



# Pentair (PNR)

Updated October 30<sup>th</sup>, 2018 by Ben Reynolds

## Key Metrics

<b>Current Price:</b>	\$40	<b>5 Year CAGR Estimate:</b>	9.2%	<b>Volatility Percentile:</b>	45.2%
<b>Fair Value Price:</b>	\$42	<b>5 Year Growth Estimate:</b>	6.5%	<b>Momentum Percentile:</b>	20.8%
<b>% Fair Value:</b>	95%	<b>5 Year Valuation Multiple Estimate:</b>	0.9%	<b>Growth Percentile:</b>	58.3%
<b>Dividend Yield:</b>	1.8%	<b>5 Year Price Target</b>	\$57	<b>Valuation Percentile:</b>	54.9%
<b>Dividend Risk Score:</b>	A	<b>Retirement Suitability Score:</b>	B	<b>Total Return Percentile:</b>	47.8%

## Overview & Current Events

Until recently, Pentair was a diversified industrial conglomerate. The company recently spun off its Technical Solutions segment and now operates as a pure-play water solutions company that operates in 3 segments: Aquatic Systems, Filtration Solutions, and Flow Technologies. Pentair was founded in 1966 and trades with a market capitalization of ~\$8 billion. Pentair has increased its dividend for 42 consecutive years (adjusting for spin offs), making it a member of the Dividend Aristocrats Index.

Pentair reported 3<sup>rd</sup> quarter 2018 results on October 23<sup>rd</sup>. Adjusted sales (accounting for the nVent divestiture and currency fluctuations) grew 6% versus the same quarter a year ago. Adjusted earnings-per-share grew 10.2% versus the same quarter a year ago. CEO John Stauch had the following to say regarding quarterly results: *"We generated strong free cash flow, purchased another \$100 million of shares, and still have a very healthy balance sheet for potential tuck-in and bolt-on acquisitions aligned with our key growth initiatives of advancing pool growth and accelerating residential and commercial water treatment."*

Pentair also updated its 2018 financial guidance to reflect strong 3<sup>rd</sup> quarter results. The company now expects adjusted earnings-per-share of \$2.33 for fiscal 2018, up from an estimate of \$2.31 in the previous quarter. Pentair also expects to generate 4% to 5% adjusted sales growth in fiscal 2018.

As a reminder, 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 30<sup>th</sup>, 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 17<sup>th</sup>.

## Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
<b>EPS</b>	\$2.20	\$1.47	\$2.00	\$2.41	\$2.39	\$3.21	\$3.14	\$3.94	\$2.47	\$3.53	<b>\$2.33</b>	<b>\$3.19</b>
<b>DPS</b>	\$0.68	\$0.72	\$0.76	\$0.80	\$0.88	\$0.96	\$1.10	\$1.28	\$1.34	\$1.38	<b>\$0.70</b>	<b>\$0.96</b>
<b>Shares</b>	98.3	98.7	98.4	98.6	206.1	197.4	182.5	180.5	181.8	180.3	<b>175.0</b>	<b>158.2</b>

While 2018's earnings-per-share are expected to be barely higher than a decade ago. This is because of the spinoff of nVent. Pentair's management believes 8% to 10% annualized earnings-per-share growth is possible. We expect growth from the following sources: 2% from share repurchases, 2% to 3% from sales growth, and 0% to 4% from margin gains. At the midpoint, this comes to 6.5% annualized earnings-per-share growth.

## Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
<b>Avg. P/E</b>	14.6	18.2	16.8	15.2	17.6	18.7	22.9	15.2	22.9	18.3	<b>17.2</b>	<b>18.0</b>
<b>Avg. Yld.</b>	2.1%	2.7%	2.3%	2.2%	2.1%	1.6%	1.5%	2.1%	2.4%	2.1%	<b>1.8%</b>	<b>1.7%</b>

As mentioned, Pentair now expects to generate \$2.33 in earnings-per-share in fiscal 2018, giving the company a price-to-earnings ratio of 17.2 using expected 2018 earnings. 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

*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.*



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Pentair's valuation can revert to 18 times earnings over the next 5 years, this will increase the company's annualized returns by 0.9% per year.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
<b>GP/A</b>	25.0%	20.1%	23.4%	23.4%	10.7%	20.2%	15.2%	13.5%	15.6%	21.2%	<b>18.0%</b>	<b>18.0%</b>
<b>Debt/A</b>	53.2%	48.6%	47.3%	57.8%	46.4%	48.1%	56.2%	66.1%	63.1%	41.6%	<b>45.0%</b>	<b>50.0%</b>
<b>Int. Cov.</b>	7.2	5.1	8.8	1.7	-1.1	10.9	7.9	6.1	5.1	6.7	<b>6.5</b>	<b>6.5</b>
<b>Payout</b>	30.9%	49.0%	38.0%	33.2%	36.8%	29.9%	35.0%	32.5%	54.3%	39.1%	<b>30.0%</b>	<b>30.1%</b>
<b>Std. Dev.</b>	49.1%	42.3%	28.2%	34.2%	29.4%	20.1%	24.0%	27.7%	27.2%	16.9%	<b>20.0%</b>	<b>20.0%</b>

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. Pentair's interest coverage ratio is acceptable, but the company doesn't have excess room for more leverage.

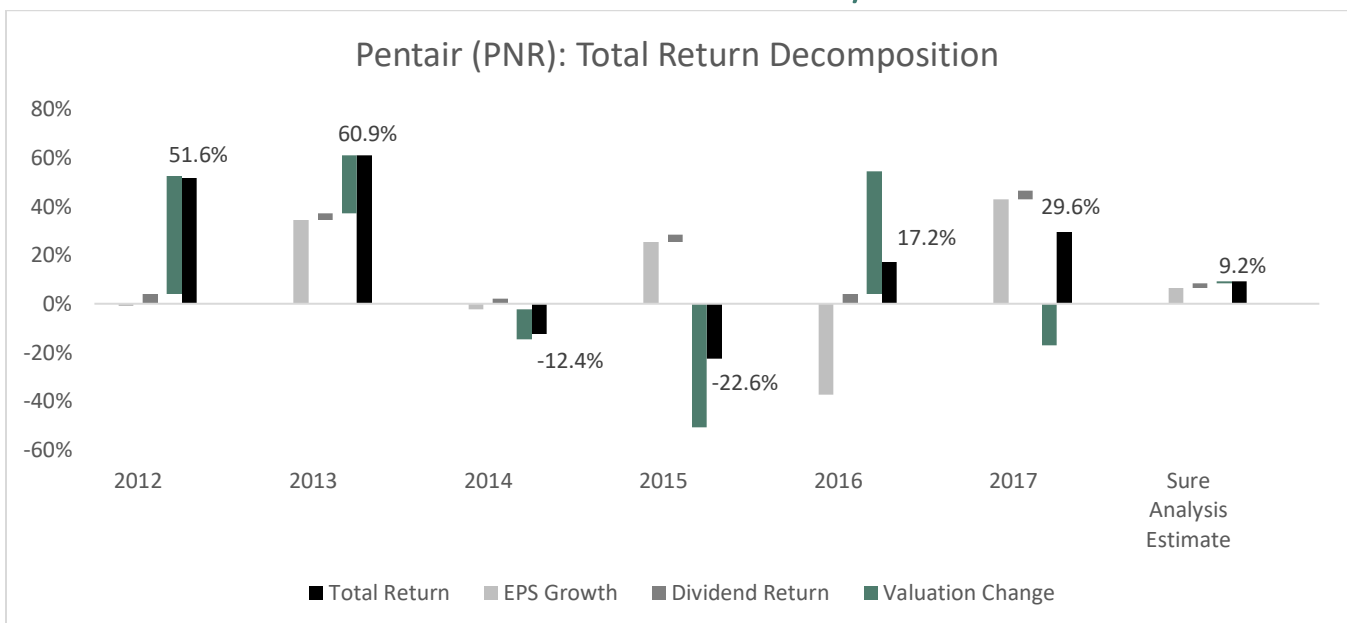
Qualitatively, Pentair's strongest competitive advantages lie within its managerial practices. The company employs a strategy called the Pentair Integrated Management System – or PIMS – which allows its organizational structure to remain lean and encourages efficiency through the company's supply chain 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 a durable competitive advantages, while its recent spinoff shows that management is constantly thinking about how to maximize shareholder value moving forward.

Pentair's valuation multiple has declined somewhat since our last report. The company is a borderline buy, and certainly a hold. We'd prefer to see expected total returns north of 10%, but this high-quality dividend growth stock is likely to generate solid returns at current prices.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
<b>Revenue</b>	3352	2692	3031	3457	4307	7000	4667	4616	4890	4937
<b>Gross Profit</b>	1015	785	931	1074	1266	2370	1621	1599	1794	1829
<b>Gross Margin</b>	30.3%	29.2%	30.7%	31.1%	29.4%	33.9%	34.7%	34.6%	36.7%	37.1%
<b>SG&amp;A Exp.</b>	627	507	551	695	1118	1494	986	884	979	1033
<b>D&amp;A Exp.</b>	87	105	84	108	160	275	140	149	181	183
<b>Operating Profit</b>	325	220	313	301	56	754	539	616	701	681
<b>Operating Margin</b>	9.7%	8.2%	10.3%	8.7%	1.3%	10.8%	11.5%	13.3%	14.3%	13.8%
<b>Net Profit</b>	229	115	185	-8	-107	537	215	-76	522	667
<b>Net Margin</b>	6.8%	4.3%	6.1%	-0.2%	-2.5%	7.7%	4.6%	-1.7%	10.7%	13.5%
<b>Free Cash Flow</b>	151	204	211	247	-51	758	925	648	744	549
<b>Income Tax</b>	108	56	89	46	-67	177	114	115	109	9

## Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
<b>Total Assets</b>	4053	3911	3974	4586	11883	11743	10655	11834	11535	8634
<b>Cash &amp; Equivalents</b>	39	33	46	50	261	256	110	126	239	113
<b>Acc. Receivable</b>	461	482	553	569	1275	1285	1206	773	764	832
<b>Goodwill &amp; Int.</b>	417	361	405	450	1334	1195	1130	565	524	581
<b>Total Liabilities</b>	2617	2575	2520	2866	7038	6611	6350	6006	5849	5910
<b>Accounts Payable</b>	2033	1785	1769	2539	5395	5526	5991	7825	7280	3596
<b>Long-Term Debt</b>	218	208	262	295	567	577	583	404	437	496
<b>Total Equity</b>	954	806	707	1309	2457	2550	3004	4686	4279	1441
<b>D/E Ratio</b>	1899	2012	2093	1933	6371	6095	4664	4009	4254	5038

## Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
<b>Return on Assets</b>	5.7%	2.9%	4.7%	-0.2%	-1.3%	4.5%	1.9%	-0.7%	4.5%	6.6%
<b>Return on Equity</b>	12.0%	5.9%	9.0%	-0.4%	-2.6%	8.6%	4.0%	-1.8%	12.6%	14.3%
<b>ROIC</b>	7.7%	3.9%	6.3%	-0.2%	-1.7%	6.1%	2.6%	-0.9%	6.1%	8.9%
<b>Shares Out.</b>	98.3	98.7	98.4	98.6	206.1	197.4	182.5	180.5	181.8	180.3
<b>Revenue/Share</b>	33.84	27.33	30.52	35.20	33.81	34.21	24.09	25.28	26.71	26.87
<b>FCF/Share</b>	1.53	2.07	2.12	2.51	-0.40	3.70	4.77	3.55	4.06	2.99

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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