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**EDITED TRANSCRIPT**  
PNR - Q1 2018 Pentair plc Earnings Call

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**OVERVIEW:**

Co. reported 1Q18 consolidated Co. sales growth of 4% and adjusted EPS of \$0.88. Expects full-year 2018 adjusted EPS to be \$2.25-2.30. Expects 2Q18 adjusted EPS to be \$0.67-0.69.

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## CORPORATE PARTICIPANTS

**James C. Lucas** *Pentair plc - VP of Investor Relations and Treasury*

**John L. Stauch** *Pentair plc - Future President and CEO*

**Mark C. Borin** *Pentair plc - Future Chief Financial Officer*

**Randall J. Hogan** *Pentair plc - Chairman & CEO*

## CONFERENCE CALL PARTICIPANTS

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**Charles Stephen Tusa** *JP Morgan Chase & Co, Research Division - MD*

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## PRESENTATION

### Operator

Good morning. My name is Angie, and I will be your conference operator today. At this time, I would like to welcome everyone to the Pentair Q1 Earnings Conference Call. (Operator Instructions) I would now like to turn the conference over to Jim Lucas. Please go ahead, sir.

**James C. Lucas** - *Pentair plc - VP of Investor Relations and Treasury*

Thanks, Angie, and welcome to Pentair's first quarter 2018 earnings conference call. We're glad you could join us. I'm Jim Lucas, Vice President of Investor Relations and Treasury; and with me today is Randy Hogan, our Chairman and Chief Executive Officer; John Stauch, our Chief Financial Officer and future President and Chief Executive Officer; and Mark Borin, our future Chief Financial Officer.

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

There will be a second conference call this morning immediately following this one to discuss the Electrical segment first quarter performance and second quarter and full year outlook for nVent. There is a separate dial-in required for that call.

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 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.



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Today's webcast is accompanied by a presentation, which can be found in the Investors 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 will now turn the call over to Randy.

### **Randall J. Hogan - Pentair plc - Chairman & CEO**

Thanks, Jim, and good morning, everyone. We're very pleased to report that Pentair started 2018 on a very positive note, with solid core sales growth in both of our reported segments, Water and Electrical, and also strong segment income and adjusted EPS growth.

The next 2 slides are our standard presentation of the reported results and the balance sheet. But given the expected imminent separation of the Water and Electrical businesses, we wanted to concentrate on this particular call on the new Pentair, or the Water business excluding Electrical.

Before I turn the call over to John and Mark to discuss the first quarter Water results and the outlook for the remainder of 2018 for the new Pentair, I wanted to provide an update on the planned separation of Electrical, or nVent. As you may have seen earlier this week, nVent began to trade on a when-issued basis. nVent has its management team and board in place, and there will be a separate call following this one to discuss its results and outlook, as Jim just said. This is the last earnings call for Pentair as it is constructed today. It's also my last earnings call.

For over half a century, Pentair has gone through many changes, and the results have been a stronger company with a successful long-term track record. While our history has been around transformation and creating shareholder value, we're excited for Pentair's next chapter, as we create 2 industry-leading pure-play companies in Water and Electrical.

I believe the excellent performance in the first quarter demonstrates the quality of both these businesses. For the consolidated company, overall sales grew 7% and were up 4% on a core basis. Segment income of \$211 million represented 13% growth. And adjusted EPS of \$0.88 per share was up 35% versus the comparable period a year ago and was a full \$0.05 above the high end of our first quarter guidance. Thus, both companies have a strong foundation from which to build, and I feel confident that both companies have strong leadership in place to drive more shareholder value as they focus on their respective strategies. It's been my honor and privilege to lead Pentair for the last 17 years, and I feel that Pentair and nVent will continue to be successful under John and Beth's leadership.

I now turn the call over to John, who'll focus on first quarter Water segment performance and the outlook for the full year for the new Pentair.

### **John L. Stauch - Pentair plc - Future President and CEO**

Thank you, Randy, not only for your 17 years or 68 quarters of distinguished leadership as CEO, but also, thank you for the opportunity to lead the new Pentair.

Please turn to slide #8 titled New Pentair Executive Summary. As a reminder, Mark and I will be discussing the results, outlook and strategies for the new Pentair, or the Water business excluding Electrical.

We reported core sales growth of 4%, with all 3 of our businesses contributing. Return on sales showed solid expansion of 180 basis points to 16%. For the full year for the new Pentair, we have narrowed our guidance to core sales growth of 3% to 4%, ROS expansion of approximately 50 basis points to 18%, and adjusted EPS is now expected to be \$2.25 to \$2.30, as our strong start to the year gives us confidence to raise the lower end of the range.

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



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### **Mark C. Borin** - *Pentair plc - Future Chief Financial Officer*

Thank you, John. Please turn to slide 9 labeled Q1'18 New Pentair Performance. Core sales grew 4%, with Aquatic Systems leading the way with 8% growth. Filtration Solutions core sales increased 4%, and Flow Technologies core sales grew 2%. Segment income was up 21%, and as John mentioned previously, return on sales expanded 180 basis points to 16%.

Please turn to slide 10 labeled Q1'18 New Pentair Business Performance. We wanted to give some additional color on how all 3 of our businesses performed in the quarter. We expect these 3 businesses will be our reporting segments after the separation.

Aquatic Systems, despite a tough year-over-year comparison, delivered 8% sales growth, driven by strong demand for existing and new products in addition to continued dealer gains. Filtration Solutions saw a 9% overall sales growth, and core sales grew 4%. The strength was in the core Residential and Commercial offerings as well as China, but equally important, we saw a stabilization in our Industrial businesses. Segment income grew dramatically, and ROS expanded significantly as we improved, and many of our cost actions last year to remove complexity in the business are reading through.

Flow Technologies grew its top line 5%, with core sales up 2%. This marked the second consecutive quarter of core growth for Flow Technologies. Segment income grew 17%, and ROS expanded over 150 basis points to 16.1%. Specialty sales, principally Precision Spray, enjoyed strong growth in the quarter. We also saw continued gains in North America and further stabilization in our long-cycle backlog.

Please turn to slide 11 labeled 2018 New Pentair Outlook. Given the solid start to the year, we wanted to update the revenue and segment income walks that we provided at our Investor Day in February. We raised our core growth outlook for the year to a range of 3% to 4%, which moves the bottom end of the range up 1 point. FX is providing a little bit more of a tailwind than we originally anticipated, but we are also exiting a few countries and product lines, as you can see on the left-hand side of the slide.

Our expectations for segment income and ROS have also improved following the strong start to the year. We are seeing some more inflation headwinds, but the better top line growth in productivity give us confidence in healthy ROS expansion even as we make the previously mentioned \$25 million of incremental growth investments this year.

Please turn to slide 12 labeled Q2'18 New Pentair Outlook. We anticipate second quarter core sales to grow 3% to 4%, with Aquatic Systems up 7% to 8%, Filtration Solutions up 1% to 2%, and Flow Technologies growing 2% to 3%.

Segment income is anticipated to be up approximately 5% and ROS relatively flat as the aforementioned growth investments accelerate. Below the line, we expect the tax rate to be around 18%, adjusted net interest and other expense to be approximately \$8 million, and our share count should be around 181 million. Adjusted EPS is expected to be \$0.67 to \$0.69 per share. In addition, we see free cash flow improve sequentially and be in line with historical seasonal trends.

Please turn to slide 13 labeled Full Year 2018 New Pentair Outlook. As mentioned previously, we now expect full year core sales to grow 3% to 4%. While our outlook for Filtration Solutions is unchanged at 2% to 4%, we have tightened the range on Aquatic Systems and now expect 5% to 6% core sales growth and Flow Technologies to grow 1% to 2%. Segment income is expected to be up around 8%, while ROS is expected to end the year at around 18%, which would represent an increase of roughly 50 basis points. Below the line, full year tax rate will be around 18%, net interest and other expense to be around \$33 million, and shares will be around 181 million. For the full year, we expect adjusted EPS to be \$2.25 to \$2.30 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 for more on the new Pentair strategy.

### **John L. Stauch** - *Pentair plc - Future President and CEO*

Thank you, Mark. Please turn to slide #14 titled The New Pentair Strategy Summary. This is a slide that we introduced at our Investor Day in February that was designed to frame our vision for the new Pentair and prioritize our path to achieving our vision.



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As you can see on the left-hand side of the page, we want to be the leading Residential and Commercial water treatment company. While we are organized around 3 businesses that we expect to be our reporting segments after the planned separation, roughly 80% of our sales serve the Residential and Commercial verticals.

From a geographical standpoint, we are more weighted toward the U.S. today, but we see opportunities in other parts of the world, particularly China and Southeast Asia.

The middle section of the page starts with who we plan to be, a pure-play water company with healthy profitability and strong cash flow and with annual sales of approximately \$3 billion.

The next areas are focused strategies, which I'll expand on in the next slide, but want to spend a moment discussing. Historically, we have sometimes been distracted by doing too many things and trying to be everything to everybody. We believe focus is the key to driving long-term sustainable and predictable growth.

While all of our businesses have a purpose, we have identified 3 key areas to focus on: advance Pool growth, accelerate Residential and Commercial filtration, and expand in China and Southeast Asia. We intend to accelerate investments and efforts in both digital transformation and technology innovation, focused on the end consumer to accelerate these 3 prioritized growth strategies.

Our foundation of Win Right values and our Pentair Integrated Management System gives us the tools to successfully and continuously deliver for our customers and our shareholders. The right-hand side is an abbreviated look at our long-term value proposition that starts with serving markets that are growing and focusing on driving differentiated growth and ultimately, looking for tuck-in and bolt-on M&A to augment the organic opportunities.

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 15 labeled focused strategies. This is an important slide and one that I wanted to spend a moment on, because this is how we plan to drive differentiated growth and hopefully, be a top-tier growth performer. We spent a lot of time looking at our portfolio over the past 9 to 12 months and identifying the most attractive opportunities for growth, and that is how we arrived at these 3 focused strategies.

The first area is to advance Pool growth. Our Aquatic Systems business has a great track record of high single-digit core growth. And while the business has been successful, we believe that some incremental investments can make their growth rate even better.

The 2 areas that we have identified are expanding our aftermarket product offering and increasing our position in a fast-growing automation space. There are roughly 5 million in-ground pools in the U.S., and the aftermarket upgrade market continues to make up nearly 80% to 85% of all pool product equipment sold and used by pool owners. There is significant opportunity remaining to grow both base content and upgrades.

Over a decade ago, we revolutionized pool pumps by introducing variable speed technology. A decade later, variable speed pumps still are only 20% penetrated, leaving ample room for continued growth. In addition, there are many other energy-efficient products in areas like lighting, heating and cleaning that we believe have significant runway for growth.

Our investments will include technology upgrades, digital marketing campaigns, incremental sales resources and dealer tools as well as working on value propositions and alternative channel support.

Our second focused growth strategy is to accelerate Residential and Commercial filtration. We are a leader in Residential water treatment components today, and we have an opportunity to capitalize on increased water quality awareness globally, both in homes and restaurants, where we are developing innovative products and engaging consumers. We see opportunities to enhance dealer loyalty, similar to what we have done successfully in our Pool business.

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The majority of water treatment dealers are not affiliated by brand, and we see an opportunity to drive higher demand of our products through a loyal dealer network. As we build out our value proposition for dealers and consumers, we believe we can generate the same type of loyalty that we have achieved in the Pool business. Investments in this focused growth area will include branding, refreshed value propositions, selling tools for our partners and technology advances that utilize smart capabilities.

The final focused growth strategy is to expand in China and Southeast Asia. While water quality is an issue globally, we have purposefully focused on China, as we have a strong presence to build from and our brand is well-known. We see opportunities in both the Residential and the Commercial space.

For consumers in China, our biggest opportunity is building out our portfolio and creating products that consumers in China are demanding. On the Commercial side, we have strong presence with our global customers that have expanded to China, and we have also developed many new customers through entry-level food service offerings.

As we increase our local manufacturing, we see opportunities to further expand our customer base outside of the Tier 1 cities and into Tier 2 and Tier 3 cities as well as expanding rapidly into Southeast Asia. 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 now like to turn the call over to Angie for Q&A, after which I will have a few closing remarks. Angie, please open the line for questions. Thank you.

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## QUESTIONS AND ANSWERS

### **Operator**

(Operator Instructions) Your first question comes from the line of Steve Tusa with JP Morgan.

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### **Charles Stephen Tusa - JP Morgan Chase & Co, Research Division - MD**

Congrats on getting through the -- getting to this point of the spin. Just on the free cash, anything in there that was related to the separation? I mean, it was -- It's usually -- first quarter is usually weak, but it was definitely a little weaker than I was expecting.

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### **Mark C. Borin - Pentair plc - Future Chief Financial Officer**

Yes, Steve, certainly there is some in there in the first quarter related to separation. And then comparing to last year, it -- we were down a little bit, but really when you look at it historically, around -- down \$150 million is a little bit more than norm. So last year was a little bit better than normal. This year is a little bit more in line with historical levels. And we're not seeing any major concern through the remainder of the year with respect to hitting the target of 100% of adjusted net income.

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### **Charles Stephen Tusa - JP Morgan Chase & Co, Research Division - MD**

How much in there was from the spin? From -- I noticed working capital is particularly weak. What was in there from the spin exactly? Can you quantify that?

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**Mark C. Borin** - Pentair plc - Future Chief Financial Officer

Yes, \$20 million, \$30 million probably now, and then there'll be more of that, that will have additional separation-related cash outflows in the second quarter as well.

**Charles Stephen Tusa** - JP Morgan Chase & Co, Research Division - MD

How much?

**Mark C. Borin** - Pentair plc - Future Chief Financial Officer

Another \$20 million to \$30 million.

**Charles Stephen Tusa** - JP Morgan Chase & Co, Research Division - MD

Okay. On the ops, on price cost, you talked about a little more inflationary pressure. Can you maybe talk about what you're doing to perhaps offset that and how the channel is (inaudible) ?

**Mark C. Borin** - Pentair plc - Future Chief Financial Officer

We've got a strong funnel of material productivity actions that the team has been building. And we're -- there's a high level of confidence that through the remainder of the year through the productivity actions, we'll be able to offset that increased inflation. And so we still view productivity and price offsetting inflation.

**Charles Stephen Tusa** - JP Morgan Chase & Co, Research Division - MD

Okay. And then one...

**John L. Stauch** - Pentair plc - Future President and CEO

Steve, if you look at waterfall real quickly, on the full year, you'll notice that inflation is slightly higher than when we gave our guidance in February. And also, though embedded in there, productivity is a little better. And then just assuming the productivity column, we might have a little contingency as we work through the rest of the year.

**Charles Stephen Tusa** - JP Morgan Chase & Co, Research Division - MD

And then, John, I think you guys bought back some stock in the quarter. Was that -- how do we think about the next kind of 9 months as far as your capital allocation priorities? And then also, interest was a little bit higher. Anything going on there? Then that's it.

**John L. Stauch** - Pentair plc - Future President and CEO

Yes. So we bought 150 million back in the quarter, and we think that was prudent. And as we look forward, I mean, as we mentioned, first of all, we want to drive the cash. And we do think we're a strong cash generator. And then we want to continue to work on organic growth, maintain investment grade and then really choosing wisely between incrementally more buybacks or doing tuck-in acquisitions. And that's how we think we can drive value, and our capital is precious, and we want to use it wisely.

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**Mark C. Borin** - *Pentair plc - Future Chief Financial Officer*

And Steve, on the interest question, we did see for the full year, we've increased the estimate for interest expense. Think of that as higher interest rates, the timing of when we'll use or be able to use the dividends back from nVent and the separation to pay down our existing debt, and then really just the imprecision in our original estimate, as we were trying to balance all the moving pieces as we were heading into separation.

**Operator**

Your next question comes from the line of Jeff Hammond with KeyBanc Capital Markets.

**Jeffrey David Hammond** - *KeyBanc Capital Markets Inc., Research Division - MD & Equity Research Analyst*

So just on capital allocation, can you, one, just talk -- I mean, you mentioned the investment grade. But what you think the right leverage profile is for the company? And how fast do you think you get there through bolt-on M&A and buybacks? And just on the M&A pipeline, can you just talk about how you've been building the funnel, where the opportunities lie and kind of how those align with what you talked about, John, on the focused strategies?

**John L. Stauch** - *Pentair plc - Future President and CEO*

Yes. I mean, long term, I mean, 2 to 2.5x leverage is probably the appropriate place to be, but we're in no rush to get there. We'll be slightly under-levered. And I think we want to continue to focus on organic growth capabilities, observe and manage our potential funnel, focused on areas that have historically organically grown, which for us is our Aquatic Systems business, and just continue to add value where we can. So I think, for modeling purposes, that's a good place to be, but I wouldn't certainly think we feel any urgency to get immediately up to that level. Right now, I think we're really encouraged by the work we're doing to build a growth cultural internally. These 3 strategic priorities have really got the focus of the organization, and we're getting good tactical execution plans below them. And I think we're all excited about the opportunity that we can drive in our organic growth.

**Jeffrey David Hammond** - *KeyBanc Capital Markets Inc., Research Division - MD & Equity Research Analyst*

Okay. And just back on price cost, can you just talk about any -- what price actions you've taken, what you've announced maybe across the different businesses to kind of get to that 1 point of price for the year?

**Mark C. Borin** - *Pentair plc - Future Chief Financial Officer*

Yes, Jeff, I mean, the price actions that we've taken so far this year are nothing out of the ordinary. So it would be our normal activities that we would do heading into the season and have not done anything unusual. Those actions have been taken and really nothing planned incrementally going forward.

**John L. Stauch** - *Pentair plc - Future President and CEO*

I mean, just the inflation that you see there is a combination of wage inflation and also material inflation. And wage inflation was a little larger this year, and the material inflation we're working to offset that with productivity, as Mark mentioned earlier. And right now, we're not overly concerned about it as we look forward.

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**Operator**

Your next question comes from the line of Scott Graham with BMO Capital Markets.

**Scott Graham - BMO Capital Markets Corp. - Head of U.S. Government Bond Trading**

So what does price cost -- if we look at it plus 1% and then minus 2.4% for the first quarter, what do those numbers look like based on today's commodity prices, because I assume you know your labor inflation? What do those numbers look like on an exit rate basis in '18?

**John L. Stauch - Pentair plc - Future President and CEO**

Well, I think we mentioned this that the total full year '18 is out there, but \$58 million, I think is inflation for the year, yes. And think of that as roughly half of that is related to labor and the other half of it roughly material, and that's what we think. And that includes the current look at what we're seeing in all the commodity prices, Scott.

**Scott Graham - BMO Capital Markets Corp. - Head of U.S. Government Bond Trading**

Right, and I do see that. I guess, I was just sort of wondering we had a pretty heavy dose of steel inflation in the second half of the first quarter. And I know you want to do your best here to kind of make sure that everything looks square versus what you've talked about previously. But I guess, I was just assuming that price would be a little bit better than that on a full year basis. Certainly, as we exited the year, it sounds like you're not saying that.

**Mark C. Borin - Pentair plc - Future Chief Financial Officer**

That's true on price. On the steel side, really when you look at our overall purchase, steel is not that significant of a component of our overall spend. And so the steel inflation that maybe you've seen on the other side of the business, we haven't seen that impact us in the same way.

**Scott Graham - BMO Capital Markets Corp. - Head of U.S. Government Bond Trading**

Got you. Fair enough. The other question I had is about tariffs. Obviously, a lot going on both in the headlines and being executed U.S. and China -- or maybe I should say U.S. versus China, even Russia a little bit here. Could you talk about -- have you analyzed how this could affect your business going forward?

**Mark C. Borin - Pentair plc - Future Chief Financial Officer**

We have looked at it. We've looked at the 2 components of the initial announcement focused on steel and aluminum. And as I mentioned earlier, that has a very limited impact on us for the year. So not even something that is worth mentioning. Kind of the second round, the more recent round of announced tariffs, the team has been diligently working to evaluate what that looks like for us. As I'm sure you know, there's a host of product codes that have been announced that are being impacted. But at the same time, it's evolving every day. There's a lot of ongoing review and comment that's coming. And so it's really too early to be able to tell what that's going to look like and how that's going to impact us. But rest assured that the team is on top of it and looking closely to understand what the implications are. And as we get closer to a timeline where it's finalized and it's more clear what it may or may not look like when it's actually put in place, we'll be able to talk a little bit more specifically about how we think that might impact us.

**Operator**

Your next question comes from the line of Deane Dray with RBC Capital Markets.



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**Deane Michael Dray - RBC Capital Markets, LLC, Research Division - Analyst**

Just to start off, Randy, congrats. I remember the first transformational move you made way back when you pivoted Pentair out of the wood working tools business and into Water. So the company and you have come a long way.

**Randall J. Hogan - Pentair plc - Chairman & CEO**

Thank you.

**Deane Michael Dray - RBC Capital Markets, LLC, Research Division - Analyst**

And then a question for John. And we saw this slide on your Investor Day, page 15, The New Pentair Focused Strategies. Look, it makes a lot of sense to us to have you go down the path of your biggest strengths in Commercial and Residential, and you said 80% of the business already are in those focus areas, but it still begs the question about that other 20%. And I'm not sure -- you may not be in a position to disclose exactly how you're going to approach this, but just share with us your thinking. What's on the table here, because you have some really strong brands and they are valued and there'd be a lot of people interested in them? But maybe you want to keep them in some sort of a runoff or noncore segment, but just what's the thinking there in terms of how that value might get unlocked?

**John L. Stauch - Pentair plc - Future President and CEO**

Yes. So half of that you could classify as more Industrial-facing opportunities, which is our Food and Beverage, and our X-Flow membranes play in there, Deane. And they're very important, not only to our short-term value creation, but also to our long-term value creation and coming back into the Residential and Commercial markets. As I think you know, the technology starts with the applications, the Municipal side and the Industrial side and then usually gets scaled and gets then some traction in the Commercial and Residential. So very key. The other half of that would be our Municipal products, primarily our pumps. And again, technology and the partnerships we have with different municipalities and EPCs help create some value and translate in the rest of the business. So right now, it's really more about that they're important businesses and they need to continue to grow and continue to drive cash. But the incremental investment will be geared to the 80%. That's what our messaging is both externally and internally, and I think it's resonating.

**Deane Michael Dray - RBC Capital Markets, LLC, Research Division - Analyst**

Got it. And just to clarify, will those be in separate segments or separate business lines that we might have some clarity as to how they're doing?

**John L. Stauch - Pentair plc - Future President and CEO**

They're in Flow Technologies, and they'll also be in the segment called Filtration Solutions. And we'll be sharing that on an annual basis kind of what our percentages of revenue are. And sure, as you ask us, we'll be able to tell you how those market segments are doing.

**Deane Michael Dray - RBC Capital Markets, LLC, Research Division - Analyst**

Got it. And then question on Aquatics. This is an important quarter for you always because there's elements at times where there's an early buy. You highlighted new products. What kind of expectation are you looking for contribution from new products? And is there anything baked in for all the rebuilding and replacement from the hurricane damage in Texas and Florida? Is any of that included in your assumptions?

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**John L. Stauch** - *Pentair plc - Future President and CEO*

Yes, that's included. And all in, we are having new product introductions this year like we usually do. And so all of that is included in the expectations for the year, Deane. And as you mentioned, Q2 is a very important quarter. Right now, all indications are it's going to be another great (inaudible) season. And we're going to participate in that.

**Deane Michael Dray** - *RBC Capital Markets, LLC, Research Division - Analyst*

Was there any early buy that was a factor in the first quarter? Or is it comparable to last year?

**John L. Stauch** - *Pentair plc - Future President and CEO*

Nothing unusual from an early-buy perspective in the first quarter.

**Operator**

Your next question comes from the line of Mike Halloran with Baird.

**Michael Patrick Halloran** - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

So just on the Filtration and the Flow Tech side. Two questions for both actually. So one, top line was pretty healthy on both sides. Obviously, just got the color on what that looked like last year with the backdated information you guys gave us. But maybe talk a little bit about what the sustainability of those healthy trends look like. Anything that you thought was unique to the quarter, because it was certainly encouraging to see the revenue start coming through there?

**Mark C. Borin** - *Pentair plc - Future Chief Financial Officer*

Sure. Really, I think the story in both places is stabilization, as I talked about a little bit. So both businesses continue to focus on the things that'll improve and reduce some of the variability, and stabilize both top line and bottom line, removing and reducing the complexity in the businesses and focusing on the areas where we can profitably grow. So we're cautiously optimistic that in both cases, we're going to see that -- those trends continue and see the return to top line growth and see improved profitability.

**Michael Patrick Halloran** - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

So the second question for both, it's just on the profitability side, very healthy year-over-year gains in both segments. The expectations for the year seem pretty healthy as well. Any way you can parse out what -- directionally, what's internally driven, what's price cost, what's volume related, just to help understand what the sustainability looks like and then also understand what the drivers are?

**John L. Stauch** - *Pentair plc - Future President and CEO*

Yes, as Mark mentioned, there's a big mix benefit here. I mean, when we go after the large projects in Filtration, which have been a nuisance to you guys as well as us, they don't bring any real value to the bottom line. So by not growing those areas, we actually do get a mix pickup, Mike. The second one in Flow, I mean, the reducing of the complexity as well. I mean, we had a lot of under-scaled product lines globally. And by exiting those and optimizing the portfolio, we're seeing the benefit of what the Residential and Commercial drop-throughs are. So I think it's a focused portfolio on both around the things that we really honestly think we can differentiate against competition and differentiate in our consumers eyes, and then we're benefiting from that growth.

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**Michael Patrick Halloran** - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Makes sense. And then last one here just making sure I understand the impact from the divested businesses that you guys talked about or the product-line shutdowns. What's the segment income impact? I'm guessing relatively negligible, otherwise, you would have pointed it out. But just curious on how that flows through?

**Mark C. Borin** - *Pentair plc - Future Chief Financial Officer*

That's right. The segment income impact is small. So it really -- to reference back to what John just said, it's part of the focused optimization strategy to really exit the things that are unprofitable and that we don't believe we can be successful in. So that's why we didn't call it out separately.

**Operator**

Your next question comes from the line of Steven Winoker with UBS.

**Steven Eric Winoker** - *UBS Investment Bank, Research Division - MD & Industrials Analyst*

Congrats on the separation, guys.

**Randall J. Hogan** - *Pentair plc - Chairman & CEO*

Thanks, Steve.

**John L. Stauch** - *Pentair plc - Future President and CEO*

We're getting there.

**Steven Eric Winoker** - *UBS Investment Bank, Research Division - MD & Industrials Analyst*

You're almost there. So listen, just first on Flow Tech, why 1% to 2% on the guide, given you have the uptick to 2%? I mean, maybe it's just so close I shouldn't worry about it. But is this any kind of deceleration though for the rest of the year? I looked at the comp. I don't think that really explained it. Just a little color for that, just conservatism?

**Mark C. Borin** - *Pentair plc - Future Chief Financial Officer*

Yes, there's no messaging there. There is no deceleration. It's just as I said earlier, cautiously optimistic and trying to stay -- not get too far out over our skis. And we'll see how the rest of the year plays out before we call it a success.

**Steven Eric Winoker** - *UBS Investment Bank, Research Division - MD & Industrials Analyst*

And you mentioned long-cycle backlog improving. A little color there would be helpful.



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**Mark C. Borin** - *Pentair plc - Future Chief Financial Officer*

The point there is that after years of kind of bouncing around and declining, it's stabilized. We're seeing relatively strong order rates and the backlog stabilizing as we look forward.

**Steven Eric Winoker** - *UBS Investment Bank, Research Division - MD & Industrials Analyst*

Okay. And the restructuring, \$6 million a quarter, I think, but no more for the rest of the year. I wasn't sure if that was total anyway. But just maybe a little perspective, given kind of what you're seeing, given the separation, all these other things going on that you think there's no more restructuring for the rest of the year. Is this just kind of -- a little color there would be helpful.

**Mark C. Borin** - *Pentair plc - Future Chief Financial Officer*

Sure. So think of the restructuring as all being tied into the optimization and some of those -- the product line and business exits that John referenced earlier. And so while we didn't necessarily indicate that we've guided to any more restructuring in Q2, I do anticipate there will be some in Q2. But we're really focused on -- and that restructuring, again, it's associated with the separation and the activities around setting up the 2 separate businesses to be successful going forward. So I see some more in Q2, but then after that, we can expect that to taper off and not anticipating anything in the second half of the year.

**Steven Eric Winoker** - *UBS Investment Bank, Research Division - MD & Industrials Analyst*

Okay. And John, one for you on Aquatics, another great quarter in terms of growth here from the business. But if you -- a lot of other businesses who have focused tended to kind of underinvest in various pieces and finally find these great opportunities when they start investing again. Your point around focus here and advancing growth in aftermarket, in automation, was this -- I mean, as great as it's been in terms of performance as much as it's kind of contributed to helping the other businesses when they've had troubles for recent years, have there been areas where you would've liked to have seen more dollars flow that are kind of pent up, and now you're getting to do that? Or is this just a case of normal course of focus and growth?

**John L. Stauch** - *Pentair plc - Future President and CEO*

Well, I think, it's first of all, the former, right. I mean, we have our best business that often is -- unfortunately, became the cash cow for funding some of those non-prioritized areas of the business that we're talking about. So it's allowing them to invest where they think the opportunities are. On the automation side, we are -- we have great product on the high end of the market. But not everybody can afford the high-end automation product. So it's about serving the mid-market and the entry level of automation. And we think we've got a great product there that's going to be introduced here in the short run. And then also making sure we've got a high-efficiency heater, which we just launched this year. So both the technology and a new product introduction. As you know, those things need to be nurtured in the earlier quarters of launch. And we also think that we have to build our brand at the consumer level. We're really well-known at the dealer level. And we'd like to market ourselves direct to the consumer to make sure we're taking advantage of all the different aftermarket opportunities that we would have.

**Operator**

Your next question come from the line of Nathan Jones with Stifel.

**Nathan Hardie Jones** - *Stifel, Nicolaus & Company, Incorporated, Research Division - Analyst*

A question on operating leverage, and so I'm looking at slide 9 here. You've got \$24 million of volume growth and then \$20 million of income growth from growth, price, acquisitions. So if I knock the \$5 million of price off there, you've got \$15 million on \$24 million of volume, or incrementals



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that are in the low \$60s million. Is that the right way to think about it just on volume growth? How much did mix impact that? And how should we be thinking about that kind of incremental over the longer term?

**John L. Stauch** - *Pentair plc - Future President and CEO*

I think the long-term incremental is closer to \$45 million, Nathan, all in. I'd remind you guys that we had a tough project challenge last year, and we called that out last year. And that was a help this year. But beyond that, \$45-ish million to \$50 million, that's our drop-throughs, and then how do we invest wisely goes into the productivity bucket.

**Nathan Hardie Jones** - *Stifel, Nicolaus & Company, Incorporated, Research Division - Analyst*

Okay, that's helpful. Then on the product line exits, business divestitures, how much of that is I'm just getting out of these businesses versus I can actually sell this for some cash? Is there going to be much of cash flow back to you from here? Or is this just exiting markets? And can you give us any detail on what kind of markets and products -- product lines that you're going to be exiting?

**Mark C. Borin** - *Pentair plc - Future Chief Financial Officer*

Yes, sure. The focus is getting out of product lines or markets that are underperforming. So I wouldn't anticipate that there's any significant cash that comes in. We're certainly not giving the businesses away by any means. But given the nature of the businesses and the size, it's not something we're seeing as a big uptick in cash. And for us, it's small geographies that we don't feel that we can -- that we've got the scale to be able to be competitive. So exiting businesses in Brazil, in Russia, in South Africa, places like that. And then small product lines in Australia, a few other smaller product lines, things that we wouldn't have talked about before. But think of them as distractions that pulled resources away from the focus on what are the priorities and the areas that we think we can really double down on and do better. And so the intent was to get those behind us, all, again, as part of this process of separating and standing up 2 new businesses and creating a water business that we feel can be successful going forward. Those things are all underway, and we anticipate that they'll be completed over the course of the next couple of quarters.

**Operator**

Your next question comes from the line of Brian Drab with William Blair.

**Brian Paul Drab** - *William Blair & Company L.L.C., Research Division - Partner & Analyst*

Brian Drab from William Blair. Two questions. Basically the same question, 1 for the Aquatic segment and then same question for Filtration. The growth in Aquatic, obviously, off to a very strong start. You're forecasting about 8% growth, again, 7.5% growth for the second quarter, but then 5.5% for the year. So it implies a deceleration from 8% growth in the first half to about 3% in the second half. So wondering if you could talk about why that would be.

**John L. Stauch** - *Pentair plc - Future President and CEO*

No real reason. I mean, if we continue trends, it will be better. But we've got to see how Q2 comes out, and then we'll adjust accordingly as the year unfolds.

**Brian Paul Drab** - *William Blair & Company L.L.C., Research Division - Partner & Analyst*

Okay. So sort of a similar mentality to what you're forecasting for the Flow Tech? There is -- seems like the theme here is that there's some conservatism in the second half guide.

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**John L. Stauch** - *Pentair plc - Future President and CEO*

Well, there's more we have to see to make a determination, yes.

**Brian Paul Drab** - *William Blair & Company L.L.C., Research Division - Partner & Analyst*

Okay. And then on the Filtration side, just doing that same exercise, looking at first quarter results, second quarter guide, you're going from 4% growth down to 1.5%. And then if you take the full year guide into account, then it reaccelerates back to 3-plus percent in the second half of the year. What's happening in the second quarter? And then what drives that rebound in the second half of the year?

**John L. Stauch** - *Pentair plc - Future President and CEO*

Right now, it's just year-over-year comparisons in Q2, Q3 and Q4. We generally took the Q1 upside and moved it through the year. And we haven't adjusted anything yet in Q2, Q3 and Q4 until we see how the seasonality unfolds in Q2.

**Operator**

Your next question comes from the line of Julian Mitchell with Barclays.

**Ronald Drew Weiss** - *Barclays Bank PLC, Research Division - Research Analyst*

This is Ronnie Weiss on for Julian. Of the \$25 million of growth investment, how much of that came in Q1? And then can you walk through how that trends through the year and what the payback timing on that investment spend looks like as we go forward here?

**John L. Stauch** - *Pentair plc - Future President and CEO*

Yes, if you were to put it linear by quarter, we spent a couple million less than that linearization in Q1, and it ramps up as we head into Q3 and Q4.

**Ronald Drew Weiss** - *Barclays Bank PLC, Research Division - Research Analyst*

Okay, great. And then going back to the inflation point, I was wondering if you could quantify or bucket out what came from raw mats, what came from labor inflation, maybe there were some freight inflation there as well, and how those 3 buckets look for the year.

**Mark C. Borin** - *Pentair plc - Future Chief Financial Officer*

I think about probably half of that inflation is labor, half is material. No real significant change in freight, and then think of that consistently throughout the year.

**Operator**

Your next question comes from the line of Robert Barry with Susquehanna.



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**Robert D. Barry** - *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

Just curious, another take on the tariff question about what you're seeing in the Ag end market, any impacts there from kind of uncertainty around tariffs.

**John L. Stauch** - *Pentair plc - Future President and CEO*

Yes. So as Mark mentioned, there's tariff, one, which is steel and aluminum, is a really nominal impact to us for the year, and that's focused into this forecast -- or factored in this forecast. As far as the next round of tariffs, as Mark mentioned, we're grinding through all the different codes and the products, and trying to explore what the impact to us would be and the actions would be. And we're not prepared to share anything on that at this moment.

**Mark C. Borin** - *Pentair plc - Future Chief Financial Officer*

But thinking of it from a market perspective, we have a global Ag business. So if the market moves from one place to the other, the business can pick that up regardless of whether it's here or in other geographies.

**Robert D. Barry** - *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

Got it. You also had called out Precision Spray. Can you just remind us how big that business is and what in particular caused it to outperform this quarter?

**John L. Stauch** - *Pentair plc - Future President and CEO*

We've got about a \$100 million of revenue annually in which we create Precision Spray. We have an OEM relationship where we've been really driving our nozzles onto the OEM side. And then we also are getting good aftermarket lift in that business. So it's a share and creating new products and those new products create value to the farmers.

**Robert D. Barry** - *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

Got it. And just finally, the divestitures, is that having a material impact on mix and helping the ROS this year? Or will it?

**Mark C. Borin** - *Pentair plc - Future Chief Financial Officer*

Yes. As John talked about, that's part of the reason why we've mixed up, it's because we've exited through divestitures or product line exits some of the lower-performing parts of the business.

**Robert D. Barry** - *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

The 10 basis point change since the analyst day, is that mostly that?

**John L. Stauch** - *Pentair plc - Future President and CEO*

I mean, basically think of really no income impact on the revenue that is highlighted there.

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**Operator**

Our final question comes from the line of Walter Liptak with Seaport Global.

**Walter Scott Liptak - Seaport Global Securities LLC, Research Division - MD & Senior Industrials Analyst**

I wanted to ask about the growth strategies, slide 15. Should we think about you've got more in -- more focused programs in Filtration. Does that mean you got more spending on new products going on there? Or are these somehow weighted by segment?

**John L. Stauch - Pentair plc - Future President and CEO**

I think in the Filtration side, think of it as a global business and a global opportunity. So yes, there is more innovation and technology required there. There's also today, we don't go to the consumer with our brand. So there's some brand investment required. And so yes, I think you're thinking about it correctly.

**Walter Scott Liptak - Seaport Global Securities LLC, Research Division - MD & Senior Industrials Analyst**

Okay, great. And then if you can just refresh us on timing of when you think you'll get benefits from the incremental spending and how will that look in terms of growth rates.

**John L. Stauch - Pentair plc - Future President and CEO**

I think we'll start to get benefits here in the second half. But I mean, we'll -- it'll be generally rounding errors as you think about differentiated growth. And we hope to build over time to getting a predictable and consistent incremental 1% to 2% of differentiated growth over the long haul from these 3 activities.

**Walter Scott Liptak - Seaport Global Securities LLC, Research Division - MD & Senior Industrials Analyst**

Okay, great. And then just a couple of kind of housekeeping things. What's your expectation for R&D spend this year and corporate expense?

**John L. Stauch - Pentair plc - Future President and CEO**

\$55 million for corporate and roughly 3% of sales for R&D.

Okay, thank you for joining us today. And I hope you have heard our excitement for new Pentair that is expected to be completed by April 30. As a pure-play water company, we believe we'll be well positioned to benefit from strong secular trends. We are driven by the Pentair Integrated Management System, and we have a proven and capable management team in place. One of the things we like most about our portfolio of businesses is our large and installed base. This allows us an opportunity to drive differentiated offerings for our customers across all of our businesses. Finally, we have a strong capital structure, our free cash flow generation is robust, and we plan to continue to be disciplined with our precious capital. Thank you for your continued interest. Angie, you can conclude the call.

**Operator**

Certainly. Thank you for participating in today's conference call. You may now disconnect your lines at this time.



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