

Watts Water (WTS)

\$107.47 (As of 02/11/20)

Price Target (6-12 Months): **\$113.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 10/11/18)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:C

Value: C

Growth: B

Momentum: D

Summary

Watts Water reported healthy fourth-quarter 2019 results wherein the bottom line and the top line surpassed the Zacks Consensus Estimate. The company is focused on accelerating organic growth, driving margin expansion and reinvesting in growth and productivity initiatives. It intends to launch a smart and connected product strategy for further differentiation in the marketplace. Watts Water is committed to enhancing shareholder value while following its long-term strategy of growing business organically and through acquisitions. However, material cost inflation due to the potential imposition of tariffs is likely to affect its cash flow. Also, increased internal investment is likely to hurt margin expansion in the near term. The company's Europe segment is exposed to volatility in organic sales due to softness in the fluid solutions platform.

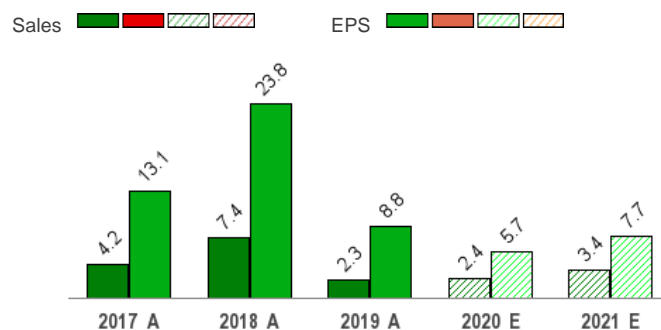
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$114.45 - \$76.15
20 Day Average Volume (sh)	130,777
Market Cap	\$3.6 B
YTD Price Change	7.7%
Beta	1.15
Dividend / Div Yld	\$0.92 / 0.9%
Industry	Instruments - Control
Zacks Industry Rank	Bottom 22% (199 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	2.0%
Last Sales Surprise	0.8%
EPS F1 Est- 4 week change	-0.1%
Expected Report Date	05/07/2020
Earnings ESP	-1.5%
P/E TTM	26.4
P/E F1	25.0
PEG F1	3.1
P/S TTM	2.3

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	419 E	449 E	425 E	428 E	1,695 E
2020	399 E	429 E	407 E	409 E	1,639 E
2019	389 A	417 A	395 A	400 A	1,601 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.12 E	\$1.23 E	\$1.15 E	\$1.15 E	\$4.63 E
2020	\$0.99 E	\$1.16 E	\$1.08 E	\$1.05 E	\$4.30 E
2019	\$0.94 A	\$1.09 A	\$1.04 A	\$1.00 A	\$4.07 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 02/11/2020. The reports text is as of 02/12/2020.

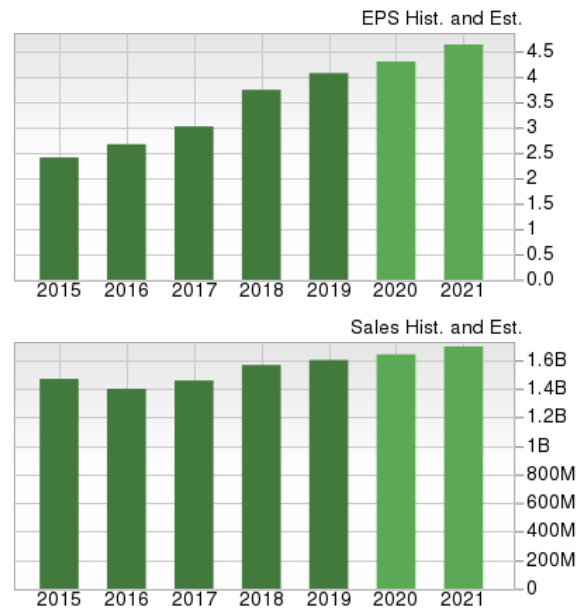
Overview

Headquartered in North Andover, MA, Watts Water Technologies, Inc. designs, manufactures and sells various water safety and flow control products for the water quality, water conservation, water safety, and water flow control markets. The company reports its business under three geographic segments: Americas (66.9% of total revenues in fourth-quarter 2019), Europe (28.4%) and APMEA consisting of Asia-Pacific, Middle East, and Africa (4.7%).

Watts Water classifies its wide range of products under four universal product lines –

- 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 (heating, ventilation and air conditioning) & 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.
- Drainage & 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.

These products are sold to wholesale distributors, original equipment manufacturers (OEMs) and major do-it-yourself (DIY) chains.



Reasons To Buy:

▲ Watts Water is focused on accelerating organic growth, drive margin expansion and reinvest in growth and productivity initiatives. Watts Water aims to launch smart and connected products, which are likely to provide it with further differentiation in the marketplace. Moreover, the company is committed to enhancing shareholder value and executing a balanced cash allocation strategy while following its long-term strategy of growing the business organically and through acquisitions. It has started to realize the expected benefits of portfolio rationalization, footprint optimization and global sourcing while simultaneously reinvesting for future growth. The company focuses on augmenting growth through new product development, geographic expansion and key account management. These initiatives are anticipated to be conducive to top-line growth and margin expansion in 2020.

Watts Water is committed to enhancing shareholder value and executing its balanced cash allocation strategy, while following a long-term strategy of expanding the business through holistic growth.

▲ Watts Water's operating margin expansion will likely be driven by higher volume and productivity increment efforts, including restructuring savings. The company continues to reinvest a portion of the productivity savings in selling and marketing, R&D and IT systems to fund future growth. The company believes Asia-Pacific segment's margin will expand primarily driven by higher volume. Furthermore, operating margin in the Americas segment will expand driven by volume leverage and productivity initiatives. Watts Water expects that its pricing actions should also help to partly mitigate commodity inflation. Thus, the company's pricing actions and restructuring benefits are expected to drive margins.

▲ Watts Water strives to invest in product innovation. Focus on differentiated product offerings provides greater opportunity to augment its market position. The company consistently looks for strategic opportunities to invest in new products. It also remains focused on maintaining stringent quality control and testing procedures at each manufacturing facilities. Over the past years, Watts Water has consistently invested in sales and marketing, and R&D to bring new products into the market. The acquisition of California-based manufacturing company Backflow Direct LLC is expected to cater a wide range of customers by leveraging broader product portfolio and R&D efforts.

Reasons To Sell:

- ▼ Material cost inflation, resulting from potential trade restrictions due to latent trade war, is likely to affect Watts Water's margins in the near term. Transportation cost is also rising due to oil price increases and labor shortages. In case the company is unable to pass on increases in raw material to its customers in the future, its profitability will be affected.
- ▼ Watts Water's Europe segment remains exposed to volatility in its organic sales primarily due to softness in the fluid solutions platform, owing to decline in water, plumbing and heating, ventilation, and air conditioning (HVAC) products. In addition, the underlying trends in the Eurozone economy remain unclear. This might affect the company's growth trajectory and profitability going forward. Also, increased internal investments is likely to impact margin expansion in the near term.
- ▼ Management expects organic growth to moderate a bit in the first half of 2020, with all segments witnessing decelerating trends. In addition, margins are likely to remain under pressure due to adverse foreign currency translation with continued dollar strength. Soft economic growth in the Asian markets are further expected to erode the profitability of the company. With about a quarter of the raw materials reportedly sourced from China, continued bitter bilateral trade relations are further likely to increase the operating costs of the company.

Raw material inflation due to the potential imposition of tariffs, increased internal investments and product rationalization costs are likely to impact Watts Water's margins in the near term.

Last Earnings Report

Watts Water Beats Q4 Earnings & Revenue Estimates

Watts Water reported healthy fourth-quarter 2019 results, wherein the bottom line and the top line surpassed the respective Zacks Consensus Estimate. The North Andover, MA-based company achieved its goals for 2019 to drive organic sales growth and margin expansion, and continued to reinvest in future growth, especially in its smart and connected products.

Net Income

On a reported basis, quarterly net income was \$31.8 million or 93 cents per share compared with \$32.3 million or 94 cents per share in the year-ago quarter. Better operating performances in all regions and lower net interest costs was more than offset by increased restructuring and other costs.

For 2019, net income was \$131.5 million or \$3.85 per share compared with \$128 million or \$3.73 per share in 2018. The improvement was backed by solid operating performance in the Americas and lower net interest costs, partly offset by restructuring and other costs and reduced foreign currency gains.

Fourth-quarter adjusted net income came in at \$34.2 million or \$1 per share compared with \$30.1 million or 88 cents per share in the year-ago quarter. The bottom line surpassed the Zacks Consensus Estimate by 2 cents.

Revenues

On a reported basis, quarterly net sales increased 3.3% year over year to \$400.3 million, driven by organic growth in all regions. The top line surpassed the Zacks Consensus Estimate of \$397 million. For 2019, net sales improved 2.3% year over year to \$1,600.5 million.

Organic sales grew 4% year over year. Regionally, organic sales in the Americas increased 4%, led by growth in plumbing, drains, electronics, water quality and hot water products. Organic sales improved 2% in Europe owing to strength in the company's drains and electronics businesses. Asia-Pacific, Middle East and Africa (APMEA) saw a jump of 20% with gains in China, Korea and the Middle East.

Quarterly Segment Results

Americas: Net sales increased 4.5% (including 1% from acquisition) year over year to \$267.9 million in the December quarter. Adjusted operating income increased 5.8% to \$45.5 million as benefits from price, volume, and productivity savings were partly offset by growth investments and inflation.

Europe: Net sales decreased 1.5% to \$113.6 million, impacted by negative foreign exchange movements. The segment's adjusted operating income was \$13.4 million compared with \$12.6 million in the year-ago quarter. This reflects benefit from increased price, volume and productivity including gains from restructuring programs.

APMEA: Net sales increased 17.5% to \$18.8 million. Adjusted operating income came in at \$3 million compared with \$1.8 million in the prior-year quarter. This is supported by an increase in third party volume, better product mix, productivity and cost controls, partly offset by lower intercompany volume, growth investments and inflation.

Other Details

Cost of goods sold in the fourth quarter went up 3.8% year over year to \$230.2 million. Gross profit increased 2.5% to \$170.1 million driven by top-line growth. Operating income was \$47.3 million, up 4.2%. GAAP operating margin was up 10 basis points (bps) to 11.8%. Adjusted operating margin came in at 12.5%, up 80 bps.

Cash Flow & Liquidity

In 2019, Watts Water generated \$194 million of net cash from operating activities compared with \$169.4 million in 2018. As of Dec 31, 2019, the company had \$219.7 million in cash and equivalents with \$204.2 million of long-term debt (net of current portion), compared with the respective tallies of \$204.1 million and \$323.4 million a year ago.

Watts Water repurchased about 49,000 shares for \$4.7 million during the quarter. It repatriated \$5.5 million in cash during the quarter. For 2019, \$43 million was repatriated, a majority of which was used to pay down revolving debt.

Quarter Ending **12/2019**

Report Date	Feb 10, 2020
Sales Surprise	0.79%
EPS Surprise	2.04%
Quarterly EPS	1.00
Annual EPS (TTM)	4.07

Valuation

Watts Water shares are up 35% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Computer and Technology sector are up 14.5% and 29.2% over the past year, respectively.

The S&P 500 Index is up 21.1% in the past year.

The stock is currently trading at 3.87X trailing 12-month book value, which compares to 3.61X for the Zacks sub-industry, 5.70X for the Zacks sector and 4.33X for the S&P 500 Index.

Over the past five years, the stock has traded as high as 3.87X and as low as 1.93X, with a 5-year median of 2.89X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$113 price target reflects 29.2X trailing 12-month book value.

The table below shows summary valuation data for WTS

Valuation Multiples - WTS					
		Stock	Sub-Industry	Sector	S&P 500
P/B TTM	Current	3.87	3.61	5.7	4.33
	5-Year High	3.87	5	5.7	4.42
	5-Year Low	1.93	2.84	3.13	2.85
	5-Year Median	2.89	3.49	4.24	3.62
P/E F12M	Current	24.75	17.66	23.09	19.3
	5-Year High	25.32	18.35	23.09	19.34
	5-Year Low	15.04	13.12	16.87	15.18
	5-Year Median	20.94	15.77	19.32	17.47
P/S F12M	Current	2.21	2.44	3.76	3.56
	5-Year High	2.21	2.44	3.76	3.56
	5-Year Low	1.09	1.53	2.3	2.54
	5-Year Median	1.53	2.04	3.02	3

As of 02/11/2020

Industry Analysis Zacks Industry Rank: Bottom 22% (199 out of 254)



Top Peers

Allied Motion Technologies, Inc. (AMOT)	Neutral
Badger Meter, Inc. (BMI)	Neutral
Roper Technologies, Inc. (ROP)	Neutral
Sensata Technologies Holding N.V. (ST)	Neutral
Thermon Group Holdings, Inc. (THR)	Neutral
Transcat, Inc. (TRNS)	Neutral
Woodward, Inc. (WWD)	Neutral
Xylem Inc. (XYL)	Neutral

Industry Comparison Industry: Instruments - Control				Industry Peers		
	WTS Neutral	X Industry	S&P 500	BMI Neutral	THR Neutral	WWD Neutral
VGM Score	C	-	-	D	A	D
Market Cap	3.64 B	442.46 M	24.31 B	1.97 B	701.43 M	7.30 B
# of Analysts	8	2	13	3	1	5
Dividend Yield	0.86%	0.00%	1.78%	1.00%	0.00%	0.55%
Value Score	C	-	-	F	B	C
Cash/Price	0.05	0.05	0.04	0.03	0.05	0.02
EV/EBITDA	15.34	15.45	13.97	22.35	10.52	15.55
PEG Ratio	3.13	2.07	2.06	NA	NA	1.68
Price/Book (P/B)	3.72	3.31	3.24	5.95	1.89	4.04
Price/Cash Flow (P/CF)	19.61	16.39	13.65	27.64	9.78	15.89
P/E (F1)	25.00	21.64	19.12	38.54	15.80	21.64
Price/Sales (P/S)	2.28	1.77	2.67	4.64	1.71	2.46
Earnings Yield	4.00%	4.62%	5.23%	2.60%	6.33%	4.62%
Debt/Equity	0.21	0.30	0.70	0.00	0.50	0.41
Cash Flow (\$/share)	5.48	2.31	6.94	2.45	2.18	7.38
Growth Score	B	-	-	A	A	B
Hist. EPS Growth (3-5 yrs)	12.50%	11.11%	10.85%	12.63%	-2.97%	15.72%
Proj. EPS Growth (F1/F0)	5.62%	9.90%	7.30%	9.11%	13.45%	11.07%
Curr. Cash Flow Growth	5.03%	12.60%	8.92%	3.00%	19.66%	26.08%
Hist. Cash Flow Growth (3-5 yrs)	6.66%	7.60%	8.36%	8.54%	4.39%	13.42%
Current Ratio	1.75	3.32	1.22	3.50	3.74	1.68
Debt/Capital	17.27%	22.59%	42.90%	0.00%	33.39%	28.85%
Net Margin	8.22%	6.74%	11.81%	11.11%	5.29%	8.89%
Return on Equity	14.80%	14.77%	16.98%	14.74%	8.78%	18.72%
Sales/Assets	0.94	0.84	0.54	1.03	0.62	0.74
Proj. Sales Growth (F1/F0)	2.43%	2.67%	3.90%	4.64%	2.91%	1.93%
Momentum Score	D	-	-	F	A	F
Daily Price Chg	5.88%	0.84%	0.65%	0.30%	1.38%	-0.48%
1 Week Price Chg	0.52%	0.26%	2.47%	10.38%	-11.43%	2.18%
4 Week Price Chg	7.51%	-3.91%	1.35%	5.25%	-18.43%	-6.35%
12 Week Price Chg	12.33%	-0.27%	5.63%	14.41%	-17.29%	1.41%
52 Week Price Chg	34.83%	6.86%	16.19%	14.88%	-10.11%	23.76%
20 Day Average Volume	130,777	72,727	1,995,746	196,479	107,689	623,939
(F1) EPS Est 1 week change	-0.15%	-0.19%	0.00%	-0.19%	0.00%	-0.61%
(F1) EPS Est 4 week change	-0.12%	-0.49%	0.00%	-0.19%	0.00%	-0.49%
(F1) EPS Est 12 week change	-0.12%	-1.72%	-0.19%	-0.19%	0.00%	-1.72%
(Q1) EPS Est Mthly Chg	-1.50%	-3.37%	0.00%	NA	0.00%	-3.37%

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	C
Growth Score	B
Momentum Score	D
VGM Score	C

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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