



Pentair PLC (PNR)

Updated April 16th, 2018 by Nick McCullum

Key Metrics

Current Price: \$70	5 Year CAGR Estimate: 8.6%	Quality Percentile: N/A
Fair Value Price: \$72	5 Year Growth Estimate: 6.0%	Momentum Percentile: N/A
% Fair Value: 97%	5 Year Valuation Multiple Estimate: 0.6%	Total Return Percentile: N/A
Dividend Yield: 2.0%	5 Year Price Target: \$96	Valuation Percentile: N/A

Overview & Current Events

Pentair is a diversified industrial conglomerate that operates in three business segments: Water Quality, Flow & Filtration, and Technical Solutions. The company was founded in 1966 and trades with a market capitalization of approximately \$13 billion. Pentair has increased its dividend for 42 consecutive years, making it a member of the Dividend Aristocrats Index.

Pentair is currently working to separate into two independent publicly-traded businesses: nVent Electric and Pentair PLC. At the time of separation, nVent will be an electrical company focused on improving utilization, lower costs, and maximizing customer uptime. Pentair will continue to operate as a leading global water company focused on smart, sustainable solutions. In early April, Pentair's board of directors approved (4/3/18) the spin-off. nVent ordinary shares are expected to begin trading on the New York Stock Exchange on May 1, 2018. Each Pentair shareholder will receive one ordinary share of nVent for every ordinary share of Pentair held as of the close of business on April 17th.

Previously, Pentair reported (1/30/18) financial results for the fourth quarter of fiscal 2017. Sales increased by 6%, while "core" sales (which exclude currency translations and acquisitions) increased by 3%. On the bottom line, adjusted earnings-per-share increased by 19.3%. Earnings growth outpaced sales growth primarily due to margin expansion. The company also introduced 2018 financial guidance, which calls for adjusted earnings-per-share of about \$4.00 and sales growth of 2%-4% on a "core" (excluding currency and acquisitions) basis.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	\$2.20	\$1.47	\$2.00	\$2.41	\$2.39	\$3.21	\$3.14	\$3.94	\$2.47	\$3.53	\$4.00	\$5.35
DPS	\$0.68	\$0.72	\$0.76	\$0.80	\$0.88	\$0.96	\$1.10	\$1.28	\$1.34	\$1.38	\$1.45	\$2.13

Pentair is forecasting adjusted earnings-per-share of \$4 in fiscal 2018, which represents a compound annual growth rate of about 6% over 2008's comparable figure. We believe that a 6% rate of growth is a reasonable expectation for Pentair in the foreseeable future, which allows us to compute a 2023 earnings-per-share estimate of \$5.35. Dividend payments will likely grow more rapidly than earnings, resulting in an expanding payout ratio over time.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	14.6	18.2	16.8	15.2	17.6	18.7	22.9	15.2	22.9	18.3	17.5	18.0
Avg. Yld.	2.1%	2.7%	2.3%	2.2%	2.1%	1.6%	1.5%	2.1%	2.4%	2.1%	2.0%	2.2%

As mentioned, Pentair is expecting to generate adjusted earnings-per-share of \$4.00 in fiscal 2018. Using this earnings-per-share guidance, the company is trading at a price-to-earnings multiple of 17.5 today. The company's average price-to-earnings ratio over the last decade has been 18.0, which we believe represents an approximation of fair value for this high-quality dividend stock. If Pentair's valuation can expand to 18 times earnings over the next five years, this will add about 0.6% to the company's annualized returns during this time period.

We also note that Pentair is about to spin-off its electrical business, and corporate spinoffs often (though not always) trade at persistent discounts to the broader stock market as institutional investors offload these shares that they may

not want to continue holding. Accordingly, we recommend that value-oriented investors watch the price of nVent closely in the months following its separation from Pentair.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	25.0%	20.1%	23.4%	23.4%	10.7%	20.2%	15.2%	13.5%	15.6%	21.2%	18.0%	18.0%
Debt/A	53.2%	48.6%	47.3%	57.8%	46.4%	48.1%	56.2%	66.1%	63.1%	41.6%	45.0%	50.0%
Int. Cov.	7.2	5.1	8.8	1.7	-1.1	10.9	7.9	6.1	5.1	6.7	6.5	6.5
Payout	30.9%	49.0%	38.0%	33.2%	36.8%	29.9%	35.0%	32.5%	54.3%	39.1%	36.3%	39.8%
Std. Dev.	49.1%	42.3%	28.2%	34.2%	29.4%	20.1%	24.0%	27.7%	27.2%	16.9%	20.0%	20.0%

Although Pentair’s gross profits as a proportion of total assets are not the highest in our investment universe, the company scores well on a number of other quality metrics. In particular, the company’s payout ratio is below average among the Dividend Aristocrats and the company’s balance sheet is composed of greater than 50% shareholders’ equity. Qualitatively, Pentair’s strongest competitive advantages lie within its managerial practices. The company employs a strategy called the Pentair Integrated Management System – or PIMS – which allows its organizational structure to remain lean and encourages efficiency through the company’s supply chain and distribution operations.

Final Thoughts & Recommendation

The most notable characteristic of an investment in Pentair today is the pending spinoff of nVent Electric. Because of the company-changing nature of this spinoff, we note that all of the estimates provided in this research report apply to investors who intend to hold shares of both pro-forma companies. If you intend to sell either the “new” Pentair stock or nVent Electric after the separation, stay tuned for next quarter’s research report on both companies for updated return estimates.

Our recommendation for existing Pentair shareholders is to continue holding this stock. It is trading at a slight discount to its long-term average valuation multiple, but its long-term return potential is not appealing enough to issue a buy recommendation. Accordingly, we suggest that prospective investors wait for more compelling buying opportunities before purchasing this blue-chip Dividend Aristocrat.

Total Return Breakdown by Year

