

Mueller Water Products, Inc.
Form 10-Q
August 08, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the quarterly period ended June 30, 2018

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 (I.R.S. Employer
incorporation or organization) 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 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Yes No

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:

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

(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).

Yes No

There were 158,169,389 shares of common stock of the registrant outstanding at July 31, 2018.

PART I

Item 1. FINANCIAL STATEMENTS

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

	June 30, 2018	September 30, 2017
	(in millions, except share amounts)	
Assets:		
Cash and cash equivalents	\$331.5	\$361.7
Receivables, net	145.8	145.3
Inventories	156.1	138.9
Other current assets	20.2	24.4
Total current assets	653.6	670.3
Property, plant and equipment, net	129.0	122.3
Intangible assets	424.6	439.3
Other noncurrent assets	26.1	26.4
Total assets	\$1,233.3	\$1,258.3
Liabilities and equity:		
Current portion of long-term debt	\$0.8	\$5.6
Accounts payable	63.8	82.5
Other current liabilities	62.8	53.5
Total current liabilities	127.4	141.6
Long-term debt	444.5	475.0
Deferred income taxes	76.9	115.1
Other noncurrent liabilities	46.4	37.1
Total liabilities	695.2	768.8
Commitments and contingencies (Note 11)		
Common stock: 600,000,000 shares authorized; 158,126,171 and 158,590,383 shares outstanding at June 30, 2018 and September 30, 2017, respectively	1.6	1.6
Additional paid-in capital	1,461.1	1,494.2
Accumulated deficit	(875.0)	(955.6)
Accumulated other comprehensive loss	(50.9)	(51.8)
Total Company stockholders' equity	536.8	488.4
Noncontrolling interest	1.3	1.1
Total equity	538.1	489.5
Total liabilities and equity	\$1,233.3	\$1,258.3

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

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

	Three months ended June 30, 2018		Nine months ended June 30, 2017	
	2018	2017	2018	2017
	(in millions, except per share amounts)			
Net sales	\$250.2	\$232.2	\$661.7	\$599.1
Cost of sales	175.7	149.6	457.3	412.2
Gross profit	74.5	82.6	204.4	186.9
Operating expenses:				
Selling, general and administrative	41.3	38.4	123.8	113.4
Gain on sale of idle property	—	—	(9.0)	—
Strategic reorganization and other charges	2.6	1.2	8.4	5.0
Total operating expenses	43.9	39.6	123.2	118.4
Operating income	30.6	43.0	81.2	68.5
Pension costs other than service	0.2	0.4	0.7	1.1
Interest expense, net	5.3	5.1	15.7	17.0
Loss on early extinguishment of debt	6.2	—	6.2	—
Gain on settlement of interest rate swap contracts	(2.4)	—	(2.4)	—
Income before income taxes	21.3	37.5	61.0	50.4
Income tax expense (benefit)	6.0	13.4	(19.6)	16.2
Income from continuing operations	15.3	24.1	80.6	34.2
Income (loss) from discontinued operations	—	(0.1)	—	69.8
Net income	\$15.3	\$24.0	\$80.6	\$104.0
Income per basic share:				
Continuing operations	\$0.10	\$0.15	\$0.51	\$0.21
Discontinued operations	—	—	—	0.44
Net income	\$0.10	\$0.15	\$0.51	\$0.65
Income per diluted share:				
Continuing operations	\$0.10	\$0.15	\$0.51	\$0.21
Discontinued operations	—	—	—	0.43
Net income	\$0.10	\$0.15	\$0.51	\$0.64
Weighted average shares outstanding:				
Basic	158.1	159.1	158.3	160.6
Diluted	159.2	160.6	159.5	162.4
Dividends declared per share	\$0.05	\$0.04	\$0.14	\$0.11

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

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

	Three months ended June 30, 2018		Nine months ended June 30, 2017	
	2018	2017	2018	2017
	(in millions)			
Net income	\$ 15.3	\$ 24.0	\$ 80.6	\$ 104.0
Other comprehensive income (loss):				
Pension	0.8	1.0	2.4	3.0
Income tax effects	(0.2)	(0.4)	(0.7)	(1.2)
Foreign currency translation	(2.0)	1.2	(2.3)	0.7
Derivative fair value change	(1.6)	(0.7)	2.4	4.5
Income tax effects	0.5	0.3	(0.9)	(1.7)
	(2.5)	1.4	0.9	5.3
Comprehensive income	\$ 12.8	\$ 25.4	\$ 81.5	\$ 109.3

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

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MUELLER WATER PRODUCTS, INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENT OF EQUITY
 NINE MONTHS ENDED JUNE 30, 2018
 (UNAUDITED)

	Common stock	Additional paid-in capital	Accumulated deficit	Accumulated other comprehensive loss	Non-controlling interest	Total
	(in millions)					
Balance at September 30, 2017	\$ 1.6	\$ 1,494.2	\$ (955.6)	\$ (51.8)	\$ 1.1	\$ 489.5
Net income	—	—	80.6	—	0.2	80.8
Dividends declared	—	(22.2)	—	—	—	(22.2)
Stock repurchased under buyback program	—	(20.0)	—	—	—	(20.0)
Shares retained for employee taxes	—	(2.1)	—	—	—	(2.1)
Stock-based compensation	—	4.3	—	—	—	4.3
Common stock issued	—	6.9	—	—	—	6.9
Other comprehensive income, net of tax	—	—	—	0.9	—	0.9
Balance at June 30, 2018	\$ 1.6	\$ 1,461.1	\$ (875.0)	\$ (50.9)	\$ 1.3	\$ 538.1

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

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

	Nine months ended June 30, 2018 2017 (in millions)	
Operating activities:		
Net income	\$80.6	\$104.0
Less income from discontinued operations	—	69.8
Income from continuing operations	80.6	34.2
Adjustments to reconcile income from continuing operations to net cash provided by operating activities of continuing operations:		
Depreciation	15.3	14.9
Amortization	17.0	16.2
Loss on early extinguishment of debt	6.2	—
Stock-based compensation	4.3	3.5
Retirement plans	2.1	2.6
Deferred income taxes	(39.7)	(14.4)
Gain on sale of idle property	(9.0)	—
Other, net	4.5	1.4
Changes in assets and liabilities:		
Receivables	(0.6)	(5.8)
Inventories	(18.0)	(4.6)
Other assets	(3.5)	(4.0)
Liabilities	10.9	(18.6)
Net cash provided by operating activities of continuing operations	70.1	25.4
Investing activities:		
Business acquisition, net of cash acquired	—	(26.0)
Capital expenditures	(26.9)	(21.6)
Proceeds from sales of assets	7.4	0.2
Net cash used in investing activities of continuing operations	(19.5)	(47.4)
Financing activities:		
Dividends	(22.2)	(17.6)
Employee taxes related to stock-based compensation	(2.1)	(2.7)
Repayments of debt	(486.3)	(3.7)
Issuance of debt	450.0	—
Common stock issued	6.9	5.2
Debt issuance costs	(6.6)	(1.0)
Stock repurchased under buyback program	(20.0)	(55.0)
Other	0.2	0.2
Net cash used in financing activities of continuing operations	(80.1)	(74.6)
Net cash flows from discontinued operations:		
Operating activities	—	(42.5)
Investing activities	—	297.2
Financing activities	—	(0.1)
Net cash provided by discontinued operations	—	254.6
Effect of currency exchange rate changes on cash	(0.7)	0.2
Net change in cash and cash equivalents	(30.2)	158.2

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Cash and cash equivalents at beginning of period	361.7	195.0
Cash and cash equivalents at end of period	\$331.5	\$353.2

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

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MUELLER WATER PRODUCTS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
NINE MONTHS ENDED JUNE 30, 2018

Note 1. Organization

Mueller Water Products, Inc., a Delaware corporation, together with its consolidated subsidiaries, operates in two business segments: Infrastructure and Technologies. Infrastructure manufactures valves for water and gas systems, including butterfly, iron gate, tapping, check, knife, plug and ball valves, as well as dry-barrel and wet-barrel fire hydrants. Technologies offers metering systems, leak detection, pipe condition assessment and other related products and services. The “Company,” “we,” “us” or “our” refer to Mueller Water Products, Inc. and its subsidiaries. With regard to the Company’s segments, “we,” “us” or “our” may also refer to the segment being discussed.

On January 6, 2017, we sold our former Anvil segment. Amounts applicable to Anvil have been classified as discontinued operations.

Infrastructure owns a 49% ownership interest in an industrial valve joint venture. Due to substantive control features in the operating agreement, all of the joint venture’s assets, liabilities and results of operations are included in our consolidated financial statements. The net gain or loss attributable to noncontrolling interest is included in selling, general and administrative expenses. Noncontrolling interest is recorded at its carrying value, which approximates fair value.

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.

Our consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”), 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. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements included in our Annual Report on Form 10-K for the year ended September 30, 2017. 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, 2017 was derived from audited financial statements, but does not include all disclosures required by GAAP.

On February 15, 2017, we acquired Singer Valve, a manufacturer of automatic control valves, and its affiliate that distributes Singer Valve products in the U.S, for an ultimate aggregate cash purchase price of \$26.6 million.

On October 1, 2017, we adopted Financial Accounting Standards Board (“FASB”) Accounting Standards Update No. 2017-07, which requires us to exclude from operating income the components of net periodic benefit cost other than service cost. Accordingly, in the Condensed Consolidated Statement of Operations we have reclassified to pension costs other than service \$0.3 million and \$0.8 million from selling, general and administrative expenses and \$0.1 million and \$0.3 million from cost of sales for the three months and nine months ended June 30, 2017, respectively. HR-1, formerly referred to as the Tax Cuts and Jobs Act, was enacted on December 22, 2017 and made significant revisions to federal income tax laws, including lowering the corporate income tax rate to 21% from 35%, effective January 1, 2018. The effects of these revisions are discussed in Note 3.

In May 2014, the FASB issued new guidance for the recognition of revenue and the requirement for additional financial statement disclosures. We plan to adopt this guidance using the modified retrospective transition method beginning in the first quarter of fiscal 2019. We have completed our initial scoping and established a project team to evaluate revenue recognition practices for each revenue stream against the new requirements, to suggest changes to the terms of our sales contracts if warranted, and to design and implement processes to comply with the new requirements. The project team has completed a preliminary evaluation our sales contracts and we are designing process controls over ongoing compliance. At this time, we do not expect the new guidance to materially affect our stockholders’ equity, net sales or operating income.

On September 7, 2017, we announced a strategic reorganization plan designed to accelerate our product innovation and revenue growth. We have adopted a matrix management structure, where business teams have line and cross-functional responsibility for managing distinct product portfolios, and engineering, operations, sales and

marketing and other functions are centralized to better align with business needs and generate greater efficiencies. Costs and expenses in the nine months ended June 30, 2018 for this plan, included in strategic reorganization and other charges, were primarily personnel-related.

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Activity in accrued restructuring, reported as part of other current liabilities, is presented below.

	Nine months ended June 30, 2018 (in millions)
Beginning balance	\$ 3.3
Expense	4.4
Payments	(6.3)
Ending balance	\$ 1.4

Note 2. Discontinued Operations and Divestitures

On December 4, 2017, we sold an idle property in Burlington, New Jersey that had previously been a plant in our former U.S. Pipe segment and recorded a gain of \$9.0 million in our Corporate segment. We received \$7.4 million in cash, recorded net current assets of \$0.8 million and conveyed plant, property and equipment with a net carrying value of \$0.4 million, and the buyer assumed related environmental liabilities with a carrying value of \$1.2 million.

On January 6, 2017, we sold our former Anvil segment to affiliates of One Equity Partners. The final cash proceeds of this sale were \$305.7 million. The table below presents a summary of the operating results for the Anvil discontinued operations during the quarter and nine months ended June 30, 2017. These operating results do not reflect what they would have been had Anvil not been sold.

	Three months ended June 30, 2017 (in millions)	Nine months ended June 30, 2017 (in millions)
Net sales	\$—	\$ 83.1
Cost of sales	—	62.8
Gross profit	—	20.3
Operating expenses:		
Selling, general and administrative	0.1	17.0
Other charges	—	0.2
Total operating expenses	0.1	17.2
Income before income taxes	(0.1)	3.1
Income tax expense	—	1.2
	(0.1)	1.9
Gain on sale, net of tax	—	67.9
Income from discontinued operations	\$(0.1)	\$ 69.8

Note 3. Income Taxes

On December 22, 2017, HR-1, formerly referred to as the Tax Cuts and Jobs Act (“Act”), was enacted, which made significant revisions to federal income tax laws, including lowering the corporate income tax rate to 21% from 35% effective January 1, 2018, overhauling the taxation of income earned outside the United States and eliminating or limiting certain deductions.

Our deferred tax assets and liabilities are recorded at the enacted tax rates in effect when we expect to recognize the related tax expenses or benefits. The average of these rates varies slightly from year to year but historically has been

approximately 39%. With the legislation changing rates taking place in the quarter ended December 31, 2017, we remeasured our deferred tax items at an average rate of approximately 25% and recorded a provisional income tax benefit of \$42.6 million, which is subject to change, as we continue to analyze certain aspects of the Act and refine our calculations. We do not expect changes to this amount to be material.

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The Act also imposes a one-time transition tax on the undistributed, previously-untaxed, post-1986 foreign “earnings and profits” (as defined by the IRS) of certain U.S.-owned corporations. Determination of our transition tax liability requires us to calculate foreign earnings and profits going back to 1992 and then to assess our historical overall foreign loss position and the applicability of certain foreign tax credits. During the quarter ended March 31, 2018, we recorded a provisional estimated transition tax of \$7.5 million, excluding any state income tax impact, on approximately \$96.8 million of undistributed accumulated earnings and profits of foreign subsidiaries. The transition tax is payable over eight years beginning in fiscal year 2019. The undistributed accumulated earnings and profits are now considered previously taxed income and will no longer be subject to U.S. federal income taxes upon repatriation of the earnings in the form of dividends. The undistributed accumulated earnings and profits are considered permanently reinvested and, accordingly, no provision for deferred taxes on financial statement and tax differences, local withholdings or foreign exchange gains or losses have been provided. However, we could be subject to additional local withholding taxes upon repatriation of these earnings in the form of a dividend. We are continuing to gather and evaluate information related to the state income tax impact of the Act, including the state income tax impact of the transition tax. In addition to these state income tax related matters, the final transition tax calculation is also dependent on our balance sheet at September 30, 2018, and therefore is subject to change. We do not expect changes to this amount to be material.

In addition to the adoption items discussed above, the results of our operations include federal income tax expense on our current period earnings at a full-year blended rate of 24.5%, since the rate reduction in the Act is effective on January 1, 2018. The reconciliation between the U.S. federal statutory income tax rate and the effective tax rate is presented below.

	Three months ended		Nine months ended	
	June 30, 2018	2017	June 30, 2018	2017
U.S. federal statutory income tax rate	24.5 %	35.0 %	24.5 %	35.0 %
Adjustments to reconcile to the effective tax rate:				
State tax apportionment change	—	—	—	1.7
State income taxes, net of federal benefit	4.8	3.9	4.5	3.9
Excess tax benefits related to stock compensation	(0.2)	(0.2)	(1.2)	(4.6)
Domestic production activities deduction	(1.7)	(4.7)	(1.6)	(4.5)
Tax credits	(1.1)	(1.0)	(1.0)	(1.7)
Other	1.9	2.7	0.2	2.3
	28.2 %	35.7 %	25.4 %	32.1 %
Transition tax	—	—	12.3	—
Remeasurement of deferred taxes for change in rates	—	—	(69.8)	—
Effective income tax rate	28.2 %	35.7 %	(32.1)%	32.1 %

At June 30, 2018 and September 30, 2017, the gross liabilities for unrecognized income tax benefits were \$3.3 million and \$3.0 million, respectively.

Note 4. Borrowing Arrangements

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

	June 30, 2018	September 30, 2017
	(in millions)	
ABL Agreement	\$—	\$—
5.5% Senior Notes	450.0	—
Term Loan	—	484.8
Other	1.9	1.7
	451.9	486.5
Less deferred debt issuance costs	6.6	5.9

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Less current portion	0.8	5.6
Long-term debt	\$444.5	\$ 475.0

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ABL Agreement. At June 30, 2018, our asset-based lending agreement (“ABL Agreement”) consisted of a revolving credit facility for up to \$225 million of revolving credit borrowings, swing line loans and letters of credit. On July 19, 2018, we reduced this by \$50 million, to \$175.0 million. 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 125 to 150 basis points, or a base rate, as defined in the ABL Agreement, plus a margin ranging from 25 to 50 basis points. At June 30, 2018, the applicable rate was LIBOR plus 125 basis points.

The ABL Agreement terminates on July 13, 2021. We pay a commitment fee for any unused borrowing capacity under the ABL Agreement of 25 basis points per annum. Our obligations under the ABL Agreement are secured by a first-priority perfected lien on all of our U.S. receivables and inventories, certain cash and other supporting obligations. Borrowings are not subject to any financial maintenance covenants unless excess availability is less than the greater of \$17.5 million and 10% of the Loan Cap as defined in the ABL Agreement. Excess availability based on June 30, 2018 data, as reduced by outstanding letters of credit, swap contract balances and accrued fees and expenses of \$18.1 million, was \$112.0 million.

5.5% Senior Unsecured Notes. On June 12, 2018, we privately issued \$450.0 million of 5.5% Senior Unsecured Notes (“Notes”), which mature in June 2026 and bear interest at 5.5%, paid semi-annually. Substantially all of our U.S. Subsidiaries guarantee the Notes, which are subordinate to borrowings under the ABL. Based on quoted market prices, the outstanding Notes had a fair value of \$452.3 million at June 30, 2018.

An indenture securing the Notes (“Indenture”) contains customary covenants and events of default, including covenants that limit our ability to incur debt, pay dividends, and make investments. We believe we were compliant with these covenants at June 30, 2018 and expect to remain in compliance through June 30, 2019.

We may redeem some or all of the Notes at any time or from time to time prior to June 15, 2021 at certain “make-whole” redemption prices (as set forth in the Indenture) and on or after June 15, 2021 at specified redemption prices (as set forth in the Indenture). Additionally, we may redeem up to 40% of the aggregate principal amount of the Notes at any time or from time to time prior to June 15, 2021 with the net proceeds of specified equity offerings at specified redemption prices (as set forth in the Indenture). Upon a change of control (as defined in the Indenture), we will be required to make an offer to purchase the Notes at a price equal to 101% of the outstanding principal amount of the Notes.

Term Loan. On November 25, 2014, we entered into a \$500.0 million senior secured term loan (“Term Loan”), which accrued interest at a floating rate equal to LIBOR, subject to a floor of 0.75%, plus 250 basis points. The principal amount of the Term Loan was required to be repaid in quarterly installments of \$1.225 million, with any remaining principal due on November 25, 2021. We repaid the Term Loan on June 12, 2018 with the proceeds from the issuance of the Notes and cash on hand. We wrote-off the associated deferred debt issuance costs and unamortized original issue discount and recorded a loss on the early extinguishment of debt of \$6.2 million.

Note 5. Derivative Financial Instruments

Prior to the June 12, 2018 retirement of our Term Loan, we were exposed to interest rate risk that we managed to some extent using derivative instruments. We terminated these instruments in conjunction with the repayment of the Term Loan described in Note 4. Under our April 2015 interest rate swap contracts, we received interest calculated using 3-month LIBOR, subject to a floor of 0.75%, and paid fixed interest at 2.341%, on an aggregate notional amount of \$150.0 million. These swap contracts effectively fixed the cash interest rate on \$150.0 million of our borrowings under the Term Loan at 4.841% from September 30, 2016 through September 30, 2021.

Upon termination of the interest rate swaps, we reclassified all associated amounts from accumulated other comprehensive loss to earnings, which resulted in a cash gain of \$2.4 million in the quarter ended June 30, 2018. We had designated our interest rate swap contracts as cash flow hedges of our future interest payments and elected to apply the “shortcut” method of assessing hedge effectiveness. As a result, the gains and losses on the swap contracts had been reported as a component of other comprehensive loss and were reclassified into interest expense as the related interest payments were made. Excluding the settlement gain described above, we included \$0.0 million and \$0.5 million of such interest expense in income from continuing operations during the quarters ended June 30, 2018 and

June 30, 2017, respectively, and \$0.6 million and \$1.5 million during the nine months ended June 30, 2018 and June 30, 2017, respectively.

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In connection with the acquisition of Singer Valve, Mueller Water Products, Inc. loaned U.S. dollars to one of our Canadian subsidiaries. Although this intercompany loan has no direct effect on our consolidated financial statements, it creates exposure to currency risk for the Canadian subsidiary. To reduce this exposure, we entered into a U.S. dollar-Canadian dollar swap contract with the Canadian subsidiary and an offsetting Canadian dollar-U.S. dollar swap with a domestic bank. We have not designated these swaps as hedges and the changes in their fair value are included in earnings, where they offset the currency gains and losses associated with the intercompany loan.

The fair values of the swap contracts are presented below.

	June 30, 2018	September 30, 2017
Interest rate swap contracts, designated as cash flow hedges:		
Other current liabilities	\$—	\$ 1.2
Other noncurrent liabilities	—	1.3
	\$—	\$ 2.5

Currency swap contracts, not designated as hedges:

Other noncurrent liabilities	\$0.6	\$ 1.3
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The fair values of the interest rate swaps and the classification of the fair values between current and noncurrent portions were based on calculated cash flows using publicly available interest rate forward rate yield curve information.

The fair values of the currency swaps are as reported to us by the bank counterparty, which we believe to be a reliable source.

Note 6. Retirement Plans

The components of net periodic benefit cost for our pension plans are presented below.

	Three months ended June 30, 2018		Nine months ended June 30, 2017	
	2018	2017	2018	2017
Service cost	\$0.5	\$0.5	\$1.4	\$1.5
Pension costs other than service:				
Interest cost	3.5	3.6	10.7	10.8
Expected return on plan assets	(4.1)	(4.2)	(12.4)	(12.7)
Amortization of actuarial net loss	0.8	1.0	2.4	3.0
	0.2	0.4	0.7	1.1
Net periodic benefit cost	\$0.7	\$0.9	\$2.1	\$2.6

The amortization of actuarial losses, net of tax, is recorded as a component of other comprehensive loss.

Note 7. Stock-based Compensation Plans

We have granted various forms of stock-based compensation, including stock options, restricted stock units and both cash-settled and stock-settled performance-based restricted stock units (“PRSUs”) under our Amended and Restated 2006 Mueller Water Products, Inc. Stock Incentive Plan (the “2006 Stock Plan”).

A PRSU award represents a target number of units that may be paid out at the end of a multi-year award cycle consisting of a series of annual performance periods coinciding with our fiscal years. After we determine the financial performance targets related to PRSUs for a given performance period, typically during the first quarter of that fiscal year, we consider that portion of a PRSU award to be granted. Thus, each award consists of a grant in the year of award and grants in the designated following years. Settlement will range from zero to two times the number of PRSUs granted, depending on our financial performance against the targets. As determined at the date of award, PRSUs may settle in cash-value equivalent of, or directly in, shares of our common stock.

We awarded 171,288 stock-settled PRSUs in the nine months ended June 30, 2018 scheduled to settle in three years. We issued 146,061 shares and 263,410 shares of common stock during the nine months ended June 30, 2018 and 2017, respectively, to settle PRSUs.

In addition to the PRSU activity, 3,333 and 342,038 restricted stock units vested during the three and nine months ended June 30, 2018, respectively.

We have granted cash-settled Phantom Plan instruments under the Mueller Water Products, Inc. Phantom Plan (“Phantom Plan”). At June 30, 2018, the outstanding Phantom Plan instruments had a fair value of \$11.72 per instrument and our liability for Phantom Plan instruments was \$1.7 million.

We granted stock-based compensation awards under the 2006 Stock Plan, the Mueller Water Products, Inc. 2006 Employee Stock Purchase Plan and the Phantom Plan during the nine months ended June 30, 2018 as follows.

	Number granted	Weighted average grant date fair value per instrument	Total grant date fair value (in millions)
Quarter ended December 31, 2017:			
Restricted stock units	171,288	\$ 12.41	\$ 2.1
Employee stock purchase plan instruments	35,099	2.28	0.1
Phantom Plan awards	160,672	12.41	2.0
PRSUs: 2018 award	57,092	12.41	0.7
2017 award	71,070	12.41	0.9
2016 award	71,072	12.41	0.9
Quarter ended March 31, 2018:			
Restricted stock units	63,389	11.67	0.7
Employee stock purchase plan instruments	32,702	2.49	0.1
Phantom Plan awards	2,527	10.95	—
Quarter ended June 30, 2018:			
Employee stock purchase plan instruments	37,939	2.16	0.1
			\$ 7.6

Income from continuing operations included stock-based compensation expense of \$1.2 million and \$0.4 million during the three months ended June 30, 2018 and 2017, respectively, and \$5.3 million and \$5.1 million during the nine months ended June 30, 2018 and 2017, respectively. At June 30, 2018, there was approximately \$6.6 million of unrecognized compensation expense related to stock-based compensation arrangements, and 178,105 PRSUs that have been awarded for the 2019 and 2020 performance periods, for which performance goals have not been set. We excluded 213,599 and 165,186 of stock-based compensation instruments from the calculations of diluted earnings per share for the quarters ended June 30, 2018 and 2017, respectively, and 245,033 and 208,868 for the nine months ended June 30, 2018 and 2017, respectively, since their inclusion would have been antidilutive.

Note 8. Supplemental Balance Sheet Information

Selected supplemental balance sheet information is presented below.

	June 30, 2018	September 30, 2017
(in millions)		
Inventories:		
Purchased components and raw material	\$80.1	\$ 67.7
Work in process	38.6	35.6
Finished goods	37.4	35.6
	\$156.1	\$ 138.9
Other current assets:		
Maintenance and repair tooling	\$3.4	\$ 3.3
Income taxes	3.5	10.9
Other	13.3	10.2
	\$20.2	\$ 24.4
Property, plant and equipment:		
Land	\$5.4	\$ 5.6
Buildings	54.5	53.4
Machinery and equipment	289.7	266.7
Construction in progress	18.8	24.7
	368.4	350.4
Accumulated depreciation	(239.4)	(228.1)
	\$129.0	\$ 122.3
Other current liabilities:		
Compensation and benefits	\$29.4	\$ 26.9
Customer rebates	7.9	6.5
Taxes other than income taxes	3.6	3.2
Warranty	8.8	3.5
Income taxes	0.6	0.9
Environmental	1.2	1.3
Interest	1.8	0.6
Restructuring	1.4	3.3
Other	8.1	7.3
	\$62.8	\$ 53.5

Note 9. Segment Information

Summarized financial information for our segments is presented below.

	Three months ended June 30, 2018		Nine months ended June 30, 2017	
	2018	2017	2018	2017
	(in millions)			
Net sales, excluding intercompany:				
Infrastructure	\$224.1	\$207.6	\$595.3	\$535.5
Technologies	26.1	24.6	66.4	63.6
	\$250.2	\$232.2	\$661.7	\$599.1
Intercompany sales:				
Infrastructure	\$—	\$—	\$—	\$1.1
Technologies	—	—	—	—
	\$—	\$—	\$—	\$1.1
Operating income (loss):				
Infrastructure	\$57.0	\$53.0	\$130.0	\$113.6
Technologies	(16.1)	(1.6)	(24.7)	(17.5)
Corporate	(10.3)	(8.4)	(24.1)	(27.6)
	\$30.6	\$43.0	\$81.2	\$68.5
Depreciation and amortization:				
Infrastructure	\$9.2	\$8.9	\$27.7	\$27.0
Technologies	1.5	1.2	4.4	3.8
Corporate	0.1	0.1	0.2	0.3
	\$10.8	\$10.2	\$32.3	\$31.1
Strategic reorganization and other charges:				
Infrastructure	\$—	\$0.4	\$0.1	\$2.1
Technologies	—	—	0.1	0.1
Corporate	2.6	0.8	8.2	2.8
	\$2.6	\$1.2	\$8.4	\$5.0
Capital expenditures:				
Infrastructure	\$10.7	\$6.1	\$21.8	\$13.8
Technologies	2.0	1.3	5.0	7.6
Corporate	(0.2)	0.1	0.1	0.2
	\$12.5	\$7.5	\$26.9	\$21.6

The Technologies operating losses for the three and nine months ended June 30, 2018 included a warranty charge of \$14.1 million and for the nine months ended June 30, 2017 included a warranty charge of \$9.8 million, as described in Note 11.

Note 10. Accumulated Other Comprehensive Loss

Accumulated other comprehensive loss is presented below.

	Pension net of tax	Foreign currency translation	Derivative instruments, net of tax	Total
Balance at September 30, 2017	\$(47.0)	\$ (3.3)	\$ (1.5)	\$(51.8)
Current period other comprehensive income (loss)	1.7	(2.3)	1.5	0.9
Balance at June 30, 2018	\$(45.3)	\$ (5.6)	\$ —	\$(50.9)

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 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 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 businesses to a previous owner 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.

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.

The purchaser of U.S. Pipe has been identified as a “potentially responsible party” (“PRP”) under the Comprehensive Environmental Response, Compensation and Liability Act (“CERCLA”) in connection with a former manufacturing facility operated by U.S. Pipe that was in the vicinity of a proposed Superfund site located in North Birmingham, Alabama. Under the terms of the acquisition agreement relating to our sale of U.S. Pipe, we agreed to indemnify the purchaser for certain environmental liabilities, including those arising out of the former manufacturing site in North Birmingham. Accordingly, the purchaser tendered the matter to us for indemnification, which we accepted. Ultimate liability for the site will depend on many factors that have not yet been determined, including the determination of EPA’s remediation costs, the number and financial viability of the other PRPs (there are four other PRPs currently) and the determination of the final allocation of the costs among the PRPs. Accordingly, because the amount of such costs cannot be reasonably estimated at this time, no amounts had been accrued for this matter at June 30, 2018.

Walter Energy. Each member of the Walter Energy consolidated group, which included us through December 14, 2006, is jointly and 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. Accordingly, we could be liable in the event any such federal income tax 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.

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 an 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 tax returns, to file all such tax returns on our behalf and to determine the amount of our liability to (or entitlement to payment from) Walter Energy for such previous periods.

As described further below, the IRS is currently alleging that Walter Energy owes substantial amounts for prior taxable periods (specifically, 1983-1994, 2000-2002 and 2005). As a matter of law, we are jointly and severally liable for any final tax determination, which means we would be liable in the event Walter Energy is unable to pay any amounts owed.

In July 2015, Walter Energy filed a petition for reorganization under Chapter 11 of the U.S. Bankruptcy Code before the Bankruptcy Court for the Northern District of Alabama (“Chapter 11 Case”). During the pendency of the Chapter 11 Case, we monitored the proceeding to determine whether we could be liable for all or a portion of this federal income tax liability if it is incurred, and not discharged, for any period during which we were included in the Walter Energy consolidated group. On January 11, 2016, the IRS filed a proof of claim in the Chapter 11 Case, alleging that Walter Energy owes taxes, interest and penalties for the years 1983-1994, 2000-2002 and 2005 in an aggregate amount of \$554.3 million (\$229.1 million of which the IRS claims is entitled to priority status in the Chapter 11 Case). The IRS asserts that its claim is based on an alleged settlement of Walter Energy’s tax liability for the 1983-1995 taxable periods in connection with Walter Energy’s prior bankruptcy proceeding in the United States Bankruptcy Court for the Middle District of Florida. In the proof of claim, the IRS included an alternative calculation in the event the alleged settlement of the prior bankruptcy court is found to be non-binding, which provides for a claim by the IRS in an aggregate amount of \$860.4 million (\$535.3 million of which the IRS claims is entitled to priority status in the Chapter 11 Case).

According to a quarterly report on Form 10-Q filed by Walter Energy with the SEC on November 5, 2015 (“Walter November 2015 Filing”), at September 30, 2015, Walter Energy had \$33.0 million of accruals for unrecognized tax benefits in connection with the matters subject to the IRS claims. In the Walter November 2015 Filing, Walter Energy stated it believed it had sufficient accruals to address any claims, including interest and penalties, and did not believe that any potential difference between any final settlements and amounts accrued would have a material effect on Walter Energy’s financial position, but such potential difference could be material to its results of operations in a future reporting period.

According to a Form 8-K filed by Walter Energy with the SEC on April 1, 2016 (“Walter April 2016 Filing”), on March 31, 2016, Walter Energy closed on the sale of substantially all of Walter Energy’s Alabama assets pursuant to the provisions of Sections 105, 363 and 365 of the Bankruptcy Code. The Walter April 2016 Filing further stated that Walter Energy would have no further material business operations after April 1, 2016 and Walter Energy was evaluating its options with respect to the wind down of its remaining assets. The asset sale did not impact the IRS’ proof of claim filed in the bankruptcy cases and the proof of claim, as well as the alleged tax liability thereunder, remain unresolved.

On February 2, 2017, at the request of Walter Energy, the Bankruptcy Court for the Northern District of Alabama signed an order converting the Chapter 11 Case to a liquidation proceeding under Chapter 7 of the U.S. Bankruptcy Code, pursuant to which Walter Energy will be wound-down and liquidated (“Chapter 7 Case”). In its objection contesting such conversion, the IRS indicated its intent to pursue collection of amounts included in the Proof of Claim from former members of the Walter Energy consolidated group.

We have been working constructively with the parties involved in this matter in an effort to reach a consensual resolution with respect to the alleged tax liabilities at issue. Based on our work to date, we believe that once certain taxpayer refunds (applicable primarily to years 1997, and 2006 through 2015) are applied against asserted income tax liabilities owing for other years, the total net tax liabilities of Walter Energy, if any, will be substantially less than those asserted by the IRS in its earlier filed proofs of claims. However, until our work with the parties involved in this matter develops further, we cannot predict the amount of, or the extent to which we will be responsible for, any such liabilities. Such liabilities could have a material adverse effect on our business, financial condition, liquidity or results of operations. Furthermore, there can be no assurance that we will be able to reach any resolution with the parties involved in this matter and, in such event, we would intend to vigorously assert any and all available defenses against any liabilities we may have as a member of the Walter Energy consolidated group.

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 divestitures of U.S. Pipe and Anvil, 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. Certain Technologies radio products produced prior to 2017 and installed in particularly harsh environments have been failing at higher-than-expected rates. During the quarter ended March 31, 2017 we conducted additional testing of these products and revised our estimates of related warranty expenses. As a result, we recorded an additional warranty expense of \$9.8 million associated with these products in the second quarter of 2017.

We monitor and analyze our warranty experience and costs periodically and may revise our warranty reserves as necessary. Critical factors in our reserve analyses include warranty terms, specific claim situations, general incurred and projected failure rates, the nature of product failures, product and labor costs, and general business conditions. During the quarter ended June 30, 2018, we completed such an analysis and determined, based on this new information, that certain Technologies products have been failing at higher-than-expected rates as well, and that the average cost to repair or replace certain products under warranty was higher than previously estimated. As a result, in the third quarter of 2018, we recorded an additional warranty expense of \$14.1 million associated with such products. We are party to a number of 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 12. Subsequent Events

On July 19, 2018, we voluntarily reduced the capacity of our ABL Agreement by \$50 million, to \$175.0 million. This reduction had no effect on our excess availability.

On July 26, 2018, our board of directors declared a dividend of \$0.05 per share on our common stock, payable on or about August 20, 2018 to stockholders of record at the close of business on August 10, 2018.

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 we intend, expect, plan, project, believe or anticipate will or may occur in the future are forward-looking statements. Forward-looking statements are based on certain assumptions and assessments made by us in light of our experience and 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 described under the section entitled "RISK FACTORS" in Item 1A. of our annual report on Form 10-K for the year ended September 30, 2017 ("Annual Report") and of our quarterly report on Form 10-Q for the quarter ended December 31, 2017 ("Quarterly Report"). Undue reliance should not be placed on any forward-looking statements. We do not have any intention or obligation to update forward-looking statements, except as required by law.

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, Infrastructure and Technologies, based largely on the products sold and the customers served.

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 common stock and in December 2006, Walter Energy distributed to its shareholders all of its equity interests in the Company, completing our spin-off.

On January 6, 2017, we sold our former Anvil segment. Amounts applicable to Anvil have been classified as discontinued operations.

Business

We expect our two primary end markets, repair and replacement of water infrastructure driven by municipal spending and new water infrastructure installation driven by residential construction, to grow in 2018. We expect the residential construction market to grow faster than municipal spending.

Infrastructure

We estimate approximately 60% of Infrastructure's 2017 net sales were for repair and replacement directly related to municipal water infrastructure spending, approximately 30% were related to residential construction activity and approximately 10% were related to natural gas utility spending.

On February 15, 2017, we acquired Singer Valve, a manufacturer of automatic control valves, and its affiliate that distributes Singer Valve products in the U.S. for an ultimate aggregate cash purchase price of \$26.6 million.

Technologies

The municipal market is the key end market for Technologies. These businesses are project-oriented and depend on customer adoption of their technology-based products and services. Mueller Systems continues to focus on the AMI segment of the market and AMI backlog was higher at June 30, 2018 than at June 30, 2017. Echologics had a greater number of projects under contract at June 30, 2018 than at June 30, 2017.

Results of Operations

Three Months Ended June 30, 2018 Compared to Three Months Ended June 30, 2017

	Three months ended June 30, 2018			
	Infrastru	Technologies	Corporate	Total
	(in millions)			
Net sales	\$224.1	\$ 26.1	\$ —	\$250.2
Gross profit (loss)	\$83.4	\$ (8.9	) \$ —	\$74.5
Operating expenses:				
Selling, general and administrative	26.4	7.2	7.7	41.3
Strategic reorganization and other charges	—	—	2.6	2.6
	26.4	7.2	10.3	43.9
Operating income (loss)	\$57.0	\$ (16.1	) \$ (10.3	) 30.6
Pension costs other than service				0.2
Interest expense, net				5.3
Loss on early extinguishment of debt				6.2
Gain on settlement of interest rate swap contracts				(2.4)
Income before income taxes				21.3
Income tax expense				6.0
Net income				\$15.3

	Three months ended June 30, 2017			
	Infrastru	Technologies	Corporate	Total
	(in millions)			
Net sales	\$207.6	\$ 24.6	\$ —	\$232.2
Gross profit	\$77.0	\$ 5.6	\$ —	\$82.6
Operating expenses:				
Selling, general and administrative	23.6	7.2	7.6	38.4
Other charges	0.4	—	0.8	1.2
	24.0	7.2	8.4	39.6
Operating income (loss)	\$53.0	\$ (1.6	) \$ (8.4	) 43.0
Pension costs other than service				0.4
Interest expense, net				5.1
Income before income taxes				37.5
Income tax expense				13.4
Income from continuing operations				24.1
Loss from discontinued operations				(0.1)
Net income				\$24.0

Consolidated Analysis

Net sales for the quarter ended June 30, 2018 increased \$18.0 million to \$250.2 million from \$232.2 million due primarily to higher shipment volumes in both segments and higher pricing.

Gross profit for the quarter ended June 30, 2018 declined \$8.1 million to \$74.5 million from \$82.6 million in the prior year period primarily due to the \$14.1 million warranty charge recorded at Technologies and higher costs associated with inflation and unexpected equipment downtime and repair, partially offset by higher pricing and shipment volumes. Gross profit margin declined to 29.8% for the quarter ended June 30, 2018 compared to 35.6% in the prior year period.

Selling, general and administrative expenses (“SG&A”) for the quarter ended June 30, 2018 increased to \$41.3 million from \$38.4 million in the prior year period due primarily to timing of personnel-related expenses. SG&A as a percentage of net sales was 16.5% in each of the quarters ended June 30, 2018 and 2017.

Net interest expense increased \$0.2 million in the quarter ended June 30, 2018 compared to the prior year period. The components of net interest expense are provided below.

	Three months ended June 30, 2018 2017 (in millions)	
Term Loan	\$4.5	\$4.5
5.5% Senior Notes	1.3	—
Interest rate swap contracts	—	0.4
Deferred financing costs amortization	0.4	0.5
ABL Agreement	0.2	0.2
Other interest expense	0.1	0.1
	6.5	5.7
Interest income	(1.2)	(0.6)
	\$5.3	\$5.1

On December 22, 2017, tax legislation was enacted that made significant revisions to federal income tax laws, including lowering the corporate income tax rate to 21% from 35%, overhauling the taxation of income earned outside the United States and eliminating or limiting certain deductions. Since the effective date of the tax rate change was January 1, 2018, we are subject to a blended federal statutory tax rate of 24.5% throughout fiscal 2018.

For the quarter ended June 30, 2018, we reported income tax expense of \$6.0 million or 28.2% of income before income taxes. The reconciliation between the U.S. federal statutory income tax rate and the effective tax rate is presented below.

	Three months ended June 30, 2018 2017	
U.S. federal statutory income tax rate	24.5 %	35.0 %
Adjustments to reconcile to the effective tax rate:		
State income taxes, net of federal benefit	4.8	3.9
Excess tax benefits related to stock compensation	(0.2)	(0.2)
Domestic production activities deduction	(1.7)	(4.7)
Tax credits	(1.1)	(1.0)
Other	1.9	2.7
Effective income tax rate	28.2 %	35.7 %

Segment Analysis

Infrastructure

Net sales for the quarter ended June 30, 2018 increased 7.9% to \$224.1 million compared to \$207.6 million in the prior year period, primarily due to higher shipment volumes and pricing.

Gross profit for the quarter ended June 30, 2018 increased to \$83.4 million from \$77.0 million in the prior year period due to higher pricing and higher shipment volumes, which were partially offset by higher costs associated with inflation and unexpected equipment downtime and repairs. Gross profit margin increased to 37.2% for the quarter ended June 30, 2018 compared to 37.1% in the prior year period.

SG&A for the quarter ended June 30, 2018 increased to \$26.4 million from \$23.6 million in the prior year period. SG&A was 11.8% and 11.4% of net sales for the quarters ended June 30, 2018 and 2017, respectively. These increases in SG&A were primarily due to timing of certain personnel-related expenses.

Technologies

Net sales in the quarter ended June 30, 2018 increased to \$26.1 million from \$24.6 million in the prior year period primarily due to higher Mueller Systems shipment volumes and increased leak detection sales.

Gross loss in the quarter ended June 30, 2018 was \$8.9 million compared to gross profit of \$5.6 million in the prior year period. Gross loss margin was 34.1% in the quarter ended June 30, 2018 and was a profit of 22.8% in the prior year period. Excluding a warranty charge of \$14.1 million in the current quarter, gross profit would have been \$5.2 million and gross profit margin would have been 19.9%. In addition to the warranty charge at Mueller Systems, unexpected equipment downtime and repair costs at Mueller Systems and higher material costs in both Mueller Systems and Echologics negatively impacted current quarter gross loss and gross loss margin.

SG&A was \$7.2 million in both the quarter ended June 30, 2018 and the prior year period. SG&A decreased to 27.6% of net sales for the quarter ended June 30, 2018 from 29.3% of net sales in the prior year period.

Corporate

SG&A was \$7.7 million in the quarter ended June 30, 2018 and \$7.6 million in the prior year period.

Nine Months Ended June 30, 2018 Compared to Nine Months Ended June 30, 2017

	Nine months ended June 30, 2018			
	Infrastructure	Technologies	Corporate	Total
	(in millions)			
Net sales	\$595.3	\$ 66.4	\$ —	\$661.7
Gross profit (loss)	\$207.3	\$ (2.9	) \$ —	\$204.4
Operating expenses:				
Selling, general and administrative	77.2	21.7	24.9	123.8
Gain on sale of idle property	—	—	(9.0	) (9.0
Strategic reorganization and other charges	0.1	0.1	8.2	8.4
	77.3	21.8	24.1	123.2
Operating income (loss)	\$130.0	\$ (24.7	) \$ (24.1	) 81.2
Pension costs other than service				0.7
Interest expense, net				15.7
Loss on early extinguishment of debt				6.2
Gain on settlement of interest rate swap contracts				(2.4
Income before income taxes				61.0
Income tax benefit				(19.6
Net income				\$80.6

	Nine months ended June 30, 2017			
	Infrastructure	Technologies	Corporate	Total
	(in millions)			
Net sales	\$535.5	\$ 63.6	\$ —	\$599.1
Gross profit	\$183.6	\$ 3.3	\$ —	\$186.9
Operating expenses:				
Selling, general and administrative	67.9	20.7	24.8	113.4
Other charges	2.1	0.1	2.8	5.0
	70.0	20.8	27.6	118.4
Operating income (loss)	\$113.6	\$ (17.5	) \$ (27.6	) 68.5
Pension costs other than service				1.1
Interest expense, net				17.0
Income before income taxes				50.4
Income tax expense				16.2
Income from continuing operations				\$34.2

Consolidated Analysis

Net sales for the nine months ended June 30, 2018 increased \$62.6 million, or 10.4%, to \$661.7 million from \$599.1 million due primarily to increased shipment volumes, including the addition of Singer Valve, and improved pricing at Infrastructure, as well as volume increases at Technologies.

Gross profit for the nine months ended June 30, 2018 increased \$17.5 million to \$204.4 million from \$186.9 million in the prior year period primarily due to increased shipment volumes at Infrastructure, the prior period's \$9.8 million warranty charge at Technologies, as well as higher pricing and cost productivity improvements at Infrastructure.

These were partially offset by the current period warranty charge of \$14.1 million and increased material costs. Gross profit margin declined to 30.9% for the nine months ended June 30, 2018 compared to 31.2% in the prior year period due primarily to increased volumes and the net effects of the warranty charges.

SG&A for the nine months ended June 30, 2018 increased to \$123.8 million from \$113.4 million in the prior year period due primarily to higher personnel-related expenses and additional SG&A from Singer Valve. SG&A as a percentage of net sales was 18.7% in the nine months ended June 30, 2018 and 18.9% in the prior year period.

Net interest expense declined \$1.3 million in the nine months ended June 30, 2018 compared to the prior year period. The components of net interest expense are provided below.

	Nine months ended June 30, 2018 2017 (in millions)	
Term Loan	\$ 14.4	\$ 14.3
5.5% Senior Notes	1.3	—
Interest rate swap contracts	0.6	1.5
Deferred financing costs amortization	1.3	1.3
ABL Agreement	0.6	0.6
Other interest expense	0.4	0.5
	18.6	18.2
Interest income	(2.9)	(1.2)
	\$ 15.7	\$ 17.0

On December 22, 2017, tax legislation was enacted that made significant revisions to federal income tax laws, including lowering the corporate income tax rate to 21% from 35%, overhauling the taxation of income earned outside the United States and eliminating or limiting certain deductions. Since the effective date of the tax rate change was January 1, 2018, we are subject to a blended federal statutory tax rate of 24.5% throughout fiscal 2018.

For the nine months ended June 30, 2018, we reported a net income tax benefit of \$19.6 million, which was driven by a provisional net benefit of \$35.1 million associated with adoption of the new tax legislation. This includes a \$42.6 million provisional benefit recorded in our first quarter related to remeasurement of our net deferred income tax liabilities using the enacted tax rates in effect when we expect to recognize the related tax expenses or benefits, partially offset by a \$7.5 million provisional expense for the transition tax. Other than these effects, income tax expense was \$15.5 million, or 25.4% of income before income taxes for the nine months ended June 30, 2018. For the nine months ended June 30, 2017, income tax expense was 32.1% of income before income taxes. The reconciliation between the U.S. federal statutory income tax rate and the effective tax rate is presented below.

	Nine months ended June 30, 2018 2017	
U.S. federal statutory income tax rate	24.5 %	35.0 %
Adjustments to reconcile to the effective tax rate:		
State tax apportionment change	—	1.7
State income taxes, net of federal benefit	4.5	3.9
Excess tax benefits related to stock compensation	(1.2)	(4.6)
Domestic production activities deduction	(1.6)	(4.5)
Tax credits	(1.0)	(1.7)
Other	0.2	2.3
	25.4 %	32.1 %
Transition tax	12.3	—
Remeasurement of deferred taxes for change in rates	(69.8)	—
Effective income tax rate	(32.1)%	32.1 %

Segment Analysis

Infrastructure

Net sales for the nine months ended June 30, 2018 increased 11.2% to \$595.3 million compared to \$535.5 million in the prior year period due primarily to increased shipment volumes, including the addition of Singer Valve, and higher pricing.

Gross profit for the nine months ended June 30, 2018 increased to \$207.3 million from \$183.6 million in the prior year period due to increased shipment volumes, higher pricing and cost savings due to productivity improvements, which were partially offset by higher costs associated with inflation and unexpected equipment downtime and repairs. Gross profit margin increased to 34.8% for the nine months ended June 30, 2018 compared to 34.3% in the prior year period. SG&A for the nine months ended June 30, 2018 increased to \$77.2 million from \$67.9 million in the prior year period due to increased personnel-related expenses and additional SG&A from Singer Valve. SG&A was 13.0% and 12.7% of net sales for the nine months ended June 30, 2018 and 2017, respectively.

Technologies

Net sales in the nine months ended June 30, 2018 increased 4.4% to \$66.4 million from \$63.6 million in the prior year period primarily due to higher leak detection sales partially offset by lower Mueller Systems shipment volumes.

Gross loss in the nine months ended June 30, 2018 was \$2.9 million and gross profit was \$3.3 million in the prior year period. This decrease was primarily due to the net effect of the warranty charges discussed above and current period increases in material costs.

SG&A was \$21.7 million in the nine months ended June 30, 2018 compared to \$20.7 million in the prior year period. SG&A was 32.7% of net sales for the nine months ended June 30, 2018 and 32.5% of net sales in the prior year period.

Corporate

SG&A was \$24.9 million in the nine months ended June 30, 2018 compared to \$24.8 million in the prior year period.

Liquidity and Capital Resources

We had cash and cash equivalents of \$331.5 million at June 30, 2018 and \$112.0 million of additional borrowing capacity under our ABL Agreement based on June 30, 2018 data, which, along with cash generated by operations, would be our source of incremental liquidity. Undistributed earnings from our subsidiaries in Canada and China are considered to be permanently invested outside the United States. At June 30, 2018, cash and cash equivalents included \$10.4 million and \$6.9 million in Canada and China, respectively.

We expect the recently enacted tax law changes to benefit our liquidity through reduction in overall income tax liability and through provisions allowing immediate deductibility for capital assets placed in service in the next five years. This benefit will be partially offset by payment of the transition tax discussed above. However, the transition tax is payable over eight years beginning in 2019 and we do not expect any payments to have a material effect on our liquidity in any particular year.

We repurchased shares of our common stock for \$20 million during the nine months ended June 30, 2018, and we had \$170 million remaining on our share repurchase authorization at that date.

The ABL Agreement and Notes contain customary representations and warranties, covenants and provisions governing an event of default. The covenants restrict our ability to engage in certain specified activities, including but not limited to the payment of dividends and the redemption of our common stock.

Cash flows from operating activities of continuing operations are categorized below.

	Nine months ended June 30, 2018 2017 (in millions)	
Collections from customers	\$660.5	\$593.4
Disbursements, other than interest and income taxes	(576.2)	(529.1)
Interest payments, net	(10.2)	(15.0)
Income tax payments, net	(4.0)	(23.9)
Cash provided by (used in) operating activities	\$70.1	\$25.4

Collections from customers were higher during the nine months ended June 30, 2018 compared to the prior year period primarily due to net sales growth.

Increased disbursements, other than interest and income taxes, during the nine months ended June 30, 2018 reflect higher purchasing activity and higher costs for raw materials and purchased products.

Income tax payments were lower during the nine months ended June 30, 2018 compared to the prior year period because we began the current year with prepaid U.S. federal income taxes.

Capital expenditures were \$26.9 million in the nine months ended June 30, 2018 compared to \$21.6 million in the prior year period. We estimate 2018 capital expenditures will be between \$52 million and \$58 million. We are investing in our Chattanooga facility to expand domestic manufacturing capabilities and introduce additive manufacturing technologies to our foundries.

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, income tax payments, capital expenditures and debt service obligations as they become due through June 30, 2019. 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 June 30, 2018, 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. On July 19, 2018, we reduced this capacity to \$175 million. 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 125 to 150 basis points, or a base rate, as defined in the ABL Agreement, plus a margin ranging from 25 to 50 basis points. At June 30, 2018, the applicable LIBOR-based margin was 125 basis points.

The ABL Agreement terminates on July 13, 2021. We pay a commitment fee for any unused borrowing capacity under the ABL Agreement of 25 basis points per annum.

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) 70% of the value of eligible inventories or (ii) 85% of the net orderly liquidation value of the value of eligible inventories, 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. inventories, 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 \$17.5 million and 10% of the Loan Cap under the ABL Agreement.

5.5% Senior Unsecured Notes

On June 12, 2018, we issued \$450.0 million of 5.5% Senior Unsecured Notes (“Notes”), which mature in June 2026 and bear interest at 5.5%, paid semi-annually. Substantially all of our U.S. Subsidiaries guarantee the Notes, which are subordinate to borrowings under the ABL. Based on quoted market prices, the outstanding Notes had a fair value of \$452.3 million at June 30, 2018.

An indenture securing the Notes (“Indenture”) contains customary covenants and events of default, including covenants that limit our ability to incur debt, pay dividends, and make investments. We believe we were compliant with these covenants at June 30, 2018 and expect to remain in compliance through June 30, 2019.

We may redeem some or all of the Notes at any time or from time to time prior to June 15, 2021 at certain “make-whole” redemption prices (as set forth in the Indenture) and on or after June 15, 2021 at specified redemption prices (as set forth in the Indenture). Additionally, we may redeem up to 40% of the aggregate principal amount of the Notes at any time or from time to time prior to June 15, 2021 with the net proceeds of specified equity offerings at specified redemption prices (as set forth in the Indenture). Upon a change of control (as defined in the Indenture), we will be required to make an offer to purchase the Notes at a price equal to 101% of the outstanding principal amount of the Notes.

Term Loan

We had \$483.9 million face value outstanding under the Term Loan, which we repaid on June 12, 2018 with the proceeds from the issuance of the Notes and cash on hand.

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

	Moody's		Standard & Poor's	
	June 30, 2018	September 30, 2017	June 30, 2018	September 30, 2017
Corporate credit rating	Ba2	Ba3	BB	BB-
ABL Agreement	Not rated	Not rated	Not rated	Not rated
Notes	Ba3	N/A	BB	N/A
Term Loan	N/A	Ba3	N/A	BB
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, at June 30, 2018 we did not have any undisclosed borrowings, debt, derivative contracts or synthetic leases. Therefore, we were 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 June 30, 2018, we had \$17.3 million of letters of credit and \$33.8 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 June 30, 2018, 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 11. 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 and our Quarterly Reports, 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 June 30, 2018, we repurchased shares of our common stock consisting of shares surrendered to us to pay the tax withholding obligations of participants in connection with the lapsing of restrictions on restricted stock units, as follows.

Period	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publically announced plans or programs	Maximum dollar value of shares that may yet be purchased under the plans or programs (in millions)
April 1-30, 2018	—	\$ —	—	\$ 170.0
May 1-31, 2018	1,140	11.75	—	170.0
June 1-30, 2018	—	—	—	170.0
Total	1,140	\$ 11.75	—	

In 2015, we announced the authorization of a stock repurchase program for up to \$50 million of our common stock. The program does not commit us to any particular timing or quantity of purchases, and we may suspend or discontinue the program at any time. In 2017, we announced an increase in the authorization of the program to \$250 million. At June 30, 2018, we had remaining authorization of \$170.0 million to repurchase shares of our common stock.

Item 6. EXHIBITS

Exhibit No. Document

4.3*	<u>Indenture, dated June 15, 2018 among Mueller Water Products, Inc., the guarantors named on the signature pages thereto and Wells Fargo Bank, N.A. as trustee (including form of global notes).</u>
31.1*	<u>Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>
31.2*	<u>Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>
32.1*	<u>Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
32.2*	<u>Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
101*	The following financial information from the Quarterly Report on Form 10-Q for the quarter ended June 30, 2018, formatted in XBRL (Extensible Business Reporting Language), (i) <u>the Condensed Consolidated Balance Sheets</u> , (ii) <u>the Condensed Consolidated Statements of Operations</u> , (iii) <u>the Condensed Consolidated Statements of Other Comprehensive Loss</u> , (iv) <u>the Condensed Consolidated Statements of Stockholders' Equity</u> , (v) <u>the Condensed Consolidated Statements of Cash Flows</u> , and (vi) <u>the Notes to Condensed Consolidated Financial Statements</u> .

* Filed with this quarterly report

** Management compensatory plan, contract, or arrangement

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: August 8, 2018 By: /s/ Michael S. Nancarrow
Michael S. Nancarrow
Chief Accounting Officer