PENTAIR LTD
Form 10-K/A
February 28, 2013

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K/A

Amendment No. 1

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

For the Fiscal Year Ended December 31, 2012

OR

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

Commission file number 001-11625

Pentair Ltd.

(Exact name of Registrant as specified in its charter)

Switzerland	**98-1050812**
(State or other jurisdiction of	*(I.R.S. Employer*
incorporation or organization)	*Identification number)*

Freier Platz 10, 8200 Schaffhausen, Switzerland
(Address of principal executive offices)
Registrant s telephone number, including area code: 41-52-630-48-00

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Shares, CHF 0.50 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes þ No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No þ

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 þ No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, 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 to post such files). Yes þ No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in PART III of this Form 10-K or any amendment to this Form 10-K. ¨

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

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

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

Aggregate market value of voting and non-voting common equity held by non-affiliates of the Registrant, based on the closing price of $38.28 per share as reported on the New York Stock Exchange on June 29, 2012 (the last business day of Registrant s most recently completed second quarter): $3,624,092,524

The number of shares outstanding of Registrant s only class of common stock on December 31, 2012 was 206,137,460.

DOCUMENTS INCORPORATED BY REFERENCE

Parts of the Registrant s definitive proxy statement for its annual meeting to be held on April 29, 2013, are incorporated by reference in this Form 10-K in response to Part III, ITEM 10, 11, 12, 13 and 14.

EXPLANATORY NOTE

The sole purpose of this Amendment No. 1 on Form 10-K/A (Form 10-K/A) to the Annual Report on Form 10-K of Pentair Ltd. for the year ended December 31, 2012, originally filed with the Securities and Exchange Commission on February 26, 2013 (Form 10-K), is to amend Item 8 of the Form 10-K to revise the Reports of Independent Registered Public Accounting Firm on pages 56 and 57 to include the name and signatures of Deloitte & Touche LLP, which were inadvertently omitted when the Form 10-K was originally filed.

Except as described above, no other changes have been made to the Form 10-K. This Form 10-K/A has not been updated for events occurring after the filing of the Form 10-K and no attempt has been made in this Form 10-K/A to modify or update other disclosures as presented in the original filing of the Form 10-K.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA
MANAGEMENT S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management of Pentair Ltd. and its subsidiaries (the Company) is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) of the Securities Exchange Act of 1934. The Company s internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. The Company s internal control over financial reporting includes those policies and procedures that (1) pertain to maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of the financial statements in accordance with generally accepted accounting principles and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of the effectiveness of internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of the Company s internal control over financial reporting as of December 31, 2012. In making this assessment, management used the criteria for effective internal control over financial reporting described in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management believes that, as of December 31, 2012, the Company s internal control over financial reporting was effective based on those criteria.

Management has excluded from its assessment the internal control over financial reporting at Tyco Flow Control International Ltd. (Flow Control), which we merged with on September 28, 2012 and whose financial statements constitute 60 percent of total assets and 20 percent of total revenues in the consolidated financial statements as of and for the year ended December 31, 2012.

Our independent registered public accounting firm, Deloitte & Touche LLP, has issued an attestation report on the Company s internal control over financial reporting as of December 31, 2012. That attestation report is set forth immediately following this management report.

Randall J. Hogan
Chairman and Chief Executive Officer

John L. Stauch
Executive Vice President and Chief Financial Officer

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of Pentair Ltd.

We have audited the internal control over financial reporting of Pentair Ltd. and subsidiaries (the Company) as of December 31, 2012, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management s Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company s internal control over financial reporting based on our audit. As described in Management s Report on Internal Control over Financial Reporting, management excluded from its assessment the internal control over financial reporting at Tyco Flow Control International Ltd. (Flow Control), which was acquired on September 28, 2012 and whose financial statements constitute 60 percent of total assets and 20 percent of total revenues on the consolidated financial statements as of and for the year ended December 31, 2012. Accordingly, our audit did not include the internal control over financial reporting at Flow Control.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed by, or under the supervision of, the company s principal executive and principal financial officers, or persons performing similar functions, and effected by the company s board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2012, based on the criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements and financial statement schedule listed in the Index at Item 15 as of and for the year ended December 31, 2012 of the Company and our report dated February 26, 2013 expressed an unqualified opinion on those financial statements and included an explanatory paragraph regarding changes in certain of the Company s methods of accounting for defined benefit pension and other postretirement benefit costs.

Minneapolis, Minnesota

February 26, 2013

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of Pentair Ltd.

We have audited the accompanying consolidated balance sheets of Pentair Ltd. and subsidiaries (the Company) as of December 31, 2012 and 2011, and the related consolidated statements of operations and comprehensive income (loss), changes in equity, and cash flows for each of the three years in the period ended December 31, 2012. Our audits also included the financial statement schedule listed in the Index at Item 15. These financial statements and financial statement schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Pentair Ltd. and subsidiaries at December 31, 2012 and 2011, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2012, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

As discussed in Note 3 to the consolidated financial statements, the Company has elected to change its method of accounting for defined benefit pension and other post-retirement benefit plan costs in 2012. Such changes are reflected in the accompanying consolidated balance sheet as of December 31, 2012 and 2011, and the related consolidated statements of operations and comprehensive income (loss), changes in equity and cash flows for each of the three years in the period ended December 31, 2012.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company s internal control over financial reporting as of December 31, 2012, based on the criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 26, 2013 expressed an unqualified opinion on the Company s internal control over financial reporting.

Minneapolis, Minnesota

February 26, 2013

Pentair Ltd. and Subsidiaries

Consolidated Statements of Operations and Comprehensive Income (Loss)

	Years ended December 31		
In thousands, except per-share data	**2012**	**2011**	**2010**
Net sales	$ 4,416,146	$ 3,456,686	$ 3,030,773
Cost of goods sold	3,146,554	2,382,964	2,100,133
Gross profit	1,269,592	1,073,722	930,640
Selling, general and administrative	1,158,436	694,841	550,501
Research and development	93,557	78,158	67,156
Impairment of trade names and goodwill	60,718	200,520	
Operating income (loss)	(43,119)	100,203	312,983
Other (income) expense			
Loss on early extinguishment of debt	75,367		
Equity income of unconsolidated subsidiaries	(2,156)	(1,898)	(2,108)
Interest income	(2,902)	(1,432)	(1,263)
Interest expense	70,537	60,267	37,379
Income (loss) from continuing operations before income taxes and noncontrolling interest	(183,965)	43,266	278,975
Provision (benefit) for income taxes	(79,353)	46,417	88,943
Income (loss) from continuing operations	(104,612)	(3,151)	190,032
Loss on disposal of discontinued operations, net of tax			(626)
Net income (loss) before noncontrolling interest	(104,612)	(3,151)	189,406
Noncontrolling interest	2,574	4,299	4,493
Net income (loss) attributable to Pentair Ltd.	$ (107,186)	$ (7,450)	$ 184,913
Net income (loss) from continuing operations attributable to Pentair Ltd.	$ (107,186)	$ (7,450)	$ 185,539
Comprehensive income (loss), net of tax			
Net income (loss) before noncontrolling interest	$ (104,612)	$ (3,151)	$ 189,406
Changes in cumulative translation adjustment	35,830	(93,706)	(32,706)
Amortization of pension and other post-retirement prior service cost and transition obligation	(253)	(11)	153
Changes in market value of derivative financial instruments	(3,630)	4,375	310
Total comprehensive income (loss)	(72,665)	(92,493)	157,163
Less: Comprehensive income (loss) attributable to noncontrolling interest	3,988	2,184	2,274
Comprehensive income (loss) attributable to Pentair Ltd.	$ (76,653)	$ (94,677)	$ 154,889
Earnings (loss) per common share attributable to Pentair Ltd.			
Basic			

Continuing operations	$	(0.84)	$	(0.08)	$	1.89
Discontinued operations						(0.01)
Basic earnings (loss) per common share	$	(0.84)	$	(0.08)	$	1.88
Diluted						
Continuing operations	$	(0.84)	$	(0.08)	$	1.87
Discontinued operations						(0.01)
Diluted earnings (loss) per common share	$	(0.84)	$	(0.08)	$	1.86
Weighted average common shares outstanding						
Basic		127,368		98,233		98,037
Diluted		127,368		98,233		99,294
Dividends paid per common share	$	0.88	$	0.80	$	0.76

See accompanying notes to consolidated financial statements.

Pentair Ltd. and Subsidiaries

Consolidated Balance Sheets

In thousands, except share and per-share data	December 31 2012	December 31 2011
Assets		
Current assets		
Cash and cash equivalents	$ 261,341	$ 50,077
Accounts and notes receivable, net of allowances of $37,455 and $39,111, respectively	1,292,648	569,204
Inventories	1,380,271	449,863
Other current assets	326,108	168,691
Total current assets	3,260,368	1,237,835
Property, plant and equipment, net	1,224,488	387,525
Other assets		
Goodwill	4,894,512	2,273,918
Intangibles, net	1,909,656	592,285
Other non-current assets	506,287	94,750
Total other assets	7,310,455	2,960,953
Total assets	$ 11,795,311	$ 4,586,313
Liabilities and Equity		
Current liabilities		
Current maturities of long-term debt and short-term borrowings	$ 3,096	$ 4,862
Accounts payable	569,596	294,858
Employee compensation and benefits	295,067	118,413
Other current liabilities	670,162	223,708
Total current liabilities	1,537,921	641,841
Other liabilities		
Long-term debt	2,454,278	1,304,225
Pension and other post-retirement compensation and benefits	378,066	280,389
Deferred tax liabilities	488,102	188,957
Other non-current liabilities	453,587	123,509
Total liabilities	5,311,954	2,538,921
Equity		
Common shares CHF 0.50 par value, 213,000,000 authorized and issued at December 31, 2012; 250,000,000 shares authorized at December 31, 2011 and 98,622,564 shares issued and outstanding at December 31, 2011	113,454	47,526
Common shares held in treasury, 6,862,540 shares at December 31, 2012	(315,519)	
Capital contribution reserve	5,283,835	457,754
Retained earnings	1,292,288	1,465,780
Accumulated other comprehensive income (loss)	(7,198)	(37,731)

Shareholders equity attributable to Pentair Ltd.	6,366,860	1,933,329
Noncontrolling interest	116,497	114,063
Total equity	6,483,357	2,047,392
Total liabilities and equity	$ 11,795,311	$ 4,586,313

See accompanying notes to consolidated financial statements.

Pentair Ltd. and Subsidiaries

Consolidated Statements of Cash Flows

	Years ended December 31		
In thousands	**2012**	**2011**	**2010**
Operating activities			
Net income (loss) before noncontrolling interest	$ (104,612)	$ (3,151)	$ 189,406
Adjustments to reconcile net income (loss) before noncontrolling interest to net cash provided by (used for) operating activities			
Loss on disposal of discontinued operations			626
Equity income of unconsolidated subsidiaries	(2,156)	(1,898)	(2,108)
Depreciation	87,835	66,235	57,995
Amortization	75,957	41,897	26,184
Deferred income taxes	(146,896)	(5,583)	29,453
Share-based compensation	35,847	19,489	21,468
Impairment of trade names and goodwill	60,718	200,520	
Loss on early extinguishment of debt	75,367		
Excess tax benefits from share-based compensation	(4,976)	(3,310)	(2,686)
Pension and other post-retirement expense	167,536	84,345	34,098
Pension and other post-retirement contributions	(238,014)	(40,294)	(52,992)
Loss (gain) on sale of assets	(2,276)	933	466
Changes in assets and liabilities, net of effects of business acquisitions			
Accounts and notes receivable	55,720	1,348	(62,344)
Inventories	125,099	18,263	(44,495)
Other current assets	(6,696)	10,032	2,777
Accounts payable	(61,990)	(24,330)	55,321
Employee compensation and benefits	(81,313)	(20,486)	27,252
Other current liabilities	27,178	(7,954)	(795)
Other non-current assets and liabilities	5,632	(15,830)	(9,250)
Net cash provided by (used for) operating activities	67,960	320,226	270,376
Investing activities			
Capital expenditures	(94,532)	(73,348)	(59,523)
Proceeds from sale of property and equipment	5,508	1,310	358
Acquisitions, net of cash acquired	470,459	(733,105)	
Other	(5,858)	(2,943)	(1,148)
Net cash provided by (used for) investing activities	375,577	(808,086)	(60,313)
Financing activities			
Net short-term borrowings	(3,700)	(1,239)	2,728
Proceeds from long-term debt	1,536,146	1,421,602	703,641
Repayment of long-term debt	(1,305,339)	(832,147)	(804,713)
Debt issuance costs	(9,704)	(8,973)	(50)
Debt extinguishment costs	(74,752)		
Excess tax benefits from share-based compensation	4,976	3,310	2,686
Shares issued to employees, net of shares withheld	68,177	13,322	9,941
Repurchases of common shares	(334,159)	(12,785)	(24,712)
Dividends paid	(112,397)	(79,537)	(75,465)
Distribution to noncontrolling interest	(1,554)		(4,647)
Net cash provided by (used for) financing activities	(232,306)	503,553	(190,591)
Effect of exchange rate changes on cash and cash equivalents	33	(11,672)	(6,812)
Change in cash and cash equivalents	211,264	4,021	12,660

Cash and cash equivalents, beginning of year	50,077	46,056	33,396
Cash and cash equivalents, end of year	$ 261,341	$ 50,077	$ 46,056

See accompanying notes to consolidated financial statements.

Pentair Ltd. and Subsidiaries

Consolidated Statements of Changes in Equity

In thousands, except share and per-share data	Common shares Number	Common shares Amount	Treasury shares Number	Treasury shares Amount	Capital contribution reserve	Retained earnings	Accumulated other comprehensive income (loss)	Total Pentair Ltd.	Non-controlling interest	Total
Balance - December 31, 2009	98,655,506	$ 47,530		$	$ 441,719	$ 1,443,319	$ 79,520	$ 2,012,088	$ 114,252	$ 2,126,340
Net income						184,913		184,913	4,493	189,406
Change in cumulative translation adjustment							(30,487)	(30,487)	(2,219)	(32,706)
Amortization of pension and other post-retirement prior service cost and transition obligation, net of $111 tax							153	153		153
Changes in market value of derivative financial instruments, net of $229 tax							310	310		310
Tax benefit of share-based compensation					2,171			2,171		2,171
Dividends declared						(75,465)		(75,465)		(75,465)
Distribution to noncontrolling interest									(4,647)	(4,647)
Share repurchase	(726,777)	(350)			(24,362)			(24,712)		(24,712)
Exercise of options, net of 27,177 shares tendered for payment	651,331	314			14,612			14,926		14,926
Issuance of restricted shares, net of cancellations	(4,122)	(2)			708			706		706
Amortization of restricted shares					3,538			3,538		3,538
Shares surrendered by employees to pay taxes	(166,746)	(80)			(5,611)			(5,691)		(5,691)
Share-based compensation					10,703			10,703		10,703
Balance - December 31, 2010	98,409,192	$ 47,412		$	$ 443,478	$ 1,552,767	$ 49,496	$ 2,093,153	$ 111,879	$ 2,205,032
Net income (loss)						(7,450)		(7,450)	4,299	(3,151)
Change in cumulative translation adjustment							(91,591)	(91,591)	(2,115)	(93,706)
Amortization of pension and other post-retirement prior service cost, net of $7 tax							(11)	(11)		(11)
Changes in market value of derivative financial instruments, net of $2,884 tax							4,375	4,375		4,375
Tax benefit of share-based compensation					3,868			3,868		3,868
Dividends declared						(79,537)		(79,537)		(79,537)
Share repurchase	(397,126)	(211)			(12,574)			(12,785)		(12,785)
Exercise of options, net of 182,270 shares tendered for payment	657,616	350			14,358			14,708		14,708

Issuance of restricted shares, net of cancellations	28,603	15		1,460			1,475		1,475
Amortization of restricted shares				1,006			1,006		1,006
Shares surrendered by employees to pay taxes	(75,721)	(40)		(2,758)			(2,798)		(2,798)
Share-based compensation				8,916			8,916		8,916
Balance - December 31, 2011	98,622,564	$ 47,526	$	$ 457,754	$ 1,465,780	$ (37,731)	$ 1,933,329	$ 114,063	$ 2,047,392

In thousands, except share and per-share data	Common shares Number	Common shares Amount	Treasury shares Number	Treasury shares Amount	Capital contribution reserve	Retained earnings	Accumulated other comprehensive income (loss)	Total Pentair Ltd.	Non-controlling interest	Total
Net income (loss)						(107,186)		(107,186)	2,574	(104,612)
Change in cumulative translation adjustment							34,416	34,416	1,414	35,830
Amortization of pension and other post-retirement prior service cost, net of $161 tax							(253)	(253)		(253)
Changes in market value of derivative financial instruments, net of $3,661 tax							(3,630)	(3,630)		(3,630)
Tax benefit of share-based compensation					5,555			5,555		5,555
Dividends declared					(141,058)	(66,306)		(207,364)		(207,364)
Distribution to noncontrolling interest									(1,554)	(1,554)
Issuance of shares related to the Merger	113,611,537	65,521	(2,712,603)	(119,626)	4,977,249			4,923,144		4,923,144
Share repurchase			(7,291,078)	(334,159)				(334,159)		(334,159)
Exercise of options, net of 45,123 shares tendered for payment	669,361	356	2,319,367	97,549	(7,833)			90,072		90,072
Issuance of restricted shares, net of cancellations	168,936	90	1,254,449	59,798	(40,904)			18,984		18,984
Amortization of restricted shares					24,209			24,209		24,209
Shares surrendered by employees to pay taxes	(72,398)	(39)	(432,675)	(19,081)	(2,775)			(21,895)		(21,895)
Share-based compensation					11,638			11,638		11,638
Balance - December 31, 2012	213,000,000	$ 113,454	(6,862,540)	$ (315,519)	$ 5,283,835	$ 1,292,288	$ (7,198)	$ 6,366,860	$ 116,497	$ 6,483,357

See accompanying notes to consolidated financial statements.

Pentair Ltd. and Subsidiaries

Notes to consolidated financial statements

1. Background and Nature of Operations

Pentair Ltd., formerly known as Tyco Flow Control International Ltd. (as used prior to the Merger (as defined below), Flow Control), is a company organized under the laws of Switzerland. In these notes, the terms the Company, Pentair, us, we or our refer to Pentair Ltd. and its consolidated subsidiaries. Our business took its current form on September 28, 2012 as a result of a spin-off of Flow Control from its parent, Tyco International Ltd. (Tyco), and a reverse acquisition involving Pentair, Inc.

Prior to the spin-off, Tyco engaged in an internal restructuring whereby it transferred to Flow Control certain assets related to the flow control business of Tyco, and Flow Control assumed from Tyco certain liabilities related to the flow control business of Tyco. On September 28, 2012 prior to the Merger (as defined below), Tyco effected a spin-off of Flow Control through the pro-rata distribution of 100% of the outstanding common shares of Flow Control to Tyco s shareholders (the Distribution), resulting in the distribution of 110,898,934 of our common shares to Tyco s shareholders. Immediately following the Distribution, an indirect, wholly-owned subsidiary of ours merged with and into Pentair, Inc., with Pentair, Inc. surviving as an indirect, wholly-owned subsidiary of ours (the Merger). At the effective time of the Merger, each Pentair, Inc. common share was converted into the right to receive one of our common shares, resulting in 99,388,463 of our common shares being issued to Pentair, Inc. shareholders. The Merger is intended to be tax-free for U.S. federal income tax purposes. After the Merger, our common shares are traded on the New York Stock Exchange under the symbol PNR. Tyco equity-based awards held by Flow Control employees and certain Tyco employees and directors outstanding prior to the completion of the Distribution were converted in connection with the Distribution into equity-based awards with respect to our common shares and were assumed by us. Pentair, Inc. equity-based awards outstanding prior to the completion of the Merger were converted upon completion of the Merger into equity-based awards with respect to our common shares and were assumed by us.

The Merger was accounted for as a reverse acquisition under the purchase method of accounting with Pentair, Inc. treated as the acquirer, reflecting the control maintained by the executive management and board of directors of Pentair, Inc. after the Merger. As such, on the acquisition date of September 28, 2012, the assets and liabilities of Flow Control have been assessed at fair value and the assets and liabilities of Pentair, Inc. are carried over at historical cost. For periods prior to September 28, 2012, the Consolidated Statements of Operations and Comprehensive Income (Loss) and Consolidated Statements of Cash Flows include the historical results of Pentair, Inc. The consolidated financial statements include the results of Flow Control from the date of the Merger. Flow Control s net sales and net loss from continuing operations for the period from the acquisition date to December 31, 2012 were $886.5 million and $117.0 million, respectively.

Our common share balances prior to the Merger have been adjusted to reflect the one-for-one conversion of the Pentair, Inc. shares to Pentair Ltd. shares, with the difference in par value recorded in *Capital contribution reserve*.

Based on the price of Pentair, Inc. common stock and our common shares issued on the date of the Merger, the purchase price was composed of the following:

In thousands	
Value of common shares issued to Tyco shareholders (1)	$ 4,811,363
Cash paid to Tyco shareholders in lieu of fractional common shares (2)	542
Value of replacement equity-based awards to holders of Tyco equity-based awards (3)	111,239
Total purchase price	$ 4,923,144

(1) Equals 110,886,444 Pentair Ltd. shares distributed to Tyco shareholders multiplied by the Merger date share price of $43.39.

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(2) Equals cash paid to Tyco shareholders in lieu of 12,490 Pentair Ltd. fractional shares multiplied by the Merger date share price of $43.39.

(3) In accordance with applicable accounting guidance, the fair value of replacement equity-based awards attributable to pre-combination service is recorded as part of the consideration transferred in the Merger, while the fair value of replacement equity-based awards attributable to post-combination service is recorded separately from the business combination and recognized as compensation cost in the post-acquisition period over the remaining service period. The fair value of our equivalent stock options was estimated using the Black-Scholes valuation model utilizing various assumptions.

During the fourth quarter of 2012, we recorded fair value adjustments to our preliminary purchase price allocation, which resulted in an increase to goodwill of $32.6 million.

The purchase price has been preliminarily allocated based on the estimated fair value of net assets acquired and liabilities assumed at the date of the Merger. The preliminary purchase price allocation is subject to further refinement and may require significant adjustments to arrive at the final purchase price allocation. These adjustments will primarily relate to accounts receivable, inventories, property, plant and equipment, certain contingent liabilities and income tax-related items. We expect the purchase price allocation to be completed in the second quarter of 2013. There can be no assurance that such finalization will not result in material changes from the preliminary purchase price allocation. The purchase price is subject to a working capital and net indebtedness adjustment.

The following table summarizes our preliminary fair values of the assets acquired and liabilities assumed in the Merger:

In thousands		
Cash and cash equivalents	$	691,702
Accounts and notes receivable		771,576
Inventories		1,046,165
Other current assets		98,212
Property, plant and equipment		822,001
Goodwill		2,520,110
Intangibles		1,425,072
Other non-current assets		275,103
Current liabilities		(856,341)
Long-term debt		(914,530)
Income taxes, including current and deferred		(364,573)
Other liabilities and redeemable noncontrolling interest		(591,353)
Total purchase price	$	4,923,144

The excess of purchase price over tangible net assets and identified intangible assets acquired was allocated to goodwill in the amount of $2.5 billion. Goodwill has been preliminarily allocated to our reporting segments as follows: $321.4 million to Water & Fluid Solutions, $1,342.6 million to Valves & Controls and $856.1 million to Technical Solutions. None of the goodwill recognized from the Merger is expected to be deductible for income tax purposes. Goodwill recognized from the Merger reflects the value of future income resulting from synergies of our combined operations. Identifiable intangible assets acquired as part of the Merger were $1.4 billion and include $362.3 million of indefinite life trade name intangibles and the following definite-lived intangibles: $905.7 million of customer relationships with a weighted average useful life of 14.2 years, $115.9 million of proprietary technology with weighted average useful life of 13.7 years and $41.2 million of customer backlog with a weighted average useful life of less than one year.

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Flow Control is a global leader in the industrial flow control market, specializing in the design, manufacture and servicing of highly engineered valves, actuation & controls, electric heat management solutions and water transmission and distribution products. Flow Control s broad portfolio of products and services serves flow control needs primarily across the general process, oil & gas, water, power generation and mining industries. Sales are conducted through multiple channels based on local market conditions and demand. A global customer base is served through major manufacturing and after-market service centers around the world. Flow Control, through its valves & controls business, is one of the world s largest manufacturers of valves, actuators and controls, with leading products, services and solutions to address many of the most challenging flow applications in the general process, oil & gas, power generation and mining industries. Through its thermal management business, Flow Control is a leading provider of complete electric heat management solutions, primarily for the oil & gas, general process and power generation industries. Additionally, Flow Control s water & environmental systems business is a leading provider of large-scale water transmission and distribution products and water/wastewater systems in the Pacific and Southeast Asia regions.

We believe the Merger combines two complementary leaders in water and fluid solutions, valves and controls and technical solutions, providing us with the ability to achieve operational and tax synergies and increase global revenue. Following the Merger, we are a diversified industrial manufacturing company comprising three reporting segments: Water & Fluid Solutions, Valves & Controls and Technical Solutions. Water & Fluid Solutions designs, manufactures, markets and services innovative water management and fluid processing products and solutions. Valves & Controls designs, manufactures, markets and services valves, fittings, automation and controls and actuators. Technical Solutions designs, manufactures and markets products that guard and protect some of the world s most sensitive electronics and electronic equipment, as well as heat management solutions designed to provide thermal protection to temperature sensitive fluid applications.

2. Basis of Presentation and Summary of Significant Accounting Policies

Basis of presentation

The accompanying consolidated financial statements include the accounts of Pentair and all subsidiaries, both the U.S. and non-U.S, which we control. Intercompany accounts and transactions have been eliminated. Investments in companies of which we own 20% to 50% of the voting stock or have the ability to exercise significant influence over operating and financial policies of the investee are accounted for using the equity method of accounting and as a result, our share of the earnings or losses of such equity affiliates is included in the Consolidated Statements of Operations and Comprehensive Income (Loss).

The consolidated financial statements have been prepared in United States dollars (USD) and in accordance with accounting principles generally accepted in the United States of America (GAAP). Certain information described under Article 663-663h of the Swiss Code of Obligations has been presented in the Company s Swiss statutory financial statements for the year ended December 31, 2012.

Fiscal year

Our fiscal year ends on December 31. We report our interim quarterly periods on a 13-week basis ending on a Saturday.

Use of estimates

The preparation of our consolidated financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the amounts reported in these consolidated financial statements and accompanying notes of assets and liabilities, disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. These estimates include our accounting for valuation of long-lived assets, including goodwill and indefinite lived intangible

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assets, percentage of completion revenue recognition, assets acquired and liabilities assumed in acquisitions and the Merger, contingent liabilities, income taxes, and pension and other post-retirement benefits. Actual results could differ from our estimates.

Revenue recognition

Generally, we recognize revenue when it is realized or realizable and has been earned. Revenue is recognized when persuasive evidence of an arrangement exists; shipment or delivery has occurred (depending on the terms of the sale); our price to the buyer is fixed or determinable; and collectability is reasonably assured.

Generally, there is no post-shipment obligation on product sold other than warranty obligations in the normal and ordinary course of business. In the event significant post-shipment obligations were to exist, revenue recognition would be deferred until substantially all obligations were satisfied.

Percentage of completion

Revenue from certain long-term contracts is recognized over the contractual period under the percentage of completion method of accounting. Under this method, sales and gross profit are recognized as work is performed either based on the relationship between the actual costs incurred and the total estimated costs at completion (the cost-to-cost method) or based on efforts for measuring progress towards completion in situations in which this approach is more representative of the progress on the contract than the cost-to-cost method. Changes to the original estimates may be required during the life of the contract and such estimates are reviewed on a regular basis. Sales and gross profit are adjusted using the cumulative catch-up method for revisions in estimated total contract costs. These reviews have not resulted in adjustments that were significant to our results of operations. Estimated losses are recorded when identified. Claims against customers are recognized as revenue upon settlement.

We record costs and earnings in excess of billings on uncompleted contracts within *Other current assets* and billings in excess of costs and earnings on uncompleted contracts within *Other current liabilities* in the Consolidated Balance Sheets. Amounts included in *Other current assets* related to these contracts were $124.4 million and $54.7 million at December 31, 2012 and 2011, respectively. Amounts included in *Other current liabilities* related to these contracts were $61.1 million and $17.7 million at December 31, 2012 and 2011, respectively.

Sales returns

The right of return may exist explicitly or implicitly with our customers. Generally, our return policy allows for customer returns only upon our authorization. Goods returned must be product we continue to market and must be in salable condition. Returns of custom or modified goods are normally not allowed. At the time of sale, we reduce revenue for the estimated effect of returns. Estimated sales returns include consideration of historical sales levels, the timing and magnitude of historical sales return levels as a percent of sales, type of product, type of customer and a projection of this experience into the future.

Pricing and sales incentives

We record estimated reductions to revenue for customer programs and incentive offerings including pricing arrangements, promotions and other volume-based incentives at the later of the date revenue is recognized or the incentive is offered. Sales incentives given to our customers are recorded as a reduction of revenue unless we (1) receive an identifiable benefit for the goods or services in exchange for the consideration and (2) we can reasonably estimate the fair value of the benefit received.

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The following represents a description of our pricing arrangements, promotions and other volume-based incentives:

Pricing is established up front with our customers and we record sales at the agreed-upon net selling price. However, one of our businesses allows customers to apply for a refund of a percentage of the original purchase price if they can demonstrate sales to a qualifying original equipment manufacturer customer. At the time of sale, we estimate the anticipated refund to be paid based on historical experience and reduce sales for the probable cost of the discount. The cost of these refunds is recorded as a reduction in gross sales.

Our primary promotional activity is what we refer to as cooperative advertising. Under our cooperative advertising programs, we agree to pay the customer a fixed percentage of sales as an allowance that may be used to advertise and promote our products. The customer is generally not required to provide evidence of the advertisement or promotion. We recognize the cost of this cooperative advertising at the time of sale. The cost of this program is recorded as a reduction in gross sales.

Volume-based incentives involve rebates that are negotiated up front with the customer and are redeemable only if the customer achieves a specified cumulative level of sales or sales increase. Under these incentive programs, at the time of sale, we reforecast the anticipated rebate to be paid based on forecasted sales levels. These forecasts are updated at least quarterly for each customer and sales are reduced for the anticipated cost of the rebate. If the forecasted sales for a customer changes, the accrual for rebates is adjusted to reflect the new amount of rebates expected to be earned by the customer.

Shipping and handling costs

Amounts billed to customers for shipping and handling are recorded in *Net sales* in the accompanying Consolidated Statements of Operations and Comprehensive Income (Loss). Shipping and handling costs incurred by Pentair for the delivery of goods to customers are included in *Cost of goods sold* in the accompanying Consolidated Statements of Operations and Comprehensive Income (Loss).

Research and development

We conduct research and development (R&D) activities in our own facilities, which consist primarily of the development of new products, product applications and manufacturing processes. We expense R&D costs as incurred. R&D expenditures during 2012, 2011 2010 were $93.6 million, $78.2 million and $67.2 million, respectively.

Cash equivalents

We consider highly liquid investments with original maturities of three months or less to be cash equivalents.

Trade receivables and concentration of credit risk

We record an allowance for doubtful accounts, reducing our receivables balance to an amount we estimate is collectible from our customers. Estimates used in determining the allowance for doubtful accounts are based on current trends, aging of accounts receivable, periodic credit evaluations of our customers financial condition, and historical collection experience. We generally do not require collateral. No customer receivable balances exceeded 10% of total net receivable balances as of December 31, 2012 and December 31, 2011.

Inventories

Inventories are stated at the lower of cost or market with substantially all inventories recorded using the first-in, first-out (FIFO) cost method and with an insignificant amount of inventories located outside the United States recorded using a moving average cost method which approximates FIFO.

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Property, plant and equipment, net

Property, plant and equipment is stated at historical cost. We compute depreciation by the straight-line method based on the following estimated useful lives:

	Years
Land improvements	5 to 20
Buildings and leasehold improvements	5 to 50
Machinery and equipment	3 to 15

Significant improvements that add to productive capacity or extend the lives of properties are capitalized. Costs for repairs and maintenance are charged to expense as incurred. When property is retired or otherwise disposed of, the recorded cost of the assets and their related accumulated depreciation are removed from the Consolidated Balance Sheets and any related gains or losses are included in income.

We review the recoverability of long-lived assets to be held and used, such as property, plant and equipment, when events or changes in circumstances occur that indicate the carrying value of the asset or asset group may not be recoverable. The assessment of possible impairment is based on our ability to recover the carrying value of the asset or asset group from the expected future pre-tax cash flows (undiscounted and without interest charges) of the related operations. If these cash flows are less than the carrying value of such asset or asset group, an impairment loss is recognized for the difference between estimated fair value and carrying value. Impairment losses on long-lived assets held for sale are determined in a similar manner, except that fair values are reduced for the cost to dispose of the assets. The measurement of impairment requires us to estimate future cash flows and the fair value of long-lived assets. There was no material impairment charge recorded related to long-lived assets.

Goodwill and identifiable intangible assets

Goodwill

Goodwill represents the excess of the cost of acquired businesses over the net of the fair value of identifiable tangible net assets and identifiable intangible assets purchased and liabilities assumed.

Goodwill is tested annually for impairment and is tested for impairment more frequently if events or changes in circumstances indicate that the asset might be impaired. The impairment test is performed using a two-step process. In the first step, the fair value of each reporting unit is compared with the carrying amount of the reporting unit, including goodwill. If the estimated fair value is less than the carrying amount of the reporting unit there is an indication that goodwill impairment exists and a second step must be completed in order to determine the amount of the goodwill impairment, if any that should be recorded. In the second step, an impairment loss is recognized for any excess of the carrying amount of the reporting unit s goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation.

The fair value of each reporting unit is determined using a discounted cash flow analysis and market approach. Projecting discounted future cash flows requires us to make significant estimates regarding future revenues and expenses, projected capital expenditures, changes in working capital and the appropriate discount rate. Use of the market approach consists of comparisons to comparable publicly-traded companies that are similar in size and industry. Actual results may differ from those used in our valuations. This non-recurring fair value measurement is a Level 3 measurement under the fair value hierarchy described below.

In developing our discounted cash flow analysis, assumptions about future revenues and expenses, capital expenditures and changes in working capital, are based on our annual operating plan and long-term business plan for each of our reporting units. These plans take into consideration numerous factors including historical experience, anticipated future economic conditions, changes in raw material prices and growth expectations for the industries and end markets we participate in. These assumptions are determined over a five year long-term planning period. The five year growth rates for revenues and operating profits vary for each reporting unit being evaluated. Revenues and operating profit beyond 2019 are projected to grow at a perpetual growth rate of 3.0%.

Discount rate assumptions for each reporting unit take into consideration our assessment of risks inherent in the future cash flows of the respective reporting unit and our weighted-average cost of capital. We utilized discount rates ranging from 12.0% to 13.0% in determining the discounted cash flows in our fair value analysis.

In estimating fair value using the market approach, we identify a group of comparable publicly-traded companies for each reporting segment that are similar in terms of size and product offering. These groups of comparable companies are used to develop multiples based on total market-based invested capital as a multiple of earnings before interest, taxes, depreciation and amortization (EBITDA). We determine our estimated values by applying these comparable EBITDA multiples to the operating results of our reporting units. The ultimate fair value of each reporting unit is determined considering the results of both valuation methods.

Impairment charge

We completed step one of our annual goodwill impairment evaluation during the fourth quarter for 2012 with each reporting unit s fair value exceeding its carrying value. Accordingly, step two of the impairment analysis was not required for 2012.

For the year ended December 31, 2011, we recorded a pre-tax non-cash impairment charge of $200.5 million in Water & Fluid Solutions as a result of our annual goodwill impairment test. The impairment charge resulted from changes in our forecasts in light of economic conditions and continued softness in the end-markets served by residential water treatment components.

Identifiable intangible assets

Our primary identifiable intangible assets include: customer relationships, trade names and trademarks, proprietary technology, backlog and patents. Identifiable intangibles with finite lives are amortized and those identifiable intangibles with indefinite lives are not amortized. Identifiable intangible assets that are subject to amortization are evaluated for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Identifiable intangible assets not subject to amortization are tested for impairment annually or more frequently if events warrant. We completed our annual impairment test during the fourth quarter for those identifiable assets not subject to amortization. As a result, an impairment charge of $60.7 million was recorded in 2012, related to trade names. These charges were recorded in *Impairment of trade names and goodwill* in our Consolidated Statements of Operations and Comprehensive Income (Loss). There was no impairment charge recorded in 2011 or 2010 for identifiable intangible assets.

The impairment test consists of a comparison of the fair value of the trade name with its carrying value. Fair value is measured using the relief-from-royalty method. This method assumes the trade name has value to the extent that the owner is relieved of the obligation to pay royalties for the benefits received from them. This method requires us to estimate the future revenue for the related brands, the appropriate royalty rate and the weighted average cost of capital. The non-recurring fair value measurement is a Level 3 measurement under the fair value hierarchy described below. The impairment charge recorded in 2012 was the result of a rebranding strategy implemented in the fourth quarter of 2012.

At December 31, 2012 our goodwill and intangible assets were $6,804.2 million and represented 58% of our total assets. If we experience future declines in sales and operating profit or do not meet our operating forecasts, we

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may be subject to future impairments. Additionally, changes in assumptions regarding the future performance of our businesses, increases in the discount rate used to determine the discounted cash flows of our businesses or significant declines in our share price or the market as a whole could result in additional impairment indicators. Because of the significance of our goodwill and intangible assets, any future impairment of these assets could have a material adverse effect on our financial results.

Equity and cost method investments

We have investments that are accounted for using the equity method. Our proportionate share of income or losses from investments accounted for under the equity method is recorded in the Consolidated Statements of Operations and Comprehensive Income (Loss). We write down or write off an investment and recognize a loss when events or circumstances indicate there is impairment in the investment that is other-than-temporary. This requires significant judgment, including assessment of the investees financial condition and in certain cases the possibility of subsequent rounds of financing, as well as the investees historical and projected results of operations and cash flows. If the actual outcomes for the investees are significantly different from projections, we may incur future charges for the impairment of these investments. Our investment in and loans to equity method investees was $10.3 million and $6.0 million at December 31, 2012 and December 31, 2011, respectively, net of our proportionate share of the results of their operations.

Investments for which we do not have significant influence are accounted for under the cost method. The aggregate balance of these investments was $6.9 million at December 31, 2012 and December 31, 2011.

Income taxes

We use the asset and liability approach to account for income taxes. Under this method, deferred tax assets and liabilities are recognized for the expected future tax consequences of differences between the carrying amounts of assets and liabilities and their respective tax bases using enacted tax rates in effect for the year in which the differences are expected to reverse. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period when the change is enacted. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Changes in valuation allowances from period to period are included in our tax provision in the period of change. We recognize the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs.

Environmental

We recognize environmental clean-up liabilities on an undiscounted basis when a loss is probable and can be reasonably estimated. Such liabilities generally are not subject to insurance coverage. The cost of each environmental clean-up is estimated by engineering, financial and legal specialists based on current law. Such estimates are based primarily upon the estimated cost of investigation and remediation required and the likelihood that, where applicable, other potentially responsible parties (PRPs) will be able to fulfill their commitments at the sites where Pentair may be jointly and severally liable. The process of estimating environmental clean-up liabilities is complex and dependent primarily on the nature and extent of historical information and physical data relating to a contaminated site, the complexity of the site, the uncertainty as to what remedy and technology will be required and the outcome of discussions with regulatory agencies and other PRPs at multi-party sites. In future periods, new laws or regulations, advances in clean-up technologies and additional information about the ultimate clean-up remedy that is used could significantly change our estimates. Accruals for environmental liabilities are included in *Other current liabilities* and *Other non-current liabilities* in the Consolidated Balance Sheets.

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Asbestos Matters

We recognize asbestos-related liabilities on an undiscounted basis when a loss is probable and can be reasonably estimated. Certain of these liabilities are subject to insurance coverage. Our subsidiaries and numerous other companies are named as defendants in personal injury lawsuits based on alleged exposure to asbestos-containing materials. These cases typically involve product liability claims based primarily on allegations of manufacture, sale or distribution of industrial products that either contained asbestos or were attached to or used with asbestos-containing components manufactured by third-parties. The process of estimating asbestos-related liabilities and the corresponding insurance recoveries receivable is complex and dependent primarily on our historical claim experience, estimates of potential future claims, our legal strategy for resolving these claims, the availability of insurance coverage, and the solvency and creditworthiness of insurers. Accruals for asbestos-related liabilities are included in *Other non-current liabilities* and the estimated receivable for insurance recoveries are recorded in *Other non-current assets* in the Consolidated Balance Sheets.

Insurance subsidiary

We insure certain general and product liability, property, workers compensation and automobile liability risks through our regulated wholly-owned captive insurance subsidiary, Penwald Insurance Company (Penwald). Reserves for policy claims are established based on actuarial projections of ultimate losses. As of December 31, 2012 and 2011, reserves for policy claims were $42.9 million ($13.3 million included in *Other current liabilities* and $29.6 million included in *Other non-current liabilities*) and $44.3 million ($13.3 million included in *Other current liabilities* and $31.0 million included in *Other non-current liabilities*), respectively.

Stock-based compensation

We account for share-based compensation awards on a fair value basis. The estimated grant date fair value of each option award is recognized in income on an accelerated basis over the requisite service period (generally the vesting period). The estimated fair value of each option award is calculated using the Black-Scholes option-pricing model. From time to time, we have elected to modify the terms of the original grant. These modified grants are accounted for as a new award and measured using the fair value method, resulting in the inclusion of additional compensation expense in our Consolidated Statements of Operations and Comprehensive Income (Loss). Restricted share awards and units are recorded as compensation cost on a straight-line basis over the requisite service periods based on the market value on the date of grant.

Earnings (loss) per common share

Basic earnings (loss) per share are computed by dividing net income (loss) attributable to Pentair Ltd. by the weighted-average number of common shares outstanding. Diluted earnings (loss) per share are computed by dividing net income (loss) attributable to Pentair Ltd. by the weighted-average number of common shares outstanding including the dilutive effects of common share equivalents.

Derivative financial instruments

We recognize all derivatives, including those embedded in other contracts, as either assets or liabilities at fair value in our Consolidated Balance Sheets. If the derivative is designated and is effective as a cash-flow hedge, changes in the fair value of the derivative are recorded in *Accumulated other comprehensive income (loss)* (AOCI) as a separate component of equity in the Consolidated Balance Sheets and are recognized in the Consolidated Statements of Operations and Comprehensive Income (Loss) when the hedged item affects earnings. If the underlying hedged transaction ceases to exist or if the hedge becomes ineffective, all changes in fair value of the related derivatives that have not been settled are recognized in current earnings. For a derivative that is not designated as or does not qualify as a hedge, changes in fair value are reported in earnings immediately.

We use derivative instruments for the purpose of hedging interest rate and currency exposures, which exist as part of ongoing business operations. We do not hold or issue derivative financial instruments for trading or

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speculative purposes. All other contracts that contain provisions meeting the definition of a derivative also meet the requirements of and have been designated as, normal purchases or sales. Our policy is not to enter into contracts with terms that cannot be designated as normal purchases or sales. From time to time, we may enter in to short duration foreign currency contracts to hedge foreign currency risks.

Fair value measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Assets and liabilities measured at fair value are classified using the following hierarchy, which is based upon the transparency of inputs to the valuation as of the measurement date:

Level 1: Valuation is based on observable inputs such as quoted market prices (unadjusted) for identical assets or liabilities in active markets.

Level 2: Valuation is based on inputs such as quoted market prices for similar assets or liabilities in active markets or other inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3: Valuation is based upon other unobservable inputs that are significant to the fair value measurement.

In making fair value measurements, observable market data must be used when available. When inputs used to measure fair value fall within different levels of the hierarchy, the level within which the fair value measurement is categorized is based on the lowest level input that is significant to the fair value measurement.

Foreign currency translation

The financial statements of subsidiaries located outside of the U.S. are measured using the local currency as the functional currency, except for certain corporate entities outside of the U.S. which are measured using USD. Assets and liabilities of these subsidiaries are translated at the rates of exchange at the balance sheet date. Income and expense items are translated at average monthly rates of exchange. The resultant translation adjustments are included in AOCI, a separate component of equity.

Discontinued Operations

In 2010, we were notified of a product recall required by our former Tools Group (which was sold to Black and Decker Corporation in 2004 and treated as a discontinued operation). Under the terms of the sale agreement we are liable for a portion of the product recall costs. We recorded a liability of $3.2 million ($2.0 million net of tax) in 2010 representing our estimate of the potential cost for products sold prior to the date of sale of the Tools Group associated with this recall. In addition, we received the remaining escrow balances from our sale of Lincoln Industrial of $0.5 million, and we reversed tax reserves of $1.0 million due to the expiration of various statues of limitations.

New accounting standards

In May 2011, the Financial Accounting Standards Board (FASB) issued authoritative guidance to improve the consistency of fair value measurement and disclosure requirements between GAAP and International Financial Reporting Standards. The provisions of this guidance change certain of the fair value principles related to the highest and best use premise, the consideration of blockage factors and other premiums and discounts, and the measurement of financial instruments held in a portfolio and instruments classified within equity. Further, the guidance provides additional disclosure requirements surrounding Level 3 fair value measurements, the uses of nonfinancial assets in certain circumstances and identification of the level in the fair value hierarchy used for

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assets and liabilities which are not recorded at fair value, but where fair value is disclosed. This guidance was effective for fiscal years and interim periods beginning after December 15, 2011. The adoption of this guidance did not have a material impact on our financial condition or results of operations.

In June 2011, the FASB issued authoritative guidance surrounding the presentation of comprehensive income, with an objective of increasing the prominence of items reported in Other Comprehensive Income (OCI). This guidance provides entities with the option to present the total of comprehensive income, the components of net income and the components of OCI in either a single continuous statement of comprehensive income or in two separate but consecutive statements. This guidance, other than certain provisions pertaining to the reclassification of items out of OCI that were deferred, was effective for fiscal years and interim periods beginning after December 15, 2011. We adopted this guidance as of January 1, 2012, and have presented total comprehensive income (loss) in our Consolidated Statements of Operations and Comprehensive Income (Loss).

In September 2011, the FASB issued an amendment to an existing accounting standard, which provides entities an option to perform a qualitative assessment to determine whether further impairment testing on goodwill is necessary. Specifically, an entity has the option to first assess qualitative factors to determine whether it is necessary to perform the current two-step test. If an entity believes, as a result of its qualitative assessment, that it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount, the quantitative impairment test is required. Otherwise, no further testing is required. The adoption of this guidance did not impact our financial condition or results of operations.

In September 2011, the FASB issued authoritative guidance which expanded and enhanced the existing disclosure requirements related to multi-employer pension and other postretirement benefit plans. The amendments require additional quantitative and qualitative disclosures to provide more detailed information regarding these plans including: the significant multi-employer plans in which we participate, the level of our participation and contributions with respect to such plans, the financial health of such plans and an indication of funded status. These disclosures are intended to provide users of financial statements with a better understanding of the employer s involvement in multi-employer benefit plans. The disclosure provisions of the guidance were adopted concurrent with the pension disclosures associated with our annual valuation process during the fourth quarter of 2012. We concluded that our participation in any individual multi-employer plan was not significant.

In July 2012, the FASB issued an amendment to an existing accounting standard, which provides entities an option to perform a qualitative assessment to determine whether further impairment testing on indefinite-lived intangible assets is necessary. Specifically, an entity has the option to first assess qualitative factors to determine whether it is necessary to perform a quantitative impairment test. If an entity believes, as a result of its qualitative assessment, that it is more-likely-than-not that the fair value of an indefinite-lived intangible asset is less than its carrying amount, the quantitative impairment test is required. Otherwise, no further testing is required. This guidance is effective for annual and interim indefinite-lived intangible asset impairment tests performed for fiscal years beginning after September 15, 2012, and early adoption is permitted. We believe that the adoption of this guidance will not have a material impact on our financial condition or results of operations.

In February 2013, the FASB issued authoritative guidance surrounding the presentation of items reclassified from OCI to net income. This guidance requires entities to disclose, either in the notes to the consolidated financial statements or parenthetically on the face of the statement that reports comprehensive income, items reclassified out of AOCI and into net income in their entirety and the effect of the reclassification on each affected net income line item. In addition, for AOCI reclassification items that are not reclassified in their entirety into net income, a cross reference to other required GAAP disclosures is required. This guidance is effective for fiscal years and interim periods beginning after December 15, 2012. We believe that the adoption of this guidance will not have a material impact on our financial condition or results of operations.

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3. Change in Accounting Principle

During the fourth quarter of 2012, we changed our method of recognizing actuarial gains and losses for all of our pension and other post-retirement plans. Historically, we recognized actuarial gains and losses as a component of AOCI in our Consolidated Balance Sheets and amortized them into our Consolidated Statements of Operations and Comprehensive Income (Loss) over the average future service period of the active employees of these plans to the extent such gains and losses were outside of a corridor. We elected to immediately recognize actuarial gains and losses in our Consolidated Statements of Operations and Comprehensive Income (Loss) on the basis that it is preferable to accelerate the recognition of such gains and losses into income rather than to delay such recognition. Additionally, for purposes of calculating the expected return on plan assets, we will no longer use a calculated value for the market-related valuation of plan assets, but instead will use the actual fair value of our plan assets. These changes will improve transparency in our operating results by more quickly recognizing the effects of external conditions on our plan obligations, investments and assumptions. We applied these changes retrospectively to all periods presented. The cumulative effect of the change on retained earnings as of January 1, 2010 was a reduction of $58.9 million, with an offset to AOCI. The annual recognition of actuarial losses totaled $146.6 million, $65.7 million and $13.6 million for the years ended December 31, 2012, 2011 and 2010, respectively. This change did not have an impact on cash provided by operating activities for any period presented.

The following table presents our results under our historical method and our results had we applied these new methods for the periods presented:

In thousands, except per-share data	Computed under previous method	Recognized under new method	Effect of Change
As of and for the year ended December 31, 2012			
Statement of Operations and Comprehensive Income (Loss)			
Selling, general and administrative	$ 1,016,698	$ 1,158,436	$ 141,738
Provision (benefit) for income taxes	(24,076)	(79,353)	(55,277)
Income (loss) from continuing operations	(18,151)	(104,612)	(86,461)
Net income (loss) attributable to Pentair Ltd.	(20,725)	(107,186)	(86,461)
Amortization of pension and other post-retirement prior service cost and transition obligation	(86,714)	(253)	86,461
Basic earnings (loss) per share attributable to Pentair Ltd.	$ (0.16)	$ (0.84)	$ (0.68)
Diluted earnings (loss) per share attributable to Pentair Ltd.	(0.16)	(0.84)	(0.68)
Balance Sheet			
Retained earnings	$ 1,492,258	$ 1,292,288	$ (199,970)
Accumulated other comprehensive income (loss)	(207,168)	(7,198)	199,970
Statement of Cash Flows			
Net income (loss) before noncontrolling interest	$ (18,151)	$ (104,612)	$ (86,461)
Pension and other post-retirement expense	25,798	167,536	141,738
Other current liabilities	82,455	27,178	(55,277)

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	Previously Reported	Adjusted	Effect of Change
As of and for the year ended December 31, 2011			
Statement of Operations and Comprehensive Income (Loss)			
Selling, general and administrative	$ 626,527	$ 694,841	$ 68,314
Provision for income taxes	73,059	46,417	(26,642)
Income (loss) from continuing operations	38,521	(3,151)	(41,672)
Net income (loss) attributable to Pentair Ltd.	34,222	(7,450)	(41,672)
Amortization of pension and other post-retirement prior service cost and transition obligation	(41,683)	(11)	41,672
Basic earnings (loss) per share attributable to Pentair Ltd.	$ 0.35	$ (0.08)	$ (0.43)
Diluted earnings (loss) per share attributable to Pentair Ltd.	0.34	(0.08)	(0.42)
Balance Sheet			
Retained earnings	$ 1,579,290	$ 1,465,780	$ (113,510)
Accumulated other comprehensive income (loss)	(151,241)	(37,731)	113,510
Statement of Cash Flows			
Net income (loss) before noncontrolling interest	$ 38,521	$ (3,151)	$ (41,672)
Pension and other post-retirement expense	16,031	84,345	68,314
Other current liabilities	18,688	(7,954)	(26,642)

	Previously Reported	Adjusted	Effect of Change
For the year ended December 31, 2010			
Statement of Operations and Comprehensive Income (Loss)			
Selling, general and administrative	$ 529,329	$ 550,501	$ 21,172
Provision for income taxes	97,200	88,943	(8,257)
Income from continuing operations	202,947	190,032	(12,915)
Net income attributable to Pentair Ltd.	197,828	184,913	(12,915)
Amortization of pension and other post-retirement prior service cost and transition obligation	(12,762)	153	12,915
Basic earnings per share attributable to Pentair Ltd.	$ 2.01	$ 1.88	$ (0.13)
Diluted earnings per share attributable to Pentair Ltd.	1.99	1.86	(0.13)
Statement of Cash Flows			
Net income (loss) before noncontrolling interest	$ 202,321	$ 189,406	$ (12,915)
Pension and other post-retirement expense	12,926	34,098	21,172
Other current liabilities	7,462	(795)	(8,257)

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4. Other Acquisitions

Other material acquisitions

In May 2011, we acquired, as part of Water & Fluid Solutions, the Clean Process Technologies (CPT) division of privately held Norit Holding B.V. for $715.3 million (502.7 million translated at the May 12, 2011 exchange rate). CPT s results of operations have been included in our consolidated financial statements since the date of acquisition. CPT is a global leader in membrane solutions and clean process technologies in the high growth water and beverage filtration and separation segments. CPT provides sustainable purification systems and solutions for desalination, water reuse, industrial applications and beverage segments that effectively address the increasing challenges of clean water scarcity, rising energy costs and pollution. CPT s product offerings include innovative ultrafiltration and nanofiltration membrane technologies, aseptic valves, CO_2 recovery and control systems and specialty pumping equipment. Based in the Netherlands, CPT has broad sales diversity with the majority of revenues generated in European Union and Asia-Pacific countries.

The fair value of the business acquired was allocated to the assets acquired and liabilities assumed based on their estimated fair values. The excess of the fair value acquired over the identifiable assets acquired and liabilities assumed is reflected as goodwill. Goodwill recorded as part of the purchase price allocation was $451.8 million, none of which is tax deductible. Identifiable intangible assets acquired as part of the acquisition were $197.2 million, including definite-lived intangibles, such as customer relationships and proprietary technology with a weighted average amortization period of approximately 10 years.

Pro forma results of material acquisitions

The following unaudited pro forma consolidated financial results of operations are presented as if the Merger described in Note 1 and the CPT acquisition described above were completed at the beginning of the comparable annual reporting period from the date of the transaction. Specifically, the unaudited pro forma results give effect as though the Merger was consummated on January 1, 2011 and as though the CPT acquisition was consummated on January 1, 2010.

	Years ended December 31	
In thousands, except per-share data	**2012**	**2011**
Pro forma net sales	$ 7,409,917	$ 7,326,432
Pro forma net income (loss) from continuing operations attributable to Pentair Ltd.	157,471	(47,373)
Diluted earnings (loss) per common share attributable to Pentair Ltd.	0.75	(0.23)

The 2011 unaudited pro forma net income includes the impact of $262.0 million in non-recurring items related to acquisition date fair value adjustments to inventory and customer backlog, $21.8 million of change of control costs and $8.7 million of transaction costs associated with the Merger. The 2011 unaudited pro forma net income excludes the impact of $12.9 million in non-recurring items related to acquisition date fair value adjustments to inventory and customer backlog and $8.0 million, respectively, of transaction costs associated with the CPT acquisition.

The 2012 unaudited pro forma net income excludes the impact $57.3 million of transaction related costs, $21.8 million of change of control costs and $178.1 million of non-recurring items related to acquisition date fair value adjustments to inventory and customer backlog associated with the Merger.

The pro forma consolidated financial information was prepared for comparative purposes only and includes certain adjustments, as noted above. The adjustments are estimates based on currently available information and actual amounts may have differed materially from these estimates. They do not reflect the effect of costs or synergies that would have been expected to result from the integration of the acquisitions. The pro forma

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information does not purport to be indicative of the results of operations that actually would have resulted had the combinations occurred at the beginning of each period presented or of future results of the consolidated entities.

Other acquisitions

On October 4, 2012, we acquired, as part of Valves & Controls, the remaining 25% equity interest in Pentair Middle East Holding S.a.R.L. (KEF), a privately held company, for $100 million in cash. Prior to the acquisition, we held a 75% equity interest in KEF, a vertically integrated valve manufacturer in the Middle East. There was no pro forma impact from this acquisition as the results of KEF were consolidated into Flow Control s financial statements prior to acquiring the remaining 25% interest in KEF.

Additionally, during 2012, we completed other small acquisitions as part of Water & Fluid Solutions with purchase prices totaling $121.2 million in cash, net of cash acquired. Total goodwill recorded as part of the purchase price allocations was $80.9 million, none of which is tax deductible. During 2011, we completed other small acquisitions as part of Water & Fluid Solutions with purchase prices totaling $21.6 million, consisting of $17.8 million in cash and $3.8 million as notes payable. Total goodwill recorded as part of the purchase price allocations was $14.4 million, none of which is tax deductible. The pro forma impact of these acquisitions was not material.

Total transaction costs related to acquisition activities for the year ended December 31, 2012 and December 31, 2011 were $57.3 million and $8.2 million, respectively, and were expensed as incurred and recorded in *Selling, general and administrative* in our Consolidated Statements of Operations and Comprehensive Income (Loss).

5. Earnings (Loss) Per Share

Basic and diluted earnings (loss) per share were calculated as follows:

	Years ended December 31		
In thousands, except per share data	**2012**	**2011**	**2010**
Net income (loss) attributable to Pentair Ltd.	$ (107,186)	$ (7,450)	$ 184,913
Net income (loss) from continuing operations attributable to Pentair Ltd.	$ (107,186)	$ (7,450)	$ 185,539
Weighted average common shares outstanding			
Basic	127,368	98,233	98,037
Dilutive impact of stock options and restricted stock awards (1)			1,257
Diluted	127,368	98,233	99,294
Earnings (loss) per common share attributable to Pentair Ltd.			
Basic			
Continuing operations	$ (0.84)	$ (0.08)	$ 1.89
Discontinued operations			(0.01)
Basic earnings (loss) per common share	$ (0.84)	$ (0.08)	$ 1.88

Diluted						
Continuing operations	$	(0.84)	$	(0.08)	$	1.87
Discontinued operations						(0.01)
Diluted earnings (loss) per common share	$	(0.84)	$	(0.08)	$	1.86
Anti-dilutive stock options and restricted stock awards [(2)]		16,007		8,357		3,711

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(1) The incremental share impact from stock options and restricted stock awards was computed using the treasury stock method.

(2) Stock options and restricted stock awards that were not dilutive were excluded from our calculation of diluted weighted average shares.

6. Restructuring

During 2012 and 2011, we initiated certain business restructuring initiatives aimed at reducing our fixed cost structure and realigning our business. The 2012 initiatives included the reduction in hourly and salaried headcount of approximately 1,000 employees, which included 500 in Water & Fluid Solutions, 300 in Valves & Controls and 200 in Technical Solutions. The 2011 initiatives included the reduction in hourly and salaried headcount of approximately 210 employees, which included 160 in Water & Fluid Solutions and 50 in Technical Solutions.

Restructuring related costs included in *Selling, general and administrative* expenses in the Consolidated Statements of Operations and Comprehensive Income (Loss) included costs for severance and other restructuring costs as follows:

	Years ended December 31		
In thousands	**2012**	**2011**	**2010**
Severance and related costs	$ 61,560	$ 11,500	$
Other	5,340	1,500	
Total restructuring costs	$ 66,900	$ 13,000	$

Total restructuring costs related to Water & Fluid Solutions, Valves & Controls and Technical Solutions were $49.1 million, $5.1 million and $12.7 million, respectively, for the year ended December 31, 2012. Total restructuring costs related to Water & Fluid Solutions and Technical Solutions were $11.0 million and $2.0 million, respectively, for the year ended December 31, 2011.

We assumed $17.1 million of restructuring accruals from actions initiated by Flow Control prior to the Merger relating to employee severance, facility exit and other restructuring costs. Activity in the restructuring accrual recorded in *Other current liabilities* and *Employee compensation and benefits* in the Consolidated Balance Sheets is summarized as follows:

	Years ended December 31	
In thousands	**2012**	**2011**
Beginning balance	$ 12,805	$ 3,994
Acquired	17,062	
Costs incurred	61,560	11,500
Cash payments and other	(34,868)	(2,689)
Ending balance	$ 56,559	$ 12,805

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7. Goodwill and Other Identifiable Intangible Assets

The changes in the carrying amount of goodwill for the year ended December 31, 2012 and December 31, 2011 by reportable segment were as follows:

In thousands	December 31, 2011	Acquisitions	Foreign currency translation/other	December 31, 2012
Water & Fluid Solutions	$ 1,994,781	$ 402,254	$ 18,684	$ 2,415,719
Valves & Controls		1,342,621		1,342,621
Technical Solutions	279,137	856,111	924	1,136,172
Total goodwill	$ 2,273,918	$ 2,600,986	$ 19,608	$ 4,894,512

In thousands	December 31, 2010	Acquisitions	Foreign currency translation/other	December 31, 2011
Water & Fluid Solutions	$ 1,784,100	$ 466,182	$ (255,501)	$ 1,994,781
Valves & Controls				
Technical Solutions	281,944		(2,807)	279,137
Total goodwill	$ 2,066,044	$ 466,182	$ (258,308)	$ 2,273,918

In 2011, we recorded an impairment charge of $200.5 million in Water & Fluid Solutions which is included in Foreign currency translation/other above. Accumulated goodwill impairment losses were $200.5 million as of December 31, 2012 and December 31, 2011.

Identifiable intangible assets consisted of the following at December 31:

	2012			2011		
In thousands	Cost	Accumulated amortization	Net	Cost	Accumulated amortization	Net
Finite-life intangibles						
Customer relationships	$ 1,276,793	$ (152,769)	$ 1,124,024	$ 358,410	$ (109,887)	$ 248,523
Trade names	1,525	(686)	839	1,515	(530)	985
Proprietary technology	263,647	(57,711)	205,936	134,737	(43,994)	90,743
Backlog	41,240	(18,278)	22,962			
Total finite-life intangibles	1,583,205	(229,444)	1,353,761	494,662	(154,411)	340,251
Indefinite-life intangibles						
Trade names	555,895		555,895	252,034		252,034
Total intangibles, net	$ 2,139,100	$ (229,444)	$ 1,909,656	$ 746,696	$ (154,411)	$ 592,285

Identifiable intangible asset amortization expense in 2012, 2011 and 2010 was $76.0 million, $41.9 million and $24.5 million, respectively.

In 2012 we recorded an impairment charge for trade name intangible assets of $49.1 million and $11.6 million in Water & Fluid Solutions and Technical Solutions, respectively.

Estimated future amortization expense for identifiable intangible assets during the next five years is as follows:

In thousands	**2013**	**2014**	**2015**	**2016**	**2017**
Estimated amortization expense	$ 135,308	$ 113,848	$ 113,559	$ 112,770	$ 111,625

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8. Supplemental Balance Sheet Information

In thousands	December 31 2012	2011
Inventories		
Raw materials and supplies	$ 615,809	$ 219,487
Work-in-process	207,794	47,707
Finished goods	556,668	182,669
Total inventories	$ 1,380,271	$ 449,863
Other current assets		
Cost in excess of billings	$ 124,447	$ 54,701
Prepaid expenses	94,950	42,831
Deferred income taxes	68,277	60,899
Other current assets	38,434	10,260
Total other current assets	$ 326,108	$ 168,691
Property, plant and equipment, net		
Land and land improvements	$ 247,868	$ 41,111
Buildings and leasehold improvements	482,106	244,246
Machinery and equipment	1,096,469	692,930
Construction in progress	114,309	40,251
Total property, plant and equipment	1,940,752	1,018,538
Accumulated depreciation and amortization	716,264	631,013
Total property, plant and equipment, net	$ 1,224,488	$ 387,525
Other non-current assets		
Asbestos-related insurance receivable	$ 157,394	$
Deferred income taxes	89,040	
Other non-current assets	259,853	94,750
Total other non-current assets	$ 506,287	$ 94,750
Other current liabilities		
Deferred revenue and customer deposits	$ 127,149	$ 10,151
Dividends payable	94,967	
Billings in excess of cost	61,126	17,732
Accrued warranty	53,696	29,355

Other current liabilities		333,224		166,470
Total other current liabilities	$	670,162	$	223,708
Other non-current liabilities				
Asbestos-related liabilities	$	234,567	$	630
Deferred revenue		73,397		
Taxes payable		49,324		26,470
Other non-current liabilities		96,299		96,409
Total other non-current liabilities	$	453,587	$	123,509

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9. Supplemental Cash Flow Information

The following table summarizes supplemental cash flow information:

	Years ended December 31		
In thousands	2012	2011	2010
Cash paid for interest, net	$ 66,683	$ 54,516	$ 37,083
Cash paid for income taxes, net	82,235	64,389	55,991

10. Accumulated Other Comprehensive Income (Loss)

Components of AOCI consist of the following:

	December 31	
In thousands	2012	2011
Unrecognized pension and other post-retirement benefit costs, net of tax	$ 364	$ 617
Cumulative translation adjustments	1,009	(33,407)
Market value of derivative financial instruments, net of tax	(8,571)	(4,941)
Accumulated other comprehensive income (loss)	$ (7,198)	$ (37,731)

11. Debt

Debt and the average interest rates on debt outstanding were as follows:

In thousands	Average interest rate at December 31, 2012	Maturity year	December 31 2012	December 31 2011
Commercial paper	0.664%	2017	$ 424,684	$ 3,497
Revolving credit facilities		2017		168,500
Senior notes - fixed rate	1.350%	2015	350,000	
Senior notes - fixed rate	1.875%	2017	350,000	
Senior notes - fixed rate	2.650%	2019	250,000	
Senior notes - fixed rate	5.000%	2021	500,000	500,000
Senior notes - fixed rate	3.150%	2022	550,000	
Senior notes - fixed rate				400,000
Senior notes - floating rate				205,000
Other	0.562%	2014-2030	8,880	16,302
Capital lease obligations	4.313%	2015-2025	23,810	15,788
Total debt			2,457,374	1,309,087
Less: Current maturities and short-term borrowings			(3,096)	(4,862)

Long-term debt	$ 2,454,278	$ 1,304,225

In December 2012, our wholly-owned subsidiary, Pentair Finance S.A. (PFSA), completed an exchange offer (the Exchange Offer) pursuant to which it exchanged $373 million in aggregate principal amount of 5.00% Senior Notes due 2021 of Pentair, Inc., a wholly-owned, indirect subsidiary of the Company (the 2021 Notes) for a like amount of new 5.00% Senior Notes due 2021 of PFSA (the New 2021 Notes) plus $5.6 million in

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transaction-related costs. Upon completion of the Exchange Offer, $127 million in aggregate principal amount of 2021 Notes remained outstanding. The remaining 2021 Notes and New 2021 Notes are guaranteed as to payment by Pentair Ltd.

In November 2012, PFSA completed a private offering of $350 million aggregate principal amount of 1.35% Senior Notes due 2015 (the 2015 Notes) and $250 million aggregate principal amount of 2.65% Senior Notes due 2019 (the 2019 Notes and, collectively, the 2015/2019 Notes), which are guaranteed as to payment by Pentair Ltd. In certain circumstances, PFSA may be required to pay additional interest on the 2015/2019 Notes. We used the net proceeds from the sale of the 2015/2019 Notes to repay commercial paper and for general corporate purposes.

In October 2012, we redeemed the remaining outstanding aggregate principal of our 5.65% fixed rate senior notes due 2013-2017 totaling $400 million and our 1.05% floating rate senior notes due 2013 totaling $100 million (the Fixed/Floating Rate Notes). The redemptions included make-whole premiums of $65.8 million. Concurrent with the redemption of the Fixed/Floating Rate Notes, we terminated a related interest rate swap that was designated as a cash flow hedge, which resulted in the reclassification of $3.4 million of previously unrecognized variable to fixed swap losses from AOCI to earnings in October 2012. All costs associated with the redemption were recorded as a *Loss on the early extinguishment of debt* including $0.6 million of unamortized deferred financing costs.

In September 2012, PFSA, completed a private offering of $550 million aggregate principal amount of 3.15% Senior Notes due 2022 (the 2022 Notes) and $350 million aggregate principal amount of 1.875% Senior Notes due 2017 (the 2017 Notes and, collectively, the 2017/2022 Notes), which are guaranteed as to payment by Pentair Ltd. In certain circumstances, PFSA may be required to pay additional interest on the 2017/2022 Notes. The 2017/2022 Notes remained outstanding after the Merger. A portion of the net proceeds from the 2017/2022 Notes offering were used to repay $435 million to Tyco in conjunction with the Distribution and the Merger.

In September 2012, Pentair, Inc. entered into a credit agreement providing for an unsecured, committed revolving credit facility (the Credit Facility) with initial maximum aggregate availability of up to $1,450 million. The Credit Facility replaced Pentair, Inc. s $700 million Former Credit Facility (as defined below). The Credit Facility matures in September 2017. Upon the completion of the Merger, Pentair Ltd. became the guarantor under the Credit Facility and PFSA and certain other of our subsidiaries became affiliate borrowers under the Credit Facility. Borrowings under the Credit Facility generally bear interest at a variable rate equal to the London Interbank Offered Rate (LIBOR) plus a specified margin based upon PFSA s credit ratings. PFSA must also pay a facility fee ranging from 10.0 to 30.0 basis points per annum (based upon PFSA s credit ratings) on the amount of each lender s commitment.

In May 2011, Pentair, Inc. completed a public offering of $500 million aggregate principal amount of the 2021 Notes. Pentair, Inc. used the net proceeds from the offering of the 2021 Notes to finance in part the CPT acquisition in 2011. The 2021 Notes which remain outstanding subsequent to the Exchange Offer are guaranteed as to payment by Pentair Ltd.

In April 2011, Pentair, Inc. entered into a Fourth Amended and Restated Credit Agreement that provided for an unsecured, committed revolving credit facility (the Former Credit Facility) of up to $700 million, with multi-currency sub-facilities to support investments outside the U.S. Borrowings under the Former Credit Facility bore interest at the rate of LIBOR plus 1.75%. We used borrowings under the Former Credit Facility to fund a portion of the CPT acquisition in 2011 and to repay $105 million of matured senior notes in May 2012. The Former Credit Facility was terminated in September 2012 in connection with the Merger and replaced by the Credit Facility, at which time the subsidiary guarantees in place under the Former Credit Facility ceased to exist.

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PFSA is authorized to sell short-term commercial paper notes to the extent availability exists under the Credit Facility. PFSA uses the Credit Facility as back-up liquidity to support 100% of commercial paper outstanding. As of December 31, 2012 and 2011, we had $424.7 million and $3.5 million, respectively, of commercial paper outstanding, all of which was classified as long-term as we have the intent and the ability to refinance such obligations on a long-term basis under the Credit Facility.

We used borrowings under the Credit Facility and proceeds from the 2017/2022 Notes offering, to repay the Former Credit Facility and to pay other fees and expenses in connection with the Merger. Total availability under the Credit Facility was $1,025.3 million as of December 31, 2012, which was not limited by any covenants contained in the Credit Facility s credit agreement. Subsequent to the Merger, we used the remaining proceeds from the 2017/2022 Notes offering and issuances of commercial paper to redeem the Fixed/Floating Rate Notes as discussed above, to repurchase shares in conjunction with our share repurchase as discussed in Note 15 and to purchase the remaining 25% interest in KEF for $100 million as discussed in Note 4.

Our debt agreements contain certain financial covenants, the most restrictive of which are in the Credit Facility, including that we may not permit (i) the ratio of our consolidated debt plus synthetic lease obligations to our consolidated net income (excluding, among other things, non-cash gains and losses) before interest, taxes, depreciation, amortization, non-cash share-based compensation expense, and up to $40 million of costs and expenses incurred in connection with the Merger (EBITDA) for the four consecutive fiscal quarters then ended (the Leverage Ratio) to exceed 3.50 to 1.00 on the last day of each fiscal quarter, and (ii) the ratio of our EBITDA for the four consecutive fiscal quarters then ended to our consolidated interest expense, including consolidated yield or discount accrued as to outstanding securitization obligations (if any), for the same period to be less than 3.00 to 1.00 as of the end of each fiscal quarter. For purposes of the Leverage Ratio, the Credit Facility provides for the calculation of EBITDA giving pro forma effect to the Merger and certain acquisitions, divestitures and liquidations during the period to which such calculation relates. As of December 31, 2012, we were in compliance with all financial covenants in our debt agreements.

In addition to the Credit Facility, we have various other credit facilities with an aggregate availability of $89.0 million, of which $3.0 million was outstanding at December 31, 2012. Borrowings under these credit facilities bear interest at variable rates.

Debt outstanding at December 31, 2012 matures on a calendar year basis as follows:

In thousands	**2013**	**2014**	**2015**	**2016**	**2017**	**Thereafter**	**Total**
Contractual debt obligation maturities	$	$ 65	$ 350,000	$	$ 777,706	$ 1,305,793	$ 2,433,564
Capital lease obligations	3,096	3,171	6,036	1,236	1,236	9,035	23,810
Total maturities	$ 3,096	$ 3,236	$ 356,036	$ 1,236	$ 778,942	$ 1,314,828	$ 2,457,374

As part of the Merger and CPT acquisition, we assumed capital lease obligations related primarily to land and buildings. As of December 31, 2012 and December 31, 2011, the recorded values of the assets acquired under those capital leases were $35.5 million and $22.7 million, respectively, less accumulated amortization of $6.0 million and $5.1 million, respectively, all of which were included in *Property, plant and equipment, net* on the Consolidated Balance Sheets.

Capital lease obligations consist of total future minimum lease payments of $26.1 million less the imputed interest of $2.3 as of December 31, 2012.

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12. Derivatives and Financial Instruments

Derivative financial instruments

We are exposed to market risk related to changes in foreign currency exchange rates and interest rates on our floating rate indebtedness. To manage the volatility related to these exposures, we periodically enter into a variety of derivative financial instruments. Our objective is to reduce, where it is deemed appropriate to do so, fluctuations in earnings and cash flows associated with changes in foreign currency rates and interest rates. The derivative contracts contain credit risk to the extent that our bank counterparties may be unable to meet the terms of the agreements. The amount of such credit risk is generally limited to the unrealized gains, if any, in such contracts. Such risk is minimized by limiting those counterparties to major financial institutions of high credit quality.

Interest rate swaps

During 2012 and 2011, we used floating to fixed rate interest rate swaps to mitigate our exposure to future changes in interest rates related to our floating rate indebtedness. We designated these interest rate swap arrangements as cash flow hedges. As a result, changes in the fair value of the interest rate swaps were recorded in *AOCI* on the Consolidated Balance Sheets throughout the contractual term of each of the interest rate swap arrangements.

During the year ended December 31, 2012, all of our interest rate swaps expired or were terminated and, as a result, we had no outstanding interest rate swap arrangements at December 31, 2012.

In August 2007, we entered into a $105 million interest rate swap agreement with a major financial institution to exchange variable rate interest payment obligations for a fixed rate obligation without the exchange of the underlying principal amounts in order to manage interest rate exposures. The effective date of the swap was August 30, 2007. The swap agreement had a fixed interest rate of 4.89% and expired in May 2012. The fixed interest rate of 4.89% plus the .50% interest rate spread over LIBOR resulted in an effective fixed interest rate of 5.39%. The fair value of the swap was $1.7 million at December 31, 2011 and was recorded in *Other current liabilities* in the Consolidated Balance Sheets.

In September 2005, we entered into a $100 million interest rate swap agreement with several major financial institutions to exchange variable rate interest payment obligations for fixed rate obligations without the exchange of the underlying principal amounts in order to manage interest rate exposures. The effective date of the fixed rate swap was April 25, 2006. The swap agreement has a fixed interest rate of 4.68% and was set to expire in July 2013. The fixed interest rate of 4.68% plus the .60% interest rate spread over LIBOR results in an effective fixed interest rate of 5.28%. This swap was terminated in October 2012. The fair value of the swap was $6.3 million at December 31, 2011 and was recorded in *Other current liabilities* in the Consolidated Balance Sheets. A loss of $3.3 million was recognized upon termination and was recorded in *Loss on early extinguishment of debt* in the Consolidated Statements of Operations and Comprehensive Income (Loss) for the year ended December 31, 2012.

Derivative gains and losses included in *AOCI* were reclassified into earnings at the time the related interest expense was recognized or the settlement of the related commitment occurred. Interest expense from swaps was $5.3 million and $9.3 million in 2012 and 2011, respectively, and was recorded in *Interest expense* in the Consolidated Statements of Operations and Comprehensive Income (Loss).

In April 2011, as part of our planned debt issuance to fund the CPT acquisition, we entered into interest rate swap contracts to hedge movement in interest rates through the expected date of closing for a portion of the expected fixed rate debt offering. The swaps had a notional amount of $400 million with an average interest rate of 3.65%. In May 2011, upon the sale of the 2021 Notes, the swaps were terminated at a cost of $11.0 million. Because we

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used the contracts to hedge future interest payments, this was recorded in *AOCI* in the Consolidated Balance Sheets and will be amortized as interest expense over the 10 year life of the 2021 Notes. The ending unrealized net loss in *AOCI* at December 31, 2012 was $9.2 million.

Foreign currency contracts

We conduct business in various locations throughout the world and are subject to market risk due to changes in the value of foreign currencies in relation to our reporting currency, the U.S. dollar. We manage our economic and transaction exposure to certain market-based risks through the use of foreign currency derivative financial instruments. Our objective in holding these derivatives is to reduce the volatility of net earnings and cash flows associated with changes in foreign currency exchange rates. The majority of our foreign currency contracts have an original maturity date of less than one year. At December 31, 2012 and 2011, we had outstanding foreign currency derivative contracts with gross notional U.S. dollar equivalent amounts of $163.7 million and $79.9 million, respectively. The impact of these contracts on the Consolidated Statements of Operations and Comprehensive Income (Loss) is not material for any period presented.

In March 2011, we entered into a foreign currency option contract to reduce our exposure to fluctuations in the euro related to the planned CPT acquisition. The contract had a notional amount of 286.0 million, a strike price of 1.4375 and a maturity date of May 13, 2011. In May 2011, we sold the foreign currency option contract for $1.0 million. The net cost of $2.1 million was recorded in *Selling, general and administrative* on the Consolidated Statements of Operations and Comprehensive Income (Loss).

Fair value of financial instruments

The recorded amounts and estimated fair values of total debt at December 31, excluding the effects of derivative financial instruments, were as follows:

	2012		**2011**	
In thousands	**Recorded Amount**	**Fair Value**	**Recorded Amount**	**Fair Value**
Variable rate debt	$ 427,706	$ 427,706	$ 406,978	$ 406,978
Fixed rate debt	2,029,669	2,081,264	902,109	954,053
Total debt	$ 2,457,375	$ 2,508,970	$ 1,309,087	$ 1,361,031

The following methods were used to estimate the fair values of each class of financial instrument measured on a recurring basis:

short-term financial instruments (cash and cash equivalents, accounts and notes receivable, accounts and notes payable and variable-rate debt) recorded amount approximates fair value because of the short maturity period;

long-term fixed-rate debt, including current maturities fair value is based on market quotes available for issuance of debt with similar terms, which are inputs that are classified as Level 2 in the valuation hierarchy defined by the accounting guidance; and

interest rate swaps and foreign currency contract agreements fair values are determined through the use of models that consider various assumptions, including time value, yield curves, as well as other relevant economic measures, which are inputs that are classified as Level 2 in the valuation hierarchy defined by the accounting guidance.

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Financial assets and liabilities measured at fair value on a recurring basis were as follows:

Recurring fair value measurements	**December 31, 2012**			
In thousands	**Level 1**	**Level 2**	**Level 3**	**Total**
Foreign currency contract assets	$	$ 2,924	$	$ 2,924
Foreign currency contract liabilities		(551)		(551)
Deferred compensation plan assets [1]	22,394			22,394
Total recurring fair value measurements	$ 22,394	$ 2,373	$	$ 24,767
Nonrecurring fair value measurements				
Trade name intangibles [2]	$	$	$ 63,700	$ 63,700

Recurring fair value measurements	**December 31, 2011**			
In thousands	**Level 1**	**Level 2**	**Level 3**	**Total**
Foreign currency contract assets	$	$ 242	$	$ 242
Foreign currency contract liabilities		(341)		(341)
Interest rate swap liabilities		(8,034)		(8,034)
Deferred compensation plan assets [1]	22,987			22,987
Total recurring fair value measurements	$ 22,987	$ (8,133)	$	$ 14,854
Nonrecurring fair value measurements				
Goodwill [3]	$	$	$ 242,800	$ 242,800

(1) Deferred compensation plan assets include mutual funds and cash equivalents for payment of certain non-qualified benefits for retired, terminated and active employees. The fair value of these assets was based on quoted market prices in active markets.

(2) In the fourth quarter of 2012, we completed our annual intangible assets impairment review. As a result, we recorded a pre-tax non-cash impairment charge of $60.7 million for trade names intangibles. The fair value of trade names is measured using the relief-from-royalty method. This method assumes the trade name has value to the extent that the owner is relieved of the obligation to pay royalties for the benefits received from them. This method requires us to estimate the future revenue for the related brands, the appropriate royalty rate and the weighted average cost of capital.

(3) In the fourth quarter of 2011, we completed our annual goodwill impairment review. As a result, we recorded a pre-tax non-cash impairment charge of $200.5 million in a reporting unit part of Water & Fluid Solutions. The fair value of each reporting unit is determined using a discounted cash flow analysis and market approach. Projecting discounted future cash flows requires us to make significant estimates regarding future revenues and expenses, projected capital expenditures, changes in working capital and the

appropriate discount rate. Use of the market approach consists of comparisons to comparable publicly-traded companies that are similar in size and industry. Actual results may differ from those used in our valuations. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation.

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13. Income Taxes

Income from continuing operations before income taxes and noncontrolling interest consisted of the following:

In thousands	Years ended December 31 2012	2011	2010
Federal [1]	$ 39,177	$ (31,471)	$ 196,101
International	(223,142)	74,737	82,874
Income (loss) from continuing operations before income taxes and noncontrolling interest	$ (183,965)	$ 43,266	$ 278,975

(1) As a result of the Merger, Federal reflects income (loss) from continuing operations before income taxes and noncontrolling interest for Switzerland in 2012 and U.S. for 2011 and 2010.

The provision (benefit) for income taxes consisted of the following: For 2012, Federal represents Swiss taxes, while International represents non-Swiss taxes, including U.S. federal, state and local taxes. For 2011 and 2010 Federal represents U.S. federal taxes, while International reflects non-U.S. taxes.

In thousands	Years ended December 31 2012	2011	2010
Currently payable			
Federal	$ 6,490	$ 51,158	$ 44,766
State		6,980	6,591
International	61,053	24,005	17,877
Total current taxes	67,543	82,143	69,234
Deferred			
Federal	1,270	(26,223)	18,188
International	(148,166)	(9,503)	1,521
Total deferred taxes	(146,896)	(35,726)	19,709
Total provision (benefit) for income taxes	$ (79,353)	$ 46,417	$ 88,943

Reconciliations of the federal statutory income tax rate to our effective tax rate were as follows:

Percentages	Years ended December 31 2012	2011	2010
Federal statutory income tax rate [1]	7.8	35.0	35.0
Tax effect of international operations [2]	23.6	(25.3)	(4.1)
Non-deductible transaction costs	(4.7)		
Impact of debt-financing	10.8		
Resolution of tax audits	5.6		

Goodwill		104.4	
Domestic manufacturing deduction		(8.4)	(1.5)
State income taxes, net of federal tax benefit		4.3	2.0
All other, net		(2.7)	0.5
Effective tax rate	43.1	107.3	31.9

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(1) As a result of the Merger, the statutory rate for 2012 reflects the Swiss statutory rate of 7.83 percent. For 2011 and 2010, the statutory rate reflects the U.S. statutory rate of 35 percent.

(2) As a result of the Merger, the tax effect of international operations for 2012 consists of non-Swiss jurisdictions. For 2011 and 2010, the tax effect of international operations consists of non-U.S. jurisdictions.

Reconciliations of the beginning and ending gross unrecognized tax benefits were as follows:

	Years ended December 31		
In thousands	**2012**	**2011**	**2010**
Beginning balance	$ 26,469	$ 24,260	$ 29,962
Gross increases for tax positions in prior periods	2,198	2,042	286
Gross decreases for tax positions in prior periods	(641)	(192)	(2,490)
Gross increases based on tax positions related to the current year	13,641	3,201	1,431
Gross decreases related to settlements with taxing authorities	(13,202)	(2,465)	(4,182)
Reductions due to statute expiration	(370)	(377)	(747)
Gross increases due to acquisitions	25,938		
Gross increases due to currency fluctuations	438		
Ending balance	$ 54,471		