012 Program also provides for the following annual retainer fees: Audit Committee Chair - $5,000, Compensation Committee chair - $5,000, Audit Committee member - $4,000, Compensation Committee member - $4,000 and Lead independent director - $15,000.

As a result of the modified 2012 Program on June 6, 2014, we issued 184,211 stock options to each of our three outside directors. Those grants vest over the fiscal year ending March 31, 2015 and have an exercise price of $0.19 per share.

All of the foregoing actions - the changes in base salaries, the option grants and the changes to the Directors Compensation Program discussed herein - were approved and recommended by the Company's Compensation Committee prior to approval by the Board.

The following outlines the significant weighted average assumptions used to estimate the fair value information presented, with respect to stock option grants utilizing the Binomial Lattice option pricing models at, and during the six months ended September 30, 2014:

Risk free interest rate	2.6%
Average expected life	10 years
Expected volatility	90.23%
Expected dividends	None

The expected volatility was based on the historic volatility. The expected life of options granted was based on the "simplified method" as described in the SEC's guidance due to changes in the vesting terms and contractual life of current option grants compared to our historical grants.

In May 2013, we granted to a scientific advisory board member and a scientific consultant a three year option to purchase 125,000 shares of our common stock at a price of $0.11 per share.

In July 2013, our compensation committee and Board of Directors approved the issuance of four stock option grants to four of our executives. The options carried an exercise price of $0.10 per share, have a ten year life and vest over the following schedule: 25% on July 1, 2014, 25% on July 1, 2015, 25% on July 1, 2016 and 25% on July 1, 2017. The numbers of shares underlying each of the stock option grants were as follows: 2,000,000 shares to our chief executive officer and 500,000 shares each to our president, chief science officer and chief financial officer (see Note 10).

The following outlines the significant weighted average assumptions used to estimate the fair value information, which is based on historical data, with respect to stock option grants utilizing the Binomial Lattice option pricing models at, and during the six months ended September 30, 2013:

Risk free interest rate	0.38% - 2.50%
Average expected life	3 years - 10 years
Expected volatility	94.6% - 102.7%
Expected dividends	None

The expected volatility was based on the historic volatility. The expected life of options granted was based on the "simplified method" as described in the SEC's guidance due to changes in the vesting terms and contractual life of current option grants compared to our historical grants.

Options outstanding that have vested and are expected to vest as of September 30, 2014 are as follows:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term in Years
Vested	24,294,227	$ 0.26	3.96
Expected to vest	4,711,811	$ 0.14	9.15
Total	29,006,038		

A summary of stock option activity during the six months ended September 30, 2014 is presented below:

	Number of Options	Range of Exercise Price	Weighted Average Exercise Price
Stock options outstanding at March 31, 2014	26,133,407	$0.076 - $0.41	$ 0.25
Exercised	–	–	–
Granted	2,972,631	0.19	$ 0.19
Cancelled/Expired	(100,000)	0.19	0.19
Stock options outstanding at September 30, 2014	29,006,038	$0.076 - $0.41	$ 0.24
Stock options exercisable at September 30, 2014	24,294,227	$0.076 - $0.41	$ 0.26

At September 30, 2014, there was approximately $497,783 of unrecognized compensation cost related to share-based payments, which is expected to be recognized over a weighted average period of 2.19 years.

On September 30, 2014, our stock options had a negative intrinsic value since the closing price of our common stock on that date of $0.12 per share was below the weighted average exercise price of our stock options.

11. WARRANTS

A summary of warrant activity during the six months ended September 30, 2014 is presented below:

	Amount	Range of Exercise Price	Weighted Average Exercise Price
Warrants outstanding at March 31, 2014	70,709,475	$0.042 - $0.25	$ 0.13
Exercised	(2,166,104)	$0.086 – $0.12	$ 0.10
Issued	15,375,614	$0.042 - $0.24	$ 0.07
Cancelled/Expired	(1,136,364)	$0.13	$ 0.13
Warrants outstanding at September 30, 2014	82,782,621	$0.042 - $0.25	$ 0.10
Warrants exercisable at September 30, 2014	82,782,621	$0.042 - $0.25	$ 0.10

The following outlines the significant weighted average assumptions used to estimate the fair value information presented, with respect to warrants utilizing the Binomial Lattice option pricing models at, and during, the six months ended September 30, 2014:

Risk free interest rate	0.79% - 2.29%
Average expected life	5 years – 7 years
Expected volatility	90.1% - 95.8%
Expected dividends	None

12. DARPA CONTRACT AND RELATED REVENUE RECOGNITION

As discussed in Note 1, we entered into a contract with the DARPA on September 30, 2011. Under the DARPA award, we have been engaged to develop a therapeutic device to reduce the incidence of sepsis, a fatal bloodstream infection that often results in the death of combat-injured soldiers. The award from DARPA was a fixed-price contract with potential total payments to us of $6,794,389 over the course of five years. Fixed price contracts require the achievement of multiple, incremental milestones to receive the full award during each year of the contract. Under the terms of the contract, we will perform certain incremental work towards the achievement of specific milestones against which we will invoice the government for fixed payment amounts.

Originally, only the base year (year one contract) was effective for the parties, however, DARPA subsequently exercised the option on the second, third and fourth years of the contract. DARPA has the option to enter into the contract for year five. The milestones are comprised of planning, engineering and clinical targets, the achievement of which in some cases will require the participation and contribution of third party participants under the contract. There can be no assurance that we alone, or with third party participants, will meet such milestones to the satisfaction of the government and in compliance with the terms of the contract or that we will be paid the full amount of the contract revenues during any year of the contract term. We commenced work under the contract in October 2011.

Due to budget restrictions within the Department of Defense, on February 10, 2014, DARPA reduced the scope of our contract in years three through five of the contract. The reduction in scope focused our research on exosomes, viruses and blood processing instrumentation. This scope reduction will reduce the possible payments under the contract by $858,491 over years three through five. We recently completed a re-budgeting of the expected costs on the remaining years of the DARPA contract based on the reduced milestones and have concluded that the reductions in our costs due to the scaled back level of work will almost entirely offset the anticipated revenue levels based on current assumptions.

During the six months ended September 30, 2014, we invoiced DARPA for three milestones totaling $444,723. The details of those milestones were as follows:

Milestone 2.4.2.2 – Determine capacity requirements of affinity resin to multiple simultaneous targets. The milestone payment was $197,362. Management considers this milestone to be substantive as it was not dependent on the passage of time nor was it based solely on another party's efforts. We demonstrated that we were able to determine the capacity requirements of affinity resin to multiple simultaneous targets. The report was accepted by the contracting officer's representative and the invoice was submitted thereafter.

Milestone 2.4.2.4 – Finish construction and delivery of 25 experimental cartridges for testing by the system integrator. The milestone payment was $50,000. Management considers this milestone to be substantive as it was not dependent on the passage of time nor was it based solely on another party's efforts. We demonstrated that we delivered the 25 cartridges to the systems integrator as part of our submission for approval. The report was accepted by the contracting officer's representative and the invoice was submitted thereafter.

Milestone M9 – Target capture > 90% in 24 hours for at least 3 targets ex vivo in blood or blood components using the optimized cartridge. The milestone payment was $197,361. Management considers this milestone to be substantive as it was not dependent on the passage of time nor was it based solely on another party's efforts. We demonstrated that we were able to capture approximately 90% in 24 hours for at least 3f targets ex vivo in blood or blood components using the optimized cartridge. The report was accepted by the contracting officer's representative and the invoice was submitted thereafter.

In the six months ended September 30, 2013, we invoiced DARPA for four milestones totaling $808,739. The details of those milestones were as follows:

Milestone 2.3.2.2 – Formulate initial design work based on work from the previous phase. Begin to build and test selected instrument design and tubing sets. The milestone payment was $195,581. Management considers this milestone to be substantive as it was not dependent on the passage of time nor was it based solely on another party's efforts. We demonstrated that we were able to formulate the initial design work and to build and test selected instrument design and tubing sets as part of our submission for approval. The report was accepted by the contracting officer's representative and the invoice was submitted thereafter.

Milestone 2.3.2.2 – Write and test software and conduct ergonomic research. Begin discussions with the systems integrator. The milestone payment was $195,581. Management considers this milestone to be substantive as it was not dependent on the passage of time nor was it based solely on another party's efforts. We obtained wrote and tested software and conducted ergonomic research and began discussions with the systems integrator. The report was accepted by the contracting officer's representative and the invoice was submitted thereafter.

Milestone 2.3.3.2 – Cartridge construction with optimized affinity matrix design for each potential target. Complete the capture agent screening. The milestone payment was $208,781. Management considers this milestone to be substantive as it was not dependent on the passage of time nor was it based solely on another party's efforts. We completed the cartridge construction with optimized affinity matrix design for each potential target and completed the capture agent screening. The report was accepted by the contracting officer's representative and the invoice was submitted thereafter.

Milestone M5 – Target capture > 90% in 24 hours for at least three targets in blood or blood components. The milestone payment was $208,781. Management considers this milestone to be substantive as it was not dependent on the passage of time nor was it based solely on another party's efforts. We demonstrated that we were able to capture approximately 90% in 24 hours for at least three of the agreed targets in blood or blood components. The report was accepted by the contracting officer's representative and the invoice was submitted thereafter.

13. COMMITMENTS AND CONTINGENCIES

LEASE COMMITMENTS

We rented approximately 2,300 square feet of executive office space at 8910 University Center Lane, Suite 660, San Diego, CA 92122 at the rate of $6,475 per month on a four year lease that expired in September 2014. We continued leasing that space for the month of October and, effective November 1, 2014, moved into a new facility of approximately 2,576 square feet located at 9635 Granite Ridge Drive, San Diego, CA 92123 under a 39 month lease with an initial rental rate of $6,054 per month. We believe this new leased facility will be satisfactory for our office needs over the term of the lease.

We also rent approximately 1,700 square feet of laboratory space at 11585 Sorrento Valley Road, Suite 109, San Diego, California 92121 at the rate of $3,917 per month on a one year lease that previously was scheduled to expire in October 2014 and was recently extended to in October 2015. We believe this new leased facility will be satisfactory for our laboratory needs over the term of the lease

Our Exosome Sciences, Inc. subsidiary rents approximately 2,055 square feet of office and laboratory space at 11 Deer Park Drive, South Brunswick, NJ at the rate of $3,596 per month on a one year lease that previously was scheduled to expire in October 2014 and was recently extended to in October 2015. We believe this new leased facility will be satisfactory for ESI’s operational needs over the term of the lease.

Rent expense approximated $84,000 and $68,000 for the six month periods ended September 30, 2014 and 2013, respectively.

LEGAL MATTERS

From time to time, claims are made against us in the ordinary course of business, which could result in litigation. Claims and associated litigation are subject to inherent uncertainties and unfavorable outcomes could occur, such as monetary damages, fines, penalties or injunctions prohibiting us from selling one or more products or engaging in other activities.

The occurrence of an unfavorable outcome in any specific period could have a material adverse effect on our results of operations for that period or future periods. Other than as mentioned here, we are not presently a party to any pending or threatened legal proceedings.

14. SEGMENTS

We operate our businesses principally through two reportable segments: Aethlon, which represents our therapeutic business activities, and ESI, which represents our diagnostic business activities. Our reportable segments have been determined based on the nature of the potential products being developed. ESI did not have any operations in the six months ended September 30, 2013.

Aethlon's revenue is generated primarily from government contracts to date and ESI does not yet have any revenues. We have not included any allocation of corporate overhead to the ESI segment.

The following tables set forth certain information regarding our segments and other operations that conforms to the consolidated balance sheet and statement of operations presented in this Report:

	Six Months Ended September 30,	
	2014	2013
Revenues:		
Aethlon	$530,371	$840,483
ESI	–	–
Total Revenues	$530,371	$840,483
Operating Losses:		
Aethlon	$(1,294,453)	$(1,013,592)

ESI	(445,674)	–
Total Operating Loss	$(1,773,200)	$(1,013,592)
Net Losses:		
Aethlon	$(4,202,873)	$(3,653,168)
ESI	(356,539)	–
Net Loss Before Non-Controlling Interests	$(4,592,485)	$(3,653,168)
Cash:		
Aethlon	$47,865	$8,754
ESI	478,322	–
Total Cash	$526,187	$8,754
Total Assets:		
Aethlon	$443,027	$411,190
ESI	646,242	–
Total Assets	$1,089,269	$411,190
Capital Expenditures:		
Aethlon	$–	$–
ESI	–	–
Capital Expenditures	$–	$–
Depreciation and Amortization:		
Aethlon	$8,885	$4,727
ESI	9,791	–
Total Depreciation and Amortization	$18,676	$4,727
Interest Expense:		
Aethlon	$156,799	$216,502
ESI	–	–
Total Interest Expense	$156,799	$216,502

15. SUBSEQUENT EVENTS

Management has evaluated events subsequent to September 30, 2014 through the date that the accompanying condensed consolidated financial statements were filed with the Securities and Exchange Commission for transactions and other events which may require adjustment of and/or disclosure in such financial statements.

Government Contracts

Subsequent to September 30, 2014, we collected $247,361 under our DARPA contract, and under the Battelle subcontract we billed $33,434 and we collected $29,519.

Debt Reduction

Subsequent to September 30, 2014, we paid off the remaining principal and interest balances on the two remaining July & August 2011 10% Convertible Notes, which had been classified as being in default, with cash payments totaling $382,748 (see Note 5).

Subsequent to September 30, 2014, we paid off in full the outstanding principal balance and interest balance on the Law Firm Note with a cash payment of $50,000 and an issuance of 170,020 common shares (see Note 5).

Subsequent to September 30, 2014, we paid an aggregate of $503,313 in principal and accrued interest on eight other outstanding notes. As a result, seven of the eight notes were paid in full. We owe an additional $37,813 under the eighth note, which we expect to pay in full in January 2015.

Note Conversions

Subsequent to September 30, 2014, we issued an aggregate of 14,237,261 shares of common stock to two accredited investors upon the conversion of an aggregate of $597,965 of unpaid principal and accrued interest due under promissory notes previously issued to the investors by the Company. The conversion price per share was $0.042.

Subsequent to September 30, 2014, we issued an aggregate of 5,625,000 shares of common stock to convert in full the outstanding principal balance of $225,000 and interest balance of $11,250 on the remaining Amended and Restated Series A 12% Convertible Note through the issuance of 5,625,000 shares of common stock. The conversion price per share was $0.042.

Issuance of Convertible Notes

Subsequent to September 30, 2014, we entered into a Subscription Agreement with two accredited investors providing for the issuance and sale of (i) convertible promissory notes in the aggregate principal amount of $527,780 and (ii) five year warrants to purchase up to 2,356,160 shares of common stock at a fixed exercise price of $0.168 per share. The convertible promissory notes bear interest at the annual rate of 10% and mature on April 1, 2016. The aggregate gross cash proceeds to us were $415,000 after subtracting legal fees of $35,000; the balance of the principal amount of the notes represents a $27,780 due diligence fee and an original issuance discount. The convertible promissory notes are convertible at the option of the holders into shares of our common stock at a fixed price of $0.112 per share, for up to an aggregate of 4,712,321 shares of common stock. There are no registration requirements with respect to the shares of common stock underlying the notes or the warrants.

Common Stock Issuances

Subsequent to September 30, 2014, we issued 374,295 shares of common stock pursuant to our S-8 registration statement covering our Amended 2010 Stock Plan at an average price of $0.146 per share in payment for legal and scientific consulting services valued at $54,800 based on the value of the services provided.

Equity Unit Investments

Subsequent to September 30, 2014, we issued and sold to eight accredited investors units (the “Units”) consisting of (a) one hundred thousand (100,000) restricted shares of common stock, par value $.001 per share at prices per share ranging from $0.105 to $0.114 and (b) a five-year warrant to purchase fifty thousand (50,000) shares of common stock at exercise prices ranging from $0.154 to $0.167 per share (the “Unit Warrants”). In total, the investors purchased for cash an aggregate of $501,700 of Units. The investors acquired an aggregate of 4,506,250 shares of common stock and Unit Warrants to acquire up to an aggregate of 2,253,125 shares of common stock.

Subsequent to September 30, 2014, we issued to an accredited investor Units consisting of an aggregate of 1,835,798 shares of common stock and Unit Warrants to acquire up to an aggregate of 1,837,798 shares of common stock at an exercise price of $0.103 per share. The Units were issued to the investor upon the conversion of an aggregate of $189,087 of unpaid principal and accrued interest due under two promissory notes (the remaining October & November 2009 10% Convertible Note and the April 2010 10% Convertible Note – see Note 5) previously issued to the investor by the Company. The amounts converted represented the entire principal and interest outstanding under the notes and the notes held by that holder were retired.

Subsequent to September 30, 2014, we sold $3,300,000 of units, comprised of common stock and warrants (the “Units”), to three affiliated institutional investors (collectively the “Purchaser”) at a price of $0.30 per Unit pursuant to a Securities Purchase Agreement (the “Agreement”). Each Unit consists of one share of common stock, $0.001 par value per share, and five-year warrants to purchase 120% of the shares of common stock in the Unit (the “Warrants”), at an exercise price per share of $0.30 (the “Financing”). Accordingly, a total of 11,000,000 shares of common stock and Warrants to purchase 13,200,000 shares of common stock were issued and sold pursuant to the Agreement.

As part of the terms of the Agreement, we entered into a Registration Rights Agreement with the Purchaser pursuant to which we agreed to file a registration statement to register for resale the shares of common stock sold in the Financing, including the shares of common stock underlying the Warrants, within 20 calendar days following the closing of the Financing. Subject to certain exceptions, in the event the registration statement does not become effective within certain time periods set forth in the Registration Rights Agreement, we would be required to pay the Purchaser in the Financing an amount in cash equal to two percent (2.0%) of the aggregate purchase price every month until such time as the registration statement becomes effective or the shares of common stock (and shares of common stock underlying the Warrants) sold in the Financing may be sold by the Purchaser pursuant to Rule 144 without any restrictions or limitations.

Roth Capital Partners served as sole placement agent for the Financing and received a cash fee of $231,000, expense reimbursement of $25,000, and a five-year warrant to purchase 550,000 shares of common stock at an exercise price of $0.30 per share (the “Purchase Agent Warrant”) for its services in the Financing. In addition, we paid $10,000 in legal expenses to the Purchaser’s counsel. We also paid $32,572 to our counsel related to this financing. The net proceeds to us after the placement fee and legal fees were $3,001,429.

Warrant Exercises and Issuance of New Warrants Upon Exercise

Subsequent to September 30, 2014, we issued an aggregate of 5,671,119 shares of common stock and seven-year warrants (the “Exchange Warrants”) to issue up to an aggregate of 5,671,119 shares of common stock at exercise prices ranging from $0.093 to $0.116 per share to eight accredited investors. One of the investors is Dr. Chetan Shah, a director of the Company. The common stock and Exchange Warrants were issued to the investors upon the cash exercise of previously issued warrants held by them. The investors paid an aggregate of $579,251 upon exercise of the previously outstanding warrants at exercise prices ranging from $0.093 to $0.115 per share. The foregoing transaction was privately negotiated with the group of participating warrant holders.

Warrant Exercises

Subsequent to September 30, 2014, we issued an aggregate of 21,516,640 shares of common stock to accredited investors upon the exercise of previously issued warrants. The warrants were exercised on a cashless or “net” basis. Accordingly, we did not receive any proceeds from such exercises. The cashless exercise of such warrants resulted in the cancellation of previously issued warrants to purchase an aggregate of 30,265,208 shares of common stock.

Stock Option Exercises

Subsequent to September 30, 2014, two former employees exercised stock options to purchase 50,000 common shares through a cash payment of $9,500 with an exercise price of $0.19 per share.

Restricted Stock Issuance to Service Provider

Subsequent to September 30, 2014, we issued 39,024 shares of restricted common stock in payment for investor relations services valued at $8,000 based on the value of the services provided.

PART II

INFORMATION NOT REQUIRED IN PROSPECTUS

Item 13. Other Expenses of Issuance and Distribution.

The following table sets forth the various expenses to be incurred in connection with the registration of the securities being registered by this registration statement, all of which will be borne by us. All amounts shown are estimates except the Securities and Exchange Commission registration fee.

Securities and Exchange Commission registration fee	$818.05
Transfer agent's fees and expenses	1,000.00
Printing and engraving expenses	2,750.00
Legal fees and expenses	110,000.00
Accounting fees and expenses	18,000.00
Total expenses	$132,568.05

Item 14. Indemnification of Directors and Officers.

The "Disclosure of Commission Position on Indemnification for Securities Act Liabilities" section of the prospectus filed as part of this registration statement is incorporated herein by this reference.

Item 15. Recent Sales of Unregistered Securities.

We have sold or issued the following securities not registered under the Securities Act of 1933, as amended, in reliance upon the exemption from registration pursuant to Section 4(a)(2) of the Securities Act of 1933, as amended, or Regulation D of the Securities Act of 1933, as amended, during the three years preceding the filing of this registration statement. Except as stated below, no underwriting discounts or commissions were payable with respect to any of the following transactions.

Equity Transactions from March 31, 2014 to Present

On May 20, 2014, May 23, 2014, June 6, 2014, June 11, 2014 and June 26, 2014, we sold seven accredited investors 2,192,444 shares of restricted common stock for an aggregate purchase price of $320,800 and an average price of $0.15 per share. The common stock purchase price was calculated as 80% of the average closing price of our common stock for the five-day period immediately preceding the date of each subscription agreement.

On June 24, 2014, we issued the holder of a convertible note 23,318,254 shares of restricted common stock and five-year warrants to acquire up to 6,809,524 shares of common stock at an exercise price of $0.042 per share and up to 397,222 shares of common stock at an exercise price of $0.108 per share. We issued the stock and warrants upon the conversion of a combined principal and interest balance of $1,003,200 due under the note. We also issued the holder 75,000 shares of common stock as a service fee for converting the note in full and for agreeing to waive anti-dilution price protection in certain warrants previously issued by the holder to us.

On July 8, 2014, we issued the holder of a convertible note 2,591,846 shares of restricted common stock and five-year warrants to acquire up to 2,321,429 shares of common stock at an exercise price of $0.042 per share and up to 135,417 shares of common stock at an exercise price of $0.108 per share. We issued the stock and warrants upon the conversion of the interest balance of $116,970 due under the note and for the holder's agreement to extend the expiration date of the note. We also issued the holder 25,000 shares of common stock as a service fee for extending the note, for converting the interest due under the note and for agreeing to waive anti-dilution price protection in certain warrants previously issued by the holder to us.

On August 6, 2014, we issued 390,301 shares of restricted common stock at an average price of $0.24 per share in payment for investor relations consulting services valued at $75,000 based on the value of the services provided.

On July 15, 2014, we issued 1,937,505 shares of restricted common stock to the holders of three convertible notes in exchange for the partial or full conversion of principal and interest in the aggregate amount of $81,375 at a conversion price of $0.042 per share.

On July 24, 2014, we issued an aggregate of 2,503,966 shares of restricted common stock and a seven-year warrant to issue up to 1,251,983 shares of common stock at an exercise price of $0.132 per share to Dr. Chetan Shah, one of our directors. We issued the common stock and warrant to Dr. Shah upon the conversion of an aggregate of $220,349 of unpaid principal and accrued interest due under a 10% Convertible Note previously issued to Dr. Shah by us on July 9, 2013.

On September 17, 2014, we issued to the holder of the remaining 2008 10% Convertible Note units consisting of an aggregate of 478,188 shares of restricted common stock and unit warrants to acquire up to an aggregate of 239,094 shares of common stock at an exercise price of $0.096 per share. The units were issued to the note holder upon the conversion of an aggregate of $45,906 of unpaid principal and accrued interest due under the promissory note, which represented the entire amount outstanding under the note.

On July 29, 2014, August 4, 2014 and August 6, 2014, we issued to four investors 2,673,231 shares of restricted common stock through the cash exercise of eight warrants for $259,474 of cash at an average exercise price of approximately $0.10 per share. As an inducement to those investors, we issued them replacement warrants to acquire up to an aggregate of 2,673,231 shares of common stock on the same terms as the warrants they exercised.

On August 29, 2014, September 2, 2014 and September 22, 2014, we issued and sold to three accredited investors units consisting of (a) 100,000 restricted shares of our common stock at prices per share ranging from $0.091 to $0.094 and (b) a five-year warrant to purchase 50,000 shares of common stock at exercise prices ranging from $0.136 to $0.143 per share. In total, the investors purchased for cash an aggregate of $591,700 of units. The investors acquired an aggregate of 974,982 shares of common stock and warrants to acquire up to an aggregate of 487,491 shares of common stock.

On November 7, 2014, we issued 170,020 shares of restricted common stock at price of $0.205 per share, along with a cash payment of $50,000, in full repayment of the outstanding principal balance and interest balance on the Law Firm Note.

On October 10, 2014, October 14, 2014 and October 15, 2014, we issued and sold to eight accredited investors units consisting of (a) 100,000 restricted shares of common stock at prices per share ranging from $0.105 to $0.114 and (b) a five-year warrant to purchase 50,000 shares of common stock at exercise prices ranging from $0.154 to $0.167 per share. In total, the investors purchased for cash an aggregate of $501,700 of units. The investors acquired an aggregate of 4,506,250 shares of common stock and warrants to acquire up to an aggregate of 2,253,125 shares of common stock.

On October 9, 2014, we issued to an accredited investor units consisting of an aggregate of 1,835,798 shares of restricted common stock and warrants to acquire up to an aggregate of 917,899 shares of common stock at an exercise price of $0.154 per share. We issued the units to the investor upon the conversion of an aggregate of $189,087 of unpaid principal and accrued interest due under two promissory notes (the remaining October and November 2009 10% Convertible Note and the April 2010 10% Convertible Note) previously issued to the investor by us. The amounts converted represented the entire principal and interest outstanding under the notes and the notes held by that holder were retired.

On October 17, 2014 and October 20, 2014, we issued an aggregate of 5,671,119 shares of restricted common stock and seven-year warrants to issue up to an aggregate of 5,671,119 shares of common stock at exercise prices ranging from $0.093 to $0.116 per share to eight accredited investors. One of the investors is Dr. Shah. The common stock and warrants were issued to the investors upon the cash exercise of previously issued warrants held by them. The investors paid an aggregate of $579,251 upon exercise of the previously outstanding warrants at exercise prices ranging from $0.093 to $0.115 per share.

On October 15, 2014, we issued an aggregate of 3,522,976 shares of restricted common stock to two accredited investors upon the conversion of an aggregate of $147,965 of unpaid principal and accrued interest due under promissory notes previously issued to the investors by us. The conversion price per share was $0.042.

On November 6, 2014, we sold two accredited investors (i) convertible promissory notes in the aggregate principal amount of $527,780 and (ii) five year warrants to purchase up to 2,356,160 shares of common stock at a fixed exercise price of $0.168 per share. The convertible promissory notes bear interest at the annual rate of 10% and mature on April 1, 2016. The aggregate gross cash proceeds to us were $415,000 after subtracting legal fees of $35,000; the balance of the principal amount of the notes represents a $27,780 due diligence fee and an original issuance discount. The convertible promissory notes are convertible at the option of the holders into shares of our common stock at a fixed price of $0.112 per share, for up to an aggregate of 4,712,321 shares of common stock.

On October 21, 2014, we issued an aggregate of 16,423,131 shares of restricted common stock to three accredited investors upon the cashless exercise of warrants previously issued to the investors by us with an exercise price of $0.042 per share.

On November 12, 2014, we issued 39,024 shares of restricted common stock to a consultant in payment for investor relations services valued at $8,000 based on the value of the services provided.

On November 18, 2014, we issued an aggregate of 5,625,000 shares of restricted common stock to two investors upon the conversion of an aggregate of $236,250 of unpaid principal and accrued interest under a promissory note previously issued by us. The conversion price was $0.042 per share.

On November 19, 2014 we issued 14,234 shares of restricted common stock to an investor upon the cashless exercise of warrants previously issued by us with an exercise price of $0.11 per share.

On November 25, 2014, we issued an aggregate of 10,714,285 shares of restricted common stock to two accredited investors upon the conversion of an aggregate of $450,000 of unpaid principal and accrued interest due under promissory notes previously issued by us with a conversion price of $0.042 per share.

On November 26, 2014, we authorized the issuance of an aggregate of 4,408,237 shares of restricted common stock to 38 accredited investors upon the cashless exercise of warrants previously issued to the investors by us with an exercise price of $0.22 per share.

On November 26, 2014, we authorized the issuance of 496,034 shares of restricted common stock to an accredited investor upon the cashless exercise of warrants previously issued by us with an exercise price of $0.11 per share.

On December 2, 2014, we sold $3,300,000 of units, comprised of common stock and warrants, to three affiliated institutional investors at a price of $0.30 per unit. Each unit consisted of one share of common stock and five-year warrants to purchase 1.2 shares of common stock at an exercise price of $0.30 per share. Accordingly, we issued a total of 11,000,000 shares of restricted common stock and warrants to purchase 13,200,000 shares of common stock. For its services as sole placement agent for the financing, we paid Roth Capital Partners, LLC a cash fee of $231,000 and expense reimbursement of $25,000 and we issued it a five-year warrant to purchase 550,000 shares of common stock at an exercise price of $0.30 per share.

On December 5, 2014, we issued an aggregate of 175,004 shares of restricted common stock to two affiliated accredited investors upon the cashless exercise of warrants previously issued by us with an exercise price of $0.042 per share.

Equity Transactions in the Fiscal Year Ended March 31, 2014

Common Stock Issuances in the Fiscal Year Ended March 31, 2014

On June 14, 2013, we completed a unit subscription agreement with three accredited investors pursuant to which we issued 1,580,248 shares of our common stock and 790,124 warrants to purchase our common stock for net cash proceeds of $128,000. Such warrants have an exercise price of $0.121 per share.

On June 20, 2013, we issued to our CEO the remaining 3,400,000 shares under his restricted share grant, all of which were vested.

On April 3, 2013, April 15, 2013, April 23, 2013, May 3, 2013, May 9, 2013, June 6, 2013 and June 25, 2013, we issued 3,675,278 shares of restricted common stock to the holders of three notes issued by us in exchange for the partial conversion of principal and interest in an aggregate amount of $246,500 at an average conversion price of $0.07 per share.

On August 5, 2013 and August 6, 2013, we completed a unit subscription agreement with four accredited investors pursuant to which we issued 900,901 shares of restricted common stock and 450,451 warrants to purchase our common stock in exchange for net cash proceeds of $100,000. Such warrants have an exercise price of $0.167 per share.

On September 10, 2013, we issued 1,168,343 shares of restricted common stock at an average price of $0.10 per share in payment for investor relations and public relations services valued at $115,000 based on the value of the services provided.

On July 16, 2013, July 24, 2013, August 5, 2013 and August 6, 2013, we issued 2,795,367 shares of restricted common stock to the holders of four notes issued by us in exchange for the partial or full conversion of principal and interest in an aggregate amount of $173,960 at an average conversion price of $0.06 per share.

On October 30, 1013, November 12, 2013, December 10, 2013 and December 30, 2013, we issued to 32 accredited investors 14,367,200 shares of restricted common stock and warrants to purchase our common stock for gross cash proceeds of $1,795,900. The warrants have an exercise price of $0.22 per share. We paid the broker that was engaged as placement agent in the transaction an aggregate cash fee in the amount of $270,508 and issued the placement agent's designees warrants to purchase an aggregate of 2,155,080 shares of our common stock. We also paid $78,360 in other costs and fees, including legal fees, blue sky fees and escrow costs. The net proceeds that we received totaled $1,447,032.

On October 24, 2013 and December 23, 2013, we issued 1,465,200 shares of restricted common stock to the holder of two notes issued by us in exchange for the partial or full conversion of accrued interest in an aggregate amount of $80,000 at an average conversion price of $0.05 per share.

On February 24, 2014 and March 31, 2014, we issued 2,638,179 shares of restricted common stock to the holders of five notes issued by us in exchange for the partial or full conversion of accrued interest in an aggregate amount of $226,316 at an average conversion price of $0.09 per share.

On February 21, 2014, we issued 399,781 shares of restricted common stock at an average price of $0.16 per share in payment for investor relations and public relations services valued at $62,500 based on the value of the services provided.

On March 31, 2014, we entered into extension agreements with three noteholders. In conjunction with the extension agreements, we agreed to issue to the noteholders an aggregate 4,507,105 shares of restricted common stock as a result of the noteholders invoking the anti-dilution protection on their notes.

Warrant-Related Issuances in the Fiscal Year Ended March 31, 2014

On August 7, 2013 and September 18, 2013, 18 warrant holders exercised 6,581,259 warrants to receive 3,407,468 restricted shares of common stock in cashless exercise transactions.

On October 23, 2013, a warrant holder exercised 2,805,000 warrants in exchange for 1,577,736 shares in a cashless exercise transaction.

On October 30, 1013, November 12, 2013, December 10, 2013 and December 30, 2013, we issued an aggregate 9,338,680 five year warrants to the investors and placement agent as part of our financing in that period (see above).

The exercise price for the warrants was $0.22 per share.

On January 29, 2014 and March 14, 2014, we issued 208,167 shares of restricted common stock to three warrant holders in cashless exercise transactions.

On February 24, 2014, we issued 7,522,854 shares of restricted common stock upon the cashless exercise of three warrants in connection with the Gemini litigation settlement.

Stock Option-Related Issuances in the Fiscal Year Ended March 31, 2014

In May 2013, we issued to a scientific advisory board member and a scientific consultant a three year option to purchase 125,000 shares of our common stock at a price of $0.11 per share.

On July 1, 2013, our compensation committee and Board of Directors approved the issuance of four stock option grants to four of our executives. The options carried an exercise price of $0.10 per share, have a ten year life and vest over the following schedule: 25% on July 1, 2014, 25% on July 1, 2015, 25% on July 1, 2016 and 25% on July 1, 2017. The numbers of shares underlying each of the stock option grants were as follows: 2,000,000 shares to our chief executive officer and 500,000 shares each to our president, chief science officer and chief financial officer.

On March 26, 2014, a former director exercised 182,927 in vested stock options through the contribution of $2,000 in cash and $13,000 in accrued expenses owed to him based on the exercise price of $0.082 per share.

Equity Transactions in the Fiscal Year Ended March 31, 2013

Common Stock Issuances in the Fiscal Year Ended March 31, 2013

During the fiscal year ended March 31, 2013, we issued 22,829,754 shares of restricted common stock to holders of notes issued by the Company in exchange for the partial or full conversion of principal and interest of several notes payable in an aggregate amount of $1,707,052 at an average conversion price of $0.07 per share based upon the conversion formulae in the respective notes.

During the fiscal year ended March 31, 2013, we issued 116,000 shares of restricted common stock to a holder of a note payable to settle past due accrued interest that we recorded as non-cash interest expense of $11,846.

During the fiscal year ended March 31, 2013, we issued 1,932,808 restricted shares of common stock to service providers for investor relations, corporate communications and business development services valued at $170,849 based upon the fair value of the shares issued. The average issuance price on the restricted share issuances was approximately $0.09 per share.

On April 5, 2012, we completed a unit subscription agreement with one accredited investor pursuant to which the investor purchased $200,000 of units, with each unit consisting of (i) one share of common stock at a price per share of $0.08 and (ii) a warrant to purchase such number of shares of common stock as shall equal (a) fifty percent of the subscription amount *divided by* (b) $0.08 at an exercise price of $0.125 per warrant share. Based on the foregoing, units consisting of 2,500,000 shares of common stock and warrants to purchase 1,250,000 shares of common stock were issued on April 5, 2012.

The warrants are exercisable for a period of seven years from the date of issuance at an exercise price of $0.125, subject to adjustments for stock splits, stock dividends, recapitalizations and the like. The investor may exercise the warrant on a cashless basis if the shares of common stock underlying the warrant are not then registered pursuant to an effective registration statement.

On June 19, 2012, we completed a unit subscription agreement with seven accredited investors pursuant to which the investors purchased $592,000 of units, with each unit consisting of (i) one share of common stock at a price per share of $0.072 and (ii) a warrant to purchase such number of shares of common stock as shall equal (a) fifty percent of the subscription amount *divided by* (b) $0.072 at an exercise price of $0.108 per Warrant Share. Based on the foregoing, units consisting of 8,222,222 shares of common stock and warrants to purchase 4,111,111 shares of common stock were issued on June 19, 2012.

On June 26, 2012, we completed a unit subscription agreement with one accredited investor pursuant to which the investor purchased $10,000 of units, with each unit consisting of (i) one share of common stock at a price per share of $0.072 and (ii) a warrant to purchase such number of shares of common stock as shall equal (a) fifty percent of the subscription amount divided by (b) $0.072 at an exercise price of $0.107 per warrant share. Based on the foregoing, units consisting of 139,821 shares of common stock and warrants to purchase 69,911 shares of common stock were issued on June 26, 2012.

On July 3, 2012, we issued 461,409 shares of common stock to the holder of a $25,000 October and November 2009 10% Convertible Note in exchange for the value of the principal and related accrued interest of $8,000 under the same terms that we used to sell units consisting of one share of common stock and one-half of a stock purchase warrant on June 29, 2012. As part of that structure, the noteholder also received seven year warrants to purchase 230,705 share of common stock at a price of $0.107 per share.

On August 29, 2012, we completed a unit subscription agreement with seven accredited investors pursuant to which the investors purchased an aggregate of $271,000 of restricted common stock at a price of $0.08 per share. The common stock purchase price under the subscription agreement was determined to be 80% of the average closing price of the our common stock for the five-day period immediately preceding the date of the subscription agreement, resulting in the issuance of 3,387,500 shares of common stock. Each investor also received one common stock purchase warrant for each two shares of common stock purchased under the subscription agreement. The warrant exercise price was calculated to be $0.12 per share based upon 120% of the average of the closing prices of our common stock for the five-day period immediately preceding the parties entering into the subscription agreement.

The warrants are exercisable for a period of seven years from the date of issuance at an exercise price of $0.12, subject to adjustments for stock splits, stock dividends, recapitalizations and the like. The investors may exercise the warrants on a cashless basis if the shares of common stock underlying the warrants are not then registered pursuant to an effective registration statement.

In October 2012, we completed a unit subscription agreement with four accredited investors pursuant to which the investors purchased an aggregate of $135,000 of restricted common stock at an average price of $0.07 per share. The common stock purchase price under the subscription agreement was determined to be 80% of the average closing price of our common stock for the five-day period immediately preceding the date of the subscription agreement, resulting in the issuance of 1,823,412 shares of common stock. Each investor also received one common stock purchase warrant for each two shares of common stock purchased under the subscription agreement. The warrant exercise price was calculated based upon 120% of the average of the closing prices of our common stock for the five-day period immediately preceding the parties entering into the subscription agreement.

In November 2012, we completed a unit subscription agreement with four accredited investors pursuant to which the investors purchased an aggregate of $213,000 of restricted common stock at an average price of $0.06 per share. The common stock purchase price under the subscription agreement was determined to be 80% of the average closing price of our common stock for the five-day period immediately preceding the date of the subscription agreement, resulting in the issuance of 3,435,484 shares of common stock. Each investor also received one common stock purchase warrant for each two shares of common stock purchased under the subscription agreement. The warrant exercise price was calculated based upon 120% of the average of the closing prices of our common stock for the five-day period immediately preceding the parties entering into the subscription agreement.

In December 2012, we completed a unit subscription agreement with four accredited investors pursuant to which the investors purchased an aggregate of $150,000 of restricted common stock at an average price of $0.06 per share. The common stock purchase price under the subscription agreement was determined to be 80% of the average closing price of our common stock for the five-day period immediately preceding the date of the subscription agreement, resulting in the issuance of 2,619,684 shares of common stock. Each investor also received one common stock purchase warrant for each two shares of common stock purchased under the subscription agreement. The warrant exercise price was calculated based upon 120% of the average of the closing prices of our common stock for the five-day period immediately preceding the parties entering into the subscription agreement.

On January 4, 2013, we issued 246,429 shares of restricted common stock to the owner of a patent as a patent license payment valued at $17,250.

On February 7, 2013, we issued an aggregate of 3,515,625 shares of restricted common stock to six accredited investors and one institutional investor for aggregate proceeds of $225,000 or an average price of $0.06 per share. The common stock purchase price was determined to be 80% of the average closing price of our common stock for the five-day period immediately preceding the purchase date. Each investor also received one common stock purchase warrant for each two shares of common stock purchased. The warrant exercise price was calculated based upon 120% of the average of the closing prices of our common stock for the five-day period immediately preceding the purchase date.

On March 4, 2013, March 14, 2013, March 15, 2013 and March 18, 2013, we issued an aggregate of 4,080,798 shares of restricted common stock to ten accredited investors and one institutional investor for aggregate proceeds of $313,834 or an average price of $0.08 per share. The common stock purchase price was determined to be 80% of the average closing price of our common stock for the five-day period immediately preceding the date of each purchase. We also issued each investor one common stock purchase warrant for each two shares of common stock purchased. The warrant exercise price was calculated based upon 120% of the average of the closing prices of our common stock for the five-day period immediately preceding the applicable purchase date.

Warrant Issuances in the Fiscal Year Ended March 31, 2013

In April 2012, we issued warrants to purchase 1,617,459 shares of common stock to the placement firm that arranged $1 million in bridge financing in the fiscal year ended March 31, 2012. Those warrants were on the same terms as those received by the investors in the bridge financing with a term of five years and an exercise price of $0.11.

On April 5, 2012, under the unit subscription agreement noted above, we issued warrants to purchase 1,250,000 shares of common stock. The warrants are exercisable for a period of seven years from the date of issuance at an exercise price of $0.125, subject to adjustments for stock splits, stock dividends, recapitalizations and the like. The investor may exercise the warrant on a cashless basis if the shares of common stock underlying the warrant are not then registered pursuant to an effective registration statement.

On June 19, 2012, under the unit subscription agreement noted above, we issued warrants to purchase 4,111,111 shares of common stock. The warrants are exercisable for a period of seven years from the date of issuance at an exercise price of $0.108, subject to adjustments for stock splits, stock dividends, recapitalizations and the like. The investor may exercise the warrant on a cashless basis if the shares of common stock underlying the warrant are not then registered pursuant to an effective registration statement.

On June 26, 2012, under the unit subscription agreement noted above, we issued warrants to purchase 69,911 shares of common stock. The warrants are exercisable for a period of seven years from the date of issuance at an exercise price of $0.107, subject to adjustments for stock splits, stock dividends, recapitalizations and the like. The investor may exercise the warrant on a cashless basis if the shares of common stock underlying the warrant are not then registered pursuant to an effective registration statement.

In July 2012, we issued 461,409 shares of common stock to the holder of a $25,000 October and November 2009 10% Convertible Note in exchange for the value of the principal and related accrued interest of $8,000 under the same terms that we used to sell units consisting of one share of common stock and one-half of a stock purchase warrant on June 29, 2012. As part of that structure, the noteholder also received seven year warrants to purchase 230,705 share of common stock at a price of $0.107 per share.

On August 29, 2012, under the unit subscription agreement noted above, we issued warrants to purchase 1,693,750 shares of common stock. The warrants are exercisable for a period of seven years from the date of issuance at an exercise price of $0.12 per share, subject to adjustments for stock splits, stock dividends, recapitalizations and the like. The investor may exercise the warrant on a cashless basis if the shares of common stock underlying the warrant are not then registered pursuant to an effective registration statement.

In October 2012, under the unit subscription agreement noted above, we issued warrants to purchase 911,707 shares of common stock. The warrants are exercisable for a period of seven years from the date of issuance at an average exercise price of $0.111 per share, subject to adjustments for stock splits, stock dividends, recapitalizations and the like. The investor may exercise the warrant on a cashless basis if the shares of common stock underlying the warrant are not then registered pursuant to an effective registration statement.

In November 2012, under the unit subscription agreement noted above, we issued warrants to purchase 1,717,742 shares of common stock. The warrants are exercisable for a period of seven years from the date of issuance at an average exercise price of $0.093 per share, subject to adjustments for stock splits, stock dividends, recapitalizations and the like. The investor may exercise the warrant on a cashless basis if the shares of common stock underlying the warrant are not then registered pursuant to an effective registration statement.

In December 2012, under the unit subscription agreement noted above, we issued warrants to purchase 1,309,843 shares of common stock. The warrants are exercisable for a period of seven years from the date of issuance at an average exercise price of $0.086 per share, subject to adjustments for stock splits, stock dividends, recapitalizations and the like. The investor may exercise the warrant on a cashless basis if the shares of common stock underlying the warrant are not then registered pursuant to an effective registration statement.

On February 7, 2013, we issued warrants to purchase 1,757,813 shares of common stock. The warrants are exercisable for a period of seven years from the date of issuance at an average exercise price of $0.096 per share, subject to adjustments for stock splits, stock dividends, recapitalizations and the like. The investor may exercise the warrant on a cashless basis if the shares of common stock underlying the warrant are not then registered pursuant to an effective registration statement.

On March 4, 2013, March 14, 2013, March 15, 2013 and March 18, 2013, we issued warrants to purchase 2,040,406 shares of common stock. The warrants are exercisable for a period of seven years from the date of issuance at an average exercise price of $0.118 per share, subject to adjustments for stock splits, stock dividends, recapitalizations and the like. The investor may exercise the warrant on a cashless basis if the shares of common stock underlying the warrant are not then registered pursuant to an effective registration statement.

Option Issuances in the Fiscal Year Ended March 31, 2013

In the fiscal year ended March 31, 2013, our Board of Directors granted, to our four outside directors, ten year options to acquire an aggregate of 1,667,105 shares of our common stock, all with an exercise price of $0.076 per share.

Equity Transactions in the Fiscal Year Ended March 31, 2012

Common Stock Issuances in the Fiscal Year Ended March 31, 2012

During the fiscal year ended March 31, 2012, we issued 28,859,559 shares of restricted common stock to noteholders in exchange for the conversion of principal and interest of several notes payable and convertible notes payable in an aggregate amount of $2,058,290 at an average conversion price of $0.07 per share based upon the conversion formulae in the respective notes.

In the fiscal year ended March 31, 2012 we issued 3,451,558 shares of stock to consultants as compensation under stock-based compensation expense for services valued at $341,547 based upon the fair value of the shares issued. Of that aggregate amount, 2,974,017 shares of common stock were issued to pursuant to our S-8 registration statements covering our Amended and Restated 2003 Consultant Stock Plan or 2010 Stock Incentive Plan for regulatory affairs, primarily managing our Hepatitis-C trial in India, scientific consulting and corporate communications valued at $279,747 based upon the fair value of the shares issued. The average issuance price on the S-8 issuances was approximately $0.09 per share. Additionally, we issued 477,541 restricted shares of common stock to certain consultants for investor relations services valued at $61,800 based upon the fair value of the shares issued. The average issuance price on the restricted share issuances was approximately $0.13 per share.

During the fiscal year ended March 31, 2012, we issued to a warrant holder 3,699,914 shares of restricted common stock related to net warrant cashless exercises.

During the fiscal year ended March 31, 2012, we issued 104,635 shares of restricted common stock as monthly interest payments to the holder on a note payable valued at $5,507 based upon the interest due for those respective months, for an average issuance price of $0.05 per share based on the interest payment formula in the note.

In January 2012, we issued 287,500 shares of restricted common stock to the owner of a patent as a patent license payment valued at $17,250.

On March 29, 2012, we entered into a unit subscription agreement with one accredited investor pursuant to which the investor purchased an aggregate of $300,000 of units, with each unit consisting of (i) one share of common stock at a price per share of $0.08 and (ii) a warrant to purchase such number of shares of common stock of the Company as shall equal (a) fifty percent of the subscription amount *divided by* (b) $0.08 at an exercise price of $0.125 per warrant share. Based on the foregoing, units consisting of 3,750,000 shares of common stock and warrants to purchase 1,875,000 shares of common stock were issued.

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Warrant Issuances in the Fiscal Year Ended March 31, 2012

In April 2011, we entered into a Subscription Agreement with two accredited investors providing for the issuance and sale of convertible promissory notes and corresponding warrants in the aggregate principal amount of $385,000. The closing under the subscription agreement resulted in the issuance and sale by us of (i) convertible promissory notes in the aggregate principal amount of $385,000, (ii) five-year warrants to purchase an aggregate of 4,004,000 shares of our common stock at an exercise price of $0.125 per share, and (iii) five-year warrants to purchase an aggregate of 4,004,000 shares of our common stock at an exercise price of $0.175 per share.

In addition, we issued (i) five-year warrants to purchase an aggregate of 812,500 shares of our common stock at an exercise price of $0.125 per share, and (iii) five-year warrants to purchase an aggregate of 812,500 shares of our common stock at an exercise price of $0.175 per share to the investors. These warrants were issued as an anti-dilution adjustment under certain common stock purchase warrants held by investors that were acquired from us in September 2010.

In May 2011, we agreed to modify three warrants held by an institutional investor as the result of anti-dilution protection.

In July and August 2011, we raised $357,656 in 10% convertible notes. Those notes had a fixed conversion price of $0.09 per share and carried an interest rate of 10%. The convertible notes mature in July and August 2012. We also issued those investors five year warrants to purchase 3,973,957 shares of common stock at $0.125 per share.

On September 23, 2011, we entered into a Subscription Agreement with two accredited investors providing for the issuance and sale of convertible promissory notes and corresponding warrants in the aggregate principal amount of $253,760. The warrants carried a five-year term to purchase an aggregate of 3,625,143 shares of our common stock at an exercise price of $0.10 per share.

In November 2011, we raised $525,000 in 5% Original Issue Discount Unsecured Convertible Debentures from five accredited investors pursuant to which the investors purchased an aggregate principal amount of $525,000 for an aggregate purchase price of $500,000. The debentures bear interest at 20% per annum and mature on April 20, 2012. The debentures will be convertible at the option of the holders at any time into shares of our common stock, at a conversion price equal to $0.0779, subject to adjustment. In connection with the debentures, the purchasers received warrants to purchase 3,369,706 shares of our common stock. The warrants are exercisable for a period of five years from the date of issuance at an exercise price of $0.11, subject to adjustment.

In February 2012, we raised $525,000 in 5% Original Issue Discount Unsecured Convertible Debentures from five accredited investors pursuant to which the investors purchased an aggregate principal amount of $525,000 for an aggregate purchase price of $500,000. The debentures bear interest at 20% per annum and mature on April 20, 2012. These subscriptions represent the completion of the $1,000,000 securities offering that was initiated and priced in November 2011. In connection with the subscription agreement, the investors received warrants to purchase 3,369,707 shares of our common stock. The warrants are exercisable for a period of five years from the date of issuance at an exercise price of $0.11 per share, subject to adjustment.

On March 29, 2012, we entered into a unit subscription agreement with one accredited investor pursuant to which the investor purchased an aggregate of $300,000 of units, with each unit consisting of (i) one share of common stock at a price per share of $0.08 and (ii) a warrant to purchase such number of shares of common stock of the Company as shall equal (a) fifty percent of the subscription amount *divided by* (b) $0.08 at an exercise price of $0.125 per warrant share. Based on the foregoing, units consisting of 3,750,000 shares of common stock and warrants to purchase 1,875,000 shares of common stock were issued. The warrants are exercisable for a period of seven years from the date of issuance at an exercise price of $0.125, subject to adjustments for stock splits, stock dividends, recapitalizations and the like. The investor may exercise the warrant on a cashless basis if the shares of common stock underlying the warrant are not then registered pursuant to an effective registration statement.

On March 31, 2012, we agreed to extend by two years the expiration date of seven warrants for a total of 2,480,000 shares held by a note holder and to reduce the exercise price on those warrants from $0.25 per share on six of the warrants and $0.19 on the seventh warrant to $0.125 per share in exchange for his extension of $50,000 of the October and November 2009 10% Convertible Notes and the $75,000 April 2010 10% Convertible Note by that same two year period.

Item 16. Exhibits and Financial Statement Schedules.

Reference is made to the Exhibit Index filed as part of this registration statement. All exhibits have been filed previously unless otherwise noted.

Item 17. Undertakings.

(a) The undersigned registrant hereby undertakes:

(1) To file, during any period in which offers or sales are being made, a post-effective amendment to this registration statement:

(i) To include any prospectus required by section 10(a)(3) of the Securities Act of 1933;

(ii) To reflect in the prospectus any facts or events arising after the effective date of this registration statement (or the most recent post-effective amendment hereof) which, individually or in the aggregate, represent a fundamental change in the information set forth in this registration statement. Notwithstanding the foregoing, any increase or decrease in volume of securities offered (if the total dollar value of securities offered would not exceed that which was registered) and any deviation from the low or high end of the estimated maximum offering range may be reflected in the form of prospectus filed with the Commission pursuant to Rule 424(b) if, in the aggregate, the changes in volume and price represent no more than 20% change in the maximum aggregate offering price set forth in the “Calculation of Registration Fee” table in the effective registration statement; and

(iii) To include any material information with respect to the plan of distribution not previously disclosed in this registration statement or any material change to such information in this registration statement.

(2) That, for the purpose of determining any liability under the Securities Act of 1933, each such post-effective amendment shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof;

(3) To remove from registration by means of a post-effective amendment any of the securities being registered which remain unsold at the termination of the offering; and

(4) That, for the purpose of determining liability under the Securities Act of 1933 to any purchaser, each prospectus filed pursuant to Rule 424(b) as part of a registration statement relating to an offering, other than registration statements relying on Rule 430B or other than prospectuses filed in reliance on Rule 430A, shall be deemed to be part of and included in the registration statement as of the date it is first used after effectiveness; provided, however, that no statement made in a registration statement or prospectus that is part of the registration statement or made in a document incorporated or deemed incorporated by reference into the registration statement or prospectus that is part of the registration statement will, as to a purchaser with a time of contract of sale prior to such first use, supersede or modify any statement that was made in the registration statement or prospectus that was part of the registration statement or made in any such document immediately prior to such date of first use.

(b) Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers and controlling persons of the registrant pursuant to the foregoing provisions, or otherwise, the registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the registrant of expenses incurred or paid by a director, officer or controlling person of the registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Act and will be governed by the final adjudication of such issue.

SIGNATURES

Pursuant to the requirements of the Securities Act of 1933, as amended, the registrant has duly caused this registration statement to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of San Diego, State of California, on December 31, 2014.

AETHLON MEDICAL, INC.,

a Nevada corporation

/s/ James A. Joyce

By: James A. Joyce

Its: Chief Executive Officer

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints James A. Joyce and James B. Frakes, or either of them, as his true and lawful attorneys-in-fact and agents, with full power of substitution and resubstitution, for him and in his name, place and stead, in any and all capacities, to file and sign any and all amendments, including post-effective amendments and any registration statement for the same offering that is to be effective under Rule 462(b) of the Securities Act of 1933, as amended, to this registration statement, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents, or their substitute or substitutes may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Act of 1933, as amended, this registration statement has been signed by the following persons in the capacities and on the dates indicated:

Signature	Title	Date

/s/ James A. Joyce James A. Joyce	Chairman, Chief Executive Officer, Principal Executive Officer	December 31, 2014
/s/ James B. Frakes James B. Frakes	Chief Financial Officer, Principal Accounting Officer	December 31, 2014
/s/ Franklyn S. Barry, Jr. Franklyn S. Barry, Jr.	Director	December 31, 2014
s/ Edward G. Broenniman Edward G. Broenniman	Director	December 31, 2014
/s/ Richard H. Tullis Richard H. Tullis	Director	December 31, 2014
/s/ Rodney S. Kenley Rodney S. Kenley	Director	December 31, 2014
/s/ Chetan S. Shah Chetan S. Shah, MD	Director	December 31, 2014

INDEX TO EXHIBITS

No.	Description
2.1	Agreement and Plan of Reorganization Between Aethlon Medical, Inc. (formerly, Bishop Equities, Inc.) and Aethlon, Inc. dated March 10, 1999 (1)
2.2	Agreement and Plan of Reorganization Between Aethlon Medical, Inc. (formerly, Bishop Equities, Inc.) and Hemex, Inc. dated March 10, 1999 (1)
3.1	Articles of Incorporation of Aethlon Medical, Inc., as amended (2)
3.2	Bylaws of Aethlon Medical, Inc., as amended (3)
4.1	Form of Common Stock Certificate *
4.2	Form of Convertible Promissory Note dated July 9, 2013 (3)
4.3	Form of Liquidated Damages Note dated December 30, 2008 (12)
4.4	Form of Common Stock Purchase Warrant dated December 29, 2008(13)
4.5	Form of Amended and Restated Warrant dated June 14, 2010 (15)
4.6	Form of Amended and Restated Warrant dated June 14, 2010 (QB) (15)
4.7	Form of Convertible Promissory Note dated April 1, 2011 (17)
4.8	Form of Common Stock Purchase Warrant dated March 29, 2012 (18)
4.9	Form of Common Stock Purchase Warrant dated June 19, 2012 (19)
4.10	Form of Common Stock Purchase Warrant dated August 29, 2012 (20)
4.11	Form of Common Stock Purchase Warrant dated October, November and December 2012 (21)
4.12	Form of Common Stock Purchase Warrant dated June 14, 2013 (22)
4.13	Form of Common Stock Purchase Warrant October 30, 2013 (23)
4.14	Form of Exosome Sciences 10% Promissory Note dated October 2013 (23)
4.15	Form of Common Stock Purchase Warrant November 12, 2013 (24)
4.16	Form of Common Stock Purchase Warrant December 10, 2013 (26)
4.17	Form of Common Stock Purchase Warrant December 30, 2013 (28)

4.18 Form of Amendment to Notes and Warrants dated March 31, 2014 (30)

4.19 Form of Common Stock Purchase Warrant dated June 24, 2014 (31)

4.20 Form of Common Stock Purchase Warrant dated July 8, 2014 (32)

4.21 Form of Common Stock Purchase Warrant dated July 24, 2014 (33)

4.22 Form of Common Stock Purchase Warrant issued August and September 2014 (34)

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4.23	Form of Class A Common Stock Purchase Warrant dated November 6, 2014 (34)
4.24	Form of Convertible Promissory Note dated November 6, 2014 (34)
4.25	Form of Common Stock Purchase Warrant issued December 2, 2014 (36)
4.26	Form of Purchase Agent Warrant dated December 2, 2014 (37)
5.1	Opinion of Raines Feldman, LLP *
10.1	Amended 2010 Stock Incentive Plan (4)
10.2	Employment Agreement between Aethlon Medical, Inc. and James A. Joyce dated April 1, 1999 (5)++
10.3	Patent License Agreement by and amongst Aethlon Medical, Inc., Hemex, Inc., Dr. Julian L. Ambrus and Dr. David O. Scamurra (6)
10.4	Employment Agreement by and between Aethlon Medical, Inc. and Dr. Richard H. Tullis dated January 10, 2000 (6)++
10.5	Cooperative Agreement by and between Aethlon Medical, Inc. and George Mason University dated February 25, 2004 (7)
10.6	Stock Option Agreement by and between Aethlon Medical, Inc. and James A Joyce dated February 23, 2005 (8)++
10.17	Stock Option Agreement by and between Aethlon Medical, Inc. and Richard Tullis dated February 23, 2005 (8)++
10.18	Stock Option Agreement by and between Aethlon Medical, Inc. and Franklyn S. Barry, Jr. dated February 23, 2005 (8)++
10.19	Stock Option Agreement by and between Aethlon Medical, Inc. and Ed Broenniman dated February 23, 2005 (8)++
10.20	Stock Option Agreement by and between Aethlon Medical, Inc. and James A. Joyce dated September 9, 2005(9)++
10.21	Stock Option Agreement by and between Aethlon Medical, Inc. and James A. Joyce dated June 13, 2007 (10)++
10.22	Stock Option Agreement by and between Aethlon Medical, Inc. and James A. Joyce dated December 15, 2008(11)++
10.23	Stock Option Agreement by and between Aethlon Medical, Inc. and Franklyn S. Barry dated December 15, 2008 (11)++
10.24	Stock Option Agreement by and between Aethlon Medical, Inc. and Edward G. Broenniman dated December 15, 2008(11)++

10.25	Stock Option Agreement by and between Aethlon Medical, Inc. and Richard H. Tullis dated December 15, 2008 (11)++
10.26	Form of Unit Subscription Agreement dated December 29, 2008 (13)
10.27	Standard Industrial Net Lease by and between Sorrento Business Complex and Aethlon Medical, Inc. dated September 28, 2009 (14)
10.28	Form of Amended and Restated Registration Rights Agreement dated February 2, 2009 (15)
10.29	Offer of Employment by and between Aethlon Medical, Inc. and Rodney S. Kenley dated October 27, 2010 (16)++

10.30	Stock Option Agreement of Rodney S. Kenley dated October 27, 2010 (16)++
10.31	Unit Subscription Agreement dated March 29, 2012 (18)
10.32	Unit Subscription Agreement dated June 19, 2012 (19)
10.33	Unit Subscription Agreement dated August 29, 2012 (20)
10.34	Unit Subscription Agreement dated October, November and December 2012 (21)
10.35	Unit Subscription Agreement dated June 14, 2013 (22)
10.36	Form of Unit Purchase Agreement dated October 30, 2013 (23)
10.37	Form of Subscription Agreement October 30, 2013 (23)
10.38	Form of Unit Purchase Agreement dated November 12, 2013 (24)
10.39	Form of Subscription Agreement November 12, 2013 (24)
10.40	Form of Exosome Sciences Stock Purchase Agreement dated November 21, 2013 (25)
10.41	Form of Unit Purchase Agreement dated December 10, 2013 (26)
10.42	Form of Subscription Agreement December 10, 2013 (26)
10.43	Form of Exosome Sciences Stock Purchase Agreement dated December 13, 2013 (27)
10.44	Form of Unit Purchase Agreement dated December 30, 2013 (28)
10.45	Form of Subscription Agreement December 30, 2013 (28)
10.46	Settlement Agreement and General Release with Gemini Master Fund, Ltd. dated February 24, 2014 (29)
10.47	Escrow Agreement dated February 24, 2014 (29)
10.48	Form of Stipulation of Dismissal (29)
10.49	Form of Restructuring Agreement dated June 24, 2014 (31)
10.50	Form of Restructuring Agreement dated June 24, 2014 (31)
10.51	Form of Restructuring Agreement dated July 8, 2014 (32)
10.52	Second Amendment to Standard Industrial Net Lease by and between Sorrento Business Complex and Aethlon Medical, Inc. dated October 10, 2014 *

10.53 Form of Subscription Agreement dated November 6, 2014 (34)

10.54 Office Lease between T-C Stonecrest LLC and Aethlon Medical, Inc. dated November 13, 2014 (35)

10.55 Securities Purchase Agreement dated November 26, 2014 (36)

10.56 Registration Rights Agreement dated November 26, 2014 (36)

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10.57	DARPA Contract dated September 30, 2011* (Portions of this exhibit have been omitted pursuant to a request for confidential treatment.)
10.58	DARPA Contract Extension dated August 8, 2012 *
10.59	DARPA Contract Extension dated September 15, 2013 *
10.60	DARPA Contract Extension dated September 29, 2014 *
21.1	List of subsidiaries *
23.1	Consent of Independent Registered Public Accounting Firm (Squar, Milner, Peterson, Miranda & Williamson, LLP) *
23.2	Consent of Raines Feldman, LLP (included in Exhibit 5.1) *
24.1	Power of Attorney (included on signature page hereto) *
101	Interactive Data Files *
101.INS	XBRL Instance Document *
101.SCH	XBRL Schema Document *
101.CAL	XBRL Calculation Linkbase Document *
101.DEF	XBRL Definition Linkbase Document *
101.LAB	XBRL Label Linkbase Document *
101.PRE	XBRL Presentation Linkbase Document *

* Filed herewith

++ Indicates a management contract or compensatory plan or arrangement

(1) Filed with the Company's Current Report on Form 8-K/A dated March 26, 1999 and incorporated by reference.

(2) Filed with the Company's Annual Report on Form 10-K filed on June 29, 2012 for the year ended March 31, 2012 and incorporated by reference.

(3) Filed with the Company's Annual Report on Form 10-K filed on July 15, 2013 for the year ended March 31, 2013 and incorporated by reference.

(4) Filed with the Company’s Registration Statement on Form S-8 (File No. 333-182902) filed on July 27, 2012 and incorporated by reference.

(5) Filed with the Company's Annual Report on Form 10-KSB filed on July 15, 1999 for the year ended March 31, 1999 and incorporated by reference.

(6) Filed with the Company's Annual Report on Form 10-KSB/A filed on September 10, 2004 for the year ended March 31, 2004 and incorporated by reference.

(7) Filed with the Company's Amendment No.2 to Registration Statement on Form SB-2 (File No. 333-117203) filed on October 28, 2004 and incorporated by reference.

(8) Filed with the Company's Annual Report on Form 10-KSB filed on July 14, 2005 for the year ended March 31, 2005 and incorporated by reference.

(9) Filed with the Company's Current Report on Form 8-K filed on September 12, 2005 and incorporated by reference.

(10) Filed with the Company’s Registration Statement on Form S-8 (File No. 333-168483) filed on August 2, 2010 and incorporated by reference.

(11) Filed with the Company's Current Report on Form 8-K dated December 19, 2008 and incorporated by reference.

(12) Filed with the Company's Current Report on Form 8-K dated January 2, 2009 and incorporated by reference.

(13) Filed with the Company's Current Report on Form 8-K dated January 20, 2009 and incorporated by reference.

(14) Filed with the Company's Quarterly Report on Form 10-Q filed on November 16, 2009 for the period ended September 30, 2009 and incorporated by reference.

(15) Filed with the Company's Annual Report on Form 10-K filed on July 2, 2010 for the year ended March 31, 2010 and incorporated by reference.

(16) Filed with the Company's Current Report on Form 8-K dated November 1, 2010 and incorporated by reference.

(17) Filed with the Company's Current Report on Form 8-K dated April 7, 2011 and incorporated by reference.

(18) Filed with the Company's Current Report on Form 8-K dated April 6, 2012 and incorporated by reference.

(19) Filed with the Company's Current Report on Form 8-K dated June 27, 2012 and incorporated by reference.

(20) Filed with the Company's Current Report on Form 8-K dated September 6, 2012 and incorporated by reference.

(21) Filed with the Company's Quarterly Report on Form 10-Q filed on February 12, 2013 for the period ended December 31, 2012 and incorporated by reference.

(22) Filed with the Company's Quarterly Report on Form 10-Q filed on August 13, 2013 for the period ended June 30, 2013 and incorporated by reference.

(23) Filed with the Company's Current Report on Form 8-K dated November 6, 2013 and incorporated by reference.

(24) Filed with the Company's Current Report on Form 8-K dated November 20, 2013 and incorporated by reference.

(25) Filed with the Company's Current Report on Form 8-K dated November 21, 2013 and incorporated by reference.

(26) Filed with the Company's Current Report on Form 8-K dated December 16, 2013 and incorporated by reference.

(27) Filed with the Company's Current Report on Form 8-K/A dated December 19, 2013 and incorporated by reference.

(28) Filed with the Company's Current Report on Form 8-K dated January 7, 2014 and incorporated by reference.

(29) Filed with the Company's Current Report on Form 8-K dated February 27, 2014 and incorporated by reference.

(30) Filed with the Company's Current Report on Form 8-K dated April 4, 2014 and incorporated by reference.

(31) Filed with the Company's Current Report on Form 8-K dated June 30, 2014 and incorporated by reference.

(32) Filed with the Company's Current Report on Form 8-K dated July 10, 2014 and incorporated by reference.

(33) Filed with the Company's Current Report on Form 8-K dated July 28, 2014 and incorporated by reference.

(34) Filed with the Company's Quarterly Report on Form 10-Q filed on November 10, 2014 for the period ended September 30, 2014 and incorporated by reference.

(35) Filed with the Company's Current Report on Form 8-K/A dated November 19, 2014 and incorporated by reference.

(36) Filed with the Company's Current Report on Form 8-K dated November 28, 2014 and incorporated by reference.

(37) Filed with the Company's Current Report on Form 8-K dated December 3, 2014 and incorporated by reference.

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