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Pentair plc (PNR)

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MANAGEMENT DISCUSSION SECTION

Operator: Good day and thank you for standing by. Welcome to the Second Quarter 2021 Pentair Earnings Conference Call. At this time, all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised that today's conference is being recorded. [Operator Instructions]

I would now like to hand the conference over to your speaker today, Jim Lucas. Please go ahead.

Jim C. Lucas

Senior Vice President, Treasurer, FP&A & Investor Relations, Pentair plc

Thanks, Michelle, and welcome to Pentair's Second Quarter 2021 Earnings Conference Call. We're glad you could join us. I'm Jim Lucas, Senior Vice President, Treasurer, FP&A and Investor Relations. With me today is John Stauch, our President and Chief Executive Officer; and Bob Fishman, our Chief Financial Officer. On today's call, we will provide details on our second quarter performance as outlined in this morning's press release.

Before we begin, let me remind you that during our presentation today, we will make forward-looking statements. Listeners are cautioned that these statements are subject to certain risks and uncertainties, many of which are difficult to predict and generally beyond the control of Pentair. These risks and uncertainties can cause actual results to differ materially from our current expectations. We advise listeners to carefully review the risk factors in our most recent Form 10-Q, and Form 10-K, and today's release.

We will also reference certain non-GAAP measures. Reconciliations of these non-GAAP measures to the most directly comparable GAAP measures can be found in the Investor Relations section of Pentair's website. 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

President, Chief Executive Officer & Director, Pentair plc

Thank you, Jim, and good morning, everyone. Please turn to slide number 4, titled Executive Summary. We are pleased to deliver a strong second quarter with sales up over 30%, adjusted EPS growth greater than 40%, and free cash flow up over \$100 million in the first half of the year. I would like to thank our Pentair teams for helping deliver these results even in the face of unprecedented material shortages and inflation.

Our orders continue to grow and our backlog ended the quarter at record levels. We believe our order trajectory gives us increased confidence not only in our ability to keep growing in the second half, but it also gives us comfort that the top line momentum we have built the past several quarters will carry over into next year. Our transformation work is on track and we have built a strong pipeline of initiatives across the enterprise. Regarding the current inflationary environment, we have implemented further price increases and we expect the price cost gap to further narrow in the second half.

Our cash flow remains robust and our balance sheet is in a very solid position. We have a strong M&A pipeline tied to our strategic growth initiatives and we plan to remain disciplined with our capital allocation. We are introducing

third quarter guidance and raising our full year expectations once again, which Bob will give more detail on later in the call. Our forecast reflects our expectations that material shortages and inflation are not going away nor will they improve materially. We believe we have better visibility than we have had in the last few quarters and that our proven focus around manufacturing and sourcing gives us the tools to navigate the current environment. We are encouraged to see our commercial industrial businesses recovering and our residential businesses remaining seasonally strong, and as mentioned earlier, our backlog support continued growth.

Please turn to slide 5 labeled Building a Track Record of Consistent Growth. At our June 10th Investor Day, we introduced several targets for 2022 to 2025 including mid-single-digit sales growth, 300 basis points margin expansion, and a 10% plus CAGR for adjusted EPS. Our 2025 targets were based on our guidance as of June 10th, which we are raising once again following our strong second quarter performance. Our longer-term target provided at Investor Day would now be based off of our revised guidance.

We have experienced significant growth since the second half of 2020 and we believe the momentum that we have created will continue into the foreseeable future. We continue to believe that we have a well-positioned portfolio, benefiting from many positive secular trends. Our Pool business serves a large installed base. Water Treatment helped solve water quality issues for residential and commercial customers. And Industrial & Flow Technologies serves some attractive niches like biogas in addition to a large installed base of pumps.

While our consumer businesses are seasonal, we do not believe them to be cyclical. While our focus is on driving the core to create consistent value creation, we are investing in a few strategic growth initiatives to accelerate the top line. These include getting closer to the consumer and Pool, expanding Water Treatment further into services, and biogas and carbon capture within Industrial & Flow Technologies. As we drive transformation more broadly across the entire enterprise, we expect that this will drive both ROS expansion and help fund growth initiatives. Finally, we believe our balance sheet provides a great degree of flexibility to drive further upside primarily through M&A tied to our strategic growth initiatives.

I would now like to turn the call over to Bob to discuss our performance and our financial results in more detail. After which, I will provide an update on our overall strategic position. Bob?

Robert P. Fishman

Executive Vice President, Chief Financial Officer & Chief Accounting Officer, Pentair plc

Thank you, John. Please turn to slide 6 labeled Q2 2021 Pentair Performance. Second quarter sales grew 32% with core sales increasing 28%. Consumer Solutions grew core sales nearly 40% and Industrial & Flow Technologies delivered core sales growth of 12%, its second consecutive quarter of growth. Segment income was up 40% and return on sales expanded 110 basis points to 18.6%.

Adjusted EPS increased 42% to \$0.84. Consistent with our guidance, the second quarter did not see price fully offset inflation as we saw higher inflation that we have continued to implement price increases to help offset. The second half should see price costs start to even out. But unprecedented amount of material and wage inflation coupled with robust demand has contributed to price reading out at a slower pace. Corporate expense was \$26 million in the quarter as we've recorded higher levels of compensation expense given the performance our businesses have delivered this year. Our tax rate was 17.4% in the quarter as we now expect the full year tax rate to approximate 16%. This is due primarily to higher levels of North American income as our residential businesses continue to grow at strong double-digit levels.

Please turn to slide 7 labeled Q2 2021 Consumer Solutions Performance. Consumer Solutions sales growth was 44% as both businesses delivered strong double-digit growth. Segment income increased 48% and return on

sales expanded 80 basis points to 24.9%. Consumer Solutions experienced significant inflation during the first half as demand continued to grow. Pool experience sales growth of 50% in the quarter. While we have seen significant growth two quarters in a row to start the year, we believe pool dealers are doing their best to keep up with robust demand. The theme of consumers investing in their backyards continued. The Pool team has significantly increased capacity even in the face of material shortages and inflation. Backlog remains at record levels and orders have more than doubled. Even with a record year, we believe the improvement in orders and strong backlog gives us improved visibility that growth will continue looking ahead to next year.

The macro trends continue to be favorable. And the installed base of pools continue to grow. Demand for new pools remained strong with many builders reporting backlogs into next year. We believe consumers remain committed to enhancing their at-home quality of life and enjoying a pool is a major part of the experience for many consumers. In addition to new pool construction, after market growth remained strong as consumers have used their pools more.

Water Treatment delivered 35% sales growth as residential demand remained robust and commercials showed strong signs of post pandemic recovery. Our Residential business grew nearly 20%, and our Commercial business grew sales by over 40% excluding the contribution from KBI in the quarter. Overall, we believe Consumer Solutions is well-positioned to deliver continued double-digit growth in the second half based on strong order and backlog trends. We expect price to read out further in the second half and close the gap on the higher inflation experienced in the first half.

Please turn to slide 8 labeled Q2 2021 Industrial & Flow Technologies Performance. Industrial & Flow Technologies increased sales 17% in the quarter as its end markets further recovered and the business continued to execute its strategy. Segment income increased 30% and return on sales expanded 160 basis points to 15.7%. Residential Flow grew to double-digit rate for the third consecutive quarter. Orders continue to exceed sales and we expect the seasonal business to end the year well-positioned within all of its channels.

Commercial Flow increased sales 11% and further build backlog. The commercial recovery has gained momentum with orders continuing to improve. We expect growth to continue for the smaller part of this segment. Industrial Filtration delivered 14% sales growth as the shorter cycle aftermarket showed further signs of improvement, particularly within food and beverage. We experienced double-digit increases in both orders and backlog. Industrial & Flow Technologies remains focused on reducing complexity, selective growth, and margin expansion.

Please turn to slide 9 labeled Balance Sheet and Cash Flow. Free cash flow continued to be a great story with over \$100 million improvement year-over-year. We generated \$340 million of free cash in the first half. We have returned \$117 million to shareholders through dividends and buybacks in the first half. We also repaid a \$104 million bond that matured during the quarter and paid approximately \$80 million to acquire KBI. Although we continue to invest our capital wisely, we ended the quarter at just under 1 times leverage. We are extremely proud and excited to see our return on invested capital exceed 18%. As we look at our cash flow needs going forward, we plan to remain disciplined in our capital allocation approach. We plan to continue working the M&A pipeline and to buyback at least \$150 million of our shares this year.

Please turn to slide 10 labeled Q3 and Full Year 2021 Pentair Outlook. We are initiating third quarter and updating our full year 2021 guidance. For the quarter, we expect sales to grow 16% to 19%, segment income to grow 18% to 23%, and adjusted EPS to grow 16% to 21% to a range of \$0.81 to \$0.85. Our forecast reflects our expectations that material shortages and inflation are not going away nor will they improve materially. For the full year, we expect sales to grow 21% to 23%, segment income to increase 30% to 34%, and adjusted EPS to grow 32% to 36% to a range of \$3.30 to \$3.40. Embedded in our full year sales guidance is anticipated growth in

Consumer Solutions around 30% with Pool expected to be up nearly 40% and Water Treatment up over 20% as commercial is expected to further recover and KBI is expected to contribute in the second half. Also incorporated in the revised guidance is anticipated low double-digit growth for Industrial & Flow Technologies.

Below the operating line, we expect corporate expense to be around \$80 million given the higher levels of compensation expense in 2021 given the record performance expected this year. We expect corporate expense to go back to more normalized levels next year. We now expect net interest to be in a range of \$15 million to \$16 million and our tax rate to be around 16%. We anticipate the share count to average between 167 million and \$168 million shares for the full year. Capital expenditures are expected to be around \$60 million while depreciation and amortization is anticipated to be around \$80 million. We continue to target free cash flow to be greater than or equal to net income.

I would now like to turn the call over to Michelle for Q&A. After which, John will have a few closing remarks. Michelle, please open the line for questions. Thank you.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from the line of Mike Halloran with Baird. Your line is open. Please go ahead.

Michael Patrick Halloran
Analyst, Robert W. Baird & Co., Inc.

Q

Hey, good morning, everyone.

John L. Stauch
President, Chief Executive Officer & Director, Pentair Plc

A

Hey, Mike.

Michael Patrick Halloran
Analyst, Robert W. Baird & Co., Inc.

Q

Thanks for taking the questions. So, can you just give some context behind the incremental confidence you're seeing in the Pool trajectory from here? Maybe just how far is the backlog stretching out? Maybe a little more detail on some of the commentary you're getting from the channel, inventory levels, and any more context would be great.

Robert P. Fishman
Executive Vice President, Chief Financial Officer & Chief Accounting Officer, Pentair plc

A

Well, as we have said in the prepared remarks, the backlog is at record levels, demand at an all-time high and remains very strong. We see pool builds into next year and beyond. So, the metrics around demand are very strong, certainly with what we see now. We have confidence that the growth will continue for a variety of reasons, everything from second homes being built to people spending more time in their backyards and a number of different products coming out. So, I believe that, that will continue. We have confidence into next year. Inventories are still catching up. So, we're working through that to satisfy our distributors and dealers.

Michael Patrick Halloran

Analyst, Robert W. Baird & Co., Inc.

Q

And then just in that question how far out is your backlog specifically tracking at this point or is it just meeting with what's available in the channel?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Yeah. So, Mike, this is John. First of all, we look at the pool season as coming to a completion at the end of September and then we start the next pool season when we get to October. So, our first goal is to get the backlogs and the inventories really to this pool season out. And as Bob mentioned, we feel like we're in a really strong position regarding that. And then we've got to work on next year which we feel is also going to be strong demand. I think another level of confidence is we've been able to start to attract labor and keep labor in our Pool factories which has been what's harder to do three to four months ago. And we're starting to manage the supply chain, the uniqueness of that, availability of product and be able to demonstrate the agility in the factories to get product out to customers. So, those are the differences of how we feel. As far as higher confidence and all Mike, I think we've always been confident this is a good business and that this is a good demand. But we wanted to make sure we were able to make progress in meeting that demand throughout the year.

Michael Patrick Halloran

Analyst, Robert W. Baird & Co., Inc.

Q

No, that makes a lot of sense. And then on the other side of the business, just maybe some incremental commentary on the recovery cadence you're seeing in the IFT, sustainability, what customers are saying, how it's tracking versus normal seasonality, any incremental color there would be great.

Robert P. Fishman

Executive Vice President, Chief Financial Officer & Chief Accounting Officer, Pentair plc

A

Yeah, I'll start with that one. We were very, very pleased again to see the IFT growth return, the residential piece of the business within flow continues to be strong. The recovery in commercial has also helped the flow of business. And then within industrial, food and beverage has been a nice growth area for us. So, it continues to grow to be able to guide to the full year. Low double-digit growth for us is exciting after the challenging year last year, and we expect the momentum to continue as well in IFT.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

And Mike, I would just add that we saw our Commercial Filtration businesses in Water Treatment finally get back to levels that they saw in 2019. Obviously, it was an easy compare in 2020 coming off the dip that we had there. But we're encouraged on those trends and we're encouraged as more restaurants and hotels and hospitality open globally that we'll continue to see sequential improvement there.

Michael Patrick Halloran

Analyst, Robert W. Baird & Co., Inc.

Q

Appreciate it. Thanks. Thanks, John. Thanks, Bob.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Thank you.

Robert P. Fishman

Executive Vice President, Chief Financial Officer & Chief Accounting Officer, Pentair plc

Thank you.

A

Operator: Thank you. And our next question comes from the line of Joe Giordano with Cowen. Your line is open. Please go ahead.

Joseph Giordano

Analyst, Cowen & Co. LLC

Hey, guys. Good morning.

Q

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

Good morning.

A

Robert P. Fishman

Executive Vice President, Chief Financial Officer & Chief Accounting Officer, Pentair plc

Good morning.

A

Joseph Giordano

Analyst, Cowen & Co. LLC

Hey, can you kind of just talk us through regionally how like, if you had to like scale 1 to 10 how crazy pool has been regionally, are certain markets just more out of whack from a go-forward basis? I live in New Jersey so I know Northeast, new pool installations is probably at levels that have never been seen before. But can you kind of scale how this is in more traditional markets and maybe it's more balanced than some of these growth rates might appear when you normalize for like the comps?

Q

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

Yeah, so we had a couple of things going on this year as you probably know. One, we had the Department of Engineering changeover from single speed to variable. So, we're already expecting that we're going to see strong growth in that particular product line and then obviously the acceleration of new pools and remodeled pools is really putting a significant demand nationally on that product. And that is the same product generally sold in all of the pool regions. And then state by state, you've got these disruptions like Texas that has been disruptive for everybody. And the fact that all of that aftermarket demand still needs to be satisfied off of what happened with the freezes.

A

And then the rest of the markets, I would say that they're just accelerated, meaning that the rate of new builds are consistent across those areas. And then the aftermarket demand replacement cycles or the additive, I want more products on my pad, have been traditionally across the Sunbelt State. So, right now, I would say the demand is not easing and we're all trying to catch up with that demand and work through our supply partners to do that.

Joseph Giordano

Analyst, Cowen & Co. LLC

Q

And then if I can just sneak one in and apologies if I missed it in the very beginning, but any update on like timeline of new product introductions from some of these like in-home point of view systems like with Rocean.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Yeah, that's a next year product introduction for us as we work to try to get that technology up to speed and then launch that somewhere around the end of the year, the early part of next year with a soft launch and then expect to ramp that up throughout next year.

Joseph Giordano

Analyst, Cowen & Co. LLC

Q

Great. Thanks, guys.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Thank you.

Operator: Thank you. And our next question comes from the line of Brian Lee with Goldman Sachs. Your line is open. Please go ahead.

Brian Lee

Analyst, Goldman Sachs & Co. LLC

Q

Hey, guys, good morning. Thanks for taking the questions. Maybe just to follow up on Joe's question, just any initial views on the new pool market for 2022? I know sounds like from listening to other supply chain players, the general expectation for about 110,000 or so, call it, this year, but wondering if you think that number grows next year? And then with respect to backlog trends, I know you're at record, but kind of what sort of visibility can you quantify to any degree you have with builders currently heading into next year?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

I think builds will continue to grow. I think its capacity constrained generally by labor and product availability beyond just pool equipment as we have to do the landscaping in those backyards. So, we continue to think that 2022 will be a robust year there, and then additive to that number, we always look at remodels. So, the pools that need to also be done in addition to those new pools. And then where we're really pleased is the penetration rate of the products on the pad and more and more awareness of heaters, automation, salt-based chlorinators. Those types of products are where we've really seen the acceleration. So, I think we want to continue to grow from here and we believe that we have right now enough visibility to feel like 2022 is a growth year.

Brian Lee

Analyst, Goldman Sachs & Co. LLC

Q

Fair enough. And just my follow-up on the price increase you mentioned, the latest price increase. Can you give us some quantification around what that level was, when that was implemented, or when that's going into effect? And then what parts of the portfolio here if I look at your Consumer Solutions segment for the back half, it seems like you're implying kind of a 20%, 25% year-on-year growth number for the back half year. How much of that is

price? How much of that is volume? I'm assuming a lot of that's going through that part of the portfolio here. Thanks, guys.

Robert P. Fishman

Executive Vice President, Chief Financial Officer & Chief Accounting Officer, Pentair plc

A

What I'll do is just share a little bit of color around price and inflation overall for Pentair. In Q2, price was a 2-point benefit for us and inflation was quite high close to 5 points. As we move into the back half, think of inflation in that 5 to 5.5-point range so slightly higher. But think of price reading out at closer to 4 points in the back half. So, we improved from Q2 and narrowed the gap but it continues to be a challenge. And the whole material shortages is a challenge for our ops and supply team. And we're really appreciative of all of the work that that team has done. In the second quarter, they really did a nice job helping us drive that 32% sales growth. They did have the luxury of more raw material sitting in that opening inventory. So, as we move into Q3 and Q4, the challenge for the team is really to deal with the lumpiness of the material shortages. So, every week is interesting as they plan the production schedule and the team is doing a remarkable job to achieve the numbers that we've guided to.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

And then just a follow-up on your price question. We look at the business – we have three general business models. In the dealer distributor short cycle businesses, obviously, it's easier to work with the supply chain and then work with the channel partners to raise price in those areas. They usually get through relatively quickly. Then we have our more OEM related businesses or our larger company programs which takes time. And then we've got the projects that you quote and you're basically dealing with the cost of inflation until you quote that next set of projects. So that's the other color I'd bring across those three business models and it all blends to the numbers that Bob shared with you.

Brian Lee

Analyst, Goldman Sachs & Co. LLC

Q

All right. Thanks, guys, for all the call. I'll pass it on.

Operator: Thank you. And our next question comes from the line of Jeff Hammond with KeyBanc Capital Markets. Your line is open. Please go ahead.

Jeffrey D. Hammond

Analyst, KeyBanc Capital Markets, Inc.

Q

Hey, good morning, guys.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Good morning.

Jeffrey D. Hammond

Analyst, KeyBanc Capital Markets, Inc.

Q

Hey, so the incrementals in the quarter were certainly better than I thought. And I think how you guys guided on the June Analyst Day. And I think that was a concern. Seems like prices is more of a help in the back half but

what kind of surprise due to the better – a--in the second quarter? And how should we think about incrementals in the back half?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Well, I think we got some of the IFT productivity that we were expecting and it read out and we feel like that's generally sustained, which was definitely better. And then obviously when we get more pool product out the door, it generally drives higher levels of margins for Pentair. And we were able to get capacity levels up in Pool and we benefited from that.

Jeffrey D. Hammond

Analyst, KeyBanc Capital Markets, Inc.

Q

Okay. And then just on I guess this view into 2022, just in the strength here in Pool, where do you think some pull forwards happening or stuff that maybe isn't repeatable? I know there's good demand trends on new and remodel but where have you seen maybe the most kind of pull forward in terms of consumer attitudes?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Well, I think every single channel partner we have is spending a disproportionate amount of time trying to work with us to get product to the next job they're doing, right, on the new build side. So, when you see the increase in new build simultaneously with the demand for aftermarket, you're trying to balance those two things at the same time. So, I think some of the traditional filter and pump are obvious because every pool pad needs those, and they have to be repositioned to where the jobs are, and how do you get the inventory where you need. And then some of the more nice-to-haves in the pool that can be deferred and or added later is really where we think the majority of the backlog is repositioned for next year.

Jeffrey D. Hammond

Analyst, KeyBanc Capital Markets, Inc.

Q

Okay. Thanks, John.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Thank you.

Operator: Thank you. And our next question comes from the line of Bryan Blair with Oppenheimer. Your line is open. Please go ahead.

Bryan F. Blair

Analyst, Oppenheimer & Co., Inc.

Q

Thanks. Good morning, guys.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Good morning.

Bryan F. Blair

Analyst, Oppenheimer & Co., Inc.

Q

Starting it off, a little more color on KBI integration and how the service network is influencing your Commercial Water Treatment recovery and prospects going forward?

Robert P. Fishman

Executive Vice President, Chief Financial Officer & Chief Accounting Officer, Pentair plc

A

So, for us, KBI is a really exciting acquisition for us that closed in the second quarter. We now are able to provide services within the commercial space. It's a business that we can learn from and then leverage to help grow in that area. So, really strong start for us in that business and exciting to see the footprint and the opportunity within that area that we really haven't been able to drive into.

Bryan F. Blair

Analyst, Oppenheimer & Co., Inc.

Q

That's excellent. Then I think you said 40% total growth for commercial treatment in the quarter. I apologize if I missed it, did you slice the organic figure?

Robert P. Fishman

Executive Vice President, Chief Financial Officer & Chief Accounting Officer, Pentair plc

A

Yeah, the growth for the full year in Water Treatment we gave...

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Well, it's 35% in the slides I think, Bob, right for Q2 and then there's just a modest contribution from KBI in the quarter. And then for the year, in the full year outlook that Bob gave, think of roughly \$20 million a quarter for KBI.

Bryan F. Blair

Analyst, Oppenheimer & Co., Inc.

Q

Okay. Appreciate that. And then John, you've...

Robert P. Fishman

Executive Vice President, Chief Financial Officer & Chief Accounting Officer, Pentair plc

A

Yeah, the growth that we gave for the second quarter excluded the 40%, excluded the contribution from KBI.

Bryan F. Blair

Analyst, Oppenheimer & Co., Inc.

Q

It did. Okay. I appreciate that clarification.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

So thank you.

Bryan F. Blair

Analyst, Oppenheimer & Co., Inc.

Q

With that momentum, John, you stated the last couple of quarters that it's unlikely that commercial demand would recover to 2019 levels. With the pace the momentum that you have in the business now, does that change your view?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Right. Actually, as I said, I think we're at 2019 levels now. So, we took a dip last year and now we're recovering to modestly growing versus 2019. We do believe that starts to accelerate from here, but we need the rest of the world to continue to open. Primarily hospitality would be the one area that is not yet as robust driven by global travel primarily. Once that gets going, I think we feel like we're growing off to 2019 levels again.

Bryan F. Blair

Analyst, Oppenheimer & Co., Inc.

Q

That's great. Thanks again, guys.

Operator: Thank you. And our next question comes from the line of Nathan Jones with Stifel. Your line is open. Please go ahead.

Nathan Jones

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Good morning, everyone.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Good morning.

Nathan Jones

Analyst, Stifel, Nicolaus & Co., Inc.

Q

I'm just going to follow up on that, on the discussion there on Commercial Water Treatment being back to 2019 levels. I can't imagine that the market is actually back to 2019 levels. So, can you talk about where you think you've gained share in this market or what's driving your ability to get back to 2019 levels when I can't imagine that the market could possibly be back to that level yet?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Yeah, there's some spaces that we have a higher participation rate in, Nathan, like quick serve restaurants and also you got gas station service and those are beverage hotspots as you can imagine. And we participate in both filtering the ice and also filtering the beverage dispense. So that is a area that has definitely picked up faster than it was in 2019. And the rest of the full-service restaurants and hospitality has been slower to recover, but it's still recovering.

Nathan Jones

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay. So, your mix is more skewed to that does have a market level back to where it is?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

Yeah, we benefit from that, yes.

A

Nathan Jones

Analyst, Stifel, Nicolaus & Co., Inc.

Got it.

Q

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

Volume based, right.

A

Nathan Jones

Analyst, Stifel, Nicolaus & Co., Inc.

I've got a follow up on that price cost equation as well. Narrowing the gap in the second half, pretty big gap there in the first half. In the unlikely event that we get kind of stable input prices, would you expect to be net price cost positive in 2022 as you make up these deficiencies from 2021?

Q

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

Don't know yet, I mean we definitely have learned a lot about inflation. I mean the sourcing inflation is usually easier to predict and see. And I think we've done a relatively good job on that one where I think we've still been playing catch up this year is labor inflation and the amount of wage increases that have occurred throughout the year, Nathan. We're making sure that we're using best practices as we quote the next projects and next year's projects ahead of time. And then we're making sure that we keep agility in focus as we think about how to price more effectively on the shorter cycle businesses.

A

Nathan Jones

Analyst, Stifel, Nicolaus & Co., Inc.

Great. Thanks for taking my questions.

Q

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

Yes.

A

Operator: Thank you. And our next question comes from the line of Ryan Connors with Boenning & Scattergood. Your line is open. Please go ahead.

Ryan Michael Connors

Analyst, Boenning & Scattergood, Inc.

Great. Thanks for taking my questions. I had a big picture question sort of the aftermarket opportunity. You alluded earlier to this idea that there are so-called nice-to-haves on a pool pad that maybe aren't going in right now because of the supply chain constraints. And so, my question is how should we think about the growth in the installed base over a couple of nice years here on new builds and what that does to the structural aftermarket opportunity in the next several years, three to five years out? I mean is that meaningful that expansion in

Q

aftermarket and presumably that's a good thing from a mix perspective, can you just give us your thoughts there?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Yeah, I mean we look at it as every new pool that goes in is additive to the 5.3 million in-ground pools that exist today. And as people use their pools more and more, the number one thing they look to is the water chemistry of their pools, and then how do they make it more enjoyable and comfortable as an experience. And those things tend to drive higher degrees of automation and consumer awareness and also then leads you to figure out what else you could do to either self-manage or self-monitor your pool or control heat and/or the other comfort aspects of your pool. So, we look at all this is good news to build out the long-term demand in the channel.

Ryan Michael Connors

Analyst, Boenning & Scattergood, Inc.

Q

Okay. And then my other one was just want to get your reaction, there's a lot in the news about this global minimum tax rate and a lot of movement on sort of tax rates. And I know you've got the unique jurisdiction as a corporate. So, any thoughts there on how that could impact Pentair or not from a tax rate standpoint depending on how that plays out?

Robert P. Fishman

Executive Vice President, Chief Financial Officer & Chief Accounting Officer, Pentair plc

A

We're in the process of assessing what the impact would be, still too early to really give a perspective. But our early view here is that there would be some upward drift in the tax rate but not significantly higher at this point and then certainly better than a number of our competitors.

Ryan Michael Connors

Analyst, Boenning & Scattergood, Inc.

Q

Yeah, okay, fair enough. Thanks for your time.

Operator: Thank you. And our next question comes from the line of Andy Kaplowitz with Citigroup. Your line is open. Please go ahead.

Andrew Kaplowitz

Analyst, Citigroup Global Markets, Inc.

Q

Hey, good morning, guys.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Good morning.

Andrew Kaplowitz

Analyst, Citigroup Global Markets, Inc.

Q

John, you mentioned you were excited about how much smart automation in heaters and you really knew pool pad products in general are adding to remodel and aftermarket growth. Can you give us a little more color into how much these new upgrades to the pool pad are maybe more secular? Have you invested enough in

yourselves and product capability to take advantage of this trend? What do they tell you about the longer-term growth potential in pool? How much do you think they could contribute to longer-term growth?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Great question. I mean we've been stuck, the industry has been stuck and we've been with it somewhere around just modestly in the double-digits of automation. And I think just with the recent trends and more mesh networks and getting Wi-Fi into the backyard on a more dependable basis, it creates more opportunities for more automation. You really need awareness and you need people to use the pool to care to really drive that behavioral change. And that's what we're most encouraged by. There's also better technology at great price points that we're participating into to manage and monitor water chemistry, and then to begin to determine what's necessary to balance those water areas.

So, that's where I'm really super excited. We also saw and we shared this openly that as people use their pools more, the heater matters. And that was always a nice-to-have on the pad on the older builds. And as they – most people remodel now, they're putting those heaters in, well, for the spa and for the pool. So, we've seen the trends in lighting earlier. We saw the trends working around some of the variable speed pump penetration. We're now starting to see that extend to the other capabilities around the pool. So, I think it's a few points of overall pad penetration for the industry over the next several years. And that encourages us and excites us.

Andrew Kaplowitz

Analyst, Citigroup Global Markets, Inc.

Q

And John, I might have missed this in the prepared remarks. But at your Analyst Day, you had mentioned that you're right in the middle of a 12-week sprint to come up with ideas to form more of the basis of the transformative plan that you laid out at that day in terms of margin improvement. So, maybe you can update us on sort of – what sort of ideas have come out of that, any sort of interesting observations you would make?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Yeah, so my official report out is this Thursday with the executive team, and I'm looking forward to that set of brainstorming actions. We've engaged a lot of people, so that we've got a voice from the broader organization. It's required patience on my part to not jump and kind of know what the answers are. So, I'm not going to jump ahead of that. But I have seen the funnel and I've seen a list of ideas. And I would say that it's more sizable than I originally thought. And now, it's about how do we put the programs around it to action them and to think about sequencing them to derive the value from them. But really, really encouraged right now on the participation, the organizations, and the ideas that are starting to surface.

Andrew Kaplowitz

Analyst, Citigroup Global Markets, Inc.

Q

Yeah, thanks for that, John.

Robert P. Fishman

Executive Vice President, Chief Financial Officer & Chief Accounting Officer, Pentair plc

A

Yeah, this is Bob, and I've probably been a little less patient than John. So, I would confirm that the pipeline of opportunities is very robust, a lot of complexity reduction initiatives. There is huge opportunities to drive margin expansion. And to really help with those Analyst Day numbers, we said in the prepared remarks that even with a higher guide this year, we're going to go ahead and add on to this year the 300 basis points of margin expansion

into the future with, well, revenue will grow at that mid-single-digit plus number that we shared at the Analyst Day. So, transformation will be a big part to us achieving those results. And embedded in all of this is ease of doing business with Pentair. So, will be a much, much – the better situation for our distributors and dealers as well.

Andrew Kaplowitz

Analyst, Citigroup Global Markets, Inc.

Q

I appreciate it, guys.

Operator: Thank you. And our next question comes from the line of Josh Pokrzywinski with Morgan Stanley. Your line is open. Please go ahead.

Joshua C. Pokrzywinski

Analyst, Morgan Stanley & Co. LLC

Q

Hey, good morning, guys.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Hey, Josh.

Joshua C. Pokrzywinski

Analyst, Morgan Stanley & Co. LLC

Q

John, just on some of the inventory commentary out there in the distribution or the channel. Any sense for what that's like kind of on a I guess a normalized basis maybe absolute levels versus 2019? I think days on hand are probably pretty low just given how strong the growth pace is. But if we were to sort of dial that back a little bit or normalize that, would inventory sort of be in the right zip code or would they still be kind of low on an absolute basis?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Josh, without getting too specific, we are lower than we should be. And our customers and channel partners are asking us every single day to pick up the pace and get in more equipment, right. That's the way I would say it. It's exhausting to the plant teams to keep up the demand and the sell-throughs you can articulate from other people's releases. And you see that we're trying to do what we can to catch up with it.

Joshua C. Pokrzywinski

Analyst, Morgan Stanley & Co. LLC

Q

Got it. That's helpful. And then just touching on the last question that I think got asked on, on some of the other quasi discretionary stuff, you mentioned heaters. How much were those up relative to the rest of the pool business? I would imagine a lot of that is more kind of first fit than necessarily replacement of an existing heater, is that fair?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Yeah, I mentioned it because we saw that really go into the back half of last year in a broader way, if you recall. And so now, when we think about anniversarying the back half, we're still growing on top of those levels which

gives us encouragement that these aren't necessarily one-and-done, but we're seeing long-term penetration of these product lines.

Joshua C. Pokrzywinski
Analyst, Morgan Stanley & Co. LLC

Q

Got it. Appreciate the color.

John L. Stauch
President, Chief Executive Officer & Director, Pentair plc

A

Thank you.

Operator: Thank you. And our next question comes from the line of Scott Graham with Rosenblatt. Your line is open. Please go ahead.

Scott Graham
Analyst, Rosenblatt Securities, Inc.

Q

Good morning, John, Bob, and Jim. I have questions, a couple of questions about price cost and I was wondering, Bob, would you be willing to split out the labor piece of the inflation that you saw in the quarter?

Robert P. Fishman
Executive Vice President, Chief Financial Officer & Chief Accounting Officer, Pentair plc

A

Roughly speaking, two-thirds material, one-third labor.

Scott Graham
Analyst, Rosenblatt Securities, Inc.

Q

And maybe help us maybe understand a little bit on the labor side. So, are you talking about increases to the compensation pool for your current employees to retain them because your business unit heads are saying, hey, we're going to lose people so you kind of got to get more aggressive there? Are these new employee adds – could you put a little color on that if you don't mind?

John L. Stauch
President, Chief Executive Officer & Director, Pentair plc

A

Yeah, I think it's both. I mean when you look at having to add to your labor base, you are confronted with what are the real market dynamics to add. And then you have to go back and you have to make sure that your existing loyal employees are paid at least that if not more. So, it creates a dual impact. One, trying to get the new people and then making sure that your current employee base is well taken care of.

Scott Graham
Analyst, Rosenblatt Securities, Inc.

Q

Thank you for that. On the productivity, particularly IFT, is that the beginning of some of the reduction in complexity, the \$10 million, is there a piece of that in there?

John L. Stauch
President, Chief Executive Officer & Director, Pentair Plc

A

Yeah, there's a big piece of that in there. And I think we're really encouraged with their efforts around that. And we think that that is – that's why Bob also mentioned transformation. I think we learned from certain categories that have done this. We've seen how it reads out and better efficiencies on sourcing and also less complexity for customers. So, we're really encouraged on that trend and we expect to bring that across the enterprise in a faster way.

Scott Graham

Analyst, Rosenblatt Securities, Inc.

Q

Okay. Thank you. Last question and this is a question you might not be able to answer but I'm just going to shoot anyway. The prices of assets are pretty inflated, speaking of. And we have IFT, which is a business that needs to – we need to do some fixing, improve the margins there. But it looks like particularly as of Thursday, you're going to have a very clear path to do that. As an acquisition announced in this space, I say in this space in sort of the multis area just in the last couple of days, where it fetched them about 17 times EBITDA, which is your multiple. And I'm just assuming that the Pool multiple is higher than the IFT multiple embedded within your valuation. Is there any thinking around IFT spinning that off at some point down the line, particularly with asset prices where they are now?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Yeah, Scott, I mean the way I look at it is I think we have a really good IFT business that continues to demonstrate progress towards its goals. I mean I'm really encouraged by the way it's growing, double-digit core growth this this quarter and starting to build out the order pipeline. And I'm also encouraged about its focus, its complexity reduction, and its commitment to the margin expansion. Now, I'm going to get to the transformation work. And I believe that this business has significant margin expansion in front of us. So, I believe the course of action is that's going to create value for Pentair while it's part of our portfolio. And it is a big important part of our portfolio.

Scott Graham

Analyst, Rosenblatt Securities, Inc.

Q

Got it. Thank you, both.

Operator: Thank you. And our next question comes from the line of Rob Wertheimer with Melius Research. Your line is open. Please go ahead.

Rob Wertheimer

Analyst, Melius Research LLC

Q

Thank you. Good morning, everybody. So, you touched on this a couple of times before, but Water Treatment, it seems like you had a really cyclical rebound but there's less yet impact from product changes, and I guess distribution changes in residential and commercial. Is that correct or is some of the work you're doing underlying really kind of allows us to call some of that growth more structural than the nice rebound that we had? And then just maybe just kind of reiterate for us the timeline of the impacts you've seen from what you're doing there? Thank you.

John L. Stauch

President, Chief Executive Officer & Director, Pentair Plc

A

Yeah, so just within Water Treatment to remind you, roughly \$800 million pro forma business, we have residential and we have commercial. And the residential has been fairly strong, a little lumpy through COVID with the ability to get in people's houses or not, and as far as what we're trying to do there, but now to the point where I think we've got steady state growth. If you recall when commercial happened, there was generally a closure of most restaurants and hospitality and that's the end offices where people drink water, and that was a huge setback for our business last Q2. That has slowly been recovering as people return to more of the normal of the way it used to be pre-COVID. But we're not yet back globally to where we expect it to be. I think our addition of KBI gives us the ability to add services components on top of products which strategically is what we think our customers want. And we're very encouraged about the early signs there. So, I think we're starting to return. And I think we're now in what I'd say every part of that portfolio growing versus the more residentially led as it was in the last several quarters.

Rob Wertheimer

Analyst, Melius Research LLC

Q

Thanks.

Operator: Thank you. And our next question comes from the line of Julian Mitchell with Barclays. Your line is open. Please go ahead.

Q

Hey, good morning, this is Trish on for Julian.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Hey, hi.

Trish Gorman

Equity Research Associate, Barclays

Hey. So, just on free cash flow, it's been very strong year-to-date under normal seasonality I think kind of second half free cash flow represents kind of 50% or 60% of the full year free cash. Should we expect this normal seasonality to occur this year? And maybe if you could just walk us through the moving pieces there for the balance of the year?

Robert P. Fishman

Executive Vice President, Chief Financial Officer & Chief Accounting Officer, Pentair plc

A

Yeah, balance of the year free cash flow remains strong. What's really helping us as we get off to a fast start at the beginning of each quarter, the linearity is very strong. So, I expect another strong free cash flow year following last year and continues to – we'll continue to drive it over 100% of net income.

Trish Gorman

Equity Research Associate, Barclays

Q

Great. And then maybe one more on IFT, I know you guys have talked about the significant margin expansion opportunities there. But how should we think about inorganic opportunities there? Can you just remind us kind of what end markets or products you might look to increase your exposure to within that segment?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Yeah. So, we hinted at Analyst Day, we really right now like the carbon capture and the, also the sustainable gas parts of that portfolio and we feel like we've got a fairly good position there. And we would love to continue to scale and also be able to provide the regional partners the solutions they need. We are at the heart of everything we do, a membrane focused company. So, we like to look into filtration and have opportunities to expand our filtration capabilities as well. And as a reminder, even though we use some of these technologies in the Consumer Solutions, they initiate those applications in IFT and we cross pollinate those across both segments. So, those are the two areas that I would say are definitely areas of focus in the IFT portfolio.

Trish Gorman

Equity Research Associate, Barclays

Q

Great. Thanks, guys.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Thank you.

Operator: Thank you. And our next question comes from the line of Deane Dray with RBC Capital Management. Your line is open. Please go ahead.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Hey, Deane.

Q

Hi, this is Tyler on for Deane.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Well, hi, Tyler on for Deane.

Q

Tyler Voight

Senior Associate, RBC Capital Markets

Sorry if I missed this, but could you discuss some of the supply chain issues that you guys are seeing. Obviously, you mentioned product availability in some of the prepared remarks, but are you seeing other supply chain issues like port congestions or anything there?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Yes, yes, and yes. I mean everything that you're hearing we're experiencing in some type of inconsistent way, right. So, we'd say that even though we've had availability of most of the supply we need, it's very inconsistent in its predictability of when and how it's coming which has forced tremendous agility in our factories to rearrange in a

lean way where we put the labor efforts. And sometimes, we're producing 75% of a product and then coming back and finishing 25% later to give you an example. So that's why we're very complimentary of our teams as Bob said because it's required all kinds of different skills to be able to move forward. Main challenges to us would be chips, would be drives, motors. Those would be the areas that are in high demand for the products that we serve.

Tyler Voight

Senior Associate, RBC Capital Markets

Q

Great. Thank you for that. And could you guys provide just kind of any updates on some of your new IoT product that have launched recently or planning on launching it?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Yeah, so we're excited by that. And I think first of all, really excited about the momentum we're building in IFT on a lot of their IoT-enabled services ability. We've launched products in the Consumer Solutions side that allow you to connect to our Pentair Home app. And we continue to add product capability to give you a better consumer experience. So, I'd say most of those have been soft launched in 2021 and we'll expect to accelerate in 2022 and beyond. And then I have to make a plug because I know Deane would be very interested in this, Tyler, is the – we feel like we're really making some progress on some smarter filtration technology for pool as well. And we're excited, as we mentioned in the Analyst Day, about the progress on that technology and making pools clearer, and more visible, and utilizing less chemicals to achieve the same outcomes.

Tyler Voight

Senior Associate, RBC Capital Markets

Q

Great. Thank you very much.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Thank you.

Operator: Thank you. And I'm showing no further questions. And I would like to turn the conference back over to John Stauch for any further remarks.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

Thank you, Michelle. And thank you for joining us today. 2021 is experiencing a phenomenal year of growth. And we believe the future continues to be bright for Pentair. We believe we have strong business platforms that are industry leaders in their designated spaces. We are in spaces that are growing faster than the overall global markets and are propelled by attractive secular trends. And we have carved out exciting strategic growth priorities in which we have already begun to demonstrate performance. Further, our transformation journey is designed to unlock value to allow us to grow faster than the industries that we participate in and help us to expand margins rapidly by 2025. And finally, our balance sheet is strong. And we believe we will continue to get stronger, supporting incremental value creation above and beyond what our base businesses can do on their own with tuck-in M&A.

Michelle, you can conclude the call.

Operator: This concludes today's conference call. Thank you for participating. You may now disconnect. Everyone, have a great day.

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