THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

PNR - Q3 2017 Pentair plc Earnings Call

EVENT DATE/TIME: OCTOBER 24, 2017 / 12:00PM GMT

OVERVIEW:

Co. reported 3Q17 adjusted EPS of $0.95. Expects 2017 adjusted core sales growth to be 2%. Expects 4Q17 adjusted core sales growth to be approx. 2% and adjusted EPS to be approx. $0.93.

CORPORATE PARTICIPANTS

James C. Lucas *Pentair plc - VP of IR*

John L. Stauch *Pentair plc - Executive VP & CFO*

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

CONFERENCE CALL PARTICIPANTS

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

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

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

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

John Walsh *Vertical Research Partners, LLC - VP*

Joseph Alfred Ritchie *Goldman Sachs Group Inc., Research Division - VP and Lead Multi-Industry Analyst*

Michael DeLalio

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

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

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

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

PRESENTATION

Operator

Good morning. My name is Kim, and I will be your conference operator today. At this time, I would like to welcome everyone to Pentair's Q3 Earnings Conference Call. (Operator Instructions)

Jim Lucas, you may begin your conference.

James C. Lucas - *Pentair plc - VP of IR*

Thanks, Kim, and welcome to Pentair's Third Quarter 2017 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; and John Stauch, our Chief Financial Officer. On today's call, we will provide details on our third quarter 2017 performance as well as our fourth quarter and full year 2017 outlook as outlined in this morning's press release.

Before we begin, let me remind you that any statements made about the company's anticipated financial results are forward-looking statements subject to future risk 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.

Today's webcast is accompanied by a presentation, which can be found in the investor's 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'll be sure to reserve time for questions and answers after our prepared remarks. (Operator Instructions)

I will now turn the call over to Randy.

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

Thanks, Jim. I'm starting on Page 4 of the deck.

Our third quarter results met or exceeded virtually all of our expectations entering the quarter and represented another positive step on delivering our 2017 commitments. I'll discuss the quarter in more detail in a moment, but we saw adjusted core sales grow, strong margin expansion and adjusted EPS increase over 20%. We remain on track to separate our Water and Electrical businesses next year, and both teams are making good progress in preparing for next year's separation.

We're raising our full-year adjusted EPS estimate to approximately $3.53 per share, reflecting the solid third quarter performance and our expectations for another solid quarter to end the year. We should exit 2017 with improved top line momentum, and we expect to benefit in 2018 from carryover on our cost-out initiatives this year as well as benefit from lower interest expense that we did not recognize for all of 2017 as a result of the April closing of our sale of Valves & Controls.

As we stated last quarter, we have 2 goals this year: deliver on our 2017 commitments and prepare to stand up 2 companies in 2018. We believe that our third quarter performance and the improved full-year 2017 outlook are positive steps towards meeting those commitments, and the activities underway on the separation are right on track with our expectations.

Now let's turn to Slide 5 for a discussion of our third quarter results in a little more detail. As mentioned, the third quarter performance was in line or better on nearly all metrics. Adjusted core sales grew 1% in the quarter, with Water up 1% and Electrical growing 2%. Segment income increased 7%, and return on sales expanded 100 basis points to 18.9%. Although material inflation remains a headwind, we continue to drive productivity and pricing actions to help mitigate the impact.

While corporate expense was a little lower than anticipated, this helped offset slightly higher-than-expected interest expense. Adjusted EPS grew 22% and at $0.95, exceeded the high end of our guidance. Free cash flow was nearly $200 million in the quarter, and we continue to target free cash flow approximating adjusted net income for the full year.

Let's turn to Slide 6 for a look at Water's performance in Q3. Our Water segment delivered adjusted core sales growth of 1% and 3% growth overall. Segment income grew 10%, and return on sales expanded 120 basis points. This was the third consecutive quarter that Water margins have expanded in excess of 100 basis points, which reflect the continued strong productivity and improved mix.

Our Filtration & Process business saw core sales decline 4%. But once again, we saw a dichotomy between the verticals served by the business. We continue to see strength in Residential and Commercial and especially in foodservice. These are 2 higher-margin businesses and contributed to the improved margin performance in the quarter. The smaller Process business continued to be hampered by minimal global desal activity and muted spending in the beverage industry. Although we have been disappointed with the top line performance of Filtration & Process year-to-date, we're approaching easier comps as we exit the year.

Flow Technologies saw core sales decline 2%, which is an improvement from the 4% decline we saw last quarter. While we've seen a recovery in agriculture, softness in our smaller infrastructure pump sales has hamstrung the top line performance year-to-date. We've seen orders and backlog improving in this longer-cycle business, but we expect it will take until next year before we see any top line recovery in Infrastructure sales. In the meantime, Residential, Commercial and agriculture remain healthy, and we expect the comparisons to continue to improve exiting the year.

Aquatic Systems saw a very strong end to the pool season, with third quarter core sales growing 9%, which is slightly faster than the year-to-date growth of 7%. Similar to the quarter-to-quarter volatility we experienced in the first half, we do not expect the strong third-quarter growth rates to repeat in the fourth quarter but likely a blended second half growth rate to approximate what we experienced in the first half. While the impact of Hurricanes Harvey and Irma in 2 of the largest pool markets in the U.S. has not fully played out in our results, we believe that any near-term disruption has not and will not materially impact our full-year results.

Now let's move to Slide 7 for a look at Electrical's performance in Q3. Adjusted core sales grew 2% as we continue to see strengthening in our short-cycle Industrial businesses. Segment income grew 2%, and return on sales expanded 50 basis points as the improved mix was not enough to offset continued price-cost headwinds. While material inflation has been a significant headwind in Electrical throughout the year and more specifically in Enclosures and Electrical & Fastening Solutions, we continue to drive productivity and pricing actions to help mitigate the impact.

Enclosures core sales grew 2% in the quarter and improved sequentially. Strength continued in the Industrial business with broad-based sales growth across all regions. Within Infrastructure, the smaller Electronics business has finally lapped its tough comparisons and grew backlog this quarter, and we believe it is poised to return to growth.

Core sales declined 11% in Thermal, but this was due solely to the top line headwinds of 3 large energy jobs last year in Canada that we've outlined at the outset of this year. Excluding these large jobs, Thermal grew nicely, thanks to its focus on both the small project and products side of the business, with particularly strong sales in the industrial MRO business. It's worth noting that the business has dramatically improved its margins this year, has realigned its cost structure and benefited from a better overall mix of higher-margin product sales.

After growth in the first quarter followed by a decline in the second quarter, core sales for Electrical & Fastening Solutions were flat. The Commercial business remained strong as we expanded in the prefabricated solutions and the Industrial business stabilized. Infrastructure sales were mixed with continued declines in our engineered construction product line offset by strength in rail.

Now please turn to Slide 8 for an update on our planned separation. Before turning the call over to John to discuss the financial outlook in more detail, I wanted to first provide an update on the separation announcement we made in May. As a reminder, our board has approved a plan to spin-off our Electrical business, which remains on track to be completed in the second quarter of 2018.

Shortly after we issued our earnings release this morning, we issued a second press release announcing the name of our SpinCo, calling it nVent. We previously announced that Beth Wozniak will be the CEO. We also announced today that we've hired a CFO for the business, Stacy McMahan, who is coming to us after 2 successful stints as a public company CFO.

The other key dates outlined on the slide include our expectation that the nVent Form-10 will be filed before the end of the month and that we anticipate hosting separate Pentair and nVent Investor Meetings on February 13 of next year. As stated previously, we're expecting the separation to be completed in the second quarter next year.

We remain excited about Pentair's next chapter as we create 2 industry-leading, pure-play companies in Water and Electrical. We strongly believe that both companies are well positioned for long-term growth and value creation with the scale and strength to control their own destinies. The increased focus of both companies should help to raise the execution even further and drive higher differentiated growth. We believe that our performance throughout 2017 has demonstrated our ability to better forecast our business and execute against our commitments. Both companies can now become appreciated for the jewels they are.

I'll now turn the call over to John.

John L. Stauch - *Pentair plc - Executive VP & CFO*

Thank you, Randy. Please turn to Slide #9 titled Balance Sheet and Cash Flow. We ended the third quarter with our balance sheet in a solid position. Our ending debt balance is $1.5 billion, which does not include just over $100 million of cash on hand at the end of the quarter.

Our free cash flow generation remained strong and was just under $200 million for the quarter and $375 million year-to-date. We had a slow start to the year due to tough comparisons, but we continue to make good progress on cash flow and remain on track to generate free cash flow equal to adjusted net income for the full year. Our ROIC continued to improve, and we ended the quarter at 11.5%.

Please turn to Slide 10 titled Q4 2017 Pentair Outlook. We are introducing fourth quarter adjusted EPS guidance of approximately $0.93 per share, which is almost a 20% increase year-over-year. We expect adjusted core sales to grow approximately 2%, and both segments are expected to grow at this rate. This marks increased momentum from the growth rates last quarter and we believe better represents the growth trajectory of both businesses, which still have not fully recovered.

We anticipate segment income to increase just over 10% and return on sales to increase roughly 80 basis points and likely exceed 18%. We expect the tax rate to be 20%, net interest expense of $14 million and the share count to be around 184 million. Free cash flow should end the year strong once again.

Please turn to Slide 11 labeled Full Year 2017 Pentair Outlook. We continue to expect adjusted core sales to grow 2% for the year, with both segments close to that growth rate. We have seen continued improvement in our base business as we projected for the year, and many of the tough comparisons we faced throughout 2017 should finally be behind us as we exit the year. We expect segment income to increase roughly 7%, return on sales to expand north of 80 basis points to 18% or better and adjusted EPS to be up over 15% for the full year.

We continue to target free cash flow to be 100% of adjusted net income. As I stated previously, we expect seasonal fourth quarter free cash flow strength. As we exit 2017, both of our businesses are not only demonstrating strengthening top-line trends, but we continue to have some carryover of cost savings and lower interest expense into 2018.

We have one more quarter to deliver for 2017, but we feel better about the momentum we are building exiting the year.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Jeff Hammond from KeyBanc Capital Markets.

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

So you mentioned building momentum into '18. Can you just talk about some of the more challenged businesses organically, Flow, Filtration, Thermal and kind of how orders and funnels are shaping up that would support growth into '18?

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

Let me talk about Thermal, and I'll -- you can talk about Process and Flow. Thermal really is -- I think it's a real bright sport in performance. You just can't see it because of the oil sand projects which aren't occurring this year. The business has totally repositioned itself, redeployed to focus on the smaller projects, which are, frankly, more profitable and they're numerous, and on the product sales and on servicing the installed base. So we're very active in building the balance sheet -- I mean, excuse me, building the backlog. And as we mentioned in the script, margins are up despite the decline in revenue overall. So I am really pleased with Thermal's progress. And I think you'll see next year -- and I'm not going to put out a specific forecast, but I expect to see growth from that next year, from the work they're doing in Thermal.

John L. Stauch - *Pentair plc - Executive VP & CFO*

Jeff, on the Water side, we've been hampered by the fact that we had a fairly depleted backlog in our infrastructure pumps, and we've been building that backlog. And on a quarterly basis, those businesses -- or the infrastructure pumps are getting better sequentially, and therefore, the year-over-year impact is less. On the Process side, in Filtration, you know we did have some projects last year, as we called out. And once again, if you look at the business on a quarterly rate, Q2 versus Q3, Q3 versus Q4, the business is improving and the year-over-year comparisons are easing. And so the business overall is getting healthier, and the year-over-year comparisons are easier. And that's why we think the organic growth rate begins to accelerate as we head into next year.

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

Okay, great. And then, John, just as you kind of develop the Water long-term strategy, any early observations around cultivating organic growth, capital deployment, M&A pipeline?

John L. Stauch - *Pentair plc - Executive VP & CFO*

Yes. We'll be talking more in detail on that certainly in our Analyst Meeting in February. Part of the reason for the spin is so that both companies can look at their own capital allocation strategies. I think both are going to focus on bolt-on M&A and using the capital in a disciplined way, primarily because both have great organic growth opportunities.

Operator

Your next question comes from the line of Steve Tusa from JPMorgan.

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

What was the pure kind of price-cost headwind for the quarter? And maybe if you could just talk about updating the bridge for the year.

John L. Stauch - *Pentair plc - Executive VP & CFO*

Yes. So Steve, just to clarify, inflation for Pentair is running about 2% of cost, and that's been pretty steady throughout the year. So when we talk about price-cost, the inflation came out of the gate pretty strong but has been right around that level. It's been the pricing that's been challenged, primarily on the Electrical side, the ability to gain the price that we expected as we began the year. It hit what we think is a low point in Q3, and we believe that we're going to start to see increased pricing in Q4 and throughout 2018. On the Water side, we've been right around 50 basis points of price throughout the year, Steve, so we've been able to recover some of that. And that's why it's been really isolated to an Electrical explanation.

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

Got it, got it. And then when we think about kind of the calendar of events here, at what stage will you be able to kind of opine a bit more on the capital allocation priorities of the new companies and how you see deploying the balance sheet?

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

Well, we want to go through the full strategy in detail with both Beth and John, and that's what we're talking about, the February 13 session that we're planning. I guess we're announcing today that we want to do so that we can really describe the companies in their own right. But both have top-of-comparison margins. Both have really strong cash flow. And one of the reasons we're splitting the company is that as we were fighting the oil and gas downturn in Valves & Controls, these businesses weren't funded the way they needed to be. And I think this year is beginning to show that that focus is going to make a difference, and it's going to make an even bigger difference when they're separate because they're -- we intend to deploy that cash flow both in M&A but also to be consistent with Pentair's legacy of dividends and having a sound balance sheet. And that's what's guiding us right now.

John L. Stauch - *Pentair plc - Executive VP & CFO*

Steve, I would just add to that. I think as we've discussed and certainly, we've started to talk about, I think both companies are going to think about simplifying their portfolios, focusing their portfolios. And then I think you're going to see capital allocation going to where each company's swim lane is identified and making sure that that's clear externally and internally and that our customers understand why they're coming to us to buy our products and we're giving them more of what they need.

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

So just to be clear, I think you had said Water pricing was consistent, but I think it was up more like 1% in the first half, so this is somewhat of a deceleration. What drove that deceleration again?

John L. Stauch - *Pentair plc - Executive VP & CFO*

Yes. That's just where we are on the year-over-year basis, Steve, and that's a fair observation. But we have a seasonal type of pricing plan, and that starts generally now as we look at some of our businesses. And so it's really -- you'll see that start to get better as we head into 2018.

Operator

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

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

So just trends in the quarter, did those shape up as you expected? I know you highlighted a little improvement. It looks like, on a segment basis, the underlying expectations for the year are down a little bit, I think 1 point for each. So just curious how the trajectory through the quarter went and how it went relative to your expectation.

John L. Stauch - *Pentair plc - Executive VP & CFO*

I mean, obviously, the revenue number externally hit the expectations. So we did have -- in the slides last quarter, we had some foreign exchange benefit in what we call a core. So that's -- when you take a look at the absolute numbers of both Electrical and Water, both achieved their expectations for the quarter and both are on their expectations for the full year from a revenue standpoint. So things are trending exactly as expected despite having to navigate, as Randy mentioned, the hurricanes in 2 relatively important states. So I think we feel good about where we are both ending Q3 and heading into Q4.

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

Then maybe just an update -- well, okay, I'll just ask on the large project side. Could you just remind me to what extent your large projects are in the fourth quarter? And then I'm assuming there are no large projects that are going to be assumed so we should get clean organic numbers next year.

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

That is absolutely the goal.

John L. Stauch - *Pentair plc - Executive VP & CFO*

Yes.

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

So the $25 million...

John L. Stauch - *Pentair plc - Executive VP & CFO*

I have it. In Electrical for Q4, the headwind on that for Q4 will be around $8 million.

Operator

Your next question comes from Deane Dray from RBC Capital Markets.

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

Maybe we could circle back on Filtration & Process and some of the end market color. Desal is always lumpy. Maybe give us a sense of what the visibility you have on some projects over the near term. And then on Food and Beverage, they've been CapEx -- or hesitant to spend on CapEx. Is that still the trend? Is there any sense that there might be some share loss there?

John L. Stauch - *Pentair plc - Executive VP & CFO*

No, I mean, in both of those instances, Deane, we're -- we have a total forecast booking in desal of 0 in 2017 from the standpoint of major projects, and last year, we had roughly $20 million of revenue into a desal project. So it's just that there's not a lot going on there. If you look at the industrial wastewater side of membranes, that's up double digits and continue to improve significantly throughout the year. So we're doing well on what we call the core revenue opportunities. And we're not counting on these projects, and we don't want to be a project-oriented business. On the Food and Beverage side, it's just the capital investment is very lumpy right now due to some consolidations in the space, and we're continuing to improve, again, sequentially throughout the year. It's just the year-over-year headwinds reflect strength in those projects last year.

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

Great. And then just as a follow-up, can you highlight some of the dynamics this quarter across the geographies? And then specifically, what are you seeing in China, especially on the residential side?

John L. Stauch - *Pentair plc - Executive VP & CFO*

Yes. So Residential Commercial for China is primarily -- there's a little bit in Thermal as well Electrical. But we're up in the high teens on a year-over-year basis, so performing well. I still think we -- think we have opportunities there that we need to capture by being a little bit more local in the way we go to market. Europe is actually up slightly, and so it's hanging in there. Despite our forecast of it being more challenged, it's actually done better. And obviously, the United States is strong here as we finish the year.

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

Was that China high teens, was that overall company?

John L. Stauch - *Pentair plc - Executive VP & CFO*

Yes.

Operator

Your next question comes from John Walsh from Vertical Research.

John Walsh - *Vertical Research Partners, LLC - VP*

So not meaning to nitpick on this number, but as we think about the Q4 free cash flow bridge, I mean, normal seasonality, at least in my model, gets you pretty close to 100%. And I don't know if it's just a squiggle. Or are there any other items on a year-over-year basis, either timing of cash tax or anything like that to be aware of? Or is it all normal seasonality that drives that lift in Q4?

John L. Stauch - *Pentair plc - Executive VP & CFO*

No, it's what it is. I mean, if you said, do we think we're slam-dunking 100% this year? No. I mean, there's probably some margin of error to that, and that margin of error would be driven by the fact that both sides are also looking at how we optimize the portfolios and what restructuring we're doing. And the number that we're giving you includes the restructuring headwinds, restructuring cash headwinds as well. So we want to do both. We want to deliver the strong free cash flow, which we think comes from working capital, but we also want to set both companies up for a really successful spin.

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

One of the capabilities that we've built in Pentair has been a focus on cash flow and managing for cash because cash is what pays the bills. And we have a solid track record, and we incent people. It's part of the incentives. So I'm quite confident in our cash flow forecast.

John Walsh - *Vertical Research Partners, LLC - VP*

Got you. And then as my second question, as we're starting to get the filings here, should we think that the portfolios are pretty static? I mean, I think there were some comments, probably within both portfolios, maybe more so in Water, that there could be some pruning at some point maybe in certain product lines where you might not have full scale relative to other competitors. But I guess you kind of addressed the addition earlier in the call, but what about on the subtraction side? And are they pretty set now going into the separation event?

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

Well, John mentioned earlier that we're taking the opportunity to really look at the whole portfolio and simplifying, streamlining and prioritizing. And by prioritizing I mean what are we going to double down in and invest in. And that's going to leave things on the other end of the spectrum. And so we'll take a look at those, and we'd like to do that earlier rather than later in this process so that we can have the new companies be focused on growth. So I would say we're not done with that, but it is a priority to accomplish.

Operator

Your next question comes from Scott Graham from BMO Capital Markets.

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

I was just hoping you could help us with -- maybe it's my understanding of how some things are presented here. So when we look at the slides on Pages 6 and 7 for the acquisition/large jobs piece, I guess I would have thought that that would have only been one number, whereas you kind of have a different number representing the bar versus the 2016 large jobs. And those numbers -- and maybe you can just sort of help us understand how those numbers tie into your Page 14.

John L. Stauch - *Pentair plc - Executive VP & CFO*

Sure. I mean I think -- first of all, I mean, I think we've given the data there, but let me just make sure it's clear. When you think about these large jobs -- and just as a reminder, these are jobs that we shipped in '16 that have no shipments in them for '17, right? So everything is behind us. We have not been producing on these large jobs, but it is a year-over-year headwind and that's why in '18, that's no longer an issue. But those large jobs, roughly in Q3, were $31 million, as we highlight. And if you break that down, it's about $25 million-ish in Electrical, and the remainder is in Water.

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

Yes. No, I get that. And as you were talking, John, I think I actually just answered my question. Because I think, on Page 14, we're supposed to take the large jobs and the acquisition/divestiture columns and add them together. That's kind of where this is.

John L. Stauch - *Pentair plc - Executive VP & CFO*

Right.

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

Okay. I apologize for that lack of confusion. Now on the press release, you say core sales declined 1%. The -- and that's an absolute number. Is there -- you also had fewer days this quarter, right?

John L. Stauch - *Pentair plc - Executive VP & CFO*

That's correct. We have 1 less day.

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

So what was that impact?

John L. Stauch - *Pentair plc - Executive VP & CFO*

[About 1%, 1.5%.]

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

1%. So your organic sales really didn't decline 1% apples to apples, excluding the large job impact. But apples to apples on a days to days, you were essentially flat?

John L. Stauch *- Pentair plc - Executive VP & CFO*

That's correct.

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

Okay, great. And can you just -- John, I know this is really kind of up your alley. The margin expansion has been excellent this year. Could you tell us kind of what the 100-plus basis points of improvement this quarter were sort of cost savings-wise from -- maybe just sort of give us some buckets? I understand price-cost might have been a little bit negative, but maybe give us a little bit on what the restructuring savings were versus sort of pure productivity.

John L. Stauch *- Pentair plc - Executive VP & CFO*

Yes. So if you take a look at where we are on a cost-out basis, we've hinted strongly and we had that slide before that we're on a run rate greater than $100 million. And so when you think about where we are here in Q3, we're getting a full quarter benefit of that. And so a lot of cost out here, Scott, and all relative to the fact that when we sold Valves & Controls, we needed to resize the organizations for what is now a $5 billion company and then both of them also focusing on a $3 billion and $2 billion company. So there's been a lot of effort and work, and the teams have really done a really nice job getting after the cost side. So significant productivity there and think of that as at least $25 million in the quarter.

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

That's exactly what I was looking for. And then the last question simply is, as the quarter progressed, could you kind of tell us how the order rates progressed in each segment?

John L. Stauch *- Pentair plc - Executive VP & CFO*

Sure. I mean, I'll give you directionally where they are. But we thought we would see strengthening Electrical orders and -- throughout the year, and we have been seeing that pretty steady Q2, Q3.

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

Right, right.

John L. Stauch *- Pentair plc - Executive VP & CFO*

And it actually improved in Q3 even versus Q2 on a daily order rate basis. So we're seeing a recovery. I mean, some of that's probably related to the some of the oil and gas recoveries we're seeing downstream.

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

I think more stabilizing.

John L. Stauch - *Pentair plc - Executive VP & CFO*

Stabilizing. And then I think that continues to be a driver as well as Industrial volumes, Scott. On the Water side, really had healthy Residential, Commercial throughout the year, and I think people have thought that that would slow. We have not seen slowing in that space. And we've seen recovering on the industrial wastewater side and also the industrial investments. So right now, exiting Q3 into Q4, things are strengthening pretty much across the board.

Operator

Your next question comes from Steven Winoker from UBS Research.

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

Listen, just a question, Randy. I'm following up your comment around underinvestment in the business given the Valves & Controls pressure over time. I know you meant capital allocation. But from a sales and marketing and R&D standpoint, can you maybe comment on kind of where those were taken to and the question of normalization in those investment areas across the business, so kind of where we stand now versus under those pressure times?

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

Well, I can't give a specific number but I think the focus, certainly my focus, on the crisis we were having in Valves & Controls because of energy reduced the amount of focus we had on driving organic growth. And so some of the sales and marketing investments that were still made just didn't pay off. They didn't pay off, and that's part of the simplification and redirection we want to make right now in both Water and in Electrical. So there were investments going on. Now we are also holding those businesses accountable to make their numbers, so they probably didn't put all the investment in they would have wanted to if we had the kind of performance we've had over most of my 17 years, which is pointing at the bleachers and then hitting it towards that. So I wouldn't point to any specific thing, but it was in both Water and Electrical. And it was one of the things that we considered as a board that told us that we -- these businesses are going to perform even better separate than they will together.

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

Have you brought back those investment levels though? Or the effectiveness -- I mean, you're mentioning things around payoff on what you guys were investing, so some comment...

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

One of our objectives and John just talked about it, we've taken more than $100 million in costs out. But what we've taken out is structure. As we've collapsed -- we've collapsed segment and corporate into -- there are only 2 corporates now. We are actually investing in marketing. We've put in chief growth officers. We've put it in, in Water. We're putting one in Electrical. We've high-graded our assignments in marketing, and we are investing in a number of places. One of the reasons, in fact, in Water that we're doing well in Residential Filtration is we've been investing in sales resources there for probably the last 2 years, I'd say. So I'd say we've begun but there's more to do.

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

Okay. And just a reminder, John, if you could. I know that things are going to move around obviously a lot. But just remind us about the difference in free cash flow conversion characteristics between the 2 -- if not standup companies, the 2 divisions at this point.

John L. Stauch - *Pentair plc - Executive VP & CFO*

Yes. Right now, Steve, I'd say each is going to be roughly around that 100% of adjusted net income, which, as you know, adds back amortization. So they're both strong cash flow generators. The only difference is...

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

Seasonality.

John L. Stauch - *Pentair plc - Executive VP & CFO*

Is the seasonality, and Water will have more of a dip in Q1 as we have our residential loads and we collect those in Q2. And Electrical is a lot more linear in its producing of its cash flow throughout the year. But on an annual basis, both are strong cash flow generators and both are around 100%.

Operator

(Operator Instructions) Your next question comes from Robert Barry from Susquehanna.

Michael DeLalio

This is Mike DeLalio on for Rob. Anything notable holding back the Enclosures business? With Industrial macro data so strong, we would have expected growth to be a little better there.

John L. Stauch - *Pentair plc - Executive VP & CFO*

I think it's just -- it's a business that generally lags by about 6 months. So that's why we've been confident it would build. And the other piece of it is -- there're 2 parts of Enclosures. Part of it is Electronics and part of it is Industrial. So the Industrial growth is about what you'd think it would be, which is more than twice the overall Enclosures. But we do have the drag of some large telecom projects. I don't want to use that word anymore, projects. So telecom business that has not been growing this year.

Michael DeLalio

Okay. That makes sense. And can you remind us of your U.S. nonres exposure and what's the outlook there? We've had some concerns nonres market growth is starting to slow.

John L. Stauch - *Pentair plc - Executive VP & CFO*

Yes. I mean, I would contend that we're seeing slowing, but we're still seeing the mid-single-digit type of projections versus coming down from high single digits. So it's still what we would call a relatively strong opportunity. And so I think, yes, we are seeing a little bit of slowing, but it's still around mid-single digits.

Operator

Your next question comes from Nathan Jones from Stifel.

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

If I could just go back to the Filtration & Process, Flow Tech and Thermal Management, the businesses that have been down this year. Some of that's large projects. It sounded like, Randy, you think Thermal is going to grow next year. The 2 Water businesses look to be flattening out, potentially growing. Do you think you've got the cost structure for those businesses appropriate for the level of revenue? Is there more cost cutting that needs to be done? If you're expecting growth, are there costs that need to be added back? Just where you think you are with the cost structure in those businesses.

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

So on the Thermal side, we've -- one of the big reasons we've had margin expansion is we have adjusted the cost structure. And at the same time, we've invested. We've invested in new products. We've increased our R&D activities in Thermal. And we've redeployed sales coverage from the really large projects in the oil and gas business to focus more on industrial MRO. And so I think that's already well positioned, and we're in the process of doing that in Water. I think virtually all the costs are out, and there are investments to be made, but they're in our plan. They're in our forecast.

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

And then just one question on -- it's on Slide 7, the productivity bucket on segment income for Electrical. Was it 0 this quarter versus $12 million last quarter? Can you just talk a little bit about why there wasn't any visible productivity improvement this quarter, timing, whatever the case may be?

John L. Stauch - *Pentair plc - Executive VP & CFO*

Yes. I would say it's primarily timing.

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

Well, there were some productivity issues because of the hurricanes too, so just some expedited shipping and things.

John L. Stauch - *Pentair plc - Executive VP & CFO*

Timing.

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

Okay. So that's something that you would expect to reaccelerate in the fourth quarter?

John L. Stauch - *Pentair plc - Executive VP & CFO*

Absolutely.

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

Yes.

Operator

(Operator Instructions) Your next question comes from Brian Drab from William Blair.

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

Just wanted to get a little more detail on the Thermal business. You talked about more small projects in that business. And I'm just wondering if you could elaborate on which end markets and regions you're seeing the strongest demand from. And are you seeing the MRO business turning back on in the energy business with some of the larger customers there?

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

I mean like, really, we're seeing strength everywhere. I wouldn't call out any particular market geographically as stronger. Our focus on Industrial, the application of Thermal Management technologies is more than just oil and gas, so chemicals and in some other process industries. I think our increased focus there may be helping us. And then when we talk about products, we're really talking about MRO. These are product -- these are installations that need to be serviced. And we've returned to, I think, a more normal level of maintenance spending in the oil and gas industry, and I think that's been -- I think that stability is giving rise to some predictable and attractive business opportunities.

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

Is there a chance we're going to see this business really step up over the next few years from some of these petrochem projects ramping?

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

Well, we have a right to play in those, and we are competing for them. And so I expect that that will be a positive market benefit for us. And again, I don't want to front run Beth with their forecast.

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

Understood. And then can you just -- and then you said the hurricane damage is really immaterial. But in the fourth quarter, wouldn't you see some tailwind related to, I don't know, damage to refineries in Texas or Enclosures business in general or the Pool business even?

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

(inaudible) or even pools, yes. Yes.

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

Is that just a yes? We're not -- does that just mean we're not certain as to the extent of that tailwind? And is it -- it's not material though, you're saying. Is that...

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

We view it as -- it's hard to say if something like that disaster is a net positive, but we'll see over time.

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

Okay, understood.

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

Certainly maintenance (inaudible).

Operator

Your next question comes from the line of Joe Ritchie from Goldman Sachs.

Joseph Alfred Ritchie - *Goldman Sachs Group Inc., Research Division - VP and Lead Multi-Industry Analyst*

Maybe just thinking on Thermal for a second. If I -- for the fourth quarter, what's the drag from the large projects in 4Q? And to the extent that you can maybe just quantify quoting activity ex clearly the large projects in 3Q. I'm just trying to get a sense for how healthy things are.

John L. Stauch - *Pentair plc - Executive VP & CFO*

Yes. So Q4 is about $8 million of 2016 shipments that are still in the year-over-year comparison, so significantly down from the $25 million-ish that we had in Q3. So the year-over-year headwinds are dissipating. And as far as quoting activity in Thermal, it's accelerating, and backlog building is accelerating.

Joseph Alfred Ritchie - *Goldman Sachs Group Inc., Research Division - VP and Lead Multi-Industry Analyst*

Okay, fair enough. I also noted that restructuring -- it looks like you've kind of gotten through all your restructuring actions for the year. It's de minimis in 4Q. How should we be thinking about that next year for the 2 separate entities? Is there any color on that at this point?

John L. Stauch - *Pentair plc - Executive VP & CFO*

Yes. So we don't really forecast what we don't know. But I think both businesses will be looking at opportunities to prioritize their portfolios and to simplify the portfolios as we head into next year. And I think over Q4 and Q1, there could still be a little bit left in the tank.

Joseph Alfred Ritchie - *Goldman Sachs Group Inc., Research Division - VP and Lead Multi-Industry Analyst*

Okay, got it. And maybe one last one, John. You mentioned earlier on the pricing side have -- being a little bit more difficult to get pricing on the Electrical side of the business. Are you guys -- is there some type of lag that we should expect? I mean, is there a possibility for a tailwind for that business next year? Or is it just that the markets right now across that piece of the portfolio are pretty competitive and we just shouldn't expect much from a pricing standpoint moving forward?

John L. Stauch - *Pentair plc - Executive VP & CFO*

No, I think what they are is seasonal price increases that go on standard cycles, and it's really hard to get the off cycle through. I think there's a natural cycle that gets followed, and I think we're expecting that price next year is better than it was this year. But you've got to be moving with the system, and I think it was hard to move incrementally against that system throughout the year.

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

Well, when the market is not growing, it's a lot harder to get pricing. And we priced to a different expectation for these businesses earlier, and now we'll fix that.

Operator

There are no further questions. I now turn the call back to Randy Hogan for closing comments.

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

Okay, great. Just in sum, we believe our third quarter was another positive step towards demonstrating the return to predictable and improving performance in our business since we divested Valves & Controls. Both Water and Electrical are building momentum, as you heard in our comments and questions, as we exit 2017. We remain confident in our ability to deliver double-digit EPS growth for the year. And as we highlighted earlier in the call, we're making great progress in standing up Pentair and nVent to be both successful and thrive after separation next year.

Thank you for your continued interest. And operator, you can conclude the call.

Operator

Thank you for participating in today's Pentair Q3 Earnings Conference Call. This call will be available for replay beginning at 11:00 Eastern time today through 11:59 p.m. Eastern time on November 24, 2017. The conference ID for this replay is 56848154. The number to dial for the replay is 1 (800) 585-8367.

This concludes today's conference call. You may now disconnect.