

**Pentair, Inc. (Q2 2018 Pentair plc Earnings Conference Call)**

**July 25, 2018**

**Corporate Speakers:**

- Jim C. Lucas; Pentair PLC; SVP, Investor Relations and Treasurer
- John L. Stauch; Pentair PLC; President & CEO
- Mark C. Borin; Pentair PLC; Executive VP & CFO

**Participants:**

- Robert Scott Graham; BMO Capital Markets Corp.; Head Government Trading
- Joseph Craig Giordano; Cowen and Company; Managing Director
- Charles Stephen Tusa; J.P. Morgan Securities LLC; Managing Director
- Deane Michael Dray; RBC Capital Markets; Managing Director
- Steven Eric Winoker; UBS; Managing Director
- Brian K. Lee; Goldman Sachs; Vice President
- Nathan Hardie Jones; Stifel Financial Corp.; Senior Equity Analyst
- Jeffrey David Hammond; KeyBanc Capital Markets; Managing Director
- Ronald Drew Weiss; Barclays Investment Bank; Vice President, Equity Research
- Brian Paul Drab; William Blair & Company; Analyst
- Walter Scott Liptak; Seaport Global Securities, LLC; Managing Director

**PRESENTATION**

Operator: Ladies and gentlemen, good day, and thank you for standing by. My name is (Lee Wei), and I'll be your conference operator today. At this time, I would like to welcome everyone to the Second Quarter 2018 Pentair Earnings Conference Call.

All lines have been placed on mute to prevent any background noise. After the speakers remarks there will be a question-and-answer session. Thank you.

I would now like to turn the call over to your host, Mr. Jim Lucas, Senior Vice President, Investor Relations and Treasurer. You may begin your conference.

Jim C. Lucas: Thanks, (Lee Wei), and welcome to Pentair's Second Quarter 2018 Earnings Conference Call. We're glad you could join us.

I'm Jim Lucas, Senior Vice President of Investor Relations and Treasurer. And with me today is John Stauch, our President and Chief Executive Officer; and Mark Borin, our Chief Financial Officer.

On today's call, we will provide details on our second quarter 2018 performance as well as our third quarter and full year 2018 outlook as outlined in this morning's press release.

Before we begin, let me remind you that any statements made about the company's anticipated financial results are forward-looking statements subject to future risks and uncertainties, such as the risks outlined in Pentair's most recent 10-Q, Form 10-K and today's press release.

Forward-looking statements included herein are made as of today, and the company undertakes no obligation to update publicly such statements to reflect subsequent events or circumstances. Actual results could differ materially from anticipated results.

Today's webcast is accompanied by a presentation, which can be found in the Investor Relations section of Pentair's website. We will reference these slides throughout our prepared remarks. Any references to non-GAAP financials are reconciled in the appendix of the presentation.

We will be sure to reserve time for questions and answers after our prepared remarks. I would like to request that you limit your questions to one and a follow-up in order to ensure everyone an opportunity to ask their questions. I will now turn the call over to John.

John L. Stauch: Thank you, Jim, and good morning to everyone. Please turn to slide number 4, titled Executive Summary.

Overall, we are pleased with our second quarter performance, which marks the first quarter we have reported since completing the separation of nVent. Despite a slow start to the quarter, we reported core sales growth of 3%, ROS expansion of 90 basis points to 21%.

Adjusted EPS grew 18% to \$0.71, and we generated \$364 million of free cash flow. Also in the quarter, we took some of our cash flow and bought back \$150 million worth of stock or about 3.3 million shares.

For the full year, we have maintained our core sales growth expectation of 3% to 4%. We are still expecting ROS expansion of approximately 50 basis points to 18%, and we are raising our adjusted EPS guidance to approximately \$2.31, reflecting the benefit of purchased shares as well as slightly better operating performance, offset by slightly worse FX impact.

With half of the year now behind us, we feel more confident in our ability to deliver earnings that should be above the high end of the guidance we provided at the beginning of the year.

I would now like to turn the call over to Mark to discuss the second quarter results and update you on the details of our full year 2018 outlook.

Mark C. Borin: Thank you, John. Please turn to slide 5, labeled Q2 '18 Pentair Performance. As John mentioned, core sales grew 3%, with Aquatic Systems and Flow

Technologies delivering growth and Filtration Solutions declining modestly. We will provide more color on the performance of all 3 segments shortly.

Segment income increased 8% while ROS expanded 90 basis points to 21%. Adjusted EPS grew 18% to \$0.71 per share while our adjusted tax rate remained 18%.

And our share count came in at 178.6 million shares, benefiting in part from the \$150 million in shares we repurchased during the quarter. Free cash flow was strong in the quarter at \$364 million, which was in line with normal seasonal patterns.

Please turn to slide 6, labeled Q2 '18 Pentair Segment Performance. This slide lays out the performance of our 3 segments with trends somewhat similar to what we saw in the first quarter.

Aquatic Systems delivered robust 10% core sales growth in the quarter and income grew 7% while ROS contracted 50 basis points. ROS was negatively impacted in the quarter by growth investments and inflation as the business elected not to implement any off-cycle price increases.

We continue to have a favorable outlook for Aquatics and believe the business is well positioned entering the second half of the year.

Filtration Solutions saw core sales decline 2% as strength in our North American Residential and Commercial businesses was offset by declines in our Industrial and Biogas product lines in the Food & Beverage business.

Segment income for Filtration grew 7% and ROS expanded an impressive 140 basis points to 20%. This is due in part to the business mixing up as we continue to move away from lower-margin project business and further remove complexity from the segment.

Flow Technologies had 2% core sales growth, segment income growth of 10% and ROS expanded 130 basis points to 18.4%. North America remained strong, driven by improvement in our Commercial pump business.

We saw continued strength in our Specialty business, and similar to Filtration Solutions, we saw improvement as we exited or walked away from lower-margin business.

Please turn to slide 7, labeled Balance Sheet and Cash Flow. This is one of our favorite slides this quarter as free cash flow was a very positive story and the balance sheet has further improved as we reduced our debt levels with the cash received as part of the nVent spin-off. In fact, our debt is now at a level not seen since 2010.

Considering our free cash flow generation expected for the remainder of the year and our current debt levels, we believe we are well positioned to invest in the business, look at

attractive, strategically aligned tuck-in or bolt-on acquisition targets and continue to return cash to shareholders.

We have bought back \$300 million in shares year-to-date, and we would remind everyone that we have raised our dividend for 42 consecutive years.

Please turn to slide 8, labeled Q3 '18 Pentair Outlook. We anticipate third quarter core sales to grow 4% to 5%; Aquatic Systems, up 8% to 9%; Filtration Solutions, up 1% to 3%; and Flow Technologies growing 2% to 3%. Segment income is anticipated to be flat while ROS is expected to decline roughly 50 basis points.

This is due principally to higher inflation, including the impact of tariffs and the timing of price increases we are implementing in the third quarter that we do not expect to fully read out until the fourth quarter.

Below the line, we expect the adjusted tax rate to be around 18%, net interest and other expense to be approximately \$8.5 million and our share count should be around 177 million. Adjusted EPS is expected to be approximately \$0.52 per share.

Please turn to slide 9, labeled Second Half 2018 Adjusted EPS Outlook. As mentioned on the previous slide, we are seeing increased inflation across the portfolio, and as a result, we are implementing price increases in all 3 segments during the third quarter.

We have announced the price increases and we are currently implementing them, but we do not expect to see the full benefit of the increases until the fourth quarter.

As a result, we expect to see more pressure on third quarter margins but benefits in the fourth quarter. In addition, second half earnings are expected to benefit from the shares we bought back in the second quarter.

While there are some anticipated shift in earnings from the third quarter to fourth quarter, we are still raising our outlook for the full year.

Please turn to slide 10, labeled 2018 Pentair Outlook. This slide is one we first introduced at our Investor Day in February, and we wanted to provide an update at the halfway point of the year.

The overall sales number is in line with our initial forecast for the year while segment income has moved up, but the walk to get to each of these numbers has changed.

We continue to look for core sales growth of 3% to 4% for the year, with price being a little more favorable. FX has gone from appearing to be a nice tailwind to being modestly positive for the year.

The right-hand section of this slide has seen a significant increase in our outlook for inflation, and we are now looking at \$20 million of incremental growth investments, which is down from our initial target of \$25 million.

We are not dialing back the investments, but the timing of some of the investments for this year were slower in the first half and we wanted to update our full year forecast to reflect this revised timing.

Please turn to slide 11, labeled Full Year 2018 Pentair Outlook. As previously mentioned, our full year core sales growth outlook remains 3% to 4%.

We expect Aquatic Systems core sales to grow 8% to 9%, Filtration Solutions to be flat to up 1% and Flow Technologies to increase 2% to 3%. Segment income is expected to be up around 8% while ROS is expected to end the year around 18%, which would represent an increase of roughly 50 basis points.

Below the line, we expect the full year adjusted tax rate to be around 18%, adjusted net interest and other expense to be roughly \$33 million and shares to be around 178.5 million.

For the full year, we now expect adjusted EPS to be around \$2.31 per share, and we continue to target free cash flow to approximate 100% of adjusted net income. I would like to turn the call back to John.

John L. Stauch: Thank you, Mark. Please turn to slide number 12, titled Pentair Strategy Summary. This page is the same slide we showed you at our Investor Day and in the first quarter earnings discussion.

The good news is nothing has changed, and all I would like to do is remind you that we are focused on our desire to be a pure-play water company, drive focused organic growth strategies and utilize our precious capital wisely to create incremental share owner value.

Regarding capital allocation, we remain committed to maintaining our investment-grade rating, reinvesting in our most attractive core businesses and paying a competitive dividend yield.

We will also look at a balanced approach between M&A and intelligent buybacks, with our M&A decisions being informed by overall valuations and the quality of assets available as well as our ability to integrate them successfully.

Please turn to slide 13, labeled Focused Strategies. As we prioritize our growth opportunities, we believe this allows us the best opportunity to drive differentiated growth in what we believe is a very attractive water quality space. I would like to give you a quick update on our progress regarding 2 of our most important focused strategies.

The first strategy is advancing Pool growth. During the second quarter, we launched a segmentation study to better understand the behaviors of pool consumers.

We believe we made great progress in winning more dealers to allow for greater aftermarket penetration, and we completed an in-depth study of how to accelerate our efforts into the expanding automation space and better penetrate the home – the automated home platforms.

Also during the quarter, we launched our next generation of automation called IntelliConnect. Our second key growth initiative is accelerating Residential and Commercial water treatment.

In the second quarter, we kicked off a consumer segmentation study here as well to better understand the residential water needs of our end consumers and make great progress driving dealer loyalty back to Pentair through our True Blue dealer initiative.

We also concluded our strategic road map of innovative product offerings and how to expand our service offerings in both Residential and Commercial water treatment. More to come in these 2 areas, both on the organic priorities and potential acquisitions as we continue to dial in our clear priorities to differentiate ourselves to customers.

I would now like to turn the call over to (Lee Wei) for Q&A, after which we'll have a few closing remarks. (Lee Wei), please open the line for questions. Thank you.

## QUESTIONS AND ANSWERS

Operator: Thank you so much. So again, ladies and gentlemen, at this time I would like to remind everyone in order to ask a question press star then the number one on your telephone keypad.

Again, that's press star then the number one on your telephone keypad. We'll pause for just a moment to compile the Q&A roster. Excuse me presenters. So we have our first question, comes from the line of Scott Graham from BMO.

Robert Scott Graham: So I just really – I apologize for jumping on a couple of minutes late, so I missed the early – I just wanted to maybe ask you a broader question. I know you've talked about and I heard you at the end here say 2 to 3 years of movement toward more of a sales model involving – reaching deeper and this kind of thing.

I was just wondering if you can kind of give us some dates on that, John, sort of like "when do you expect to be where" type of thing.

By the end of this year, with your channel partners, what do you expect to have accomplished, by the end of next year, that kind of thing? Because, obviously, the – there's a big opportunity here to connect more closely with customers than you have before.

I know that that's what you want to do. And I was just kind of hoping you can kind of give us how this lays out, maybe if you have any type of benchmarks, any type of metrics that you use internally to measure yourselves on this, end of this year, end of next year kind of thing.

John L. Stauch: All right. Thanks, Scott. I – yes, I mean, I just want to remind everybody we're 85 days in, and I think the best way to express is we're where we thought we'd be at this stage.

I think we're really excited about our strategy, but more importantly, our commercial excellence process that we've rolled out and really utilizing the commercial excellence process to drive our prioritized growth.

And so as an example, making sure that we understand that we're – we've served a traditional dealer channel, distribution and dealers, but we also have to influence the consumer.

And so this consumer segmentation work that we're doing is to inform us of what are the buying behaviors of the consumers that we service and how do they want to be served and then helping our dealers run their businesses better so that they can take advantage of what those consumers want.

I think in the Pool business, where we do roughly \$900 million of revenue in Pool and we have about \$800 million net in the U.S., we have a lot of scale and we have a good offering and we have a really good business model.

We happen to go through our next sets of businesses, which, for us, would be our Residential and Commercial water filtration, which is just under \$600 million and then also our Residential pump business, which is just under \$400 million, and we have to have that same model, Scott.

So I have high expectations for the team clearly. But to answer your metric question, it's going to be accelerated organic growth.

And that's the one measurement we're trying to drive here and then making sure that's profitable and we're getting the same drop-throughs. So we're – we've got other metrics, how are we doing on dealer conversions, how are we doing in turning leads into sales.

The earlier indications suggest we're becoming more of a growth culture. But again, I just want to be balanced here. It's 85 days in. So it's hard to call victory on it, but I love the attitude. I love the way the team leaned in, and I'm really appreciative of how they're doing it.

The other thing I would tell you, Scott, is as we move to a growth culture, I was proud that the team worked the price angles the way they are. I mean, we saw some of our competition going off cycle with price increases.

We considered that, but we also thought that it would be better if we were to wait, reflect and go on our normal cycle so that our dealers and our customers can prepare for those price increases, quote their jobs and not have to suffer the consequences of us going off cycle.

So it is hurting us here a little bit in Q3, but I'd say in the long haul, we think that that's going to help us out in Q4 and into next year. And our customers are very appreciative of the way we responded with our price increases.

Robert Scott Graham: Right. And as just my quick follow-up to that. One of the things that we – you and I talked about recently was that there's going to be a cost to this. And I – certainly, it's a welcome cost to get more sustainable organic on a go-forward basis, particularly given your markets are pretty positive.

I guess my simple question is – and I heard you say this, you want to keep the same drop-through. That's obviously a key point. So are you out there internally kind of telling the business units, "Hey, this is kind of – if you want to spend this, you have to fund it with that?" Or is that more of a corporate kind of funding?

John L. Stauch: Yes. I think the funding that we're working on is the focused priorities and the two that I took you through. And most of that is more of what I call enterprise funding, meaning we all know what we're spending the money on and we have ability to measure it.

We're willing to do some slightly lower-margin revenue. I don't think we want to just be margin focused, but at the same time, we want to make sure that, as we grow our revenue, we're not adding complexity.

And we're making sure that that growth leads to share owner value, and that's critical to us. I mean, we are a public company. We're here for the benefit of the share owners, and we have to serve our customers in a way that's good for all.

Operator: And your next question comes from the line of Joe Giordano from Cowen.

Joseph Craig Giordano: John, maybe if you can take us through some of the more obvious, like immediately accretive things that you've done to kind of drive margins in the business.

In like particularly Flow, like margins there look pretty good, considering where the growth was. So what are some of the things that you were able to put through very quickly that are seeing like kind of early results?



John L. Stauch: Yes. I'll hit it quickly, and then Mark can chime in as well. But in Filtration, it's about mix. As you know, we've had some really interesting businesses and we still have those interesting businesses.

We love the technology of those businesses, but we're a lot more focused on where we actually make money and where we should be spending our time and energy. And I think you're seeing that in the benefit there.

In Flow, to Flow's credit, and I really appreciate all the hard work by the team, we've introduced the optimization efforts, getting out of some product lines and getting out of some geographies that were not only not making money but constraining resources and challenging the resources of the SBU.

So by being focused on these core businesses, we may have actually been able to really improve the mix in both of those 2 businesses, and I think you're seeing that in the margin expansion in the quarter.

Joseph Craig Giordano: And is there anything that you called out kind of between the 3Q and 4Q split? I mean, generally, I think those quarters for you are fairly similar in terms of margin, and it looks like maybe a bit more of an acceleration into 4Q. Is that just timing of initiatives that you're putting through? Or is there anything more specific you called out there?

Mark C. Borin: Yes. Really, the key driver of the Q4 ramp is that's when price kicks in. So price comes in at the back half of – the end of Q3, and then we see it fully implemented in Q4.

John L. Stauch: But we publicly announced our price increases here in the last week. Those go effective mid-September-ish for most of our businesses. That's a normal cycle, by the way. And that is what Mark said. We're not going to have the benefit in Q3, but we expect to receive that benefit and then some in Q4.

Joseph Craig Giordano: And then just last for me on the Aquatic side. I mean there was obviously some fear in the market given some comments made earlier by POOLCORP. It seems like your – not just the numbers that you put out, but the guide, it seems like you've gone through that.

Does the channel seem pretty clear? And I know POOLCORP comments for the second half seemed pretty robust. So curious as to like what your view on the channel is there. And any maybe update on some of the newer technologies in that business on the automation side and how those – that's progressing there?

John L. Stauch: Yes. So we just had a slow start in April. I mean, weather was not as we hoped it would be, and I think the team did a really good job responding and making sure we got all the shipments and all the demand service in the back half of the quarter.

The outlook for Pool is very, very strong, and I think we're reflecting that in our current guidance. And demand continues to be almost full up in that business, and things are progressing nicely.

As far as the new products, yes, we got a couple of really good products that we're launching. We launched a new hybrid heater, and we have another version of the heater that's got a high-efficiency rating.

So those are 2 products that we've been working on for some period of time, and we're really excited by IntelliConnect, which is a lower price point. And the purpose of that is to really make sure that automation gets more penetrated across pools.

The penetration rate for automation across all the 5 million pools is less than 10% right now. And we really think by – raising that penetration rate gives us the ability to really upgrade our products and capabilities.

What's really cool about IntelliConnect is it connects to all of the other Pentair products in Filtration and on pump and Flow, which gives you the ability to control those devices.

But also, and I think this is the real breakthrough, it connects to all of the products in the industry if Pentair makes it or doesn't make it within Pool.

And we do think that that is what's necessary to really increase that penetration rate, and then it also gives us the ability to connect with the consumer and begin to think about their experiences with Pentair versus maybe their experiences with some of our competitors in the industry today. So we're very excited by that.

Operator: And your next question comes from the line of Mr. Steve Tusa from JPMorgan.

Charles Stephen Tusa: On Filtration Solutions, what was the weakness in Industrial? What – can you give some color on that, the projects you said were down?

John L. Stauch: Yes. Food and Beverage – it's in the sustainable gas area, where there's a merger that's taking place that's not yet completed, and those investments have substantially stalled. There's also on the Food and Beverage space regarding beer and the de-investment in some of the global breweries that are out there. That's the weakness.

Charles Stephen Tusa: OK. And then just more specifically, I'm not sure, I might have missed this, but what is now kind of the guidance on price/cost for the year?

John L. Stauch: Meaning?

Charles Stephen Tusa: Price/cost like material inflation versus pricing?

John L. Stauch: Yes. So it's in the slides, Steve. I'll point them out for you. So full year, we're getting \$0.19 of price and our inflation is \$0.35. It's on slide 9. About 2/3 is related to material and about 1/3 of that being related to – no, I'm sorry – 1/3 and 2/3...

Mark C. Borin: 2/3 of it is material, and 1/3 of it is labor.

Charles Stephen Tusa: OK. And as far as the timing of these price increases, I mean, have you already kind of gone out with some of these in – early in the third quarter here? Are we – or is it more kind of back-end loaded?

John L. Stauch: I shared that too, Steve. We went out with everything so far, but they're not effective until mid-September. And that's why we're (getting slightly) in Q3 and then we expect to have more of a benefit in Q4 related to those price increases.

We probably – real quick, Steve. I shared this. I think it was important that we – we listen to the channel. We listen to our customers. And our customers were asking for non-off cycle because they're out there with quotes. Especially in the Pool industry, you're quoting 6 to 9 months ahead of time.

We just didn't feel it was right for them to absorb that price without having a heads up that it was coming. So we feel like this is giving 60 days notice, is what's appreciated by the channel.

And I'm proud of the team for bringing that forward and, for us, exercising these price increases in a way that everybody can get behind.

Charles Stephen Tusa: I mean, isn't the – is your competition not putting price through? Like, I mean, in HVAC, they didn't really seem to have that kind of problem of conditioning the channel.

They went with kind of a mid-season – unusual mid-season price increase. Is there something going on in the industry that kind of drove that kind of behavior? I mean, it's just a little unusual to kind of ask your customers and then oblige when they say that they don't want a price increase.

John L. Stauch: Yes. I mean, they didn't say they didn't. The issue is – I mean, it's – any job that was quoted – and I do know the industry you're referring to.

That's more of a break and fix and – other than the new construction jobs that they're working. But if you're installing a pool, for instance, and you quoted the customer, those price increases coming off cycle are coming completely out of your pocket.

You're not passing it along. If you have the ability to know that price increase is coming and even though it's significant price increases we're going forward with, you'll at least have the ability to know how to quote your next set of jobs and you're not losing on the jobs you originally have.

So I don't know about the HVAC industry. We're not in it. But for our industries, we think we did it the appropriate way.

Operator: And your next question comes from the line of Mr. Deane Dray from RBC.

Deane Michael Dray: I'd like to start with Mark and get some perspective on the free cash flow this quarter, which was significantly above expectations. I think part of it – the explanation is both we should be looking at this as a first half as opposed to a second quarter.

And aren't we also now seeing the – Pentair is a water pure play, and the Pool, sort of the build of inventory in the first quarter and then that gets – comes through in the second quarter. Just want to make sure that's – we're just seeing the seasonality to this. And is it – a first half comparison is more appropriate?

Mark C. Borin: Sure. That's right. You kind of answered the question there. A couple of things. One, what we're seeing now is Pentair on its own with nVent in discontinued operations, and that includes the cash associated with the separation and discontinued operations.

So what you see in our numbers is the continuing operations, which is really reflective of the ongoing business. And as you said, the Pool business really has that big seasonal cash influx in the second quarter – at the end of the second quarter. So on a year-to-date basis, we're at about \$160 million.

And then we see – to get to the 100% of net income, which is about \$410 million, that will be a little bit more ratable in the back half. Think of it as 125-ish per quarter to round out the year. But yes, we feel very good about the cash that came in, in the quarter and where we are on a year-to-date basis.

Deane Michael Dray: Got it. And then just shifting back to the price increase and price/cost. Just a couple of clarifications, the first being, wouldn't it make – first of all, I get why you're not – you didn't put the – go off cycle with pricing, and that makes sense to us.

But the idea here is, wouldn't you maybe get some pull forward as you got some dealers doing some pre-buy ahead of the price increase? And wouldn't that benefit the tail end – or benefit third quarter more? So that question. And then what's the impact of tariffs? And how have you calibrated that?

Mark C. Borin: Sure. So maybe first just on the timing of the price increase. So as John referenced, we announced it last week, effective middle of September. And to clarify, the normal cycle of price increases is mid-September for the Pool business.

The other businesses are typically at the beginning of the year. So in fact, the timing of the increase in the Flow and Filtration side was accelerated for the very reasons that we talked about. And so that – as we said, that will start to pick up at the end of September and then be fully in our Q4 numbers.

Deane Michael Dray: Tariffs?

Mark C. Borin: Yes, sorry. Thank you. Tariffs are included in our number. And frankly, the reason why we're not breaking those out separately is we really think of tariffs as just a form of inflation, and when you look at the direct impact, that's not really the most significant piece.

What we're really looking at is the indirect and the indirect indirect, so trying to make assumptions around what we think is going to be passed through to us and then really what are – other suppliers that may not be impacted by China, how are they going to use that as an opportunity potentially to raise price to us.

So we factored all of that into our inflation assumptions for the back half of the year and for next year as we think about the price increase that we put in place here.

Now – and we're going to stay agile and continue to look at things as they develop. And as I said, because this was off cycle in Flow and Filtration, if we need to reevaluate further, we certainly have the ability to do that.

Deane Michael Dray: Got it. And then last question is – we had the opportunity a couple of weeks ago to meet with Pentair at Singapore Water Week and then at – in Shanghai to see your big commercial beverage customer. And just reflecting what your opportunities are in China and Asia Pacific.

John, under focused strategies, it looks like maybe it didn't fit on the page, but there was a third priority earlier in your outlook that talked about the China opportunity and Asia Pacific broadly. So if you could just bring us up to date on that, appreciate it.

John L. Stauch: Yes. It's still a very important priority. It's more longer term. As you know, Deane, it's \$160 million in China, Southeast Asia today, and we think it can grow at a very significant rate.

And as you probably saw, and I really appreciated you spending the time out there, we got to control our own destiny, especially around the Internet and the fact that we have to think of the MSRP or list price and then work back off of that and really understand Tmall and JD.com and make sure that we've got our capabilities and we're controlling our own destinies around that.

So in the near term, I would expect a little bit of disruption as we start to manage a lot of that, product descriptions and how we want to demonstrate our products in the marketplace and control the consumer and the customer experience.

But in the long run, we're very excited about our growth opportunities there and really are excited about the market and our ability to serve it.

We do have the right products. I think we're well positioned, especially around food service. And I'm really proud of the way the team is leaning in and driving those results. Thanks for bringing it up.

Operator: Your next question comes from the line of Mr. Steven Winoker from UBS.

Steven Eric Winoker: And John, congrats on the first quarter as a standalone. That's great.

John L. Stauch: Thank you, Steve. A lot of work went into it, as you know.

Steven Eric Winoker: I do, I do. I just want to first hit on the capital deployment comment that you made in light of debt levels also coming down fairly quickly here.

As you look at those priorities at this point and we look at the share repo, et cetera, is that – should there be an expectation in the investment community that given the pipeline and given where you were in sort of building the standalone right now, that the repurchase could accelerate even further?

John L. Stauch: No, Steve. I think, first of all, we did buy back some stock, and I think we want to be agile with our capital allocation strategy.

And if we see an opportunity or we feel that we're not – the value we think we could drive is not properly reflected in the market, I think we're going to use our capital in that way.

At the same time, I do think we have the ability to really build some great businesses here, and we want to continue to build out those funnels and those pipelines of opportunities.

And as those opportunities become more and more realistic, we want to be able to act on them and then integrate them in a way that the share owner benefits significantly from.

So we're active, we're looking. We're encouraged by the direction of the funnel right now. And the potential discussions that didn't seem likely 6 months ago and now we're starting to see more discussions happen as I think some of these owners of these properties are looking forward and it might not feel as robust to them on a look-forward basis as it did just 3 months ago before there was maybe global supply chain challenges, to use a fancy word there.

But I think the opportunity in front of us, Steve, is great, and I want to be flexible with our capital and use it in the share owners' best interest.

Steven Eric Winoker: OK. Well, I was going to ask about Aquatics, but given that answer, if you look at Filtration and Flow Control versus Aquatics on the M&A pipeline that's out there and given the levels of consolidation globally in all of that, I mean, should we expect activity on the Filtration side more, the Flow? Or how are you thinking about that?

John L. Stauch: I think we should look at it as – Water Filtration is our second-biggest business next to Pool, and it's a business that's definitely worth investing in.

I think some of the themes about getting closer to a consumer, meaning how do we connect through automation and how do we maybe connect to the services realm, are a couple of themes that we would think are likely to occur as we build out the M&A pipeline, Steve.

Steven Eric Winoker: OK. And just one other question or clarification for Mark is, on that tariff answer that you gave, does that mean in the pricing increases that you've already taken that you are contemplating sort of the 301 tariffs but nothing further this point?

Because it was a little unclear to me sort of which part of the tariffs you've already kind of baked in that are – that the current price announcement that you've talked about cover versus some of the ones that are maybe, I don't want to use the word, that are still uncertain that are out there.

Mark C. Borin: Yes. So the – our price and our view of inflation overall is reflective of all of the tariff information that's currently out there, whether it's actually enacted or not.

And frankly, the second – or the third round or the most recent round that was announced a few weeks ago has very little impact to us, but we did take a look at that and feel that we have that covered but, again, very small dollars.

John L. Stauch: Steve, at some point, we'll be – have the tariffs on all of – everything that we get out of China, right? There's very little left to tariff for.

Operator: And your next question comes from the line of Brian Lee from Goldman Sachs.

Brian K. Lee: Just had one. Most of mine have actually been covered. But on the guidance specifically, Mark, you're moving around the sales growth outlook for Aquatics and Filtration quite a bit here, and then you're also coming off a quarter where ROS beat by a pretty healthy margin.

So wondering why there's no change here to the full year ROS views across the board and by segment. And I guess curious, is that some conservatism for the back half given some moving pieces around price, cost and mix?

But particularly for Aquatics, given the better growth expectation here, I was wondering how you're thinking about the ROS targets here through the back half of the year.

Mark C. Borin: Yes, sure. As I said in my remarks, the numbers themselves are pretty similar, but the way we get to the numbers are quite a bit different. So it is some of the things that you mentioned.

As we talked about, Q3 with inflation kicking in and the impact of tariffs coming in but price not yet being there, that's really the biggest driver of why – as you look at margins across the three businesses and overall, why they tend to not be expanding as much as you might otherwise think. We see that ramp and improve a little bit in Q4. And we're continuing to invest.

So I talked about the fact that, in the first half, the timing and the pace of our growth investment was a little bit lower than what we had originally planned, but we're still very committed to investing for growth.

And in the back half of the year, we're maintaining the growth investments in those key parts of the business that we think we have the biggest opportunities.

Operator: And your next question comes from the line of Nathan Jones from Stifel.

Nathan Hardie Jones: John, you talked a little bit about exiting some low-margin revenue, I think, particularly in Filtration at the moment, but you've also talked about opportunities to do that in Flow.

Can you guys comment just a little bit on what potentially the drag to your core sales growth number for fiscal '18 are from voluntary exit of some of this revenue so we can get maybe a little bit of a better idea of what core sales growth really is?

John L. Stauch: Yes. That's all – just to be clear, all of that is being handled in the divestiture. Right. So it's about ...

Mark C. Borin: About 1 point.

John L. Stauch: About 1 point, about – just shy of \$40 million for the year.

Nathan Hardie Jones: So those – the Filtration targets of 0 to 1% and Flow of 2% to 3% are actually independent of those exited product lines?

John L. Stauch: That is correct.

Nathan Hardie Jones: OK. Productivity goal for the year, I think, is about \$28 million. I know you guys had been disappointed in 2017 with productivity, though I think a lot of that resided in nVent.



Is that a number that you can see accelerating as we go through 2019? Is it a number you're happy with? Do you think it can be improved? Or just any color you can give us on future productivity expectations?

Mark C. Borin: Sure. One thing I'd remind you is that the productivity that's reflected, it's on page 10 of the presentation, that does include the \$20 million of growth investments.

So it's really something closer to \$50 million. But that said, we certainly think that there remains opportunities to get after further productivity.

And as we talked about before, that \$20 million will then be embedded in the underlying numbers of the business. So it'll still be there for continued investment in the future, but it won't be a year-over-year headwind.

Nathan Hardie Jones: Are there specific initiatives that you're looking at, at the moment to improve productivity?

John L. Stauch: Yes. I mean, I think, we're – just to remind you, I mean, productivity is also – think about OCOGS, right, manufacturing efficiency.

And we're – we've got a higher freight cost going through, which we're working on those elements as well. And I think that we feel that we have a path to accelerate organic growth, and we're going to get that leverage on top of the existing facilities.

But if you look longer term, I mean, automation is a theme, more intelligent factories is a theme. I mean, we've got a lot of things we're working on, Nathan. But as far as large cost-out initiatives or incremental restructuring, we'd like to say that, that's generally behind us.

Operator: And your next question comes from the line of Jeff Hammond from KeyBanc Capital.

Jeffrey David Hammond: Just to be clear on the investments. So I think you were saying \$25 million and now you're saying \$20 million, so it's pretty de minimis what the deferral is.

Mark C. Borin: That's correct, yes.

Jeffrey David Hammond: OK, OK. That's helpful. And then just on Filtration, I know you cited the Industrial project weakness, but it just seems like, in a pretty good global demand environment, growth still seems to be problematic, anemic. So what do you need to see to kind of start to see better growth within that business?

John L. Stauch: Yes. So just to be clear, we have an Industrial filtration business within Filtration Solutions as well, and that's doing really well, obviously, with the recovery of oil and gas and a lot of the global manufacturing.

It's specifically the piece exposed to the Food and Beverage, which is beer, Jeff, and also our sustainable gas offerings that also go into that industry via a couple of gas management companies that are in the process of a merger.

So that's where we're really seeing that headwind. And yes, what do we need? We need to make sure that the Residential and Commercial portfolio, which has done well, continues to become a higher percentage of the revenue, that it continues to grow at a rate greater than it's currently growing today.

So it's the focus within the portfolio, and I think the focus has helped margins. You're not yet seeing that on the core growth in Filtration. We understand that, and we got to get that going.

Jeffrey David Hammond: OK. And anything in Food and Beverage that would indicate that starts to get better or these gas management companies indicating that they would be picking back up into '19?

John L. Stauch: Only in the sense that – if you think about where those projects are in the whole scheme of things, you're looking at about \$30 million, \$40 million right now, right?

So as a percentage of the overall portfolio, it's come down substantially. But it's not necessarily – I mean, you take worst-case scenario of that and you'll see it's not that much of a headwind going forward.

Mark C. Borin: We – so the headwinds that we saw in the first half of the year, we don't anticipate continuing in the back half of the year mainly because of the comps and because, as John said, the business has shrunk to a point that it's a lot smaller so...

Jeffrey David Hammond: OK. And then just back on Aquatics. I don't know if I missed this, did you see any pre-buy impact? Or just maybe talk about sell-in versus sell-through.

Mark C. Borin: No change in the normal buying habits and process. No increase in any kind of early buy or timing of orders. So a pretty normal process and the sell-through was strong.

Operator: And your next question comes from the line of Julian Mitchell from Barclays.

Ronald Drew Weiss: This is Ronnie Weiss on for Julian. I know you don't want to get into 2019 guidance yet, but back on the growth initiatives, as I think about them being pushed out, should we think about these growth initiatives being a multiyear initiative?

And given that volume's a little lighter than initially expected, can we see acceleration into that into next year or 2018 is the peak of what you guys are going to be putting into that?

John L. Stauch: No. I mean, we set out to spend around \$25 million, and we knew that it would be tough to spend it all wisely given the fact that you had – we ratably didn't get there in Q1. So what we're doing is really reflecting where we think the full year spend will likely be.

We're running these ideas – we're a lean company which is process rich, but we also want to be a growth culture which is much more innovative.

But innovative ideas still have to run through a standard process, and you have to test these ideas and we're doing that. And to – before we launch a brand-new product, for instance, we like to have consumer feedback on it.

That takes time. And so we're gathering that consumer information and deciding if consumers actually want what we think they want. And once we have that, we move on to the next phase and move on to the next phase. So yes, do you expect to ramp this a little bit next year?

Probably, as far as investment, but as Mark said, we've ramped \$20 million incremental this year. If you put it on a scale next year, maybe it's \$5-ish incremental, maybe it's \$10 million. So you're still going to have a ratable impact that's positive next year as part of the year-over-year investment there. So I'm not worried about it.

Ronald Drew Weiss: Understood. And then you guys mentioned some mix benefit for Filtration. I was just wondering if you could quantify how much of a margin uplift that was for the quarter and kind of how much it should be for the year.

Mark C. Borin: Yes. Benefit is, on the income side, about 1 point, 1.5 points.

Operator: And your next question comes from the line of Brian Drab from William Blair.

Brian Paul Drab: Most of my questions have been answered, but I just wanted to get clarification on the pricing. I know there's been a lot of questions on pricing, but in terms of the three business segments, which price increases are going through on cycle versus off cycle?

And when is the normal cycle for those price increases to go through? I know, Mark, you mentioned some were accelerated. Can you just clarify that?

Mark C. Borin: Sure. And so the Aquatic Systems business is always – it follows the pool season, which is September to September, so those price increases are normally in the September time frame.

It's the other two businesses that, for the most part, within the businesses, the normal time frame would be the beginning of the year. So early January would be the normal time frame. So those 2, with the announcement here in July with an effective target of mid-September, have been accelerated.

John L. Stauch: And just to clarify my point there, we're hopeful we're going forward with one, and that reflects what we need in 2019 as well. And we're doing that in mid-September, as Mark said.

And so that's hopeful that this stays as the pricing necessary and then those businesses can get on with that expectation in their forecast and our customers can react to that in the appropriate way.

Brian Paul Drab: OK. And then just the last quick one is, on slide 7, 2018 forecast D&A of \$183 million. I think I just need to think about this more, but I mean, \$21 million in D&A in the second quarter, how do we get to \$183 million for the year? I assume that has to do, everything, with the split, but...

John L. Stauch: I think that's wrong number. We'll update it. It's 90-ish for the full year.

Mark C. Borin: Yes.

Operator: And your last question comes from the line of Walter Liptak from Seaport Global.

Walter Scott Liptak: I wanted to ask – we've talked a lot about Aquatics, but I wanted to ask about market share gains. It sounds like, with the more focused strategy, that you may be gaining market share.

This 9.5% growth is pretty good. I wonder if you could help us understand what was market growth, what was market share gains.

John L. Stauch: I mean, we're estimating that, we call it, incremental penetration or differentiated growth is probably somewhere around 1.5 points to 2 points, and the rest would reflect the general volume and the price that we're getting.

Walter Scott Liptak: OK, good. Right. And so there was some price in there. Can you split that out, volume versus price?

John L. Stauch: I think it was – we don't do that. No, just – price is just about under 1 point.

Walter Scott Liptak: OK, great. And then in the restructuring charges, it looks like you're done with the charges now year-to-date. I'm wondering if you can help us understand what the restructuring charges were for.

Is that part of the productivity benefits that you're already receiving? Or is that going to show up in the back half? You talked a little bit about productivity already. I wonder if this is part of that productivity that you were talking about.

Mark C. Borin: Sure. The restructuring is really the – it's the end of the program that we started last year and into this year associated with the separation of the businesses and optimizing the portfolio as we were standing up for the stand-alone Water business.

And a lot of that relates to the – some of the business exits and the product line exits that we've talked about. So those are underway and, certainly, we would expect will drive further productivity as we move into 2019.

Operator: Presenters, there are no further questions at this time. You may continue.

John L. Stauch: Thank you. So thank you for joining us today. And I hope you agree that we delivered a solid second quarter, and we're demonstrating our ability to use agility and prioritization to meet our commitments.

By building up a track record of meeting and exceeding commitments, we hope to earn the trust and right to pursue a compounding strategy that allows us to not only achieve core growth in earnings but also utilize our strong cash flow and capital structure to pursue strategic, targeted and accretive acquisitions. Thank you for your continued interest. And (Lee Wei), you can conclude the call.

Operator: Thank you so much presenters and thank you ladies and gentlemen. This concludes today's conference call. We appreciate your participation. You may now disconnect.