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# Pentair plc (PNR)

Q3 2022 Earnings Call

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**John L. Stauch**

*President, Chief Executive Officer & Director, Pentair plc*

**Robert P. Fishman**

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## OTHER PARTICIPANTS

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**Michael Patrick Halloran**

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

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Good morning and welcome to the Pentair's Third Quarter 2022 Results Conference Call. All participants will be in listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the conference over to Jim Lucas, Senior Vice President, Treasurer and Investor Relations. Please go ahead.

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### James C. Lucas

*Senior Vice President, Treasurer and Investor Relations, Pentair plc*

Thanks, Andrea, and welcome to Pentair's third quarter 2022 earnings conference call. We're glad you can join us. With me today is John Stauch, our President and Chief Executive Officer; and Bob Fishman, our Chief Financial Officer. On today's call, we will provide details on our third quarter performance as outlined in this morning's press release.

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

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

We will be sure to reserve time for questions and answers after our prepared remarks. I would like to request that you please limit your questions to one and a follow-up to ensure everyone an opportunity to ask their questions.

I will now turn the call over to John.

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### John L. Stauch

*President, Chief Executive Officer & Director, Pentair plc*

Thank you, Jim, and good morning, everyone. Please turn to slide number 4, titled Executive Summary. We are pleased to announce that our Q3 results was strong considering near-term challenges and were in line with our expectations. Sales growth of 9% and segment income growth of 15%, included a partial quarter of our recently completed Manitowoc Ice acquisition. ROS expanded 110 basis points, demonstrating that price and productivity offset inflation. And our adjusted EPS grew 11% to \$0.99 in Q3, which included incremental debt from our acquisition and rising interest rates.

We are very excited about the addition of Ice to our portfolio and the expansion of our Commercial Water Solutions platform and the team in the integration process is off to a fast start. Bob will give more detail on our updated full year 2022 guidance later in the call.

While we have modestly reduced our full year expectations due primarily to increased FX headwinds and high interest rates, the year is generally playing out the way we thought it would after our Q2 earnings call. We are

seeing the previously communicated inventory correction in most of our residential channels, which we believe the industry is now addressing as supply chain challenges begin to abate.

With our updated guidance, we now expect that we will have cleared nearly \$200 million of channel inventory in Pool by the end of the year. We are encouraged that underlying demand is still up year-over-year, as evidenced by dealer and distributor sell-through despite the rising interest rates within the US residential industry. I will speak in a few slides about some preliminary thoughts on 2023, but the main takeaway is that we believe we are well-positioned to grow sales, segment income, margins and adjusted EPS next year.

Please turn to slide number 5, labeled Water. With everything going on and the market reacting to shorter-term challenges, I wanted to take a moment to remind you that we believe Pentair is well positioned to solve some of the world's toughest water challenges in a sustainable way.

Today, over 70% of Pentair's solutions support water and energy efficiency through helping to reduce water usage, reuse or recovery of water, or requiring less energy to operate or operate more efficiently. With a lot of the ongoing challenges, we believe that our solutions are needed to improve the lives of people and sustain our planet.

Please turn to slide number 6, labeled Purpose. Our purpose is important to our employees, our customers, and is growing more important to you, our shareholders. We hold ourselves to very high standards and our annual sustainability report has shown progress. We believe that further progress not only benefits the planet, but customers, employees, and shareholders as well.

Please turn to slide number 7, labeled Pentair at a Glance. Given how much focus has been on our residential businesses, particularly Pool, we want to take a step back and remind people of the diversity of the Pentair portfolio. Our mission as a company is to help the world sustainably move, improve, and enjoy water, life's most essential resource. And we do this in residential, commercial, agricultural, and industrial applications.

On a pro forma basis, with a full year of our Manitowoc Ice acquisition and inclusive of our current 2022 guidance, US residential sales comprise roughly half of our revenue and the other half comes from our other serve industries. I will spend the next few slides talking about our three businesses and how they help comprise the overall Pentair results.

We are on track to generate over \$4 billion in sales this year. And we have a strong focus on profitability with ROS in the high teens. 75 is an important number for Pentair. 75% of our products are replacement inside a large installed base that benefits from over 75,000 trade partners.

We believe the large served installed base and relationships with our trade channel partners drive resiliency of revenue and create a steady funnel for continued growth as new products and technologies are introduced. We have a long, successful track record of generating cash flow and being disciplined with our capital allocation. In fact, we have increased our dividend for 46 consecutive years and we are especially proud of our high teens ROIC, demonstrating that we have been good stewards with your invested money. We believe we have a very solid foundation and we know there is still more that we can do.

Please turn to slide 8, labeled Aligning Organization for Accelerated Success. We announced last quarter that effective January 1, 2023, we will be splitting our Consumer Solutions segment into two new segments; Pool and Water Solutions. Our Industrial & Flow Technologies segment will remain unchanged. We believe this new

segment structure will help us accelerate our efforts to improve customer service, differentiate our products and drive profitability for our shareholders.

Please turn to slide number 9, labeled Pool Business. Pool is a leading in-ground equipment maker with the largest installed base in North America, primarily across the Sun Belt states. Pool is on track to generate \$1.6 billion in sales this year, has return on sales in the high-20s and has generated a 10-year revenue CAGR of approximately 10%. We are a preferred business partner to pool professionals and a trusted source for all things pools. Our Pool business helps people sustainably enjoy water by using less energy and chemicals.

One of the most attractive characteristics of the pool industry in North America is serving a large installed base of approximately 5.4 million pools. The average age of these pools is approaching 25 years. The industry is roughly 60% break and fix, 20% major remodeling and 20% new pools.

Over the last two years, there was undoubtedly an increase in demand for products such as heaters and cleaners that were not as deeply penetrated on the pool pad. People were moving to warmer climates and buying homes with a pool or wanting to build the pool, the emergence of Airbnb and Vrbo as people rent homes with pools rather than staying in hotels.

Our industry-leading variable speed pumps have faced supply chain disruptions that kept us from shipping as many as the industry wants, but we are starting to catch up on these shipments as their supply chain improves. Only about half of all in-ground pools have some form of automation, and we believe this is another long-term opportunity for Pentair, the industry and consumers.

Pool dealers continue to be constrained by the lack of available labor. While dealers may have been busier with new pools the last two years, this has come at the expense of remodeling activity. We believe we have strong opportunities to continue to grow in key categories, particularly pumps. Our new IF3 pump was soft launched this year as we were not able to get enough chips and drives to meet demand. The initial feedback is very positive and we believe this is an opportunity to build on our leading technology position in pool pumps. We believe the long-term outlook for the pool industry remains very positive and we are well-positioned to enhance our position as a leader in North American pool equipment.

Please turn to slide 10, labeled Water Solutions Business. Our Water Solutions business has undergone a transformation of its own with our acquisition of Manitowoc Ice. On a pro forma basis, Water Solutions is approaching \$1.2 billion in sales with return on sales of roughly 20%. The business is approximately two-thirds commercial and one-third residential.

Similar to Pool, our Water Solutions business sees a large percentage of its sales go through distribution into trusted water treatment specialist. Our Water Solutions business improves water by providing great tasting, higher quality water and ice while helping our customers use water more productively. We have discussed our Commercial Water Solutions business quite a lot this year given the acquisition of Manitowoc Ice. When put together with our Everpure filtration business and our KBI services business, we have created a leading platform to provide quality water and ice to our foodservice customers.

Our residential water treatment business consists of components and systems. Our focus within residential water treatment is re-establishing the core of components, while also investing a differentiated point of entry and point of view systems.

We have a strong position with our core pro trade specialists. We have brands such as Fleck and RainSoft that have strong recognition in their respective channels. Commercial Water Solutions is already a high margin business, where the focus is on driving growth. Residential water treatment is focused more on complexity reduction and margin improvement while investing in core channels. We are excited about the opportunities for the soon to be Water Solutions segment.

Please turn to slide 11, labeled Industrial & Flow Technologies Segment. Industrial & Flow Technologies does not always get the same attention from investors as our other two segments. But it's important to our long-term strategy. As we help the world sustainably move, improve, and enjoy water, our Flow business helps move water where you need it, when you need it, more efficiently.

While our Industrial Solutions business might not be as water-focused as the rest of the portfolio, the business is focused on transforming waste into value. Our Flow business is just north of \$1 billion in sales, with healthy margins that are improving. Professionals represent roughly 80% of sales for Flow, and we have many highly recognized brands.

Our deep relationships with channel partners are important long-term growth drivers. Flow is roughly two-thirds residential and one-third commercial. We also serve irrigation and infrastructure on a smaller scale, which helps bring balance to the business with a combination of short cycle products and engineered products that are longer cycle. Flow has seen solid margin improvement this year, and we believe this business has a long runway ahead to drive margins even higher.

Our Industrial Solutions business is roughly \$500 million and is a technology leader in several niches, including Beer Membrane Filtration and sustainable gas solutions. Industrial Solutions is the one part of our portfolio that is not tied to professional trade channels, but this business provides filtration technology to help solve customers' environmental goals through smart and sustainable solutions. Similar to Flow, we believe there's a lot of opportunity for margin improvement within Industrial Solutions.

Please turn to slide 12, labeled Transformation to Enhance Value Creation. We continue to believe that transformation will be a large value creation opportunity for Pentair. We are building capabilities and training businesses in new tools to use. We are furthest along in our sourcing initiatives. We have completed wave one that is focused on key categories like electronics, motors and drives, casting, and indirect. In fact, we had an early win in the quarter regarding our MRO spend, where we went from over 100 different suppliers down to one. This allows us to not only save money, but it also reduces complexity across our entire organization in this channel. If we institutionalize our wave one learnings, we believe this will drive future waves as we look at additional categories.

On pricing, we're establishing a foundation for pricing across our different go-to-market strategies. This includes looking at our dealer and distributor programs to better optimize them. We're gaining insight into profitability by customer and product category, and using this data to better drive our forecast. Pricing remains a big opportunity, and this year has been about building capabilities, and next year should start to see benefits materialize.

We've made a few small strides on footprint optimization this year. We believe this presents longer-term opportunities, but not until 2024 and beyond as we build out the funnel. From an organizational standpoint, there remain ample opportunities for complexity reduction across the entire portfolio and a realignment of needed skills within our top priorities. Transformation has moved from funnel to execution, and we expect more material benefits to contribute to our longer-term margin expansion targets. We'll be providing more detail regarding specific expectations when we introduce our 2023 guidance.

Please turn to slide 13, labeled Early Thoughts on 2023. While we are not yet ready to provide full guidance for 2023, we did want to share some early thoughts as we go through our internal planning process. We expect to grow revenue next year for a few reasons. First, we expect the inclusion of Manitowoc Ice will contribute significantly. Second, we expect carryover pricing from the actions we have already taken this year. And third, we believe the diversity of our portfolio will be demonstrated and create resiliency.

The focus from investors feels solely on our Pool business. But we have many other contributing businesses in our portfolio. In fact, Pool has its own diversification, with 60% break and fix that we expect will likely continue to grow. While the smaller exposure to new pool construction may decline double digits, and maybe there will also be softness in remodeling, we expect the 5.4 million in-ground pools and the break and fix portion of the industry will likely grow modestly. And this, along with carryover pricing, should help limit the anticipated declines from inventory correction early next year.

The remainder of the Pentair portfolio has more exposure to some later-cycle business, with Industrial & Flow Technologies that offers further diversification. We also expect to grow income next year. Again, we expect that Manitowoc Ice and pricing carryover will be contributors. We are also taking actions this year to better align our manufacturing costs and overhead with the lower volumes we are experiencing. We also expect productivity to return to more normalized levels, as manufacturing inefficiencies abate with improved supply chain performance. Transformation is also expected to be a big contributor to income and margin performance next year.

We also expect to see adjusted EPS growth with the accretion from Manitowoc Ice, overall business performance and benefits from transformation. We expect free cash flow return to more normalized levels and perhaps even a little better, as we expect better inventory performance as supply chain inefficiencies go away and backlogs are reduced. Overall, we believe we are positioned to grow in 2023 despite the challenges and a softening economy, residential inventory and stocking challenges, and FX headwinds.

I would now like to turn the call over to Bob to discuss our performance and our financial results in more detail. Bob?

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## Robert P. Fishman

*Executive Vice President, Chief Financial Officer, Chief Accounting Officer & Interim President-Consumer Solutions, Pentair plc*

Thank you, John. Please turn to slide 14, labeled Q3 2022 Pentair Performance. We delivered second quarter sales growth of 9%, with core sales increasing 4%, as strong price contribution offset anticipated volume declines. Consumer Solutions core sales were down 2% as residential channels rebalanced inventory levels as our supply chain constraints lessened, and as a result of our lead times beginning to return to more normal levels. Industrial & Flow Technologies reported strong 14% core sales growth with strength across the entire segment.

Segment income increased 15% and return on sales increased 110 basis points year-over-year to 19.6%. Price once again offset inflation and productivity showed some sign of improvement as manufacturing inefficiencies improved modestly as supply chain constraints eased a little in the quarter. Below the line, net interest and other expense was \$18.6 million, with increased debt as we closed our Manitowoc Ice acquisition earlier in the quarter. Our adjusted tax rate was 13% during the quarter as we chewed up our planning for the year with the new full year rate now expected to be 15%. Our share count was 165.2 million and adjusted EPS grew 11% to \$0.99 and exceeded our guidance for the quarter.

Please turn to slide 15, labeled Q3 2022 Consumer Solutions Performance. Consumer Solutions increased sales 8% with core sales declining 2% comprised of 16 points of price offset by an 18% decline in volume. The volume

decline was due to tough year-over-year comparison and the anticipated inventory correction across many product lines in our residential channel. Segment income grew 10% and return on sales expanded 30 basis points to 23.8%.

Our Pool business had a 4% decline in sales as many product lines, such as heater, cleaners and lighting experienced a delay in orders as inventory in the channel took a pause at the end of the season. We experienced growth in pumps during the quarter as we were able to get the drive needed to fulfill demand.

As we have been discussing throughout the year, we have been expecting a decline in the second half of this year as lead times for many products have returned to more normal levels and our channel partners no longer needed to place orders far in advance. Further, Pool is a seasonal business and historically the fourth and first quarters tend to be at lower level than the second and third quarters.

We believe the underlying demand for pool equipment should continue to be strong as the average age of the approximately 5.4 million pools installed in the US approaches 25 years. About half of these pools have no form of automation, which we believe is also a long-term driver of demand and increased content on pools. We are expecting to slow in the next few quarters, as channel inventories normalize to more historical pattern, which we expect will likely result in continued volume decline, partially offset by strong pricing.

Water treatment sales grew 34% in the quarter, helped in large part by two months of contribution from Manitowoc Ice. Our residential business sales declined low double digits as the channel goes through an inventory correction similar to what is happening in Pool. Consumers continue to be focused on water quality, and demand for the product remained strong. However, channel inventory, needs to return to more historical levels.

Our commercial business grew organically and benefited from the acquisition of Manitowoc Ice. Both Everpure and KBI experienced solid demand in the quarter with Everpure experiencing several new total water management contract wins. The integration of Manitowoc Ice is off to a good start, and we remain very excited about the long-term prospects for our Commercial Water Solutions platform.

Please turn to slide 16, labeled Q3 2022 Industrial & Flow Technologies Performance. Industrial & Flow Technologies grew sales 10% in the quarter, partially offset by a 5% FX headwind, with core sales increasing 14%. Segment income grew 25%, and return on sales expanded an impressive 210 basis points to 16.9%. The strong margin expansion was a result of positive mix, improved productivity, and strong price contribution.

Our residential flow business sales grew 6% in the quarter, as price continued to read out profitably, which helped to offset continued supply chain disruptions. Inventory in the channel is in good shape, and our focus remains on working down backlog as supply chain disruptions continue to ease.

Commercial flow sales grew 13%, as delayed second quarter shipments occurred and underlying demand remained solid. This business has made significant gains this year, reducing complexity, and has been a big contributor to the segment's margin expansion.

Industrial Solutions sales increased 13% as most product lines experienced growth. Demand for our sustainable gas solutions remained strong and continue to grow in orders and backlog. Our beer business has helped many customers work on productivity solutions given the ongoing CO2 shortage that exists. Overall, Industrial & Flow Technologies delivered a great quarter with sales, segment income and margin growth.

Please turn to slide 17, labeled Balance Sheet and Cash Flow. This slide reflects the closing of the Manitowoc Ice transaction at the end of July. We ended the quarter with pro forma leverage at 2.6 times and our ROIC was at 17%. Given the rising interest rate environment, we are comfortable being two-thirds variable as we were less inclined to lock into higher rates for longer. We have no long-term debt maturing for the next few years, and the majority of our debt is in term loans going up three to five years.

Cash flow in the quarter was \$72 million and \$211 million year-to-date. Working capital has been a significant headwind this year, primarily inventory, which is leading to a timing issue on cash flow. Our inventories are higher primarily due to inflation, buy-ahead and inefficiencies in the supply chain requiring us to purchase more products. We believe we are well-positioned to drive improvement in free cash flow in the fourth quarter, but we expect to fall short of our target to a 100% free cash flow conversion for the full year. We believe this is a timing issue and expect next year to benefit from working capital improvement as inventory levels come down.

Please turn to slide 18, labeled Q4 and Full Year 2022 Pentair Outlook. For the fourth quarter, we are introducing adjusted EPS guidance of approximately \$0.79, which represents a year-over-year decrease of 9%. We expect sales to be roughly flat as the contribution of Manitowoc Ice helps to offset growing FX headwinds and expected volume declines as a result of residential channel inventory correction. We expect segment income to increase 8% with corporate expense coming in around \$20 million. Net interest expense of roughly \$28 million and adjusted tax rate of 15%, and a share count of 165 million to 166 million.

With the third quarter outperformance and our expectations for the fourth quarter, we now expect full year sales to grow approximately 9% for the year. We expect segment income to increase approximately 12% with strong price contribution. We expect adjusted EPS of roughly \$3.65 or an increase of 7% for the year. Below the line, we expect corporate expense to be around \$80 million, net interest expense of \$55 million and adjusted tax rate of approximately 15% and shares to be around 165 million to 166 million. With the working capital headwinds experienced this year, we now expect free cash flow to be approximately 60% to 70% of net income with free cash flow returning to more normalized levels next year.

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

## QUESTION AND ANSWER SECTION

**Operator:** We will now begin the question-and-answer session. [Operator Instructions] And our first question will come from Andy Kaplowitz of Citigroup. Please go ahead.

**Andrew Kaplowitz**

*Analyst, Citigroup Global Markets, Inc.*

Hey. Good morning, everyone.

Q

**John L. Stauch**

*President, Chief Executive Officer & Director, Pentair plc*

Morning.

A

**Robert P. Fishman**

*Executive Vice President, Chief Financial Officer, Chief Accounting Officer & Interim President-Consumer Solutions, Pentair plc*

Morning.

A

**Andrew Kaplowitz**

*Analyst, Citigroup Global Markets, Inc.*

John and Bob, can give us a little more color into your volume expectations for Pool in Q4 and a little more color into how you're thinking about 2023 in Pool? I know you said that you baked in channel destocking in Pool in the second half of the year, but has the destocking been higher than your expectations? And it seems like you have confidence in break and fix, but you mentioned more uncertainty regarding renovation. Have you seen a drop-off in that backlog at this point?

Q

**John L. Stauch**

*President, Chief Executive Officer & Director, Pentair plc*

Yeah. I mean, as a reminder, we did start the year saying that we expected that the supply chain constraints that were there throughout 2020 and 2021 would likely, as they start to abate, identify that there's probably excess inventory in the channel. As the year played out in Q2 and after our Q2 conference call, I mean, what was happening and you can see it happening in other industries like retail, we expected that we would see a pullback again in demand and therefore have to burn through inventory in the channel.

A

So, I'd say it's playing out generally as expected, maybe a little bit higher in Q4 with a little bit higher being that the overall demand in the industry has slowed modestly, right? So we're not at the high- to mid-single-digit sell-through numbers that we were historically. And we're starting to see some pullback actually in the overall demand, and therefore that needs to add to the inventory correction.

**Andrew Kaplowitz**

*Analyst, Citigroup Global Markets, Inc.*

Got it. And then, John, maybe backing up, could you give us a little more color into the buckets you cited that can help you provide the 2023 growth that you seem confident of? I think in the past, you've talked about the Manitowoc Ice accretion being around \$0.10. Maybe any sort of color on pricing carryover or transformation-related tailwind would help. And then how much manufacturing inefficiencies impacted you this year?

Q

**John L. Stauch**

*President, Chief Executive Officer & Director, Pentair plc*

A

Yeah. I mean, it's really early for a guide, and obviously, you understand base interests. I mean, I think where our confidence level comes on growing in an absolute basis on revenue EPS is that Manitowoc has been extremely well over \$200 million, as it brings the full-year performance to Pentair. And that's a fairly high margin business. So we really feel good about the income contribution. And their backlog substantiate everything we saw on the business model and we're off to a strong start in integration. So I'll start there.

I know people are worried about Pool, but we're nowhere near what we saw in 2008, 2009, when we saw the correction. And so, when you think about how a POOLCORP on their call, it's a major distributor of ours, characterizes the industry dynamics, I mean, we look at it as 20% of the industry is new, 20% is remodeled. And we have the overall break and fix in the service to our Pool business.

Usually the way those dynamics work, since our dealers are capacity constrained on labor, they'll shift their work to either building new pool or remodeling, not doing both at the same time, and/or servicing the pools on a break and fix basis. So we think that that's going to – even if you project downward trends in the industry, we think that's going to be a modest impact to Pentair. And then ultimately, we believe that we have carryover pricing as a company, and then we like the diversity of our portfolio. And we're trying to remind everybody that we're not 100% exposed to residential. Matter of fact, we're less than 50% exposed to residential, and the rest of our cycles are still in growth mode. They're building orders and pipelines and backlogs, and we're going to see those contributions in the next year. That's on the revenue side.

On the income side, our manufacturing inefficiencies are really more about we receive product late in the quarter from our suppliers, and we have to rally and push it out to our customers. And so those inefficiencies come in the form of premium freight in, and less than full truckloads on the way out, as well as a lot of overtime and extra people required to get that product out the door. So, if I had to quantify it, I'd say it's around \$50 million. And so, we're going to address all that and bring the costs in line. And we feel very confident that you're going to see the ROS expand next year because we're going to get back to our standard productivity levels that we were at prior to the whole COVID impact.

**Andrew Kaplowitz**

*Analyst, Citigroup Global Markets, Inc.*

Q

Appreciate all the color, John.

**John L. Stauch**

*President, Chief Executive Officer & Director, Pentair plc*

A

Thank you.

**Operator:** The next question comes from Mike Halloran of Baird. Please go ahead.

**Michael Patrick Halloran**

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

Q

Hey. Good morning, everyone. So, John, just a clarification on something you were saying in there. You referenced POOLCORP's commentary in the prepared remarks, talked about the splits there. Was that for Pentair specific, or was that an industry sellout thought process or sell-through versus what you're expecting for your revenue base, if that makes sense?

**John L. Stauch**

*President, Chief Executive Officer & Director, Pentair plc*

A

Yeah. The specifics I get on a sell-through basis we've been using for a very long period of time. And they're generally in line with what I said, like they don't change very much. It's hard to get as specific, because our dealers serve all three of the channels. And as they buy product, we make assumptions based upon pool permits and/or what we've bought at the pool pad versus maybe just a couple products that feel more like replacement.

But our dealers serve all three forms of the industry. And most of what we've been selling lately feels more pool pad oriented, and so therefore, we're convinced that there's more to go on the break and fix. And when we talk about break and fix, we're talking about putting our dealers out there to help that individual try to automate their pool. And it's hard to push that if you don't have the electronics that produce that product. And we feel like we're catching up on that, and we feel like we got runway in 2023 and 2024 to really change that penetration rate.

**Michael Patrick Halloran**

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

Q

So, just to clarify, sorry, I just want to make sure I understand. So the sell-through pieces, the 20%, that's the news which – where you're going to get industry headwinds, repair/replace up a little bit, maybe flattish as per your commentary and then the [ph] Fleck is (00:34:12) in the remodel side, where you just don't quite have the visibility yet, and then the inventory piece would be Pentair specific as you get some correction, so a little bit worse than those sell-through numbers is what the thought process is, correct?

**John L. Stauch**

*President, Chief Executive Officer & Director, Pentair plc*

A

Yes.

**Michael Patrick Halloran**

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

Q

Okay, good.

**John L. Stauch**

*President, Chief Executive Officer & Director, Pentair plc*

A

I think we're pretty good – Mike, we feel like we're pretty good [indiscernible] (00:34:33) what we've already done in Q3 and Q4. But as Bob alluded to in his comments, I still think there's more to go in Q1.

**Michael Patrick Halloran**

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

Q

Got it. Got it. All right. That makes a lot of sense. So then, on the commercial side of things, maybe just talk about the trends through the quarter here, backlog levels and what the customer base is saying, essentially kind of get into the confidence level and the sustainability of the solid underlying trends you're seeing on the commercial side.

**John L. Stauch**

*President, Chief Executive Officer & Director, Pentair plc*

A

Yeah. I mean, I think, where we have the best visibility would be on the Manitowoc side. We recently acquired them, but they've got a good visibility because they make a machine, and that machine takes a little longer time to make than our Everpure filtration would. And so, we still see growth both in volume basis and in the backlog and

order build. And then as we get to IFT, Mike, we're actually seeing accelerating orders and also building backlogs in those business that's giving us confidence that we're going to see further growth next year in the IFT side.

**Michael Patrick Halloran**

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

Q

Great. Appreciate it. Thank you.

**John L. Stauch**

*President, Chief Executive Officer & Director, Pentair plc*

A

Thank you.

**Operator:** The next question comes from Joe Giordano of Cowen. Please go ahead.

**Joseph Giordano**

*Analyst, Cowen and Company, LLC*

Q

Hey guys, good morning.

**Robert P. Fishman**

*Executive Vice President, Chief Financial Officer, Chief Accounting Officer & Interim President-Consumer Solutions, Pentair plc*

A

Morning.

**Joseph Giordano**

*Analyst, Cowen and Company, LLC*

Q

Since you mentioned POOLCORP, when they talked on their last quarter, their commentary on ending inventory, so the fourth quarter, had an enormous range. And it implies for their inventory purchases for fourth quarter, like anywhere from almost minus 30% to minus 8%. So, like a pretty big range and they talked about like free buy as well. Can you kind of talk about what you're guiding in the fourth quarter somewhat like in the context of that huge framework that they're laying out?

**John L. Stauch**

*President, Chief Executive Officer & Director, Pentair plc*

A

Yeah. I can't speak to theirs at all. Joe, [indiscernible] (00:36:35) and I'll try to answer this as we can. We're only a third probably of our key distributors businesses because they produce a lot of other product for our customers and, obviously POOLCORP is an important customer of ours, but they're not our only customer. So, when we look at inventory, we look at it broadly across the entire channel.

For pool equipment that we produce, but think about Pool, they're actually being about 30% down in volume for Q4, which is a pretty big number and therefore a pretty big dent in any inventories in the channel if volume were to be relatively flat absent that, right? But we're being honest in the sense that when we look at it, we see early buy needs in Q4 that our customers are going to take advantage of. And we believe that in Q1, we're going to start to have a better understanding product by product where the excess inventory is in the channel. And those also need to be looked at branch by branch and state by state. And therefore, we still think there'll be a little bit further impact in Q1 as people ready themselves for the 2023 pool season, which generally ramps up in Q2.

**Robert P. Fishman**

*Executive Vice President, Chief Financial Officer, Chief Accounting Officer & Interim President-Consumer Solutions, Pentair plc*

A

Yeah, I would just say that our goal is to work down as much of the channel inventory this year. John talked about a \$200 million number. There will be a little bit to go in Q1, but I think we're going to end this year much better positioned for 2023 by working down that channel inventory in Pool. That's really our goal.

**Joseph Giordano**

*Analyst, Cowen and Company, LLC*

Q

Just to clarify, you broke up a little, did you say, John, you're talking volumes in Pool minus 30% or so in 4Q, I just didn't catch the number?

**John L. Stauch**

*President, Chief Executive Officer & Director, Pentair plc*

A

Correct.

**Joseph Giordano**

*Analyst, Cowen and Company, LLC*

Q

Okay. Thank you, guys.

**Operator:** The next question comes from Nathan Jones of Stifel. Please go ahead.

**Nathan Jones**

*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

Good morning, everyone.

**John L. Stauch**

*President, Chief Executive Officer & Director, Pentair plc*

A

Good morning, Nathan.

**Nathan Jones**

*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

Very helpful the commentary around where the Pool inventory is likely to be at the end of the year. I think if you put the pieces together on your outlook for the different parts of Pool, your sell-through expectations for the Pool business in 2023 look like they're maybe up a little bit, maybe down a bit, and the inventory comes out mostly in 2022. Is that a fair way to characterize it? And if the Pool sell-through happen to be lower next year, how much longer do you think it would take to work through this channel inventory?

**John L. Stauch**

*President, Chief Executive Officer & Director, Pentair plc*

A

Well, Bob, I don't know if you want to try this. I think I'm not going to comment. You've got a lot in there. I think, we've already said that we do believe overall industry dynamics are down next year from a volume perspective for Pool. We just don't know how much, right? We do believe that builds are going to moderate on the new side. We don't know what remodels are going to do on their 25-year old pools. We'll see where that steps up. And we overall think aftermarket grows and then, we got carryover pricing that helps mitigate it.

So the forecast we have or the thoughts we have as we head into next year is the understanding we'll probably see down sell-through for our particular product. And our inventory corrections are based on those assumptions.

As Bob said, we'll try to clear as much as possible in Q4, but we do believe that it's not going to be a perfect solution and we'll see a little bit of run-off in Q1. It's all I can give you right now.

**Nathan Jones**

*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

Fair enough. The commentary today has been pretty bullish on the improvement around supply chain. Maybe you can talk a little bit more about where you are on supply chain, what disruptions remain, and what your expectation is for how those play out in 2023?

**Robert P. Fishman**

*Executive Vice President, Chief Financial Officer, Chief Accounting Officer & Interim President-Consumer Solutions, Pentair plc*

A

Yeah. I would point to pumps as an example, while we're still catching up on pumps, our supply chain there is getting marginally better. When we look at inflation, we expect inflation to still be a headwind in Q4, but to improve from Q3. So we are seeing some supply chain improvement. We're encouraged by that. John talks about some of the inefficiencies within the manufacturing process. Those should lessen as we go into 2023 and be a tailwind for us. So I would say, we are seeing that piece of the business improving.

**Nathan Jones**

*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

John, I think you said like \$50 million of inefficiencies this year. Do you think you can get rid of all of that in 2023 or there'll still be some of that lingering around?

**John L. Stauch**

*President, Chief Executive Officer & Director, Pentair plc*

A

I think that's a target that we believe we're after, and we believe between transformation and catching up on the supply chain that's what we're after.

**Robert P. Fishman**

*Executive Vice President, Chief Financial Officer, Chief Accounting Officer & Interim President-Consumer Solutions, Pentair plc*

A

Yeah, I would add a third component to that. So, we are adjusting our manufacturing costs for the volumes that we're seeing. So, being right-sized going into 2023 from a manufacturing perspective is the third lever that we have.

**Nathan Jones**

*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

Great. Thanks very much for taking my questions.

**John L. Stauch**

*President, Chief Executive Officer & Director, Pentair plc*

A

Thank you.

**Operator:** The next question comes from Bryan Blair of Oppenheimer. Please go ahead.

**Bryan F. Blair**

*Analyst, Oppenheimer & Co. Inc.*

Q

Thank you. Good morning, guys.

**John L. Stauch**

*President, Chief Executive Officer & Director, Pentair plc*

A

Good morning, Bryan.

**Bryan F. Blair**

*Analyst, Oppenheimer & Co. Inc.*

Q

You had mentioned, resi water treatment down low double digits, channel dynamics somewhat similar to Pool. Just curious what your team is contemplating in terms of fourth quarter sales from resi treatments. And given current visibility, how long you expect channel normalization to take?

**John L. Stauch**

*President, Chief Executive Officer & Director, Pentair plc*

A

Yeah. We're taking advantage of spreading to other – in other places. And what we're doing there is refocusing the business. We were putting product probably closer to the consumer, taking advantage of some of the themes and the trends that were happening during COVID. And we're now repositioning our business to be 100% focused on the trade channel and/or going through our direct market, which is our RainSoft-affiliated dealers. So what you're seeing there is really business exits, ROS doing some 80/20 and walking away from product line revenue, and then reposition the business for success in 2023. So, I think you're going to see a similar trend in Q4 than you've seen. And then, we think we've put all that behind us.

**Bryan F. Blair**

*Analyst, Oppenheimer & Co. Inc.*

Q

Okay. Understand. And just to confirm, is \$0.10 still the guide for Manitowoc Ice accretion next year, and I guess, to level set a bit more, if we were to exclude that, is the expectation just given current visibility that you grow core earnings given all the levers that you've walked through on today's call?

**Robert P. Fishman**

*Executive Vice President, Chief Financial Officer, Chief Accounting Officer & Interim President-Consumer Solutions, Pentair plc*

A

\$0.10 is still the EPS accretion target for 2023. And we're really not in a position to give guidance for 2023 other than to say, we have the five levers for earnings growth next year, whether it's price carryover, Manitowoc, manufacturing inefficiencies, adjusting for volume or transformation. We feel good about income, EPS growth, and ROS expansion next year.

**Bryan F. Blair**

*Analyst, Oppenheimer & Co. Inc.*

Q

Over encouraging. Thanks again.

**Operator:** The next question comes from Brian Lee of Goldman Sachs. Please go ahead.

**Miguel de Jesus**

*Analyst, Goldman Sachs & Co. LLC*

Q

Hey, everyone. This is Miguel on for Brian Lee. Thanks for taking the question. Just to maybe piggyback off of that last question. I appreciate the early thoughts you gave on 2023. Can you maybe give a bit more color on maybe the mix of the contribution on revenue of price and volume and on Manitowoc Ice for 2023?

**John L. Stauch**

*President, Chief Executive Officer & Director, Pentair plc*

A

No. I mean, the reason we introduced the 2023 early thoughts chart is really to remind people that we're more than just a pool company. We believe we have a strong diversity of our portfolio that goes well beyond residential. It seems like, and you can tell by the questions we're being asked, we don't get a lot of questions on the other half of the business and we want to remind people that we just cleared an acquisition that is a really healthy contributor to our commercial water pipeline and portfolio. We're way too early to be able to give the exact science behind all of the different revenue streams. We haven't finished our planning process internally and we haven't seen where some of the global economics are going to land. So, we're not in a position to do that other than tell you, given those five levers that Bob mentioned, we feel really strong about our ability on an absolute basis to grow revenue and EPS next year.

**Miguel de Jesus**

*Analyst, Goldman Sachs & Co. LLC*

Q

Okay. Thanks. I appreciate that. That's fair enough. And then switching gears, and it's my last question. Recognizing that new pool is a relatively small part of the business but I wanted to make sure I heard correct. Are you able to provide an early view on new pool construction in 2023? I thought I heard a double-digit decline next year from the prepared remarks. Did I hear that correctly? And if not, I guess how are you thinking about new pool in 2023?

**John L. Stauch**

*President, Chief Executive Officer & Director, Pentair plc*

A

Yeah. I think it's fair. You know what, the only indication we have is as pool permits are pulled, we generally get a look at what those pool permits are in the main states that we serve. And they would suggest that there's likely to be a double-digit decline in actual new pool builds next year. And so, that's how we're formulating our thought process.

**Miguel de Jesus**

*Analyst, Goldman Sachs & Co. LLC*

Q

Okay. Awesome. Thanks. Very helpful. I'll pass it on.

**Operator:** The next question comes from Jeff Hammond of KeyBanc Capital Markets. Please go ahead.

**Jeffrey D. Hammond**

*Analyst, KeyBanc Capital Markets, Inc.*

Q

Hey, guys. Good morning.

**John L. Stauch**

*President, Chief Executive Officer & Director, Pentair plc*

A

Morning.

**Robert P. Fishman**

*Executive Vice President, Chief Financial Officer, Chief Accounting Officer & Interim President-Consumer Solutions, Pentair plc*

A

Good morning.

**Jeffrey D. Hammond**

*Analyst, KeyBanc Capital Markets, Inc.*

Q

Maybe just if you can speak to price carryover into 2023, just based on what you've already announced, and then just you mentioned the transformation savings. I know, yeah, I think early next year, you're ready to talk more about that. But just any kind of early thoughts on how you're thinking about those savings into next year.

**John L. Stauch**

*President, Chief Executive Officer & Director, Pentair plc*

A

Yeah. I mean, I think the best way to characterize it, Jeff, and you're familiar with the industry, I mean, 75% of our revenue goes through the professional trade channel, through distributors. So, in most normalized seasons, which we think we'll be heading into one in 2023, when we put price through, we normally are able to maintain those price levels throughout the process.

And so we feel there's a stickiness to announced price increases and implemented price increases that we feel we're going to benefit from. So, I would say that we are moving into next year, and in most cases, we are experiencing labor inflation, and we did further our price increases here in Q4 for the 2023 season. So between the incremental price increases we announced and the ones that we implemented previously in the year, we believe we're starting from a fairly healthy carryover position heading into 2023.

**Jeffrey D. Hammond**

*Analyst, KeyBanc Capital Markets, Inc.*

Q

And transformation?

**John L. Stauch**

*President, Chief Executive Officer & Director, Pentair plc*

A

We'll give a number when we produce the guide. But we've been working very, very hard on these individual streams, and we'll give directional views of what we think we're going to achieve across each of those streams when we give our guide for next year on the Q4 earnings announcement.

**Jeffrey D. Hammond**

*Analyst, KeyBanc Capital Markets, Inc.*

Q

Okay, great. And then just on Manitowoc Ice, maybe just level set us on, yeah, I think that's a fairly stable business and you've got pretty good visibility, but just how it's acted in maybe past recessions around cyclical.

**Robert P. Fishman**

*Executive Vice President, Chief Financial Officer, Chief Accounting Officer & Interim President-Consumer Solutions, Pentair plc*

A

If they – think of Manitowoc Ice as being roughly a 5% grower. When we look back historically, that's typically what the business does. There's seasonality associated with it. So about 60% of its revenue comes in Q2 and Q3, with 40% in Q1 and Q4. But, overall, when we looked at the business, it's a pretty solid 5% grower. We talked about revenue synergies that could accelerate that to 10%, when you add on the Everpure business, the KBI, and the cross-selling across some of the customers that each of us have. So again, when we look out over the next couple of years, we're encouraged by the revenue growth of that business.

**John L. Stauch**

*President, Chief Executive Officer & Director, Pentair plc*

A

And, Jeff, it's [indiscernible] (00:50:03) business could benefit a lot from quick-serve restaurants, and they generally do relatively better in downturns and recessions. And they're very focused on cold drink dispense. And that market tends to do best with inside those restaurant stores.

**Jeffrey D. Hammond**

*Analyst, KeyBanc Capital Markets, Inc.*

Q

Okay. Thanks so much, guys.

**Operator:** The next question comes from Scott Graham of Loop Capital Markets. Please go ahead.

**Scott Graham**

*Analyst, Loop Capital Markets LLC*

Q

Hey, good morning, John, Bob, Jim. Really two questions. Could you – the Pool side has been beaten to death, so I'm going to stay away from resi altogether. Could you tell us a little bit more about commercial and industrial sort of order or sales cadence as the quarter progressed? I don't mean dollars because everything is seasonal, of course. Now the year-over-years, did you see any kind of falloff at all on into October?

**John L. Stauch**

*President, Chief Executive Officer & Director, Pentair plc*

A

No. I think, in our non-residential businesses, we feel like we continue to see order trends and the funnels as growing, as we're working through those particular cycles. The only place that we've seen the year-over-year headwinds has really been on the residential channel so far. So that's where we sit today.

**Robert P. Fishman**

*Executive Vice President, Chief Financial Officer, Chief Accounting Officer & Interim President-Consumer Solutions, Pentair plc*

A

Yeah. I would say, because we started disclosing backlog in our Q, what you'll see when we file our Q is backlogs are very healthy in the IFT business. So, that's an encouraging data point as well.

**Scott Graham**

*Analyst, Loop Capital Markets LLC*

Q

Okay. And so both of your comments also are – but particularly [indiscernible] (00:52:07), year-over-year growth in the commercial side of Consumer Solutions. Is that fair?

**John L. Stauch**

*President, Chief Executive Officer & Director, Pentair plc*

A

As we sit here today, yes.

**Scott Graham**

*Analyst, Loop Capital Markets LLC*

Q

Great. Okay. Thank you. And then, the longer-term goal talked about in the Analyst Investor Day last year of getting to, I think it was 21% margin in 2025, you got residential that's going to be a little weaker for a couple quarters coming, with a Pool, a big chunk of that being higher margin. Does that enable us to keep to the 20 – I mean, netting off against some of the other things you said about supply chain and internal inefficiencies, what have you, can you still get to that number in 2025?

**Robert P. Fishman**

*Executive Vice President, Chief Financial Officer, Chief Accounting Officer & Interim President-Consumer Solutions, Pentair plc*

A

Yeah. I mean, we would be very disappointed if we did not. We talked the trends at the Investor Day about transformation being our lever to expand 100 basis points a year. That excludes Manitowoc Ice. So when you add Manitowoc Ice to the mix, we would be disappointed if we just got to 21%. And I would say that we would get there much sooner than what we had described at our Analyst Day. Our focus is very much on ROS expansion.

**Scott Graham**

*Analyst, Loop Capital Markets LLC*

Q

Yes, that's great. Thank you.

**John L. Stauch**

*President, Chief Executive Officer & Director, Pentair plc*

A

Thank you.

**Operator:** The next question comes from Julian Mitchell of Barclays. Please go ahead.

**Matthew Shaffer**

*Analyst, Barclays Capital, Inc.*

Q

Hi, this is Matthew Shaffer on for Julian Mitchell. I was wondering how management is thinking about balancing inventory liquidation with the potential EPS headwind from under producing to normalized inventory here over the next few quarters?

**John L. Stauch**

*President, Chief Executive Officer & Director, Pentair plc*

A

Well, I mean, I think our inventory situation for today is mainly a result of us doing the best we can to get the raw inventory in around the core aspects have been hard to get. And we would expect to work that down pretty aggressively here over the next couple of quarters. And as Bob mentioned earlier, we'd be in a position to benefit from the cash generation of that inventory. It serves two purposes to move it down faster if you think we can buy cheaper in the future. Obviously, we don't want to be sitting on higher cost inventory, so we're aggressive moving to that reason. And the second one is the cash mobilization and getting the cash benefit from that inventory.

**Matthew Shaffer**

*Analyst, Barclays Capital, Inc.*

Q

Okay, that's helpful. And then, on IFT, I was just curious like how management is thinking about the price volume dynamics here in Q4 and into 2023 after a pretty strong quarter here in Q3?

**John L. Stauch**

*President, Chief Executive Officer & Director, Pentair plc*

A

Well, we want to continue the momentum that we've built over the last couple of quarters and not, I mean, we'd like to accelerate it is what we'd like to do.

**Robert P. Fishman**

*Executive Vice President, Chief Financial Officer, Chief Accounting Officer & Interim President-Consumer Solutions, Pentair plc*

A

Yeah, we're very focused on the complexity reduction and the transformation will help that segment significantly.

**Matthew Shaffer**

*Analyst, Barclays Capital, Inc.*



Okay. Great. Thank you.

**John L. Stauch**

*President, Chief Executive Officer & Director, Pentair plc*

Okay. We'd like to thank everybody for joining us today. At Pentair, we are focused on creating a better world for people in the planet through smart, sustainable water solutions. We appreciate your interest today. And as we continue to focus on helping the world sustainably move, improve, enjoy water, life's most essential resource, we remain committed to driving superior shareholder value that we may be the world's most valued, sustainable water solutions company for our employees, customers and shareholders.

Andrea, you can conclude the call.

**Operator:** The conference has now concluded. Thank you for attending today's presentation, and you may now disconnect.

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