Mueller Water Products, Inc.
Form 10-Q
February 08, 2012

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 December 31, 2011
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission File Number 001-32892

MUELLER WATER PRODUCTS, INC.
(Exact name of registrant as specified in its charter)

Delaware	20-3547095
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1200 Abernathy Road N.E.
Suite 1200
Atlanta, GA 30328
(Address of principal executive offices)
(770) 206-4200
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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 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 Smaller reporting company o
(Do not check if a smaller reporting company)

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

There were 156,506,978 shares of Series A common stock of the registrant outstanding at January 31, 2012.

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

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

	December 31, 2011	September 30, 2011
	(in millions)	
Assets:		
Cash and cash equivalents	$39.6	$61.2
Receivables, net	197.8	220.8
Inventories	250.6	237.7
Deferred income taxes	29.3	28.7
Other current assets	56.7	50.4
Total current assets	574.0	598.8
Property, plant and equipment, net	239.4	243.8
Identifiable intangible assets	603.3	610.9
Other noncurrent assets	30.3	31.5
Total assets	$1,447.0	$1,485.0
Liabilities and stockholders' equity:		
Current portion of long-term debt	$0.9	$0.9
Accounts payable	97.2	107.6
Other current liabilities	74.8	86.3
Total current liabilities	172.9	194.8
Long-term debt	677.6	677.4
Deferred income taxes	153.2	154.2
Other noncurrent liabilities	75.8	79.6
Total liabilities	1,079.5	1,106.0
Commitments and contingencies (Note 11)		
Common stock:		
Series A common stock: 600,000,000 shares authorized;156,438,509 and 155,793,612 shares outstanding at December 31, 2011 and September 30, 2011, respectively	1.6	1.6
Additional paid-in capital	1,591.8	1,593.2
Accumulated deficit	(1,173.5)	(1,161.6)
Accumulated other comprehensive loss	(52.4)	(54.2)
Total stockholders' equity	367.5	379.0
Total liabilities and stockholders' equity	$1,447.0	$1,485.0

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

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

	Three months ended December 31,	
	2011	2010
	(in millions, except per share amounts)	
Net sales	$311.5	$287.6
Cost of sales	259.7	238.0
Gross profit	51.8	49.6
Operating expenses:		
Selling, general and administrative	53.4	52.0
Restructuring	1.3	1.9
Total operating expenses	54.7	53.9
Loss from operations	(2.9)	(4.3)
Interest expense, net	15.7	15.9
Loss before income taxes	(18.6)	(20.2)
Income tax benefit	(6.7)	(8.1)
Net loss	(11.9)	(12.1)
Other comprehensive income (loss):		
Derivatives	(0.3)	—
Income tax effects	0.1	—
Amortization of interest expense on terminated swap contracts	1.4	1.9
Income tax effects	(0.5)	(0.7)
Foreign currency translation	0.6	1.7
Minimum pension liability	0.7	1.1
Income tax effects	(0.2)	(0.4)
Other	—	(0.3)
	1.8	3.3
Comprehensive loss	$(10.1)	$(8.8)
Net loss per share:		
Basic	$(0.08)	$(0.08)
Diluted	$(0.08)	$(0.08)
Weighted average shares outstanding:		
Basic	156.0	154.9
Diluted	156.0	154.9
Dividends declared per share	$0.0175	$0.0175

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

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MUELLER WATER PRODUCTS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
THREE MONTHS ENDED DECEMBER 31, 2011
(UNAUDITED)

	Common stock	Additional paid-in capital	Accumulated deficit	Accumulated other comprehensive income (loss)	Total
	(in millions)				
Balance at September 30, 2011	$1.6	$1,593.2	$(1,161.6)	$(54.2)	$379.0
Net loss	—	—	(11.9)	—	(11.9)
Dividends declared	—	(2.7)	—	—	(2.7)
Stock-based compensation	—	1.3	—	—	1.3
Derivative instruments	—	—	—	0.7	0.7
Foreign currency translation	—	—	—	0.6	0.6
Minimum pension liability	—	—	—	0.5	0.5
Balance at December 31, 2011	$1.6	$1,591.8	$(1,173.5)	$(52.4)	$367.5

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

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

	Three months ended December 31,	
	2011	2010
	(in millions)	
Operating activities:		
Net loss	$(11.9)	$(12.1)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation	11.8	12.6
Amortization	7.6	7.5
Stock-based compensation	1.5	1.9
Deferred income taxes	(2.4)	(3.0)
(Gain) loss on disposal of assets	0.8	(0.6)
Retirement plans	0.6	1.5
Interest rate swap contracts	1.4	1.9
Other, net	0.7	0.7
Changes in assets and liabilities, net of acquisitions:		
Receivables	23.6	42.2
Inventories	(12.8)	1.4
Other current assets and other noncurrent assets	(1.7)	(5.2)
Accounts payable and other liabilities	(31.1)	(43.6)
Net cash provided by (used in) operating activities	(11.9)	5.2
Investing activities:		
Capital expenditures	(8.2)	(6.4)
Acquisitions	—	(7.9)
Proceeds from sales of assets	0.1	0.6
Net cash used in investing activities	(8.1)	(13.7)
Financing activities:		
Increase (decrease) in outstanding checks	0.6	(1.4)
Debt borrowings	0.1	0.2
Common stock issued	—	0.1
Payment of deferred financing fees	—	(0.3)
Dividends paid	(2.7)	(2.7)
Net cash used in financing activities	(2.0)	(4.1)
Effect of currency exchange rate changes on cash	0.4	0.8
Net change in cash and cash equivalents	(21.6)	(11.8)
Cash and cash equivalents at beginning of period	61.2	83.7
Cash and cash equivalents at end of period	$39.6	$71.9

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

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MUELLER WATER PRODUCTS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Organization
Mueller Water Products, Inc., a Delaware corporation, together with its consolidated subsidiaries, operates in three business segments: Mueller Co., U.S. Pipe and Anvil. Mueller Co. manufactures valves for water and gas systems, including butterfly, iron gate, tapping, check, plug and ball valves, as well as dry-barrel and wet-barrel fire hydrants and a broad range of metering, leak detection and pipe condition assessment products for the water infrastructure industry. U.S. Pipe manufactures a broad line of ductile iron pipe, joint restraint products, fittings and other products. Anvil manufactures and sources a broad range of products, including a variety of fittings, couplings, hangers, nipples and related products. The "Company," "we," "us" or "our" refer to Mueller Water Products, Inc. and its subsidiaries or their management. With regard to the Company's segments, "we," "us" or "our" may also refer to the segment being discussed or its management.
Our consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America, which require us to make certain estimates and assumptions that affect the reported amounts of assets, liabilities, sales and expenses and the disclosure of contingent assets and liabilities for the reporting periods. Actual results could differ from those estimates. All significant intercompany balances and transactions have been eliminated. In our opinion, all normal and recurring adjustments that we consider necessary for a fair financial statement presentation have been made. Certain reclassifications have been made to previously reported amounts to conform to the current presentation. The condensed consolidated balance sheet data at September 30, 2011 was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States.
Unless the context indicates otherwise, whenever we refer to a particular year, we mean the fiscal year ended or ending September 30 in that particular calendar year.

Note 2. Acquisition
On December 14, 2010, we acquired Echologics Engineering Inc., a leak detection and pipe condition assessment company headquartered in Toronto, Canada, for $7.9 million in cash, which included $1.5 million placed in escrow related primarily to seller indemnifications scheduled to be settled by July 2012. During the quarter ended December 31, 2011, we resolved one of these indemnifications in our favor and reduced the purchase price by $0.5 million, which reduced the associated goodwill balance to zero. We have included the operating results of the business in Mueller Co.'s results effective December 14, 2010. The fair values of the related assets and liabilities are presented below, in millions.

Assets acquired:		
Receivables	$0.3	
Inventories	0.1	
Other current assets	0.2	
Property, plant and equipment	0.1	
Identifiable intangible assets	7.3	
Liabilities:		
Accounts payable and other current liabilities	(0.2	)
Deferred income taxes	(0.4	)
	$7.4	

Identifiable intangible assets consist of trade names and trademarks of $0.6 million that have indefinite useful lives and technology of $6.7 million that has an estimated useful life of 15 years.
Goodwill of $0.5 million was included in other noncurrent assets at September 30, 2011.

Note 3. Income Taxes

At December 31, 2011 and September 30, 2011, the gross liabilities for unrecognized income tax benefits were $7.6 million and $7.8 million, respectively.

We recognize interest related to uncertain income tax positions as interest expense and would recognize any penalties that may be incurred as selling, general and administrative expense. At December 31, 2011 and September 30, 2011, we had $1.7

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million and $1.8 million, respectively, of accrued interest related to uncertain tax positions.

Generally, our state income tax returns are closed for years prior to 2007 and our Canadian income tax returns are closed for years prior to 2004. We are under audit by the Internal Revenue Service (the "IRS") for the years 2007 through 2010. We are also under audit by several states at various levels of completion. We do not have any material unpaid assessments.

Note 4. Borrowing Arrangements

The components of our long-term debt are presented below.

	December 31, 2011	September 30, 2011
	(in millions)	
ABL Agreement	$34.0	$34.0
8.75% Senior Unsecured Notes	221.8	221.7
7.375% Senior Subordinated Notes	420.0	420.0
Other	2.7	2.6
	678.5	678.3
Less current portion	(0.9)	(0.9)
Long-term debt	$677.6	$677.4

ABL Agreement. At December 31, 2011, our asset based lending agreement (the “ABL Agreement”) consisted of a revolving credit facility for up to $275 million of revolving credit borrowings, swing line loans and letters of credit. The ABL Agreement also 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. We estimate the fair value of the borrowings under the ABL Agreement approximates the carrying value.

Borrowings under the ABL Agreement bear interest at a floating rate equal to LIBOR plus a margin ranging from 275 to 325 basis points, or a base rate, as defined in the ABL Agreement, plus a margin ranging from 175 to 225 basis points. At December 31, 2011, the applicable rate was LIBOR plus 300 basis points and the interest rate was 3.27%, including the margin.

The ABL Agreement terminates in August 2015. We pay a commitment fee of 50 basis points for any unused borrowing capacity and our obligations 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 $34 million and 12.5% of the aggregate commitments under the ABL Agreement. Excess availability at December 31, 2011, as reduced by outstanding borrowings, outstanding letters of credit and accrued fees and expenses of $73.0 million, was $148.8 million. At December 31, 2011, our additional borrowing capacity was $114.4 million.

8.75% Senior Unsecured Notes. The 8.75% Senior Unsecured Notes (the “Senior Unsecured Notes”) mature in September 2020 and bear interest at 8.75%, paid semi-annually. Based on quoted market prices, the outstanding Senior Unsecured Notes had a fair value of $245.3 million at December 31, 2011.

We may redeem up to $22.5 million of the Senior Unsecured Notes at a redemption price of 103% plus accrued and unpaid interest once in each year ending September 1, 2012 and 2013. We may also redeem up to $78.8 million of the Senior Unsecured Notes at a redemption price of 108.75%, plus accrued and unpaid interest, with the net cash proceeds from certain equity offerings prior to September 2013, provided that at least $146.2 million remains outstanding immediately after such redemption. After August 2015, we may redeem the Senior Unsecured Notes at specified redemption prices plus accrued and unpaid interest. 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% plus accrued and unpaid interest. The Senior Unsecured Notes are subordinate to borrowings under the ABL Agreement.

The indenture securing the Senior Unsecured Notes contains customary covenants and events of default, including covenants that limit our ability to incur debt, pay dividends and make investments. Substantially all of our U.S. subsidiaries guarantee the Senior Unsecured Notes. We believe we were compliant with these covenants at December 31, 2011 and expect to remain in compliance through December 31, 2012.

7.375% Senior Subordinated Notes. The 7.375% Senior Subordinated Notes (the “Senior Subordinated Notes”) mature in June 2017 and bear interest at 7.375%, paid semi-annually. Based on quoted market prices, the outstanding Senior Subordinated Notes had a fair value of $382.2 million at December 31, 2011.

After May 2012, we may redeem any portion of the Senior Subordinated Notes at specified redemption prices plus accrued and unpaid interest. 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 a purchase price of 101%, plus accrued and unpaid interest. The Senior Subordinated Notes are subordinate to the borrowings under the ABL Agreement and the Senior Unsecured Notes.

The indenture securing the Senior Subordinated Notes contains customary covenants and events of default, including covenants that limit our ability to incur debt, pay dividends and make investments. Substantially all of our U.S. subsidiaries guarantee the Senior Subordinated Notes. We believe we were compliant with these covenants at December 31, 2011 and expect to remain in compliance through December 31, 2012.

Note 5. Derivative Financial Instruments

Our ongoing business operations expose us to commodity price risk, which we manage to some extent using derivative instruments. We enter into natural gas swap contracts to manage the price risk associated with future purchases of natural gas used in certain of our manufacturing processes. We have used interest rate swap contracts to manage interest rate risk associated with our variable-rate borrowings in the past, but no such contracts have been outstanding since prior to September 30, 2010.

We designated our natural gas swap contracts and interest rate swap contracts as cash flow hedges of our purchases of natural gas and future interest payments, respectively. As a result, to the extent the hedges are effective, the changes in the fair value of these contracts prior to settlement are reported as a component of other comprehensive loss and reclassified into earnings in the periods during which the hedged transactions affect earnings. Gains and losses on those contracts representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in earnings as they occur.

Natural Gas Swap Contracts. Our natural gas swap contracts result in a fixed natural gas purchase price ranging from $4.16 to $4.35 per MMBtu through September 2012. Our outstanding natural gas swap contracts at December 31, 2011 and September 30, 2011 are presented below.

Rate benchmark	December 31, 2011	September 30, 2011
	(MMBtu)	
NYMEX natural gas	317,000	406,000

The effects of our natural gas swap contracts on the consolidated statements of operations are presented below, net of tax.

	Three months ended December 31,	
	2011	2010
	(in millions)	
Gain recognized in other comprehensive loss	$0.2	$—

Interest Rate Swap Contracts. In the quarters ended December 31, 2011 and 2010, we reclassified $1.4 million and $1.9 million, respectively, related to previously terminated interest rate swap contracts to interest expense from accumulated other comprehensive loss. The unamortized portion remaining in accumulated other comprehensive loss was $2.2 million, net of tax, at December 31, 2011, and the pre-tax component is scheduled to be amortized to interest expense through May 2012.

Our derivative contracts were recorded at fair value using publicly observable data such as market interest rates and market natural gas prices. The fair values of our derivative contracts are presented below.

	Balance sheet location	Fair value December 31, 2011 (in millions)	September 30, 2011
Liability derivatives:			
Derivatives designated as hedging instruments:			
Natural gas swap contracts	Other current liabilities	$0.3	$—

Note 6. Retirement Plans

The components of net periodic benefit cost (gain) for defined benefit pension plans and other postretirement benefit plans are as follows.

	Three months ended December 31,			
	2011	2010	2011	2010
	Pension Plans (in millions)		Other Plans	
Service cost	$0.5	$0.9	$—	$—
Interest cost	5.2	5.3	0.1	0.1
Expected return on plan assets	(5.7)	(5.8)	—	—
Amortization of prior service cost (gain)	0.1	0.1	(0.6)	(0.6)
Amortization of net loss (gain)	1.6	1.9	(0.5)	(0.3)
Net periodic benefit cost (gain)	$1.7	$2.4	$(1.0)	$(0.8)

The amortization of unrecognized prior service cost and of actuarial net losses, net of tax, are recorded as components of accumulated other comprehensive loss.

During the quarter ended December 31, 2011, we contributed $4.0 million to our defined benefit pension plans. We expect to contribute a total of $20 million to $22 million to our pension plans during 2012. We also expect to contribute a total of $0.5 million to our other postretirement benefit plans during 2012.

Note 7. Stock-based Compensation Plans

During the quarter ended December 31, 2011, the Company adopted the Mueller Water Products, Inc. Phantom Plan (the "Phantom Plan"). Phantom Plan awards entitle a recipient to a cash payment equal to the number of awards vesting multiplied by the closing price per share of our common stock on the vesting date. Awards generally vest in thirds on successive anniversaries of the grant date. Compensation expense for Phantom Plan awards is charged against income over the vesting period, based on the closing stock price at each balance sheet date until vested.

We recorded stock-based compensation expense of $1.5 million during the quarter ended December 31, 2011. At December 31, 2011, there was approximately $6.1 million of unrecognized compensation expense related to stock-based awards.

We recorded net losses in the quarters ended December 31, 2011 and 2010. Because the effect of including normally dilutive securities in the earnings per share calculation would have been antidilutive, we excluded all stock-based compensation instruments from the calculations of diluted net loss per share.

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We granted equity awards under our Mueller Water Products, Inc. Amended and Restated 2006 Stock Incentive Plan, Mueller Water Products, Inc. 2006 Employee Stock Purchase Plan and Phantom Plan during the quarter ended December 31, 2011 as follows.

	Number of instruments	Weighted average fair value per instrument	Total fair value
	(in millions, except per instrument value)		
Quarter ended December 31, 2011:			
Restricted stock units	1.2	$2.04	$2.4
Non-qualified stock options	0.6	2.07	1.2
Employee stock purchase plan instruments	0.1	1.95	0.3
Phantom awards	0.4	2.03	0.7
			$4.6

Note 8. Accumulated Other Comprehensive Loss

Accumulated other comprehensive loss is presented below.

	December 31, 2011	September 30, 2011
	(in millions)	
Net unrecognized loss on derivatives	$(2.3)	$(3.0)
Foreign currency translation	6.9	6.3
Minimum pension liability	(57.0)	(57.5)
	$(52.4)	$(54.2)

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Note 9. Supplemental Balance Sheet Information

Selected supplemental balance sheet information is presented below.

	December 31, 2011	September 30, 2011
	(in millions)	
Inventories:		
Raw materials and purchased parts	$89.2	$72.5
Work in process	32.0	37.4
Finished goods	129.4	127.8
	$250.6	$237.7
Other current assets:		
Prepaid income taxes	$17.1	$12.6
Maintenance and repair tooling	30.7	30.3
Other	8.9	7.5
	$56.7	$50.4
Property, plant and equipment:		
Land	$23.0	$23.0
Buildings	92.9	92.8
Machinery and equipment	555.0	554.9
Construction in progress	17.6	13.9
	688.5	684.6
Accumulated depreciation and amortization	(449.1)	(440.8)
	$239.4	$243.8
Other current liabilities:		
Compensation and benefits	$28.2	$33.9
Customer rebates	16.7	15.0
Interest	10.1	13.0
Taxes other than income taxes	5.9	5.5
Warranty	2.5	3.4
Severance	1.3	1.5
Income taxes	—	1.9
Restructuring	1.8	1.4
Environmental	0.3	0.3
Other	8.0	10.4
	$74.8	$86.3

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Note 10. Segment Information

Segment assets consist primarily of receivables, inventories, property, plant and equipment and identifiable intangible assets. Summarized financial information for our segments is presented below.

	Three months ended December 31,	
	2011	2010
	(in millions)	
Net sales, excluding intersegment sales:		
Mueller Co.	$128.1	$129.8
U.S. Pipe	96.1	74.4
Anvil	87.3	83.4
	$311.5	$287.6
Intersegment sales:		
Mueller Co.	$1.7	$2.1
U.S. Pipe	0.1	—
Anvil	—	—
	$1.8	$2.1
Income (loss) from operations:		
Mueller Co.	$4.7	$8.4
U.S. Pipe	(8.8)	(10.3)
Anvil	7.7	5.9
Corporate	(6.5)	(8.3)
	$(2.9)	$(4.3)
Depreciation and amortization:		
Mueller Co.	$11.2	$11.7
U.S. Pipe	4.4	4.5
Anvil	3.6	3.7
Corporate	0.2	0.2
	$19.4	$20.1
Restructuring:		
Mueller Co.	$0.4	$0.4
U.S. Pipe	0.9	0.9
Anvil	0.1	0.6
Corporate	(0.1)	—
	$1.3	$1.9
Capital expenditures:		
Mueller Co.	$3.4	$3.2
U.S. Pipe	2.9	1.4
Anvil	1.9	1.4
Corporate	—	0.4
	$8.2	$6.4

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Note 11.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 future results of operations cannot be predicted with certainty as any such effect depends on future results of operations and 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 businesses, operations 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 September 1987, U.S. Pipe implemented an Administrative Consent Order ("ACO") for its 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 U.S. Pipe has completed, and received final approval on, the soil cleanup required by the ACO. U.S. Pipe continues to address ground-water issues as well as issues associated with the demolition of its former manufacturing facilities at this site. Further remediation could be required. Long-term ground-water monitoring may also be required, but we do not know how long such monitoring will be required and do not believe monitoring or further remediation costs, if any, will have a material adverse effect on our financial condition or results of operations.

In June 2003, Solutia Inc. and Pharmacia Corporation (collectively "Solutia") filed suit against U.S. Pipe and a number of co-defendant foundry-related companies in the U.S. District Court for the Northern District of Alabama for contribution and cost recovery allegedly incurred and to be incurred by Solutia in performing remediation of polychlorinated biphenyls ("PCBs") and heavy metals in Anniston, Alabama, pursuant to a partial consent decree with the EPA. U.S. Pipe and certain co-defendants subsequently reached a settlement with the EPA concerning their liability for certain contamination in and around Anniston, which was memorialized in an Administrative Agreement and Order on Consent ("AOC") that became effective in January 2006. U.S. Pipe has reached a settlement agreement whereby Phelps Dodge Industries, Inc., a co-defendant and co-respondent on the AOC, has assumed U.S. Pipe's obligation to perform the work required under the AOC.

U.S. Pipe and the other settling defendants contend that the legal effect of the AOC extinguishes Solutia's claims for contribution and cost recovery and they filed a motion for summary judgment to that effect. The district court granted the motion for summary judgment as to contribution claims in June 2008 and as to cost recovery claims in July 2010. The plaintiffs have appealed the grant of summary judgment to the Eleventh Circuit Court of Appeals, and oral argument before the Eleventh Circuit Court of Appeals was held on February 1, 2012. While the district court granted summary judgment for U.S. Pipe and other defendants, plaintiffs have alleged that the issues raised in the appeal involve complex matters of law and that U.S. Pipe should share liability for cost recovery in excess of costs already incurred under the AOC, based on facts and expert testimony to be developed at trial. In view of the inherent difficulty of predicting the outcome of litigation such as this, where important factual information and legal issues remain to be developed or decided, we cannot at this time estimate the reasonably possible loss, or range of loss, if any, for this matter.

On July 13, 2010, Rohcan Investments Limited ("Rohcan"), 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 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.

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. In addition, 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. In June 2007, Tyco was separated into three separate publicly traded companies. In September 2011, Tyco International Ltd., one of the companies that was separated in the June 2007 split, announced it would split into three separate companies. Should Tyco's successors become financially unable or fail to comply with the terms of the indemnity, we may be responsible for such obligations or liabilities.

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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 years 1980 through 1994 allegedly owed by the Walter Energy consolidated group, which included U.S. Pipe during these periods. 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, 2011. 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.

The separation of the Company 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 of 1986, as amended. 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 a predecessor to the Company 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 $10.9 million 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. We recorded this receivable in other noncurrent assets.

Other Matters. We are party to a number of other lawsuits arising in the ordinary course of our businesses, 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 results of operations cannot be predicted with certainty as any such effect depends on future results of operations and 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 consolidated financial statements.

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Note 12. Subsequent Events
On January 25, 2012, our board of directors declared a dividend of $0.0175 per share on our Series A common stock, payable on February 21, 2012 to stockholders of record at the close of business on February 10, 2012.

Note 13. 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 1, LLC	Delaware
Anvil 2, LLC	Delaware
Anvil International, LLC	Delaware
AnvilStar, LLC	Delaware
Echologics, LLC	Delaware
Fast Fabricators, LLC	Delaware
Henry Pratt Company, LLC	Delaware
Henry Pratt International, LLC	Delaware
Hunt Industries, LLC	Delaware
Hydro Gate, LLC	Delaware
J.B. Smith Mfg. Co., LLC	Delaware
James Jones Company, LLC	Delaware
MCO 1, LLC	Alabama
MCO 2, LLC	Alabama
Milliken Valve, LLC	Delaware
Mueller Co. International Holdings, LLC	Delaware
Mueller Co. LLC	Delaware
Mueller Financial Services, LLC	Delaware
Mueller Group Co-Issuer, Inc.	Delaware
Mueller Group, LLC	Delaware
Mueller International, LLC	Delaware
Mueller Service California, Inc.	Delaware
Mueller Service Co., LLC	Delaware
Mueller Systems, LLC	Delaware
U.S. Pipe Valve & Hydrant, LLC	Delaware
United States Pipe and Foundry Company, LLC	Alabama

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Mueller Water Products, Inc. and Subsidiaries
Consolidating Balance Sheet
December 31, 2011

	Issuer	Guarantor companies	Non-guarantor companies	Eliminations	Total
			(in millions)		
Assets:					
Cash and cash equivalents	$11.3	$(2.2)	$30.5	$—	$39.6
Receivables, net	—	187.4	10.4	—	197.8
Inventories	—	237.0	13.6	—	250.6
Deferred income taxes	28.7	—	0.6	—	29.3
Other current assets	18.9	34.9	2.9	—	56.7
Total current assets	58.9	457.1	58.0	—	574.0
Property, plant and equipment	1.5	229.0	8.9	—	239.4
Identifiable intangible assets	—	596.1	7.2	—	603.3
Other noncurrent assets	27.1	1.9	1.3	—	30.3
Investment in subsidiaries	28.6	33.6	—	(62.2)	—
Total assets	$116.1	$1,317.7	$75.4	$(62.2)	$1,447.0
Liabilities and equity:					
Current portion of long-term debt	$—	$0.9	$—	$—	$0.9
Accounts payable	7.5	85.7	4.0	—	97.2
Other current liabilities	20.9	52.0	1.9	—	74.8
Total current liabilities	28.4	138.6	5.9	—	172.9
Long-term debt	676.1	1.5	—	—	677.6
Deferred income taxes	152.8	—	0.4	—	153.2
Other noncurrent liabilities	7.2	68.0	0.6	—	75.8
Intercompany accounts	(1,115.9)	1,081.0	34.9	—	—
Total liabilities	(251.4)	1,289.1	41.8	—	1,079.5
Equity	367.5	28.6	33.6	(62.2)	367.5
Total liabilities and equity	$116.1	$1,317.7	$75.4	$(62.2)	$1,447.0

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Mueller Water Products, Inc. and Subsidiaries
Consolidating Balance Sheet
September 30, 2011

	Issuer	Guarantor companies	Non-guarantor companies	Eliminations	Total
			(in millions)		
Assets:					
Cash and cash equivalents	$35.7	$(3.2)	$28.7	$—	$61.2
Receivables, net	0.1	203.9	16.8	—	220.8
Inventories	—	225.2	12.5	—	237.7
Deferred income taxes	28.1	—	0.6	—	28.7
Other current assets	15.4	34.0	1.0	—	50.4
Total current assets	79.3	459.9	59.6	—	598.8
Property, plant and equipment	1.6	233.0	9.2	—	243.8
Identifiable intangible assets	—	603.7	7.2	—	610.9
Other noncurrent assets	27.7	2.0	1.8	—	31.5
Investment in subsidiaries	26.7	33.7	—	(60.4)	—
Total assets	$135.3	$1,332.3	$77.8	$(60.4)	$1,485.0
Liabilities and equity:					
Current portion of long-term debt	$—	$0.9	$—	$—	$0.9
Accounts payable	6.1	97.8	3.7	—	107.6
Other current liabilities	26.9	56.5	2.9	—	86.3
Total current liabilities	33.0	155.2	6.6	—	194.8
Long-term debt	676.0	1.4	—	—	677.4
Deferred income taxes	153.8	—	0.4	—	154.2
Other noncurrent liabilities	7.3	71.6	0.7	—	79.6
Intercompany accounts	(1,113.8)	1,077.4	36.4	—	—
Total liabilities	(243.7)	1,305.6	44.1	—	1,106.0
Equity	379.0	26.7	33.7	(60.4)	379.0
Total liabilities and equity	$135.3	$1,332.3	$77.8	$(60.4)	$1,485.0

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Mueller Water Products, Inc. and Subsidiaries
Consolidating Statement of Operations
Three Months Ended December 31, 2011

	Issuer	Guarantor companies	Non-guarantor companies (in millions)	Eliminations	Total
Net sales	$—	$289.5	$22.0	$—	$311.5
Cost of sales	—	242.2	17.5	—	259.7
Gross profit	—	47.3	4.5	—	51.8
Operating expenses:					
Selling, general and administrative	6.5	42.9	4.0	—	53.4
Restructuring	—	1.3	—	—	1.3
Total operating expenses	6.5	44.2	4.0	—	54.7
Income (loss) from operations	(6.5)	3.1	0.5	—	(2.9)
Interest expense, net	15.6	0.1	—	—	15.7
Income (loss) before income taxes	(22.1)	3.0	0.5	—	(18.6)
Income tax expense (benefit)	(7.9)	1.1	0.1	—	(6.7)
Equity in income of subsidiaries	2.3	0.4	—	(2.7)	—
Net income (loss)	$(11.9)	$2.3	$0.4	$(2.7)	$(11.9)

Mueller Water Products, Inc. and Subsidiaries
Consolidating Statement of Operations
Three Months Ended December 31, 2010

	Issuer	Guarantor companies	Non-guarantor companies (in millions)	Eliminations	Total
Net sales	$—	$261.2	$26.4	$—	$287.6
Cost of sales	—	214.6	23.4	—	238.0
Gross profit	—	46.6	3.0	—	49.6
Operating expenses:					
Selling, general and administrative	8.6	41.6	1.8	—	52.0
Restructuring	—	1.9	—	—	1.9
Total operating expenses	8.6	43.5	1.8	—	53.9
Income (loss) from operations	(8.6)	3.1	1.2	—	(4.3)
Interest expense, net	15.9	—	—	—	15.9
Income (loss) before income taxes	(24.5)	3.1	1.2	—	(20.2)
Income tax expense (benefit)	(9.8)	1.2	0.5	—	(8.1)
Equity in income of subsidiaries	2.6	0.7	—	(3.3)	—
Net income (loss)	$(12.1)	$2.6	$0.7	$(3.3)	$(12.1)

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Mueller Water Products, Inc. and Subsidiaries
Consolidating Statement of Cash Flows
Three Months Ended December 31, 2011

	Issuer	Guarantor companies	Non-guarantor companies	Eliminations	Total
			(in millions)		
Operating activities:					
Net cash provided by (used in) operating activities	$(21.7)	$8.3	$1.5	$—	$(11.9)
Investing activities:					
Capital expenditures	—	(8.1)	(0.1)	—	(8.2)
Proceeds from sales of assets	—	0.1	—	—	0.1
Net cash used in investing activities	—	(8.0)	(0.1)	—	(8.1)
Financing activities:					
Increase in outstanding checks	—	0.6	—	—	0.6
Debt borrowings	—	0.1	—	—	0.1
Dividends paid	(2.7)	—	—	—	(2.7)
Net cash provided by (used in) financing activities	(2.7)	0.7	—	—	(2.0)
Effect of currency exchange rate changes on cash	—	—	0.4	—	0.4
Net change in cash and cash equivalents	(24.4)	1.0	1.8	—	(21.6)
Cash and cash equivalents at beginning of period	35.7	(3.2)	28.7	—	61.2
Cash and cash equivalents at end of period	$11.3	$(2.2)	$30.5	$—	$39.6

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Mueller Water Products, Inc. and Subsidiaries
Consolidating Statement of Cash Flows
Three Months Ended December 31, 2010

	Issuer	Guarantor companies	Non-guarantor companies (in millions)	Eliminations	Total
Operating activities:					
Net cash provided by (used in) operating activities	$2.5	$16.1	$(13.4)	$—	$5.2
Investing activities:					
Capital expenditures	(0.4)	(5.9)	(0.1)	—	(6.4)
Acquisitions	—	(7.9)	—		(7.9)
Proceeds from sales of assets	—	0.6	—	—	0.6
Net cash used in investing activities	(0.4)	(13.2)	(0.1)	—	(13.7)
Financing activities:					
Decrease in outstanding checks	—	(1.4)	—	—	(1.4)
Debt borrowings	0.2	—	—	—	0.2
Common stock issued	0.1	—	—	—	0.1
Payment of deferred financing fees	(0.3)	—	—	—	(0.3)
Dividends paid	(2.7)	—	—	—	(2.7)
Net cash used in financing activities	(2.7)	(1.4)	—	—	(4.1)
Effect of currency exchange rate changes on cash	—	—	0.8	—	0.8
Net change in cash and cash equivalents	(0.6)	1.5	(12.7)	—	(11.8)
Cash and cash equivalents at beginning of period	50.8	(1.9)	34.8	—	83.7
Cash and cash equivalents at end of period	$50.2	$(0.4)	$22.1	$—	$71.9

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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 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 general trends in residential housing construction, spending by municipalities on water infrastructure, raw material costs and our sales pricing. 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 following:

- the spending level for water and wastewater infrastructure;
- the level of manufacturing and construction activity;
- our ability to service our debt obligations; and
- the other factors that are described in the section entitled “RISK FACTORS” in Item 1A. of annual report on Form 10-K for the year ended September 30, 2011 ("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.

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

Business

Most of the net sales of Mueller Co. and U.S. Pipe are for water infrastructure related directly to municipal spending and residential construction activity in the United States. December single family housing starts were at their highest level since April 2010. Anvil sells primarily to non-residential construction businesses in the United States. Independent forecasts of non-residential construction activity indicate calendar 2012 will be similar to calendar 2011.

Spending on water infrastructure by municipalities is based on the condition of their infrastructure systems and their access to funding. Funding generally comes from their overall fiscal condition, the availability of additional capital from the issuance of debt, higher tax rates or increased water rates. Municipalities may find it challenging to increase tax or water rates.

We have experienced raw material cost increases in all segments, and we believe these cost increases may persist through 2012. Mueller Co. experienced a 2% increase in the average cost of brass ingot purchased and a 9% increase in the average cost per ton of scrap steel purchased in the first quarter of 2012 compared to the prior year period. U.S. Pipe's average scrap iron cost per ton purchased in the first quarter of 2012 was 17% higher compared to the prior year period.

We have increased sales prices to offset these cost increases, and we anticipate maintaining higher year-over-year prices in 2012. U.S. Pipe experienced a 11% increase in the average sales price per ton of ductile iron pipe in the first quarter of 2012 compared to the prior year period. Mueller Co. and Anvil net sales also benefited from sales price increases.

U.S. Pipe received a $37 million order from the Middle East during the 2011 fourth quarter. A portion of that order shipped during the fourth quarter of 2011 and the first quarter of 2012. We expect the remainder to ship in the second quarter of 2012.

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We announced on May 2, 2011 that our board of directors, after considering many factors, has authorized the exploration of a variety of alternatives for U.S. Pipe, including strategic alternatives such as divestiture, sale of a controlling interest, a joint venture with a third party or other financial or structural alternatives. We are making progress in this process, working very closely with our financial adviser, Bank of America Merrill Lynch. We have been particularly focused on a potential sale of the business and are actively engaged in this process. No decision has been made at this time to enter into any transaction and there can be no assurance that the exploration of alternatives will result in a transaction or as to the terms, conditions or timetable of any such transaction. Any eventual sale or other transaction involving U.S. Pipe is subject to the negotiation of a final agreement and a negotiated transaction price could be below the current carrying value of U.S. Pipe's net assets. Such a transaction could result in recognition of a material loss on the disposition of U.S. Pipe.

Results of Operations

Three Months Ended December 31, 2011 Compared to Three Months Ended December 31, 2010

	2011				
	Mueller Co.	U.S. Pipe	Anvil	Corporate	Total
	(in millions)				
Net sales	$128.1	$96.1	$87.3	$—	$311.5
Gross profit (loss)	$28.5	$(1.0			