

Pentair plc (Q1 2023 Earnings)

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Corporate Speakers:

- Shelly Hubbard; Pentair plc; Vice President, Investor Relations
- John Stauch; Pentair plc; President, Chief Executive Officer & Director
- Robert Fishman; Pentair plc; Executive Vice President, Chief Financial Officer & Chief Accounting Officer

Participants:

- Mike Halloran; Robert W. Baird & Co.; Analyst
- Bryan Blair; Oppenheimer; Analyst
- Brett Linzey; Mizuho Americas; Executive Director
- Andy Kaplowitz; Citigroup; Managing Director
- Saree Boroditsky; Jefferies; Analyst
- Nathan Jones; Stifel; Analyst
- Miguel De Jesus; Goldman Sachs; Analyst
- Steve Tusa; JPMorgan; Managing Director
- Scott Graham; Loop Capital Markets; Managing Director
- Deane Dray; RBC Capital Markets; Analyst
- Julian Mitchell; Barclays; Analyst
- Joe Giordano; TD Cowen; Analyst

PRESENTATION

Operator^ Welcome to the Pentair First Quarter 2023 Earnings Conference Call.
(Operator Instructions)

Please note, this event is being recorded.

I would now like to turn the conference over to Shelly Hubbard, Vice President, Investor Relations.

Shelly, please go ahead.

Shelly Hubbard^ Thank you, [MJ]. Welcome to Pentair's first quarter 2023 earnings conference call.

On the call with me are 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 first quarter's performance as outlined in this morning's press release.

On the Pentair Investor Relations website, you can find our earnings release and slide deck, which is intended to supplement our prepared remarks during today's call and provide a reconciliation of differences between GAAP and non-GAAP financial measures that we will reference.

The non-GAAP financial measures provided should not be considered as a substitute for or superior to the measures of financial performance prepared in accordance with GAAP.

They are included as additional clarifying items to aid investors in further understanding the company's performance in addition to the impact these items and events have on the financial results.

Before we begin, let me remind you that during our presentation today we will make forward-looking statements, which are predictions, projections or other statements about future events.

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, Form 10-K and today's release.

Following our prepared remarks, we will open up the call for questions. (Operator Instructions)

Before I hand it over to John, I wanted to highlight Slides 4 through 6, in our earnings slide deck that illustrate our strategic framework, Pentair at a glance and a Pentair overview.

We believe, this information is helpful to understanding who Pentair is, especially for those new to Pentair. Our strategic framework states our purpose, mission, vision and values that drive our performance as a smart sustainable Water Solutions company.

Pentair at a glance on Slide 5 provides a great snapshot of our company, our performance, our installed base and our 40-year track record -- 47-year track record of annual dividend increases, which places us in a small group of companies.

Lastly, the Pentair overview on Slide 6 provides our historical sales and ROS performance on a consolidated level and by segment. This information was first disclosed last quarter in the supplemental data section and is now illustrated on one slide. As you can see, over the last 3 years, we have grown sales by a compound annual growth rate of nearly 12%, and ROS has expanded by 110 basis points, on a consolidated basis.

I will now turn the call over to John.

John Stauch^ Thank you, Shelly. And good morning, everyone.

Let's begin with our strong Q1 results in the executive summary on Slide 7. We are very pleased with our first quarter performance, which reflected a strong start to our fiscal year, as we help the world sustainably move, improve, enjoy water, life's most essential resource.

Q1 sales rose 3% to over \$1 billion, segment income increased 23% to \$211 million, and ROS expanded by 330 basis points to 20.5%. Adjusted EPS rose over 7% to \$0.91. Segment income and ROS each achieved record levels post the nVent separation in 2018. I'd like to thank our talented Pentair employees for once again delivering for customers, while creating value for shareholders.

Strong results reflect the strength of our diversified Water portfolio and progress on our transformation initiatives, which drove greater efficiencies across each segment. For example, growth in our Industrial & Flow Technologies, or IFT, and Water Solutions segment more than offset the expected volume declines in Pool year-over-year. We improved ROS expansion across the enterprise and realized operational efficiencies, as our transformation initiatives accelerated.

We are driving these actions at the revenue stream or category level, which not only provides the go-to-market and customer insights, but also the ownership and accountability to realize savings and other opportunities that we have identified.

Let's move on to Slide 8, titled Q1 Highlights. Within our IFT segment, growth was driven primarily across our commercial, industrial and even residential and irrigation verticals. We are excited about the near- and long-term growth and margin profile of this segment, as our transformation is taking hold. We are focused on capturing the right projects with improved offerings to drive margin expansion. We realized benefits in pricing, sourcing and operational excellence, and we expect more opportunities ahead.

We also had customer wins for our sustainability-related technology that reduces Water usage and recapture CO2. Additionally, we drove aftermarket and replacement revenue in our membranes and pump portfolio.

In our Water Solutions segment, we are very pleased with our Manitowoc Ice acquisition, which complements our commercial Water Solutions businesses, enabling us to provide end-to-end Water Solutions for customers from filtration to ice to services. The integration remains on track, has progressed well and was accretive to segment margins.

As I mentioned last quarter, we expect 2023 to be a softer year for our Pool segment. During the first quarter, unusual U.S. weather in the West, expected higher channel inventory and strong demand in the prior year contributed to declining volume. Despite the decline in year-over-year volume, the installed base has continued to grow over the last 3 years, and we believe the Pool segment is an attractive market.

As we look forward, we continue to invest in leading innovation, specifically automation, which helps save energy, time and Water and enables Pool owners control of their pools directly from their smart device. Today, roughly 50% of installed pools have automated systems. This is an area where we see the greatest opportunity, as consumers look to maintain control of their Pool function at the tip of their fingers.

Good examples of our latest Pool innovations are the IntelliFlo 3 variable speed and Flow Pool pump, also known as the IF3 and the IntelliCenter pool automation system. Our IF3 is the first pump with WiFi and Bluetooth connectivity for remote control monitoring and over-the-air, or OTA, updates. It also features built-in IoT connectivity, which simplifies installation setup and operation for our dealers.

Market reactions and dealer feedback to the launch of our new flagship IF3 pool pump has been extremely positive, and we're pleased overall with the demand we have seen, despite a slower start to the pool season.

We believe our IntelliCenter pool automation system is the most feature-rich and expandable pool automation system on the market to easily control even the most complex and advanced pools. The system is powered by AWS Cloud technology for improved stability, connectivity, scheduling and reliability. Our digital automation technology centralizes control for multiple pool devices from Water features to lights and pumps. In Pool, lead times have continued to improve, enabling us to better serve our customers and deliver our products more quickly.

Moving on to Slide 9, titled Making Better Essential. We recently released our 2022 Corporate Responsibility Report on April 18, and we are excited that we have made progress on our strategic social responsibility targets. We are focused on advancing a sustainable future through innovation in our products and solutions to create a better world for people on the planet through smart, sustainable Water Solutions.

Turning to Slide 10, titled Social Responsibility Strategic Targets. In 2022, we reduced Scope 1 and 2 greenhouse gas emissions by 29%, as compared to our 2019 baseline. And we decreased our Water withdrawal, which represents a 9.3% reduction compared to 2021. We also implemented a sustainability scorecard process for all new Pentair product development to help us better understand the sustainability impact, and opportunity of each new product.

Moving to Slide 11, titled Positive Impacts from our Products and Solutions. We are proud of the continued progress we have made in our operations and towards sustainable products and solutions. A few examples include 37% of our total electricity usage came from renewable sources and 83% of Pentair's solutions support energy efficiency and 71% support Water efficiency.

For the 11th consecutive year, Pentair has received the ENERGY STAR Partner of the Year Award from the EPA. This award recognizes Pentair pool pumps and Manitowoc

Ice excellence in energy efficiency. In fact, Pentair was the first manufacturer of pool equipment to receive this certification for our pool pumps. Since 2005, our ENERGY STAR pool pumps have saved a cumulative 38.9 billion kilowatt hours of energy savings, reduced greenhouse gas emissions by nearly 16 million tons of CO₂ and saved over \$5 billion in operating costs for U.S. consumers.

Before I turn it over to Bob, let's turn to Slide 12, titled CEO Summary. We delivered quality earnings across our diversified portfolio, and positioned the company for sustained value creation. Our Q1 performance was a strong start to our fiscal year, which reflected sales growth and ROS expansion driven by a diverse Water portfolio, as well as efficiencies from transformation. Manitowoc Ice has assimilated well and contributed ahead of expectations.

Bob will discuss our second quarter and full year 2023 guidance in more detail. However, I wanted to share with you some of my thoughts on our current outlook. As we look to the remainder of 2023, we continue to closely monitor macroeconomic developments and remain mindful of an uncertain operating environment. We are implementing risk-mitigation strategies, and accelerating transformation funnels is necessary, while focusing on investing in the long-term growth of our company.

We've reduced our pool revenue expectations, reflecting both a lower sell-through due to economic uncertainty and the previously expected inventory headwinds, while increasing our expected margin expansion, reflecting Q1 performance and confidence in our transformation progress. We also expect Water Solutions and IFT performance to continue throughout 2023 as informed by orders, backlog and transformation efficiencies.

As a result, we are raising the midpoint of our adjusted EPS guidance to \$3.65, reflecting our strong Q1 performance, while maintaining the high end of our adjusted EPS guidance range at \$3.70. We are confident in our diversified Water business model, long-term strategy and our transformation initiatives, which we anticipate will continue to drive shareholder returns.

We have a long successful track record of generating strong cash flow and being disciplined with capital allocation. This year marks our 47th consecutive year of dividend increases. And longer term, we are targeting getting back to high teens ROIC.

We have the right purpose, the right team, the right portfolio and the right strategy to win in this market. We believe, we have a very solid foundation and the competitive advantages to continue to succeed.

I will now pass the call over to Bob, who will discuss our performance and financial results in more detail. Bob?

Robert Fishman^ Thank you, John, and good morning, everyone. Let's start on Slide 13, titled Q1 2023 Pentair Performance. We delivered better-than-expected first quarter sales growth of 3% driven by pricing benefits across all 3 segments and the contribution of our

Manitowoc Ice acquisition, which were partially offset by volume declines in our residential businesses.

Our higher-than-expected sales in the quarter were driven by better performance in IFT and Water Solutions, offset by slightly lower-than-expected sales in our Pool segment, primarily due to unusual weather in the West. Core sales declined 3% mainly driven by a 16% decrease in Pool, after Pool grew 23% in last year's Q1 and 48% in Q1 of 2021, partially offset by core growth of 11% in IFT and 2% in Water Solutions.

First quarter segment income increased 23%, and return on sales expanded 330 basis points year-over-year to 20.5%, driven by price more than offsetting inflation, productivity benefits from our transformation initiatives and accretive margins from our Manitowoc Ice acquisition. As John mentioned, both segment income and ROS in Q1 hit record levels post separation of nVent.

We delivered better-than-expected adjusted EPS of \$0.91, up 7% versus the prior year. Net interest and other expense was \$33 million, and our adjusted tax rate was 15% during the quarter, with a share count of 165.8 million. Our better-than-expected segment income and adjusted EPS were driven by higher sales, price offsetting inflation and better contribution from our transformation initiatives.

Please turn to Slide 14, labeled Q1 2023 Industrial & Flow Technologies Performance. IFT sales increased 9% in the quarter, which included 2 points of FX headwinds. Core sales increased 11%, segment income grew 25% and return on sales expanded 200 basis points to 16.6%, marking the third consecutive quarter of equal to or greater than 200 basis points of improvement. The strong margin expansion was a result of price offsetting inflation and continued progress on our transformation initiatives. Sales growth in IFT was driven across all businesses, led by commercial flow and industrial solutions, along with growth in residential flow.

Please turn to Slide 15, labeled Q1 2023 Water Solutions Performance. In Q1, Water Solutions sales increased 32% driven by our Manitowoc Ice acquisition and price. Core sales grew 2%. The 3 points of volume decline was primarily due to the continued inventory correction, across many product lines in our residential channels. Segment income grew 136%, and return on sales expanded 850 basis points to 19.3%, driven by our ICE acquisition as well as efficiencies from our transformation initiatives.

Please turn to Slide 16, labeled Q1 2023 Pool Performance. In Q1, Pool sales declined 16%, which was slightly below our expectations. The volume decline of 27 points was primarily due to unusual weather in the Western U.S. in the first quarter of this year, inventory corrections in this year's Q1, and a strong prior year comparison. The pricing benefit of 11 points helped partially offset the volume decline and was due to carryover from the prior year.

Despite lower sales year-over-year, return on sales expanded 520 basis points to 31.9%, due to price significantly offsetting inflation, rightsizing to lower volumes and benefits from our transformation initiatives.

Please turn to Slide 17, labeled Transformation Expectations. We continue to make progress on our transformation with realized successes in Q1 regarding pricing and sourcing, which drove margin expansion. As we shared with you last quarter, we expect to drive ROS expansion of over 400 basis points by year-end 2025 as compared to 2022.

As I mentioned last quarter, in pricing, we completed wave one, which established a new strategic pricing playbook. This creates a foundation for pricing across our different go-to-market strategies and includes looking at our dealer and distributor programs to better optimize them. We continue to gain insight into profitability by customer and product category, and use this data to better drive our forecast.

We believe pricing remains a big opportunity. We are building capabilities and starting to see benefits materialize. We expect future waves to include the implementation of a pricing playbook, across all of our product categories.

We are furthest along in our strategic sourcing initiatives. As I've mentioned previously, material costs represent roughly 40% of our revenue. We have completed wave one negotiations that focused on key categories like electronics, motors and drives, castings, packaging, logistics and MRO. Wave one included roughly 35% of material spend and identified over 12% in saving opportunities.

We have unlocked value through supplier-dedicated resources supply base reduction, inventory solutions, enhanced supplier executive-level relationships and rebate programs. In Q1, over 120 Pentair cross-functional team members attended workshops to begin the wave one implementation process.

Wave two was launched in Q1 and covers another 35% of material spend for commodity groups, such as metals, plastics and molding, purchased finished goods, transportation and indirect spend, such as IT, fleet management and office supplies. We expect this will create a funnel of savings for 2023 and 2024.

In operations excellence, we are focused on reducing complexity and driving lean processes across all our operations. We believe this presents longer-term opportunities but not until 2024 and beyond, as we build out the funnel.

Lastly, in organizational effectiveness, we are focusing on sales and functional excellence to simplify our organization. From an organizational standpoint, we believe ample opportunities remain for complexity reduction across the entire portfolio and a realignment of needed skills within our top priorities.

We continue to move transformation from funnel to execution, and we expect more material benefits to contribute to our longer-term margin expansion targets. We continue

to believe that our transformation initiatives will be a large value-creation opportunity for Pentair.

Please turn to Slide 18, labeled Balance Sheet and Cash Flow. This slide reflects the closing of the Manitowoc acquisition at the end of July of last year. We ended the quarter with pro forma leverage at 2.6x. Our ROIC was at 15.2%. And as a reminder, this includes debt from the Manitowoc Ice acquisition, with only approximately 3/4 of Manitowoc EBITDA contribution.

We recently entered into interest rate swap and collar agreements in order to hedge our variable rate debt. We now expect the mix of variable to fixed debt to be closer to 50-50, by the end of Q2. We have no significant long-term debt maturing for the next few years, and almost the majority of our debt is in term loans going out 3 to 5 years.

We used \$123 million of free cash flow in Q1, which reflects typical seasonality and was roughly \$25 million better than the prior year. As a reminder, the second quarter is typically our highest free cash flow quarter of the year, and we expect full year free cash flow to be in line with our historical performance of 100% of net income. We plan to remain disciplined with our capital and continue to focus on debt reduction, amid the higher interest rate environment.

Moving to Slide 19, titled Q2 and Full Year 2023 Pentair Outlook. For the full year, we are updating adjusted EPS guidance to approximately \$3.60 to \$3.70, raising the midpoint. Also for the full year, we expect sales to be roughly down 2% to flat. We expect segment income to increase 7% to 10% with corporate expense of approximately \$80 million, net interest expense of roughly \$125 million, an adjusted tax rate of approximately 15%, and a share count of 165 million to 166 million.

For the second quarter, we expect sales to be approximately down 1% to flat versus last year's Q2, as the contribution of Manitowoc Ice and our commercial and industrial businesses are expected to help offset expected volume declines from our residential businesses. We are introducing adjusted EPS guidance of approximately \$0.94 to \$0.96, which represents a year-over-year decrease of approximately 6% to 8%, primarily due to lower Pool volumes.

We expect an improvement in the second quarter versus the \$0.91 of adjusted EPS in Q1. We expect segment income to increase 5% to 7% with corporate expense coming in around \$21 million, net interest expense of roughly \$34 million, an adjusted tax rate of approximately 15% and a share count of 165 million to 166 million.

Moving to Slide 20, titled Full Year 2023 Guidance at Midpoint. At the midpoint, we expect total Pentair sales to be down approximately 1%. While the sales midpoint has not changed, our sales mix and assumptions have. We now expect IFT to perform better than we expected 90 days ago, and Pool sales to decline from our original expectations due to increased economic uncertainty and lower new pool construction.

We now expect IFT sales to be up low single digits, Water Solutions to be unchanged with sales up mid-teens and Pool sales to be down approximately in the mid-teen range, as compared to down low double digits previously.

As we have discussed in prior quarters, our Pool sales consist of 20% from new pools, 20% from remodels and 60% from the aftermarket. Within our current Pool guidance, we now expect new pools and remodels to be down approximately 25% versus previous assumptions of down approximately 20% and inventory in aftermarket to be down roughly 20% compared to previous assumptions of down 15% with approximately 2/3 of the decline relating to inventory corrections.

We expect price carryover of roughly mid-single digits. We do expect Pool to return to more normalized demand in 2024 after absorbing significant headwinds in the current year. Segment income is now expected to increase approximately 9% as compared to 8% previously with ROS expansion of nearly 200 basis points to 20.5%, as compared to 20.2% last quarter.

We are encouraged by the diversity of our portfolio, the integration of Manitowoc Ice and the continued momentum of our transformation initiatives, which are expected to drive significant margin expansion.

Before I turn the call over for Q&A, I wanted to highlight why we believe that Pentair is a compelling investment opportunity. Please turn to Slide 21. There are 6 distinguishing characteristics that we believe sets Pentair apart. We are an industry leader with a diversified brand portfolio and a focus on driving innovation across all 3 segments. We have a transformation strategy that is expected to drive operational efficiencies and margin expansion.

We have an ESG focus on people, the planet and governance to provide smart, sustainable Water Solutions. And we just recently published our 2022 Corporate Responsibility Report, highlighting progress towards our strategic targets. We have favorable secular trends driving end-market growth. We have a strong balance sheet and cash flow, which we expect to drive additional value creation. And we are a dividend aristocrat with 47 consecutive years of increasing dividends.

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

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions) Today's first question comes from Mike Halloran with Baird.

Mike Halloran^ Really nice quarter. Really nice quarter. So a couple of questions here. First on the Man Ice side of things. Maybe can you just talk a little bit about, where you're seeing the outperformance from and then also a little bit of context on how you're

looking at the forward outlook, what kind of visibility you have, what customers are saying? Any kind of context around that?

Robert Fishman^ The Manitowoc Ice performance has been significant from our perspective. We -- I often get asked the question. So this year, in Q1, we drove roughly \$95 million of sales in Manitowoc, and that's versus them doing around \$75 million last year. And again, think of that business as high 20s, from a margin perspective.

I would say one thing that's helped is they have significant backlog in the business. They're clearing that. But probably more importantly, if you think about the go-to-market strategy, as we combine Ice services and our commercial filtration business, my view is that 1 plus 1 plus 1 adds up to more than 3, and the opportunity to go to market in that way has really helped the business.

Mike Halloran^ And then on the Pool side of things, obviously, the margins were particularly impressive given where the volume levels we're at. Maybe you can just frame, you provide a little bit more context around the drivers behind that? I know you commented on price transformation, but a little more detail on that. And then, how should we think of the sustainability of this margin range, particularly given you still have a lot of volume variability ahead of you?

John Stauch^ Yes. Mike, I'll tag team this one and -- I think, we talked openly last couple of years about the inefficiencies in our manufacturing process from not having our supply chain aligned to the volume demands. And those inefficiencies came from freight premiums to get product in and out, as well as the overtime that we were running in our factories.

As we were able to have more visibility and clarity on the demand throughout the channel, Mike, we were able to eliminate most of those inefficiencies. And spot buys are a big piece of what we are dealing with, too, and we saw huge positive impacts in Q1 regarding that.

I share that because while we're getting some of the transformation benefits in Pool, what really ups our confidence as most of the transformation benefits around the ongoing sourcing savings and the operational efficiencies really are in the later quarters. And we have a lot of confidence that we're going to realize those in addition to these inefficiencies going away.

Robert Fishman^ The only thing, I would add is I think Pool has done a really nice job. Back in Q3, Q4 of last year and seeing the channel correction ahead of us, they did a nice job of rightsizing to those lower volumes.

Operator^ The next question comes from Bryan Blair with Oppenheimer.

Bryan Blair^ Actually wanted to follow up on Mike's question on the Manitowoc outperformance. Obviously, pacing ahead of plan. You mentioned the strong pro forma

growth year-on-year. Is high 20s margin an EBITDA or ROS figure, just to clarify on that? And, how should we think about that phasing through the year, whether there's lift possible? And are you willing to speak to a new accretion range for 2023?

Robert Fishman^ It is a ROS number to answer your first question. And again, our view is that Manitowoc Ice is an extremely well-run business, as part of our portfolio. Our goal is to continue to keep the margins in that high 20s range and have them take advantage of the transformation initiatives as well. But we don't want to get ahead of ourselves with that business either. For now, the performance is going exceptionally well.

John Stauch^ And as a reminder, when COVID evolved, I mean, the space that we're in, took one of the bigger hits across the Pentair portfolio, right? So we're still dealing with global openings of restaurants, hospitality, gyms, et cetera. And that's really driving the trends in our foodservice operations, both with Manitowoc performance, but also with our Everpure filtration and our services operations as well. So really feel good that we've got visibility in this space and that we're coming together to solve customer solutions in a way that make those customers want to continue to work with us.

Bryan Blair^ All makes sense. It's good to hear. And within Water Solutions, resi weakness to start the year, that was obviously anticipated. Any update you can offer, insight into current channel trends and whether over the next couple of quarters, we may be more in balance in terms of channel inventory?

John Stauch^ Yes. As a reminder, we've had -- part of this delta negative year-over-year is driven by our exits of our direct-to-consumer initiatives. But when you look at the core underlying residential Water treatment trends, they're still positive and encouraging as people are looking for the best Water that they can have in their homes. And when you look across your channels, we're still seeing modest growth across most of our end channels.

Operator^ The next question comes from Brett Linzey with Mizuho Americas.

Brett Linzey^ Want to come back to wave 2 of the transformation. It sounds like, you've got a lot of organizational muscle around these opportunities. With regards to wave 2, is there anything unique about the phasing or the timing of the benefits relative to wave 1? Or should we think of this as sort of linear through 2024?

Robert Fishman^ Yes. And just as a reminder, we have the 4 major initiatives in transformation. They all have different waves, in particular around sourcing, the wave 1 negotiations is complete now. So we're moving on to the wave 1 implementation, and at the same time, running a parallel activity around the next \$500 million, \$600 million of spend in wave 2. So our view is it's a really nice runway that benefits more significantly in 2024 but then also gives us upside in 2025 and beyond.

Brett Linzey^ Okay. Got it. And just on price, I mean, the traction continues to be very strong there. Was Q1 in line with your Q1 expectation? Or did that realization come in a

little bit better? I'm just curious if there might be a little upward tension on that 5% assumption for the full year.

Robert Fishman^ It was a little bit better than we expected. We always knew that Q1 would be our better price quarter and that it would slowly come down, throughout the year. But we have seen less discounting than we thought. So we're certainly comfortable with pricing and had a little bit of upside in the first quarter.

Operator^ The next question comes from Andy Kaplowitz with Citigroup.

Andy Kaplowitz^ Just focusing on the overall pool market for a second. Can you possibly quantify how much weather impacted your Pool equipment business in the quarter? And are you still thinking normalization of Pool markets occurs end of Q2 or Q3? And I think, you've been focused on attempting to take share back this year, as supply chains have improved in Pool? Have you been able to do that?

Robert Fishman^ So to start the question, it was a couple of points relating to weather in Q1. So it did cause us to come in slightly lower than what we thought. We -- our belief is still that we are back to normal inventory levels by the end of the pool season, which would be the third quarter. So that continues to be our assumption there. Third part of your question, Andy, was what?

Andy Kaplowitz^ Share. As supply chains have gotten better, have you been able to sort of get more equipment into the market and take some share?

John Stauch^ Yes. I mean we're excited about the new product offerings, as I mentioned, and getting the industry and the market again focused on those new products. I think, when everybody's busy and things are active, you just kind of want to put in more of the products that you know very well. So we've been very actively training the dealer channels on the new IF3 pump, as I mentioned in my comments, which was really the first product that has the Internet capability and WiFi and Bluetooth built into the pump itself, which allows us for some basic features that can be run without the full automation pad.

The second one that we launched is -- we're excited about our new IntelliCenter and the improvement in the IntelliCenter app, which we've been able to, again, get the channel excited about. And then, the third element that we still have coming is a new filtration capability both for safety and clarity of space.

So I think, if we talk about winning, it's going to come from new products and having, again, the most innovative products for the channel and getting the channel excited to be partnered with Pentair to bring those to the consumers.

Andy Kaplowitz^ And then, John, your CapEx businesses, such as industrial solutions, continue to look strong. Can you talk about the durability of the CapEx cycle? What are your conversations like with customers at this point across that IFT segment?

John Stauch^ Yes. I'm extremely impressed with the IFT team both under Jerome's leadership when he was there and the way that Devon has continued to lead it. Our business leaders know that what we want is predictable growth. And growth that comes both profitable on the project element but also brings with it the aftermarket and services component.

So we've limited the growth opportunity to those projects that we feel like we can bring forward at a positive margin for Pentair and also then bring on those future businesses. So I think, we feel good about the engagements we have with the customer space, the investments that are happening and the solutions we're providing, which, again, are taking waste to value.

So in most cases, these projects are bringing value to our end customers while they're investing in it. So we're keeping an eye on it. You would expect higher interest rates to slow that industrial investment. But right now, from what we can see, the pipeline remains strong.

Operator^ The next question comes from Saree Boroditsky with Jefferies.

Saree Boroditsky^ Just kind of building a little bit on Pool. You talked about inventory normalizing after the pool season. So if you could just update us on how you're thinking about the early buy potential as we get into 4Q, and what that should look like as we get into 2024.

Robert Fishman^ We expect early buy to return to normalized levels. It was roughly at normalized levels as we closed out 2022. So no significant difference there. Again, as we said, the -- from our perspective, the inventory correction should be done by the end of the pool season, and then we can return to more normalized growth.

Saree Boroditsky^ And when you talk about the demand normalizing for 2024, I know it's really early, but any color on how we should think about new pool construction versus aftermarket, if we are entering a weaker macro environment? And then, how are you thinking about price increases? Does that normalize after the recent high levels we've seen?

Robert Fishman^ From a new pool construction perspective, we mentioned that we assume that new pools would be down in that kind of 25% to 30% range. So again, think of new pool construction around that 80,000 mark back in '18 and '19 and '21 inclined to around 115,000. '22 about 100,000 new pools, and this year, we're estimating kind of in that 70,000 to 75,000 range.

Our view is that a lot of this is predicated on interest rates and the macroeconomic environment, but we do expect growth in new pools next year, more normalized demand across the aftermarket, really the inventory correction done. So when you think about '24, you're looking at normalized growth against 2023 that has significant headwinds.

So we're optimistic that as we turn the corner here in '23, we have a positive story for Pool. And just as a reminder, we had started the year saying that Pool would be down low double digits. We did change that assumption to down low mid-teens. And, if you think about that, we're absorbing about \$100 million more of a headwind than what we thought at the beginning of the year. So if you take the low end of double digit down and you take the high end of mid-teens, there's \$100 million that we think will work its way through this year, again, setting ourselves up for a better 2024.

And that, again, is one of the reasons why we were pleased to bring up the midpoint of our guidance this year that even with that headwind, we were able to increase with the strength of IFT, Manitowoc Ice and the great start to the year.

Operator^ The next question comes from Nathan Jones with Stifel.

Nathan Jones^ A follow-up on Manitowoc Ice to start with. Bob, you talked about then working down backlog in the quarter. Can you quantify kind of that increasing sales from 75 to 95, how much of that was burning off backlog? And are we going to be talking about a difficult comp there next year with that backlog reduction contributing to the performance in the first quarter?

Robert Fishman^ A piece was backlog, Nathan. I don't have the split between what was backlog. As we mentioned last year, backlog has been strong in Manitowoc Ice at the -- since we acquired the business in July. But overall, our view is to go to market not only with Manitowoc Ice, but with commercial filtration and services. And historically, this business has been a very consistent grower. So our view is Manitowoc Ice will continue to perform well.

John Stauch^ Yes. Nate, and if you look at order rates, our order rates there continue to be strong in the space. I don't think, we would believe that our normal organic growth rates in the Ice business will maintain at these levels. But right now, the visibility would suggest that getting back to being able to ship at the same order rates is where we're at today, and we'll begin to work that backlog down, as we exit the year.

Nathan Jones^ That's helpful. And then, maybe a broad one across the portfolio. We've talked a fair bit about lead times coming down across a lot of your businesses. Are there businesses that still have lead times that are longer than where they were before COVID 2019, kind of time frame? Are you back to more normalized lead times across all the businesses? You're going to see normalization of order rates, normalization of inventory levels, and we should be basically done talking about this stuff by the end of the year?

John Stauch^ In the majority of our businesses across the majority of the high-running SKUs, we're back to normalized lead times. We still have a few specialized products and SKUs, but those are becoming fewer and fewer quarter-by-quarter.

Operator^ The next question comes from Brian Lee with Goldman Sachs.

Miguel De Jesus^ This is Miguel on for Brian. I just had one question, maybe high level. For the -- for your commercial end markets, have you seen any concerns out there on financing just given everything going on with the banking sector? I guess, what are you seeing in real time there, if anything at all?

John Stauch^ Yes. I mean, I think we're all expecting it. We don't have a huge commercial building offering. We generally provide the fire pumps and then the aftermarket service pumps into that space. And then, we do have some pumps that connect the building of commercials back into the city Water aspects.

And yes, I think we're anticipating that higher interest rates will put pressure on those buildings and the REITs that own them and the challenges in that space. But it's going to be a modest impact to Pentair just because of the size of the business offering we have there.

Operator^ The next question is from Steve Tusa with JPMorgan.

Steve Tusa^ On this -- on the IFT growth, I know you guys went through it a little bit. I might have missed it at the beginning of the call, but the commercial and industrial solutions up mid-teens. Any more like any deeper color you can give on like the types of end markets that were driving the growth there, and why that was so strong?

John Stauch^ Yes. So I mean, first of all, relative size, this business has been really focused. We're talking about those 2 markets, Steve, being roughly around 300 and some change on an annualized basis for us, so just to frame what the teens growth would be. And I think, these are projects that we won primarily to our focus around the aftermarket, the services. And again, as I mentioned, we're into larger irrigation. We're into industrial wastewater, and we're also into commercial buildings. That would be the end markets.

Steve Tusa^ Okay. And those were -- I think that was stronger than you guys had expected in the quarter?

John Stauch^ Well, I think it's probably in line with our expectations, but it's stronger than historical averages, correct.

Steve Tusa^ Right. Okay. And then as far as the behavior of your customers on the Pool side, any color seasonally on how you would expect 3 and 4Q to play out EPS-wise? And you've given us the 2Q guide, but the third and the fourth quarter, anything to note kind of seasonally there? I guess this goes to kind of like the prebuy question in the fourth quarter?

Robert Fishman^ No doubt that, that Pool will face down 16%. They'll be down a little more than that in Q2 and Q3 and then should be at -- turning the corner in the fourth quarter. So from an EPS perspective, we think Q3 will probably be the most challenging

quarter, and then Q4 EPS will improve as a lot of these transformation initiatives kick in and then Pool starts to improve.

John Stauch^ Steve, we don't anticipate that there's hardly any dealer inventory out in the channel anymore. And obviously, the financing that they're paying, they're working more of their jobs in the sense of how do they bill and pay in the same cycle. And so the inventory we're referring to is the channel inventory distributors.

And based upon feedback and conversations, everybody is aligned to try and burn all that inventory by the end of Q3, which would mean for us, our normalized Q2 will be a lot lower than normal. And then, we'd expect that to be gone and behind us by the end of Q3, meaning we're growing sequentially from Q3 to Q4 for Pool and then, continue to grow from there as we head through 2024.

Steve Tusa^ One more question. Are you -- when it comes to pricing, are you approaching this year any differently than you have in the past? And is there -- like what's the exit rate on your price capture into next year? Should we assume that that's a normal price capture? Or is there -- are there signs that with the downturn that people are getting maybe aggressive in pockets?

John Stauch^ I think, we would be going back to really normal areas, Steve.

Steve Tusa^ Which is what, like a couple of percent?

John Stauch^ Low single digits, like more normalized based upon -- I mean way too early to call it, but I mean, your general assumptions are making sure that you're selling the value, that you're going out and you're pricing effectively and you're being able to handle any fluctuations in commodity or labor wages.

Operator^ The next question comes from Scott Graham with Loop Capital Markets.

Scott Graham^ I was just on Slide 20, where you break down the Pool view for the year. So the new remodel went from 20% to down 25%. How much of that was the first quarter weather was there -- I mean, how much of this is sort of rest of the year versus what's already happened?

Robert Fishman^ It really wasn't weather-related as much as it was just the economic uncertainty, the higher interest rates. So that was our assumption was that by bringing new and remodel down 5%, it was more related to that.

John Stauch^ Yes. And then, Scott, it's Q2 and 3 and 4, not Q1. I mean, Q1 related to the West weather, but most of all this adjustment is in Q2, Q3 and Q4.

Scott Graham^ Okay. Got it. Makes sense. And to the same end -- well, not the same, the aftermarket inventory. Last quarter, you were kind enough to sort of parse that out

between impact of aftermarket versus inventory. Could you give some color on that this time?

Robert Fishman^ Yes. Our view is the mix of that, so the down 20%, is roughly 2/3 relating to the inventory correction and 1/3 relating to the aftermarket or items that were bought in advance over the last couple of years, so think heaters, lighting, those type of products.

Scott Graham^ Yes. Got it. And last question is kind of going back to the commercial water. We've kind of had some fits and starts in that business with, varying distribution plans and different channels and what have you. Could you kind of tell us, what is Manitowoc Ice doing for you in commercial? I know you have -- you sort of lined up that in Everpure when you first bought this, but we're now kind of into this thing. What are you guys doing in the market right now, to really leverage the 3 pieces of this business?

John Stauch^ Yes. I appreciate the question. I mean, first of all, I'd say the fits and starts are more on the residential side. Global business and always experimenting or trying to think about how to go to market differently. We're now convinced that just accepting where we are with our pro channel, partner with their pro channel, drive leads to pro channel, that's our strategy in residential. And that's going to be consistent, as we go forward.

On the commercial side, we've always had a strong offering with our filtration products in Everpure and the RO systems that we sell into our commercial customers. What Manitowoc brings is added strength and capability across a wider selection of customers. And ultimately, we're able to discuss the end-to-end solutions that really drive productivity and value to our core OEM customers.

So very excited, and very pleased with the progress. And as a reminder, I mean, we're using the Manitowoc team to run that combined business. And we've integrated all those go-to-market strategies under one leadership team. And I believe that that's going to drive sustained value for our customers.

Operator^ The next question comes from Deane Dray with RBC Capital Markets.

Deane Dray^ Just a couple of cleanup questions here. Just a follow-up on the banking turmoil question. You answered, it with regard to commercial construction. Interested in hearing, if there's any sort of impact on the Pool side or consumer Water side, maybe dealer financing. Some customers finance a pool construction with a personal loan. Just is there anything at the margin that you would call out there?

John Stauch^ Yes. I think it's going to vary by geography and demographics. I think, all of us that serve the channel, Deane, believe that there is some economic turmoil that could come from these current interest rates and the impact it has on varying degrees of consumers and buyers. And I think that's in Bob's expectation of the lower new pool sales.

Also, I think we're going to see it slightly impacting the remodeling space as well because a lot of those remodel pools might have used some form of home equity or some type of borrowing to do it. I think, the bigger uncertainty is what happens to where interest rates are and when they settle out. So we're hopeful that we get clarity as we exit this year and people can predict what the longer-term interest rates will be.

Deane Dray^ Yes. That's really helpful. That's the way we've been thinking about it. And just to clarify on the Pool outlook, a year ago or so, we were talking about how you were supply-constrained, on the number of construction capacity. Where does that stand? Is it - are they able to fill all the demand? Is the supply of labor at all part of this equation?

John Stauch^ Yes. We believe that they'll be at the more normalized areas. I mean, I think they're finishing up the backlog that they had that was pre-bought and they're out then probably trying to sell the remodeled pools and the upgrades on the pool equipment, which will bring us back into more, what I call normal pattern of how our dealer channel works to provide value for us and our consumers.

Deane Dray^ Great. And just last one for me, for Bob. Gross margin was significantly above our expectations. I know that's a high-quality problem to have to answer. But, if you could just take us through what the impact was, maybe -- is there a carryover pricing? Just how do you give color there, please?

Robert Fishman^ Yes. I couldn't have been more pleased with the margin expansion. From our perspective, it was a number of different drivers that should drive sustainable margin expansion in the future. So, to the earlier point made, we did a much better job of removing the inefficiencies that existed last year. So think about logistics, think about air freight, think about even spot buy on electronics, all getting better in the first quarter.

Again, our price read out better than expected because we didn't have to do the discounting that we had perhaps put in as an assumption but felt good about how pricing read out from the carryover activities that we had done. The accretive nature of Manitowoc and then finally, just the transformation initiatives, including rightsizing to those lower volumes in Pool. Those are all things that we got significantly better at in Q1 and should be sustainable as we go forward.

Operator^ The next question comes from Julian Mitchell with Barclays.

Julian Mitchell^ I just wanted to look at the sort of the EBIT bridge assumptions that you've got laid out. Just trying to understand, when I'm looking at that first quarter on Slide 13, you've got that sort of close to \$60 million headwind for the year from inflation, the productivity tailwind, very narrow in the quarter at \$6 million.

As you look at the year as a whole, how are you thinking about those 2 pieces, inflation and productivity, kind of as we go through the year? Does inflation narrow, as a

headwind steadily and productivity move up steadily? Sort of anything you could flesh out on those 2 pieces, please?

John Stauch^ I think you nailed it. I think our year-over-year price contribution starts to anniversary some of the price increases we've put in midyear and 3 quarters away through last year. And you got it, we continue to see productivity sequentially getting better. And we think, inflation starts to slide off here as it wraps around on year-over-year headwinds that it compares to.

Julian Mitchell^ And then, just my quick follow-up. The pool market, I realized there's been about 82 questions on it, but just your revenue guide down mid-teens for the year. It's not that different from kind of what you did in Q1 year-on-year. So just trying to understand sort of the year-on-year cadence. Like what's the kind of exit rate in Q -- or the Q4 sort of sales decline rates, assuming that you have succeeded in getting those inventories back to normal, by the beginning of Q4?

Because I noticed that in, say, the Water piece residential there, you're down 25% in Q1. The year has guided only down 10%, so we can kind of understand the steep rate of narrowing declines through the year, and makes sense given the comps and everything else. Just want to understand in Pool, how we think about that down mid-teens off the kind of down mid-teens in Q1 already?

John Stauch^ Yes. Think about the biggest impact to Q2 and Q3 just being the inventory headwinds that we're experiencing. We'll still run up in Q4 of last year, some of the year-over-year challenges with early buy but will generally be slightly positive. And we'd expect to then have the tailwind of not having that inventory burn as we head into 2024.

Operator^ The last question comes from Joe Giordano with TD Cowen.

Joe Giordano^ So on IFT, I mean, obviously, what's going on there is interesting in a macro uncertain environment to have the margin expansion that you can have here. But, it's been exclusively driven by -- on the top line by price for like 3 quarters now. So as we get into a different type of market eventually where we want to see the growth side, how do you position that portfolio to be able to capitalize on like an up-cycle, rather than right now capitalizing on like a flat down-cycle?

John Stauch^ Yes. I mean real quickly. I mean there's several revenue streams in IFT. And we've got our focus on the ones that are higher value. And yes, to your point, we're being very critical to what projects we take on, which ones we don't. And, as we start to work with our customers, I do think you'll be able to see this business produce on a regular basis low single digits, in line with our expectations with more of that being value and less being a price contribution.

Joe Giordano^ Fair enough. And then, we've kind of danced around this, but like in Pool in the fourth quarter, possible that, that's up, right, organically?

Robert Fishman^ It's possible. Our view -- roughly flat to up slightly would be our view now after that inventory correction makes its way through in Q2 and Q3.

John Stauch^ All right. Well, thank you for joining us. We know this is a busy earnings day. I just want to reiterate our earnings call key themes, in case some missed part of our call. First, our diversified portfolio and transformation initiatives drove Q1 sales growth with margin expansion across all 3 segments.

Second, we expect strength in our Water Solutions and IFT segments as well as transformation efficiencies to drive upside. Third, we raised the midpoint of our adjusted EPS guide due to Q1's strong start, as well as our confidence in the sustainability of our performance while acknowledging that we expect Pool to be softer than we had initially expected.

Fourth, our transformation initiatives are expected to drive greater benefits later in full year '23 and beyond, and we implement actions towards identified savings. And we expect to continue to deliver value creation beyond this 2023 fiscal year.

Thank you, everyone, and enjoy your day.

Operator^ The conference has now concluded. Thank you for your participation. You may now disconnect.