BRIDGE BANCORP INC
Form 10-Q
August 08, 2018

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 30, 2018

Commission file number 001-34096

BRIDGE BANCORP, INC.

(Exact name of registrant as specified in its charter)

NEW YORK	11-2934195

(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification Number)
2200 MONTAUK HIGHWAY, BRIDGEHAMPTON, NEW YORK	11932
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (631) 537-1000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No ¨

Indicate 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes x No ¨

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨

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

There were 19,785,248 shares of common stock outstanding as of July 31, 2018.

BRIDGE BANCORP, INC.

Item 1. Financial Statements

BRIDGE BANCORP, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

(*In thousands, except share and per share amounts*)

	June 30, 2018 (unaudited)	December 31, 2017
Assets		
Cash and due from banks	$74,255	$ 76,614
Interest earning deposits with banks	31,636	18,133
Total cash and cash equivalents	105,891	94,747
Securities available for sale, at fair value	659,076	759,916
Securities held to maturity (fair value of $165,606 and $179,885, respectively)	169,717	180,866
Total securities	828,793	940,782
Securities, restricted	26,747	35,349
Loans held for sale	6,338	-
Loans held for investment	3,180,676	3,102,752
Allowance for loan losses	(31,652)	(31,707)
Loans, net	3,149,024	3,071,045
Premises and equipment, net	36,043	33,505
Accrued interest receivable	11,625	11,652
Goodwill	105,950	105,950
Other intangible assets	4,866	5,214
Prepaid pension	10,141	9,936
Bank owned life insurance	88,594	87,493
Other real estate owned	175	-
Other assets	40,598	34,329
Total assets	$4,414,785	$ 4,430,002
Liabilities		
Demand deposits	$1,307,325	$ 1,338,701
Savings, NOW and money market deposits	1,919,653	1,773,478
Certificates of deposit of $100,000 or more	119,774	158,584
Other time deposits	206,445	63,780
Total deposits	3,553,197	3,334,543

Federal funds purchased	-	50,000
Repurchase agreements	1,437	877
Federal Home Loan Bank advances	300,863	501,374
Subordinated debentures, net	78,711	78,641
Other liabilities and accrued expenses	40,822	35,367
Total liabilities	3,975,030	4,000,802
Commitments and contingencies	-	-
Stockholders' equity		
Preferred stock, par value $.01 per share (2,000,000 shares authorized; none issued)	-	-
Common stock, par value $.01 per share (40,000,000 shares authorized; 19,798,989 and 19,719,575 shares issued, respectively; and 19,785,889 and 19,709,360 shares outstanding, respectively)	198	197
Surplus	349,538	347,691
Retained earnings	106,206	96,547
Treasury stock at cost, 13,100 and 10,215 shares, respectively	(441)	(296)
	455,501	444,139
Accumulated other comprehensive loss, net of income taxes	(15,746)	(14,939)
Total stockholders' equity	439,755	429,200
Total liabilities and stockholders' equity	$4,414,785	$ 4,430,002

See accompanying condensed notes to the Unaudited Consolidated Financial Statements.

BRIDGE BANCORP, INC. AND SUBSIDIARIES

Consolidated Statements of Income (unaudited)

(*In thousands, except per share amounts*)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Interest income:				
Loans (including fee income)	$ 35,770	$ 30,252	$ 71,383	$ 59,635
Mortgage-backed securities, CMOs and other asset-backed securities	3,825	3,898	7,549	7,715
U.S. GSE securities	243	301	522	601
State and municipal obligations	747	1,010	1,559	2,005
Corporate bonds	358	293	713	583
Deposits with banks	106	71	196	117
Other interest and dividend income	502	409	993	795
Total interest income	41,551	36,234	82,915	71,451
Interest expense:				
Savings, NOW and money market deposits	3,438	1,812	5,952	3,363
Certificates of deposit of $100,000 or more	582	431	1,099	810
Other time deposits	493	179	688	357
Federal funds purchased and repurchase agreements	57	355	1,172	671
Federal Home Loan Bank advances	1,917	1,529	3,266	2,678
Subordinated debentures	1,135	1,135	2,270	2,270
Junior subordinated debentures	-	-	-	48
Total interest expense	7,622	5,441	14,447	10,197
Net interest income	33,929	30,793	68,468	61,254
Provision for loan losses	400	950	1,200	1,750
Net interest income after provision for loan losses	33,529	29,843	67,268	59,504
Non-interest (loss) income:				
Service charges and other fees	2,562	2,220	4,725	4,270
Net securities losses	(7,921)	-	(7,921)	-
Title fee income	450	541	955	1,091
Gain on sale of loans	322	-	322	-
Gain on sale of Small Business Administration loans	691	799	1,062	1,342
BOLI income	555	567	1,101	1,127
Other operating income	763	382	1,291	801
Total non-interest (loss) income	(2,578)	4,509	1,535	8,631
Non-interest expense:				
Salaries and employee benefits	13,055	11,592	25,867	23,092

Occupancy and equipment	3,205	3,439	6,448	6,837
Technology and communications	1,568	1,390	3,211	2,725
Marketing and advertising	1,240	1,577	2,202	2,488
Professional services	881	642	2,093	1,423
FDIC assessments	436	332	900	643
Amortization of other intangible assets	242	274	488	553
Other operating expenses	1,880	1,760	3,896	3,541
Total non-interest expense	22,507	21,006	45,105	41,302
Income before income taxes	8,444	13,346	23,698	26,833
Income tax expense	1,701	4,505	4,882	8,821
Net income	$ 6,743	$ 8,841	$ 18,816	$ 18,012
Basic earnings per share	$ 0.34	$ 0.45	$ 0.95	$ 0.91
Diluted earnings per share	$ 0.34	$ 0.45	$ 0.95	$ 0.91

See accompanying condensed notes to the Unaudited Consolidated Financial Statements.

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BRIDGE BANCORP, INC. AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income (unaudited)

(In thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net income	$ 6,743	$ 8,841	$ 18,816	$ 18,012
Other comprehensive income (loss):				
Change in unrealized net gains (losses) on securities available for sale, net of reclassifications and deferred income taxes	2,616	1,533	(3,472)	2,543
Adjustment to pension liability, net of reclassifications and deferred income taxes	68	66	135	163
Unrealized gains (losses) on cash flow hedges, net of reclassifications and deferred income taxes	479	(547)	2,530	(373)
Total other comprehensive income (loss)	3,163	1,052	(807)	2,333
Comprehensive income	$ 9,906	$ 9,893	$ 18,009	$ 20,345

See accompanying condensed notes to the Unaudited Consolidated Financial Statements.

BRIDGE BANCORP, INC. AND SUBSIDIARIES

Consolidated Statements of Stockholders' Equity (unaudited)

(*In thousands, except share and per share amounts*)

	Common Stock	Surplus	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Loss	Total
Balance at January 1, 2018	$ 197	$347,691	$96,547	$ (296)	$ (14,939)	$429,200
Net income			18,816			18,816
Shares issued under the dividend reinvestment plan		468				468
Stock awards granted and distributed	1	(523)		522		-
Stock awards forfeited		115		(115)		-
Repurchase of surrendered stock from vesting of restricted stock awards				(552)		(552)
Share based compensation expense		1,787				1,787
Cash dividend declared, $0.46 per share			(9,157)			(9,157)
Other comprehensive loss, net of deferred income taxes					(807)	(807)
Balance at June 30, 2018	$ 198	$349,538	$106,206	$ (441)	$ (15,746)	$439,755

	Common Stock	Surplus	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Loss	Total
Balance at January 1, 2017	$ 191	$329,427	$91,594	$ (161)	$ (13,064)	$407,987
Net income			18,012			18,012
Shares issued under the dividend reinvestment plan		469				469
Shares issued for trust preferred securities conversions (529,292 shares)	5	14,944				14,949
Stock awards granted and distributed	1	(416)		415		-
Stock awards forfeited		20		(20)		-
Repurchase of surrendered stock from vesting of restricted stock awards				(264)		(264)
Share based compensation expense		1,324				1,324
Cash dividend declared, $0.46 per share			(9,103)			(9,103)
Other comprehensive income, net of deferred income taxes					2,333	2,333
Balance at June 30, 2017	$ 197	$345,768	$100,503	$ (30)	$ (10,731)	$435,707

See accompanying condensed notes to the Unaudited Consolidated Financial Statements.

BRIDGE BANCORP, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows (unaudited)

(*In thousands*)

	Six Months Ended June 30,	
	2018	2017
Cash flows from operating activities:		
Net income	$18,816	$18,012
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,200	1,750
Depreciation and amortization of premises and equipment	1,897	1,900
Net (accretion) and other amortization	(1,444)	(3,949)
Net amortization on securities	2,507	3,291
Increase in cash surrender value of bank owned life insurance	(1,101)	(1,127)
Amortization of intangible assets	488	553
Share based compensation expense	1,787	1,324
Net securities losses	7,921	-
Decrease in accrued interest receivable	27	504
Small Business Administration ("SBA") loans originated for sale	(19,446)	(14,483)
Proceeds from sale of the guaranteed portion of SBA loans	14,417	16,123
Gain on sale of the guaranteed portion of SBA loans	(1,062)	(1,342)
Gain on sale of loans	(322)	-
Decrease (increase) in other assets	279	(2,203)
Increase in accrued expenses and other liabilities	2,929	3,636
Net cash provided by operating activities	28,893	23,989
Cash flows from investing activities:		
Purchases of securities available for sale	(194,835)	(73,916)
Purchases of securities, restricted	(481,422)	(303,890)
Purchases of securities held to maturity	(1,000)	(2,031)
Proceeds from sales of securities available for sale	230,372	-
Redemption of securities, restricted	490,024	299,814
Maturities, calls and principal payments of securities available for sale	50,431	59,170
Maturities, calls and principal payments of securities held to maturity	11,696	20,756
Net increase in loans	(118,281)	(192,825)
Proceeds from loan sale	40,133	-
Purchase of premises and equipment	(4,435)	(1,685)
Net cash provided by (used in) investing activities	22,683	(194,607)
Cash flows from financing activities:		
Net increase in deposits	218,676	133,646
Net decrease in federal funds purchased	(50,000)	(50,000)

Net (decrease) increase in Federal Home Loan Bank advances	(200,427)	67,479
Repayment of junior subordinated debentures	-	(352)
Net increase in repurchase agreements	560	57
Net proceeds from issuance of common stock	468	469
Repurchase of surrendered stock from vesting of restricted stock awards	(552)	(264)
Cash dividends paid	(9,157)	(9,103)
Net cash (used in) provided by financing activities	(40,432)	141,932
Net increase (decrease) in cash and cash equivalents	11,144	(28,686)
Cash and cash equivalents at beginning of period	94,747	113,838
Cash and cash equivalents at end of period	$105,891	$85,152
Supplemental disclosure of cash flow information:		
Cash paid for:		
Interest	$14,382	$10,498
Income taxes	$2,471	$165
Non-cash investing and financing activities:		
Conversion of junior subordinated debentures	$-	$15,350
Transfers from portfolio loans to other real estate owned	$175	$-

See accompanying condensed notes to the Unaudited Consolidated Financial Statements.

BRIDGE BANCORP, INC. AND SUBSIDIARIES

CONDENSED NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. BASIS OF PRESENTATION

Bridge Bancorp, Inc. (the “Registrant” or “Company”), is a registered bank holding company for BNB Bank (the “Bank”), which was formerly known as The Bridgehampton National Bank prior to the Bank’s conversion to a New York chartered commercial bank in December 2017. The Registrant was incorporated under the laws of the State of New York in 1988, at the direction of the Board of Directors of the Bank for the purpose of becoming a bank holding company pursuant to a plan of reorganization under which the former shareholders of the Bank became the shareholders of the Company. Since commencing business in March 1989, after the reorganization, the Registrant has functioned primarily as the holder of all of the Bank’s common stock. In May 1999, the Bank established a real estate investment trust subsidiary, Bridgehampton Community, Inc. (“BCI”), as an operating subsidiary. The assets transferred to BCI are viewed by the bank regulators as part of the Bank’s assets in consolidation. The operations of the Bank also include Bridge Abstract LLC (“Bridge Abstract”), a wholly owned subsidiary of the Bank, which is a broker of title insurance services and Bridge Financial Services LLC (“Bridge Financial Services”), an investment services subsidiary that was formed in March 2014. The Company formed Bridge Statutory Capital Trust II (the “Trust”) as a subsidiary in 2009, which sold $16.0 million of 8.5% cumulative convertible Trust Preferred Securities (the “Trust Preferred Securities”) in a private placement to accredited investors. The Trust Preferred Securities were redeemed effective January 18, 2017 and the Trust was cancelled effective April 24, 2017.

The accompanying Unaudited Consolidated Financial Statements, which include the accounts of the Company and its wholly-owned subsidiary, the Bank, have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. The Unaudited Consolidated Financial Statements included herein reflect all normal recurring adjustments that are, in the opinion of management, necessary for a fair presentation of the results for the interim periods presented. In preparing the interim financial statements, management has made 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 revenue and expense during the reported periods. Such estimates are subject to change in the future as additional information becomes available or previously existing circumstances are modified. Actual future results could differ significantly from those estimates. The annualized results of operations for the six months ended June 30, 2018 are not necessarily indicative of the results of operations that may be expected for the entire fiscal year. Certain information and note disclosures normally included in the financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). Certain reclassifications have been made to prior year amounts, and the related discussion and analysis, to conform to the current year presentation. These reclassifications did not have an impact on net income or total stockholders’ equity. The Unaudited Consolidated Financial Statements should be read in conjunction with the Audited Consolidated Financial Statements and notes thereto included in the Company’s Annual

Report on Form 10-K for the year ended December 31, 2017.

2. EARNINGS PER SHARE

Financial Accounting Standards Board Accounting Standards Codification ("FASB ASC") No. 260-10-45 addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings per share ("EPS"). The restricted stock awards and certain restricted stock units granted by the Company contain non-forfeitable rights to dividends and therefore are considered participating securities. The two-class method for calculating basic EPS excludes dividends paid to participating securities and any undistributed earnings attributable to participating securities.

The following table presents the computation of EPS for the three and six months ended June 30, 2018 and 2017:

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands, except per share data)	2018	2017	2018	2017
Net income	$ 6,743	$ 8,841	$ 18,816	$ 18,012
Dividends paid on and earnings allocated to participating securities	(148)	(182)	(405)	(360)
Income attributable to common stock	$ 6,595	$ 8,659	$ 18,411	$ 17,652
Weighted average common shares outstanding, including participating securities	19,884	19,781	19,859	19,725
Weighted average participating securities	(445)	(410)	(433)	(401)
Weighted average common shares outstanding	19,439	19,371	19,426	19,324
Basic earnings per common share	$ 0.34	$ 0.45	$ 0.95	$ 0.91
Income attributable to common stock	$ 6,595	$ 8,659	$ 18,411	$ 17,652
Impact of assumed conversions - interest on 8.5% trust preferred securities	-	-	-	32
Income attributable to common stock including assumed conversions	$ 6,595	$ 8,659	$ 18,411	$ 17,684
Weighted average common shares outstanding	19,439	19,371	19,426	19,324
Incremental shares from assumed conversions of options and restricted stock units	29	23	27	20
Incremental shares from assumed conversions of 8.5% trust preferred securities	-	-	-	35
Weighted average common and equivalent shares outstanding	19,468	19,394	19,453	19,379
Diluted earnings per common share	$ 0.34	$ 0.45	$ 0.95	$ 0.91

There were 47,393 stock options outstanding at June 30, 2018 that were not included in the computation of diluted earnings per share for the three and six months ended June 30, 2018 because the options' exercise prices were greater than the average market price of common stock and were, therefore, antidilutive. There were no stock options outstanding at June 30, 2017.

There were no restricted stock units that were antidilutive for the three months ended June 30, 2018 and 2017. There were zero and 20,084 restricted stock units that were antidilutive for the six months ended June 30, 2018 and 2017, respectively.

The $15.7 million in trust preferred securities outstanding at December 31, 2016 were redeemed effective January 18, 2017 and therefore were not included in the computation of diluted earnings per share for the three months ended June 30, 2017, but were dilutive for the six months ended June 30, 2017 and therefore were included in the computation of diluted earnings per share for that period.

3. STOCK BASED COMPENSATION PLANS

The Bridge Bancorp, Inc. 2012 Stock-Based Incentive Plan (“2012 SBIP”) provides for the grant of stock-based and other incentive awards to officers, employees and directors of the Company. The 2012 SBIP superseded the Bridge Bancorp, Inc. 2006 Equity Incentive Plan. The number of shares of common stock of Bridge Bancorp, Inc. available for stock-based awards under the 2012 SBIP is 525,000 plus 278,385 shares that were remaining under the 2006 Equity Incentive Plan. Of the total 803,385 shares of common stock approved for issuance under the 2012 SBIP, 273,585 shares remain available for issuance at June 30, 2018, including shares that may be granted in the form of stock options, restricted stock awards (“RSAs”), or restricted stock units (“RSUs”).

The Compensation Committee of the Board of Directors determines awards under the 2012 SBIP. The Company accounts for the 2012 SBIP under FASB ASC No. 718.

Stock Options

Stock options may be either incentive stock options, which bestow certain tax benefits on the optionee, or non-qualified stock options, not qualifying for such benefits. All options have an exercise price that is not less than the market value of the Company’s common stock on the date of the grant.

The fair value of each option granted is estimated on the date of the grant using the Black-Scholes option-pricing model. The intrinsic value for stock options is calculated based on the exercise price of the underlying awards and the market price of the Company’s common stock as of the exercise or reporting date.

During the six months ended June 30, 2018, in accordance with the Long Term Incentive Plan ("LTI Plan") for Named Executive Officers ("NEOs"), the Company granted 47,393 stock options. All of the stock options granted vest ratably over three years. The estimated weighted-average grant-date fair value of all stock options granted in the six months ended June 30, 2018 was $6.52 per stock option, using the Black-Scholes option-pricing model with assumptions as follows: dividend yield of 2.80%; expected volatility rate of 27.53%; risk-free interest rate of 2.67%; and expected option life of 6.5 years. There were no stock options granted during the six months ended June 30, 2017.

Compensation expense attributable to stock options was $26 thousand and $39 thousand for the three and six months ended June 30, 2018, respectively. There was no compensation expense attributable to stock options for the six months ended June 30, 2017 because there were no stock options outstanding as of June 30, 2017 and December 31, 2016. As of June 30, 2018, there was $270 thousand of total unrecognized compensation cost related to unvested stock options. The cost is expected to be recognized over a weighted-average period of 2.6 years.

The following table summarizes the status of the Company's stock options as of and for the six months ended June 30, 2018:

(Dollars in thousands, except per share amounts)	**Number of Options**	**Weighted Average Exercise Price**	**Weighted Average Remaining Contractual Life**	**Aggregate Intrinsic Value**
Outstanding, January 1, 2018	-	$ -		
Granted	47,393	36.19		
Outstanding, June 30, 2018	47,393	$ 36.19	9.6 years	$ -
Vested and Exercisable, June 30, 2018	-	$ -	$ -	$ -

Range of Exercise Prices	Number of Options	Weighted Average Exercise Price
$ 36.19	47,393	$ 36.19
	47,393	$ 36.19

Restricted Stock Awards

The Company's RSAs are shares of the Company's common stock that are forfeitable and are subject to restrictions on transfer prior to the vesting date. RSAs are forfeited if the award holder departs the Company before vesting. RSAs carry dividend and voting rights from the date of grant. The vesting of time-vested RSAs depends upon the award holder continuing to render services to the Company. The Company's performance-based RSAs vest subject to the achievement of the Company's 2018 corporate goals.

The following table summarizes the unvested RSA activity for the six months ended June 30, 2018:

	Shares	**Weighted Average Grant-Date Fair Value**
Unvested, January 1, 2018	317,692	$ 27.16
Granted	82,982	33.00
Vested	(58,233)	23.90
Forfeited	(3,766)	30.48
Unvested, June 30, 2018	338,675	$ 29.12

During the six months ended June 30, 2018, the Company granted a total of 82,982 RSAs. Of the 82,982 RSAs granted, 44,750 time-vested RSAs vest ratably over five years, 13,115 time-vested RSAs vest ratably over three years, and 25,117 performance-based RSAs vest ratably over two years, subject to the achievement of the Company's 2018 corporate goals. As of June 30, 2018, there were 338,675 unvested RSAs consisting of 314,175 time-vested RSAs and 24,500 performance-based RSAs.

Compensation expense attributable to RSAs was $717 thousand and $1.3 million for the three and six months ended June 30, 2018, respectively, and $503 thousand and $916 thousand for the three and six months ended June 30, 2017, respectively. As of June 30, 2018,

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there was $6.4 million of total unrecognized compensation cost related to non-vested RSAs. The cost is expected to be recognized over a weighted-average period of 3.5 years.

Restricted Stock Units

Long Term Incentive Plan

An RSU is an award that is denominated in shares of the Company’s common stock on the date of grant and is similar to an RSA award, except no shares of the Company’s common stock are actually issued to the award recipient on the date of grant of an RSU. RSUs are subject to a time-based vesting schedule or the satisfaction of performance conditions, and are settled in shares of the Company’s common stock. RSUs do not provide voting rights and RSUs may provide dividend equivalent rights from the date of grant.

During the six months ended June 30, 2018, in accordance with the LTI Plan for NEOs, the Company granted 21,693 RSUs. Of the 21,693 RSUs granted, 12,522 time-vested RSUs vest ratably over five years and 9,171 performance-based RSUs vest subject to the achievement of the Company’s three-year corporate goal for the years 2018, 2019 and 2020.

The following table summarizes the unvested NEO RSU activity for the six months ended June 30, 2018:

	Shares	**Weighted Average Grant-Date Fair Value**
Unvested, January 1, 2018	68,776	$ 24.46
Granted	21,693	33.23
Reinvested dividends	987	26.01
Forfeited	(13,333)	21.85
Unvested, June 30, 2018	78,123	$ 27.36

Compensation expense attributable to LTI Plan RSUs was $119 thousand and $220 thousand for the three and six months ended June 30, 2018, respectively, and $79 thousand and $148 thousand in connection with these awards for the three and six months ended June 30, 2017, respectively. As of June 30, 2018, there was $1.5 million of total unrecognized compensation cost related to non-vested RSUs. The cost is expected to be recognized over a weighted-average period of 3.5 years.

Directors Plan

In April 2009, the Company adopted a Directors Deferred Compensation Plan (“Directors Plan”). Under the Directors Plan, independent directors may elect to defer all or a portion of their annual retainer fee in the form of RSUs. In addition, directors receive a non-election retainer in the form of RSUs. These RSUs vest ratably over one year and have dividend rights but no voting rights. In connection with the Directors Plan, the Company recorded expense of $140 thousand and $275 thousand in connection with these RSUs for the three and six months ended June 30, 2018, respectively, and $132 thousand and $260 thousand for the three and six months ended June 30, 2017, respectively.

4. SECURITIES

The following tables summarize the amortized cost and estimated fair value of the available for sale and held to maturity investment securities portfolio at June 30, 2018 and December 31, 2017 and the corresponding amounts of unrealized gains and losses therein:

	June 30, 2018			
(*In thousands*)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available for sale:				
U.S. GSE securities	$ 29,996	$ -	$ (1,258)	$ 28,738
State and municipal obligations	38,423	50	(525)	37,948
U.S. GSE residential mortgage-backed securities	101,884	-	(3,688)	98,196
U.S. GSE residential collateralized mortgage obligations	340,978	6	(8,937)	332,047
U.S. GSE commercial mortgage-backed securities	3,584	-	(67)	3,517
U.S. GSE commercial collateralized mortgage obligations	94,845	-	(2,438)	92,407
Other asset backed securities	24,250	-	(727)	23,523
Corporate bonds	46,000	-	(3,300)	42,700
Total available for sale	679,960	56	(20,940)	659,076
Held to maturity:				
State and municipal obligations	57,350	497	(481)	57,366
U.S. GSE residential mortgage-backed securities	10,441	-	(451)	9,990

	Foreign currency translation	Minimum pension liability, net of tax	Total
		(in millions)	
Balance at September 30, 2013	$ 6.8	$ (35.4)	$ (28.6)
Current period other comprehensive income (loss)	(2.0)	(3.0)	(5.0)
Balance at December 31, 2013	$ 4.8	$ (38.4)	$ (33.6)

Note 10. Commitments and Contingencies

We are involved in various legal proceedings that have arisen in the normal course of operations, including the proceedings summarized below. The effect of the outcome of these matters on our financial statements cannot be predicted with certainty as any such effect depends on the amount and timing of the resolution of such matters. Other than the litigation described below, we do not believe that any of our outstanding litigation would have a material adverse effect on our business or prospects.

Environmental. We are subject to a wide variety of laws and regulations concerning the protection of the environment, both with respect to the operations at many of our properties and with respect to remediating environmental conditions that may exist at our own or other properties. We strive to comply with federal, state and local environmental laws and regulations. We accrue for environmental expenses resulting from existing conditions that relate to past operations when the costs are probable and reasonably estimable.

In the acquisition agreement pursuant to which a predecessor to Tyco sold our Mueller Co. and Anvil businesses to the prior owners of these businesses in August 1999, Tyco agreed to indemnify us and our affiliates, among other things, for all “Excluded Liabilities.” Excluded Liabilities include, among other things, substantially all liabilities relating to the time prior to August 1999, including environmental liabilities. The indemnity survives indefinitely. Tyco's indemnity does not cover liabilities to the extent caused by us or the operation of our businesses after August 1999, nor does it cover liabilities arising with respect to businesses or sites acquired after August 1999. Since 2007, Tyco has engaged in multiple corporate restructurings, split-offs and divestitures. While none of these transactions directly affects the indemnification obligations of the Tyco indemnitors under the 1999 acquisition agreement, the result of such transactions is that the assets of, and control over, such Tyco indemnitors has changed. Should any of these Tyco indemnitors become financially unable or fail to comply with the terms of the indemnity, we may be responsible for such obligations or liabilities.

In September 1987, we implemented an Administrative Consent Order (“ACO”) for our Burlington, New Jersey property, which was required under the New Jersey Environmental Cleanup Responsibility Act (now known as the Industrial Site Recovery Act). The ACO required soil and ground-water cleanup, and we completed, and received final approval on, the soil cleanup required by the ACO. We retained this property related to the sale of our former U.S. Pipe segment. We expect ground-water issues as well as issues associated with the demolition of former manufacturing facilities at this site will continue and remediation by us could be required. Long-term ground-water monitoring may also be required, but we do not know how long such monitoring would be required and do not believe monitoring or further remediation costs, if any, will have a material adverse effect on any of our financial statements.

On July 13, 2010, Rohcan Investments Limited, the former owner of property leased by Mueller Canada Ltd. and located in Milton, Ontario, filed suit against Mueller Canada Ltd. and its directors seeking C$10.0 million in damages arising from the defendants' alleged environmental contamination of the property and breach of lease. Mueller Canada Ltd. leased the property from 1988 through 2008. We are pursuing indemnification from a former owner for certain potential liabilities that are alleged in this lawsuit, and we have accrued for other liabilities not covered by indemnification. On December 7, 2011, the Court denied the plaintiff's motion for summary judgment.

Walter Energy-related Income Taxes. Each member of a consolidated group for federal income tax purposes is severally liable for the federal income tax liability of each other member of the consolidated group for any year in which it is a member of the group at any time during such year. Each member of the Walter Energy consolidated group, which included us through December 14, 2006, is also jointly and severally liable for pension and benefit funding and termination liabilities of other group members, as well as certain benefit plan taxes. Accordingly, we could be liable under such provisions in the event any such liability is incurred, and not discharged, by any other member of the Walter Energy consolidated group for any period during which we were included in the Walter Energy consolidated group.

A dispute exists with regard to federal income taxes for 1980 through 1994 allegedly owed by the Walter Energy consolidated group. According to Walter Energy's last available public filing on the matter, Walter Energy's management estimated that the amount of tax claimed by the IRS was approximately $34.0 million for issues currently in dispute in bankruptcy court for matters unrelated to us. This amount is subject to interest and penalties. Of the $34.0 million in claimed tax, $21.0 million represents issues in which the IRS is not challenging the deductibility of the particular expense but only whether such expense is deductible in a particular year. Walter Energy's management believes that Walter Energy's financial exposure should be limited to interest and possible penalties and the amount of any tax claimed will be offset by favorable adjustments in other years.

In addition, the IRS previously issued a Notice of Proposed Deficiency assessing additional tax of $82.2 million for the fiscal years ended May 31, 2000 through December 31, 2005. Walter Energy filed a formal protest with the IRS, but had not reached a final resolution with the Appeals Division at December 31, 2013. The unresolved issues relate primarily to Walter Energy's method of recognizing revenue on the sale of homes and related interest on the installment notes receivable. The items at issue relate primarily to the timing of revenue recognition and consequently, should the IRS prevail on its positions, Walter Energy's financial exposure should be limited to interest and penalties. As a matter of law, we are jointly and severally liable for any final tax determination for any year in which any of our subsidiaries were members of the Walter Energy consolidated group, which means that we would be liable in the event Walter Energy is unable to pay any amounts owed. Walter Energy has disclosed that it believes its filing positions have substantial merit and that it intends to defend vigorously any claims asserted.

Walter Energy effectively controlled all of our tax decisions for periods during which we were a member of the Walter Energy consolidated group for federal income tax purposes and certain combined, consolidated or unitary state and local income tax groups. Under the terms of the income tax allocation agreement between us and Walter Energy dated May 26, 2006, we generally compute our tax liability on a stand-alone basis, but Walter Energy has sole authority to respond to and conduct all tax proceedings (including tax audits) relating to our federal income and combined state returns, to file all such returns on our behalf and to determine the amount of our liability to (or entitlement to payment from) Walter Energy for such previous periods. This arrangement may result in conflicts between Walter Energy and us.

Our separation from Walter Energy on December 14, 2006 was intended to qualify as a tax-free spin-off under Section 355 of the Internal Revenue Code. In addition, the tax allocation agreement provides that if the spin-off is determined not to be tax-free pursuant to Section 355, we generally will be responsible for any taxes incurred by Walter Energy or its shareholders if such taxes result from certain of our actions or omissions and for a percentage of any such taxes that are not a result of our actions or omissions or Walter Energy's actions or omissions or taxes based upon our market value relative to Walter Energy's market value. Additionally, to the extent that Walter Energy was unable to pay taxes, if any, attributable to the spin-off and for which it is responsible under the tax allocation agreement, we could be liable for those taxes as a result of being a member of the Walter Energy consolidated group for the year in which the spin-off occurred.

In accordance with the income tax allocation agreement, Walter Energy used certain tax assets of one of our predecessors in its calendar 2006 tax return for which payment to us is required. The income tax allocation agreement only requires Walter Energy to make the payment upon realization of the tax benefit by receiving a refund or otherwise offsetting taxes due. Walter Energy currently owes us $11.6 million, which includes recent tax audit and amended tax return adjustments, that is payable pending completion of an IRS audit of Walter Energy's 2006 tax year and the related refund of tax from that year. This receivable is included in other current assets at December 31, 2013.

Indemnifications. We are a party to contracts in which it is common for us to agree to indemnify third parties for certain liabilities that arise out of or relate to the subject matter of the contract. In some cases, this indemnity extends to related liabilities arising from the negligence of the indemnified parties, but usually excludes any liabilities caused by gross negligence or willful misconduct. We cannot estimate the potential amount of future payments under these indemnities until events arise that would trigger a liability under the indemnities.

Additionally, in connection with the sale of assets and the divestiture of businesses, such as the divestiture of our U.S. Pipe segment, we may agree to indemnify buyers and related parties for certain losses or liabilities incurred by these parties with respect to: (i) the representations and warranties made by us to these parties in connection with the sale and (ii) liabilities related to the pre-closing operations of the assets or business sold. Indemnities related to pre-closing operations generally include certain environmental and tax liabilities and other liabilities not assumed by these parties in the transaction.

Indemnities related to the pre-closing operations of sold assets or businesses normally do not represent additional liabilities to us, but simply serve to protect these parties from potential liability associated with our obligations existing at the time of the sale. As with any liability, we have accrued for those pre-closing obligations that are considered probable and reasonably estimable. Should circumstances change, increasing the likelihood of payments related to a specific indemnity, we will accrue a liability when future payment is probable and the amount is reasonably estimable.

Other Matters. We are party to a number of other lawsuits arising in the ordinary course of business, including product liability cases for products manufactured by us or third parties. We provide for costs relating to these matters when a loss is probable and the amount is reasonably estimable. Administrative costs related to these matters are expensed as incurred. The effect of the outcome of these matters on our future financial statements cannot be predicted with certainty as any such effect depends on the amount and timing of the resolution of such matters. While the results of litigation cannot be predicted with certainty, we believe that the final outcome of such other litigation is not likely to have a materially adverse effect on our business or prospects.

Note 11. Subsequent Events

On January 29, 2014, our board of directors declared a dividend of $0.0175 per share on our common stock, payable on or about February 20, 2014 to stockholders of record at the close of business on February 10, 2014.

Note 12. Consolidating Guarantor and Non-Guarantor Financial Information

The following information is included as a result of the guarantee by certain of our wholly-owned U.S. subsidiaries ("Guarantor Companies") of the Senior Unsecured Notes and the Senior Subordinated Notes. None of our other subsidiaries guarantee the Senior Unsecured Notes and the Senior Subordinated Notes. Each of the guarantees is joint and several and full and unconditional. Guarantor Companies are listed below.

Name	State of incorporation or organization
Anvil International, LLC	Delaware
Echologics, LLC	Delaware
Henry Pratt Company, LLC	Delaware
Henry Pratt International, LLC	Delaware
Hydro Gate, LLC	Delaware
J.B. Smith Mfg. Co., LLC	Delaware
James Jones Company, LLC	Delaware
Milliken Valve, LLC	Delaware
Mueller Co. LLC	Delaware
Mueller Group, LLC	Delaware
Mueller Group Co-Issuer, Inc.	Delaware
Mueller International, L.L.C.	Delaware
Mueller Property Holdings, LLC	Delaware
Mueller Co. International Holdings, LLC	Delaware
Mueller Service California, Inc.	Delaware
Mueller Service Co., LLC	Delaware
Mueller Systems, LLC	Delaware
OSP, LLC	Delaware
U.S. Pipe Valve & Hydrant, LLC	Delaware

Mueller Water Products, Inc. and Subsidiaries
Condensed Consolidating Balance Sheet
December 31, 2013

	Issuer	Guarantor companies	Non-guarantor companies	Eliminations	Total
			(in millions)		
Assets:					
Cash and cash equivalents	$68.9	$(2.9)	$40.8	$—	$106.8
Receivables, net	0.1	127.1	7.2	—	134.4
Inventories	—	202.6	11.7	—	214.3
Deferred income taxes	63.6	—	0.4	—	64.0
Other current assets	18.0	26.2	2.3	—	46.5
Total current assets	150.6	353.0	62.4	—	566.0
Property, plant and equipment	1.4	132.5	8.0	—	141.9
Identifiable intangible assets	—	543.7	1.8	—	545.5
Other noncurrent assets	14.8	0.2	1.3	—	16.3
Investment in subsidiaries	177.5	38.1	—	(215.6)	—
Intercompany accounts	882.7	—	—	(882.7)	—
Total assets	$1,227.0	$1,067.5	$73.5	$(1,098.3)	$1,269.7
Liabilities and stockholders' equity:					
Current portion of long-term debt	$—	$1.2	$—	$—	$1.2
Accounts payable	4.9	62.6	3.9	—	71.4
Other current liabilities	23.8	40.1	3.0	—	66.9
Total current liabilities	28.7	103.9	6.9	—	139.5
Long-term debt	598.1	1.4	—	—	599.5
Deferred income taxes	175.8	—	0.6	—	176.4
Other noncurrent liabilities	24.3	7.5	0.7	—	32.5
Intercompany accounts	78.3	777.2	27.2	(882.7)	—
Total liabilities	905.2	890.0	35.4	(882.7)	947.9
Stockholders' equity	321.8	177.5	38.1	(215.6)	321.8
Total liabilities and stockholders' equity	$1,227.0	$1,067.5	$73.5	$(1,098.3)	$1,269.7

Mueller Water Products, Inc. and Subsidiaries
Condensed Consolidating Balance Sheet
September 30, 2013

	Issuer	Guarantor companies	Non-guarantor companies	Eliminations	Total
			(in millions)		
Assets:					
Cash and cash equivalents	$ 86.6	$ (2.3)	$ 39.3	$ —	$ 123.6
Receivables, net	0.1	150.4	14.0	—	164.5
Inventories	—	195.3	13.2	—	208.5
Deferred income taxes	26.3	—	0.4	—	26.7
Other current assets	18.2	25.7	2.2	—	46.1
Total current assets	131.2	369.1	69.1	—	569.4
Property, plant and equipment	1.5	132.0	8.4	—	141.9
Identifiable intangible assets	—	551.3	1.8	—	553.1
Other noncurrent assets	16.0	0.2	1.3	—	17.5
Investment in subsidiaries	155.2	39.2	—	(194.4)	—
Intercompany accounts	882.7	—	—	(882.7)	—
Total assets	$ 1,186.6	$ 1,091.8	$ 80.6	$ (1,077.1)	$ 1,281.9
Liabilities and stockholders' equity:					
Current portion of long-term debt	$ —	$ 1.3	$ —	$ —	$ 1.3
Accounts payable	4.6	90.0	6.6	—	101.2
Other current liabilities	29.7	46.6	4.3	—	80.6
Total current liabilities	34.3	137.9	10.9	—	183.1
Long-term debt	598.0	1.5	—	—	599.5
Deferred income taxes	140.9	—	0.6	—	141.5
Other noncurrent liabilities	21.3	7.5	0.8	—	29.6
Intercompany accounts	63.9	789.7	29.1	(882.7)	—
Total liabilities	858.4	936.6	41.4	(882.7)	953.7
Stockholders' equity	328.2	155.2	39.2	(194.4)	328.2
Total liabilities and stockholders' equity	$ 1,186.6	$ 1,091.8	$ 80.6	$ (1,077.1)	$ 1,281.9

Mueller Water Products, Inc. and Subsidiaries
Condensed Consolidating Statement of Operations
Three months ended December 31, 2013

	Issuer	Guarantor companies	Non-guarantor companies	Eliminations	Total
			(in millions)		
Net sales	$—	$235.8	$21.6	$—	$257.4
Cost of sales	—	172.7	17.6	—	190.3
Gross profit	—	63.1	4.0	—	67.1
Operating expenses:					
Selling, general and administrative	9.1	40.7	3.2	—	53.0
Restructuring	—	0.1	—	—	0.1
Total operating expenses	9.1	40.8	3.2	—	53.1
Operating income (loss)	(9.1)	22.3	0.8	—	14.0
Interest expense, net	12.6	0.1	(0.1)	—	12.6
Income (loss) before income taxes	(21.7)	22.2	0.9	—	1.4
Income tax expense (benefit)	(7.9)	8.0	0.2	—	0.3
Equity in income of subsidiaries	14.9	0.7	—	(15.6)	—
Net income	$1.1	$14.9	$0.7	$(15.6)	$1.1

Mueller Water Products, Inc. and Subsidiaries
Condensed Consolidating Statement of Operations
Three months ended December 31, 2012

	Issuer	Guarantor companies	Non-guarantor companies	Eliminations	Total
			(in millions)		
Net sales	$—	$221.8	$23.3	$—	$245.1
Cost of sales	—	167.6	20.4	—	188.0
Gross profit	—	54.2	2.9	—	57.1
Operating expenses:					
Selling, general and administrative	7.1	39.2	3.2	—	49.5
Restructuring	—	0.7	—	—	0.7
Total operating expenses	7.1	39.9	3.2	—	50.2
Operating income (loss)	(7.1)	14.3	(0.3)	—	6.9
Interest expense (income), net	13.4	0.1	—	—	13.5
Income (loss) before income taxes	(20.5)	14.2	(0.3)	—	(6.6)
Income tax expense (benefit)	(5.0)	3.5	(0.1)	—	(1.6)
Equity in income (loss) of subsidiaries	10.5	(0.2)	—	(10.3)	—
Income (loss) from continuing operations	(5.0)	10.5	(0.2)	(10.3)	(5.0)
Income from discontinued operations	12.0	—	—	—	12.0
Net income (loss)	$7.0	$10.5	$(0.2)	$(10.3)	$7.0

Mueller Water Products, Inc. and Subsidiaries
Condensed Consolidating Statement of Comprehensive Income (Loss)
Three months ended December 31, 2013

	Issuer	Guarantor companies	Non-guarantor companies	Eliminations	Total
			(in millions)		
Net income	$1.1	$14.9	$0.7	$(15.6)	$1.1
Other comprehensive income (loss):					
Minimum pension liability, net of tax	(3.0)	—	—	—	(3.0)
Equity in other comprehensive loss of subsidiaries	(2.0)	(2.0)	—	4.0	—
Foreign currency translation	—	—	(2.0)	—	(2.0)
	(5.0)	(2.0)	(2.0)	4.0	(5.0)
Comprehensive income (loss)	$(3.9)	$12.9	$(1.3)	$(11.6)	$(3.9)

Mueller Water Products, Inc. and Subsidiaries
Condensed Consolidating Statement of Comprehensive Income (Loss)
Three months ended December 31, 2012

	Issuer	Guarantor companies	Non-guarantor companies	Eliminations	Total
			(in millions)		
Net income (loss)	$7.0	$10.5	$(0.2)	$(10.3)	$7.0
Other comprehensive income (loss):					
Minimum pension liability, net of tax	3.4	—	—	—	3.4
Equity in other comprehensive income of subsidiaries	(0.7)	(0.7)	—	1.4	—
Foreign currency translation	—	—	(0.7)	—	(0.7)
	2.7	(0.7)	(0.7)	1.4	2.7
Comprehensive income (loss)	$9.7	$9.8	$(0.9)	$(8.9)	$9.7

Mueller Water Products, Inc. and Subsidiaries
Condensed Consolidating Statement of Cash Flows
Three months ended December 31, 2013

	Issuer	Guarantor companies	Non-guarantor companies	Eliminations	Total
			(in millions)		
Operating activities:					
Net cash provided by (used in) operating activities	$(12.8)	$6.1	$2.9	$—	$(3.8)
Investing activities:					
Capital expenditures	—	(7.3)	(0.2)	—	(7.5)
Proceeds from sales of assets	—	0.2	—	—	0.2
Net cash used in investing activities from continuing operations	—	(7.1)	(0.2)	—	(7.3)
Financing activities:					
Dividends paid	(2.8)	—	—	—	(2.8)
Common stock issued	0.9	—	—	—	0.9
Shares retained for employee taxes	(3.0)	—	—	—	(3.0)
Other	—	0.4	—	—	0.4
Net cash provided by (used in) financing activities from continuing operations	(4.9)	0.4	—	—	(4.5)
Effect of currency exchange rate changes on cash	—	—	(1.2)	—	(1.2)
Net change in cash and cash equivalents	(17.7)	(0.6)	1.5	—	(16.8)
Cash and cash equivalents at beginning of period	86.6	(2.3)	39.3	—	123.6
Cash and cash equivalents at end of period	$68.9	$(2.9)	$40.8	$—	$106.8

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Mueller Water Products, Inc. and Subsidiaries
Consolidating Statement of Cash Flows
Three months ended December 31, 2012

	Issuer	Guarantor companies	Non-guarantor companies	Eliminations	Total
			(in millions)		
Operating activities:					
Net cash provided by (used in) operating activities from continuing operations	$(5.9)	$6.0	$0.5	$—	$0.6
Investing activities:					
Capital expenditures	—	(6.0)	(0.2)	—	(6.2)
Acquisitions, net of cash acquired	—	(0.3)	—	—	(0.3)
Net cash used in investing activities from continuing operations	—	(6.3)	(0.2)	—	(6.5)
Financing activities:					
Dividends paid	(2.7)	—	—	—	(2.7)
Common stock issued	0.3	—	—	—	0.3
Shares retained for employee taxes	(1.3)	—	—	—	(1.3)
Payment of deferred financing fees	(0.7)	—	—	—	(0.7)
Other	(0.7)	0.1	—	—	(0.6)
Net cash provided by (used in) financing activities from continuing operations	(5.1)	0.1	—	—	(5.0)
Net cash flows from discontinued operations:					
Operating activities	(1.7)	—	—	—	(1.7)
Investing activities	4.5	—	—	—	4.5
Net cash provided by discontinued operations	2.8	—	—	—	2.8
Effect of currency exchange rate changes on cash	—	—	(0.4)	—	(0.4)
Net change in cash and cash equivalents	(8.2)	(0.2)	(0.1)	—	(8.5)
Cash and cash equivalents at beginning of period	53.3	(3.7)	33.4	—	83.0
Cash and cash equivalents at end of period	$45.1	$(3.9)	$33.3	$—	$74.5

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Item 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the unaudited condensed consolidated financial statements and notes thereto that appear elsewhere in this report. This report contains certain statements that may be deemed “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. All statements that address activities, events or developments that the Company's management intends, expects, plans, projects, believes or anticipates will or may occur in the future are forward-looking statements. Examples of forward-looking statements include, but are not limited to, statements we make regarding the general municipal spending environment, the condition of our end markets and the performance of each of Mueller Co. and Anvil over future periods. Forward-looking statements are based on certain assumptions and assessments made by management in light of their experience and their perception of historical trends, current conditions and expected future developments. Actual results and the timing of events may differ materially from those contemplated by the forward-looking statements due to a number of factors, including regional, national or global political, economic, business, competitive, market and regulatory conditions and the other factors that are described in the section entitled “RISK FACTORS” in Item 1A. of our annual report on Form 10-K for the year ended September 30, 2013 ("Annual Report"). Undue reliance should not be placed on any forward-looking statements. The Company does not have any intention or obligation to update forward-looking statements, except as required by law.

Overview

Organization

On October 3, 2005, Walter Energy acquired all outstanding shares of capital stock representing the Mueller Co. and Anvil businesses and contributed them to its U.S. Pipe business to form the Company. In June 2006, we completed an initial public offering of 28,750,000 shares of Series A common stock and in December 2006, Walter Energy distributed to its shareholders all of its equity interests in the Company, consisting of all of the Company's outstanding shares of Series B common stock. On January 28, 2009, each share of Series B common stock was converted into one share of Series A common stock and the Series A designation was discontinued.

Unless the context indicates otherwise, whenever we refer to a particular year, we mean our fiscal year ended or ending September 30 in that particular calendar year. We manage our businesses and report operations through two business segments, Mueller Co. and Anvil, based largely on the products sold and the customers served.

On April 1, 2012, we sold the businesses comprising our former U.S. Pipe segment. U.S. Pipe's results of operations have been reclassified as discontinued operations for fiscal 2013.

Business

We expect Mueller Co.'s 2014 net sales growth rate will be comparable to the 2013 growth rate, based on our current outlook for growth in residential construction and in municipal spending. We expect Mueller Co.'s operating income to improve for the second quarter of 2014 compared to the second quarter of the prior year, although at a slower growth rate than Mueller Co. experienced in the first quarter of 2014 compared to the first quarter of the prior year. In the second quarter, Mueller Co. is changing its approach to the production of certain sizes of iron gate valves. This change is expected to result in a write-down of the related production equipment. We expect Mueller Co. will record an associated $1.5 million non-cash charge during the second quarter and that the project will deliver annual cost savings of $3.0 million to $3.5 million.

At Anvil, while we expect the energy and non-residential construction markets to improve during 2014, we will most likely benefit from these improvements in the second half of 2014. Consequently, we believe Anvil's second quarter net sales and operating income will be essentially flat year-over-year.

On a consolidated basis, we expect that results for the remainder of 2014 will improve year-over-year primarily due to expected growth in our key end markets and the benefits of expected stronger operating leverage.

Results of Operations

Three months ended December 31, 2013 Compared to Three months ended December 31, 2012

	Three months ended December 31, 2013			
	Mueller Co.	Anvil	Corporate	Total
	(in millions)			
Net sales	$ 165.0	$ 92.4	$ —	$ 257.4
Gross profit	$ 41.7	$ 25.4	$ —	$ 67.1
Operating expenses:				
Selling, general and administrative	25.7	18.1	9.2	53.0
Restructuring	0.1	—	—	0.1
	25.8	18.1	9.2	53.1
Operating income (loss)	$ 15.9	$ 7.3	$ (9.2)	14.0
Interest expense, net				12.6
Income before income taxes				1.4
Income tax expense				0.3
Net income				$ 1.1

	Three months ended December 31, 2012			
	Mueller Co.	Anvil	Corporate	Total
	(in millions)			
Net sales	$ 151.1	$ 94.0	$ —	$ 245.1
Gross profit	$ 32.9	$ 24.2	$ —	$ 57.1
Operating expenses:				
Selling, general and administrative	24.1	18.3	7.1	49.5
Restructuring	0.7	—	—	0.7
	24.8	18.3	7.1	50.2
Operating income (loss)	$ 8.1	$ 5.9	$ (7.1)	6.9
Interest expense, net				13.5
Loss before income taxes				(6.6)
Income tax benefit				(1.6)
Loss from continuing operations				(5.0)
Income from discontinued operations				12.0
Net income				$ 7.0

Consolidated Analysis

Net sales for the quarter ended December 31, 2013 increased to $257.4 million from $245.1 million in the prior year period. Net sales increased primarily due to $9.6 million of higher shipment volumes and $5.1 million of higher pricing at Mueller Co., which were partially offset by lower shipment volumes at Anvil.

Gross profit for the quarter ended December 31, 2013 increased to $67.1 million from $57.1 million in the prior year period. Gross margin increased 280 basis points to 26.1% in the quarter ended December 31, 2013 from 23.3% in the prior year period. Gross profit and gross margin benefited primarily from increased shipment volumes and higher sales pricing.

Selling, general and administrative expenses ("SG&A") for the quarter ended December 31, 2013 increased to $53.0 million from $49.5 million in the prior year period. SG&A increased primarily due to higher expenses associated with higher shipment volumes and higher stock-based compensation expense. SG&A as a percentage of net sales was 20.6% in the quarter ended December 31, 2013 and 20.2% in the prior year period.

Interest expense, net decreased in the quarter ended December 31, 2013 compared to the prior year period due to a lower level of total debt outstanding. The components of interest expense, net are detailed below.

	Three months ended December 31,	
	2013	2012
	(in millions)	
7.375% Senior Subordinated Notes	$ 7.7	$ 7.7
8.75% Senior Unsecured Notes	4.0	4.5
Deferred financing fees amortization	0.5	0.6
ABL Agreement	0.3	0.5
Other interest expense	0.2	0.2
	12.7	13.5
Interest income	(0.1)	—
	$ 12.6	$ 13.5

The components of income tax expense in continuing operations are provided below.

	Three months ended December 31,	
	2013	2012
	(in millions)	
Expense (benefit) from income (loss) before income taxes	$ 0.5	$ (2.4)
Deferred tax asset valuation allowance adjustment	—	0.8
Other discrete items	(0.2)	—
	$ 0.3	$ (1.6)

Segment Analysis

Mueller Co.

Net sales for the quarter ended December 31, 2013 increased to $165.0 million from $151.1 million in the prior year period. Net sales increased primarily due to $9.6 million of higher shipment volumes and $5.1 million of higher pricing.

Gross profit for the quarter ended December 31, 2013 increased to $41.7 million from $32.9 million in the prior year period primarily due to higher sales pricing and higher shipment volumes. Gross margin increased to 25.3% for the quarter ended December 31, 2013 compared to 21.8% in the prior year period primarily due to higher sales pricing and higher shipment volumes.

SG&A in the quarter ended December 31, 2013 increased to $25.7 million from $24.1 million in the prior year period primarily due to expenses associated with higher shipment volumes. SG&A were 15.6% and 15.9% of net sales for the quarter ended December 31, 2013 and 2012, respectively.

Anvil

Net sales in the quarter ended December 31, 2013 decreased to $92.4 million from $94.0 million in the prior year period. Net sales decreased primarily due to lower shipment volumes.

Gross profit in the quarter ended December 31, 2013 increased to $25.4 million from $24.2 million in the prior year period. The decrease in net sales was substantially offset by lower costs of goods sold. Gross margin increased to 27.5% in the quarter ended December 31, 2013 compared to 25.7% in the prior year period.

SG&A decreased to $18.1 million in the quarter ended December 31, 2013 from $18.3 million in the prior year period. SG&A was 19.6% of net sales for the quarter ended December 31, 2013 and 19.5% in the prior year period.

Corporate

SG&A increased to $9.2 million in December 31, 2013 from $7.1 million in the prior year period primarily due to higher stock-based compensation expense.

Liquidity and Capital Resources

We had cash and cash equivalents of $106.8 million at December 31, 2013 and $138.5 million of additional borrowing capacity under our ABL Agreement based on December 31, 2013 data. Undistributed earnings from our subsidiaries in Canada and China are considered to be permanently invested outside of the United States. At December 31, 2013, cash and cash equivalents included $35.7 million and $4.8 million in Canada and China, respectively.

On April 1, 2012, we sold our former U.S. Pipe segment and received proceeds of $94.0 million in cash, subject to adjustments, and the agreement by the purchaser to reimburse us for expenditures to settle certain previously-existing liabilities estimated at $10.1 million at March 31, 2012. During the quarter ended December 31, 2012, we received an additional $4.5 million in cash for certain purchase price adjustments and reduced our loss on sale of discontinued operations accordingly.

Cash flows from operating activities are categorized below.

	Three months ended December 31,	
	2013	2012
	(in millions)	
Collections from customers	$ 287.2	$ 274.4
Disbursements, other than interest and income taxes	(275.3)	(257.7)
Interest payments, net	(15.7)	(16.0)
Income tax payments, net	—	(0.1)
Cash provided by (used in) operating activities	$ (3.8)	$ 0.6

Collections from customers were higher during the quarter ended December 31, 2013 compared to the prior year period primarily related to the increased net sales compared to a year ago.

Increased disbursements, other than interest and income taxes, during the quarter ended December 31, 2013 reflect higher purchasing activity associated with higher net sales and general timing differences of disbursements related to the purchase of material, labor, overhead and other costs.

Capital expenditures were $7.5 million in the quarter ended December 31, 2013 compared to $6.2 million in the prior year period. We estimate 2014 capital expenditures to be $34 million to $36 million.

Our U.S. pension plan was 101% funded at January 1, 2013 (the most recent date this analysis has been performed) under the provisions of the Pension Protection Act. We do not expect to make any contributions to our U.S. pension plan during 2014. The proportion of the assets held by our U.S. pension plan invested in fixed income securities, instead of equity securities, has increased over historical levels. Because of this shift in the strategic asset allocation, the estimated rate of return on these assets has decreased, which could ultimately cause our pension expense and our required contributions to this plan to increase.

We anticipate that our existing cash, cash equivalents and borrowing capacity combined with our expected operating cash flows will be sufficient to meet our anticipated operating expenses, capital expenditures and debt service obligations as they become due through December 31, 2014. However, our ability to make these payments will depend partly upon our future operating performance, which will be affected by general economic, financial, competitive, legislative, regulatory, business and other factors beyond our control.

ABL Agreement

At December 31, 2013, the ABL Agreement consisted of a revolving credit facility for up to $225 million of revolving credit borrowings, swing line loans and letters of credit. The ABL Agreement permits us to increase the size of the credit facility by an additional $150 million in certain circumstances subject to adequate borrowing base availability. We may borrow up to $25 million through swing line loans and may have up to $60 million of letters of credit outstanding.

Borrowings under the ABL Agreement bear interest at a floating rate equal to LIBOR plus a margin ranging from 175 to 225 basis points, or a base rate, as defined in the ABL Agreement, plus a margin ranging from 75 to 125 basis points. At December 31, 2013, the applicable LIBOR-based margin was 175 basis points.

The ABL Agreement terminates on the earlier of (1) December 18, 2017 and (2) 60 days prior to the final maturity of our 7.375% Senior Subordinated Notes. We pay a commitment fee for any unused borrowing capacity under the ABL Agreement of either 37.5 basis points per annum or 25 basis points per annum, based on daily average availability during the previous

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calendar quarter. At December 31, 2013, our commitment fee was 37.5 basis points. As measured using December 31, 2013 data, excess availability as reduced by outstanding letters of credit and accrued fees and expenses of $30.8 million was $138.5 million.

The ABL Agreement is subject to mandatory prepayments if total outstanding borrowings under the ABL Agreement are greater than the aggregate commitments under the revolving credit facility or if we dispose of overdue accounts receivable in certain circumstances. The borrowing base under the ABL Agreement is equal to the sum of (a) 85% of the value of eligible accounts receivable and (b) the lesser of (i) 65% of the value of eligible inventory or (ii) 85% of the net orderly liquidation value of the value of eligible inventory, less certain reserves. Prepayments can be made at any time with no penalty.

Substantially all of our U.S. subsidiaries are borrowers under the ABL Agreement and are jointly and severally liable for any outstanding borrowings. Our obligations under the ABL Agreement are secured by a first-priority perfected lien on all of our U.S. inventory, accounts receivable, certain cash and other supporting obligations.

Borrowings are not subject to any financial maintenance covenants unless excess availability is less than the greater of $22.5 million and 10% of the aggregate commitments under the ABL Agreement. The ABL Agreement contains customary negative covenants and restrictions on our ability to engage in specified activities, such as:

- limitations on other debt, liens, investments and guarantees;
- restrictions on dividends and redemptions of our capital stock and prepayments and redemptions of debt; and
- restrictions on mergers and acquisition, sales of assets and transactions with affiliates.

8.75% Senior Unsecured Notes

We had $180.0 million face value of 8.75% Senior Unsecured Notes outstanding at December 31, 2013, which was reported net of $2.0 million unamortized discount. Interest on the Senior Unsecured Notes is paid semi-annually and the principal is due September 1, 2020. After August 2015, the Senior Unsecured Notes may be redeemed at specified redemption prices. Upon a “Change of Control” (as defined in the indenture securing the Senior Unsecured Notes), we are required to offer to purchase the outstanding Senior Unsecured Notes at a purchase price of 101%. The Senior Unsecured Notes are guaranteed by essentially all of our U.S. subsidiaries, but are subordinate to borrowings under the ABL Agreement.

7.375% Senior Subordinated Notes

We had $420.0 million face value of 7.375% Senior Subordinated Notes outstanding at December 31, 2013. Interest on the Senior Subordinated Notes is payable semi-annually and the principal is due June 1, 2017. We may redeem any portion of the Senior Subordinated Notes at specified redemption prices, subject to restrictions in the Senior Unsecured Notes. Upon a “Change of Control” (as defined in the indenture securing the Senior Subordinated Notes), we are required to offer to purchase the outstanding Senior Subordinated Notes at 101%. The Senior Subordinated Notes are guaranteed by essentially all of our U.S. subsidiaries, but are subordinate to the borrowings under the ABL Agreement and the Senior Unsecured Notes.

Our corporate credit rating and the credit rating for our debt are presented below.

	Moody’s		Standard & Poor's	
	December 31, 2013	September 30, 2013	December 31, 2013	September 30, 2013
Corporate credit rating	B2	B2	BB-	BB-
ABL Agreement	Not rated	Not rated	Not rated	Not rated
8.75% Senior Unsecured Notes	B1	B1	BB-	BB-
7.375% Senior Subordinated Notes	Caa1	Caa1	B	B
Outlook	Stable	Stable	Stable	Stable

Off-Balance Sheet Arrangements

We do not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. In addition, we do not have any undisclosed borrowings

or debt or any derivative contracts or synthetic leases. Therefore, we are not exposed to any financing, liquidity, market or credit risk that could have arisen had we engaged in such relationships.

We use letters of credit and surety bonds in the ordinary course of business to ensure the performance of contractual obligations. At December 31, 2013, we had $30.6 million of letters of credit and $47.3 million of surety bonds outstanding.

Seasonality

Our business is dependent upon the construction industry, which is seasonal due to the impact of cold weather conditions. Net sales and operating income have historically been lowest in the quarterly periods ending December 31 and March 31 when the northern United States and all of Canada generally face weather conditions that restrict significant construction activity.

Item 4. CONTROLS AND PROCEDURES

During the quarter ended December 31, 2013, there were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports we file or submit under the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission and that such information is accumulated and communicated to our management, including the Chief Executive Officer and the Chief Financial Officer as appropriate, to allow timely decisions regarding required disclosure.

Our Chief Executive Officer and our Chief Financial Officer have concluded, based on an evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended) by our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, that such disclosure controls and procedures were effective as of the end of the period covered by this report.

Our management, including the Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls can prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. There are inherent limitations in all control systems, including the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of one or more persons. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and, while our disclosure controls and procedures are designed to be effective under circumstances where they should reasonably be expected to operate effectively, there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Because of the inherent limitations in any control system, misstatements due to error or fraud may occur and not be detected.

PART II OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

Refer to the information provided in Note 10 to the notes to the condensed consolidated financial statements presented in Item 1 of Part I of this report.

Item 1A. RISK FACTORS

In addition to the other information set forth in this report, you should carefully consider the factors discussed in PART I, “Item 1A. RISK FACTORS” in our Annual Report, each of which could materially affect our business, financial condition or operating results. These described risks are not the only risks facing us. Additional risks and uncertainties not known to us or that we deem to be immaterial also may materially adversely affect our business, financial condition or operating results.

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

During the quarter ended December 31, 2013, we repurchased shares of our common stock as follows.

Period	Total number of shares purchased[1]	Average price paid per share	Total number of shares purchased as part of publically announced plans or programs	Maximum number of shares that may yet be purchased under the plans or programs
October 1-31, 2013	—	$—	—	—
November 1-30, 2013	312,774	8.61	—	—
December 1-31, 2013	46,082	8.34	—	—
Total	358,856		—	—

[1] These are shares surrendered to us to pay the tax withholding obligations of participants in connection with the lapsing of restrictions on restricted stock units.

Item 6. EXHIBITS

Exhibit No.	Document
10.4*	Mueller Water Products, Inc. Form of Notice of Stock Option Grant.
10.5*	Mueller Water Products, Inc. Form of Restricted Stock Unit Award Agreement.
10.23*	Mueller Water Products, Inc. Form of Performance Restricted Stock Unit Award Agreement.
10.23.1*	Exhibit A (2013-15 Award Cycle)
10.23.2*	Exhibit A (2014-16 Award Cycle)
10.24.1*	Exhibit A (2013-14 Award Cycle)
14.1*	Code of Business Conduct and Ethics for Mueller Water Products, Inc.
31.1*	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2*	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101*	The following financial information from the Quarterly Report on Form 10-Q for the quarter ended December 31, 2013, formatted in XBRL (Extensible Business Reporting Language), (i) the Condensed Consolidated Balance Sheets, (ii) the Condensed Consolidated Statements of Operations, (iii) the Condensed Consolidated Statements of Other Comprehensive Income (Loss), (iv) the Condensed Consolidated Statements of Stockholders' Equity, (v) the Condensed Consolidated Statements of Cash Flows, and (vi) the Notes to Condensed Consolidated Financial Statements.

* Filed with this quarterly report

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.

			MUELLER WATER PRODUCTS, INC.
Date:	February 7, 2014	By:	/s/ Evan L. Hart
			Evan L. Hart
			Chief Financial Officer

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