Pentair PLC (PNR)

Updated July 25th, 2018 by Nick McCullum

Key Metrics

Current Price:	$44	**5 Year CAGR Estimate:**	6.4%	**Volatility Percentile:**	55.5%
Fair Value Price:	$42	**5 Year Growth Estimate:**	6.0%	**Momentum Percentile:**	39.3%
% Fair Value:	97%	**5 Year Valuation Multiple Estimate:**	-1.2%	**Valuation Percentile:**	58.9%
Dividend Yield:	1.6%	**5 Year Price Target**	$56	**Total Return Percentile:**	46.1%

Overview & Current Events

Until recently, Pentair was a diversified industrial conglomerate that operates in three business segments: Water Quality, Flow & Filtration, and Technical Solutions. The company recently spunoff its Technical Solutions segment and now operates as a pure-play water solutions company. Pentair was founded in 1966 and trades with a market capitalization of approximately $8 billion. Pentair has increased its dividend for 42 consecutive years, making it a member of the Dividend Aristocrats Index.

In late July, Pentair reported (7/25/18) financial results for the second quarter of fiscal 2018. In the quarter, sales of $781 million increased by 4% compared to the same period a year ago. Excluding currency effects and the one-time impacts of acquisitions and divestitures, Pentair's core sales grew by 3% in the quarter. Moving down the income statement, Pentair generated GAAP earnings-per-share of $0.44, far better than the $0.02 *loss* reported in last year's quarter. Unsurprisingly, the stark improvement in Pentair's GAAP performance numbers is due to one-time accounting charges. Excluding these factors, the company generated adjusted earnings-per-share of $0.71, which improved by 18.3% over the same period in 2017. The company's strong earnings performance was driven by top-line growth and significant margin expansion of nearly a full percentage point over last year's comparable period.

Pentair also updated its 2018 financial guidance to reflect both its second quarter financial performance and a recent spinoff (more on that later). The company expects to generate GAAP earnings-per-share of approximately $1.81 and adjusted earnings-per-share of approximately $2.31. Pentair also expects to generate 3%-4% sales growth in fiscal 2018.

In the second quarter, Pentair also completed the tax-free spin-off of its Electrical Business, nVent Electric plc, to its shareholders. The transaction was completed on April 30th, 2018, with each Pentair shareholder receiving one ordinary share of nVent for every ordinary share of Pentair held as of the close of business on April 17th. This spinoff has meaningfully reduced our earnings and fair value estimates for Pentair as a portion of the company's value is now contained in the public shares of nVent, which trade under the New York Stock Exchange under the ticket NVT.

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	***$2.31***	***$3.09***
DPS	$0.68	$0.72	$0.76	$0.80	$0.88	$0.96	$1.10	$1.28	$1.34	$1.38	***$0.70***	***$0.94***

While 2018's earnings-per-share are expected to be barely higher than a decade ago, this is because of the spinoff of nVent. We believe that a 6% rate of growth is a reasonable expectation for Pentair for the foreseeable future, which gives a 2023 earnings-per-share estimate of $3.09 when the growth rate is applied to 2018's financial guidance.

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	***19.1***	***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 now expects to generate $2.31 in earnings-per-share in fiscal 2018. Using this earnings-per-share guidance, the company is trading at a price-to-earnings ratio of 19.1 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 revert to 18 times earnings over the last decade, this will reduce the company's annualized returns by 1.2% per year during this time period.

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.

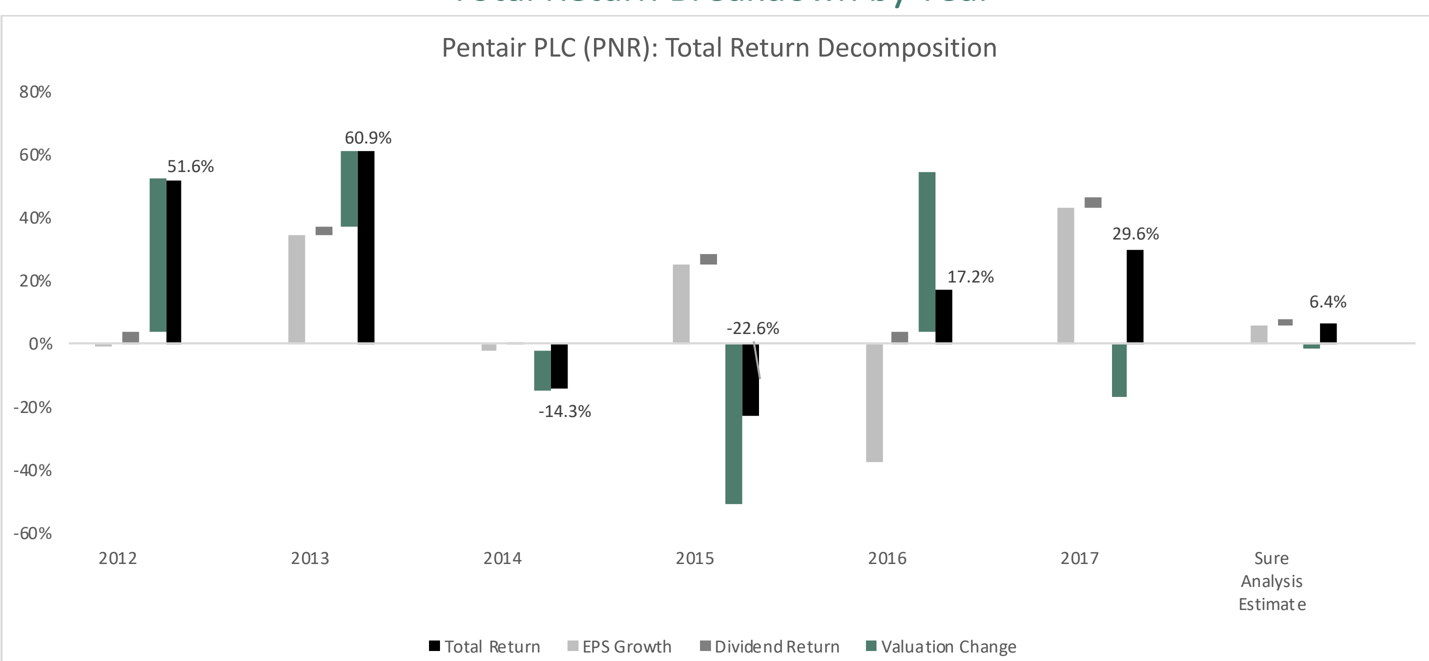
Qualitatively, Pentair's strongest competitive advantages lie within its managerial practices. The company employs a strategy called the Pentair Integrated Management System – or PIMS – which allows its organizational structure to remain lean and encourages efficiency through the company's supply chain and distribution operations.

Final Thoughts & Recommendation

Pentair has many of the classic characteristics of a high-quality business. It's four-decade streak of consecutive dividend increases speaks to durable competitive advantages, while its recent spinoff shows that management is constantly thinking about how to maximize shareholder value moving forward.

Pentair's business has changed significantly since the time of our last quarterly research update due to the spinoff of nVent Electrical. Still, our recommendation remains relatively unchanged. Pentair's valuation is not attractive enough for the company to earn a buy recommendation at its current price. Accordingly, we suggest that prospective investors wait for more compelling buying opportunities before purchasing this blue-chip Dividend Aristocrat.

Total Return Breakdown by Year



Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.