



Pentair (PNR)

Updated May 3rd, 2019 by Jonathan Weber

Key Metrics

Current Price:	\$39	5 Year CAGR Estimate:	9.9%	Volatility Percentile:	96.4%
Fair Value Price:	\$42	5 Year Growth Estimate:	6.5%	Momentum Percentile:	19.4%
% Fair Value:	93%	5 Year Valuation Multiple Estimate:	1.5%	Growth Percentile:	63.7%
Dividend Yield:	1.9%	5 Year Price Target	\$57	Valuation Percentile:	67.1%
Dividend Risk Score:	A	Retirement Suitability Score:	B	Total Return Percentile:	57.5%

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 \$6.7 billion. Pentair has increased its dividend for 42 consecutive years, when adjusted for spin offs, which makes Pentair a member of the Dividend Aristocrats Index.

Pentair reported its first quarter earnings results on April 17. The company was able to generate revenues of \$689 million during the first quarter, which was 6.0% less than the company's revenues during the first quarter of the previous year. Core sales, which excludes the impact of currency rate movements, acquisitions, and disposessions, were down 4% year over year. Management blames this relatively weak performance on headwinds from cold and wet weather, as well as on inventory being worked down in key distribution channels. Pentair's gross margin declined marginally, but due to the hit to its top line and the adverse impact of negative operating leverage, Pentair's operating margin declined substantially, by 290 base points compared to the previous year's first quarter. Pentair recorded earnings-per-share of \$0.43 during the first quarter, down from \$0.49 in Q1 of 2018. Pentair's earnings-per-share missed the analyst consensus slightly. The market reacted negatively to the company's Q1 earnings release.

Pentair guides for earnings-per-share of \$0.63 to \$0.66 during the second quarter of fiscal 2019, while also seeing a sales growth rate of 1%-2%. On top of that, Pentair forecasts that its revenues will rise by 1% to 2% during all of fiscal 2019, which shows that the remainder of the year should be better than what Pentair delivered during the first quarter. Full year earnings-per-share guidance stands at \$2.30 to \$2.35, which implies a small earnings decline versus the \$2.35 that Pentair earned during 2018. We have adjusted our estimates downwards slightly to reflect this.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	\$1.47	\$2.00	\$2.41	\$2.39	\$3.21	\$3.14	\$3.94	\$2.47	\$3.53	\$2.35	\$2.33	\$3.19
DPS	\$0.72	\$0.76	\$0.80	\$0.88	\$0.96	\$1.10	\$1.28	\$1.34	\$1.38	\$0.70	\$0.72	\$1.04
Shares	99	98	99	206	197	183	181	182	180	177	172	160

At first look the results in the above table do not look overly promising, as 2019's earnings-per-share will be slightly below the company's earnings-per-share during 2011. Earnings-per-share results during 2018 and the following years are impacted by the spin-off of nVent, though, as the results of Pentair's former technical solutions segment are not included in the company's reported results any longer. Between 2008 and 2017 (before the nVent spin-off) Pentair grew its earnings-per-share by 5.5% annually. Adjusted for the impact of the last financial crisis - an unusually harsh recession which made Pentair's earnings-per-share decline by slightly more than 30% between 2008 and 2009 - Pentair's long-term earnings-per-share growth rate would have been higher in the past.

Pentair's management believes that a long-term earnings-per-share growth rate of 10% is possible, but we are a bit more conservative. It is, we believe, realistic to expect a 6%-7% earnings-per-share growth rate from Pentair going forward, which will consist of some sales growth, some margin increases, and the impact of stock buybacks.

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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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	18.2	16.8	15.2	17.6	18.7	22.9	15.2	22.9	18.3	16.2	16.7	18.0
Avg. Yld.	2.7%	2.3%	2.2%	2.1%	1.6%	1.5%	2.1%	2.4%	2.1%	1.8%	1.9%	1.8%

Pentair's valuation has moved in a relatively tight range throughout most of the last decade, and shares did not become significantly more expensive during the recovery from the last financial crisis (relative to the profits that Pentair generated). Shares are trading towards the cheap side of the historic range right now, which is why we see some valuation expansion potential that should positively impact Pentair's total returns going forward.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	49.0%	38.0%	33.2%	36.8%	29.9%	35.0%	32.5%	54.3%	39.1%	29.8%	30.9%	32.6%

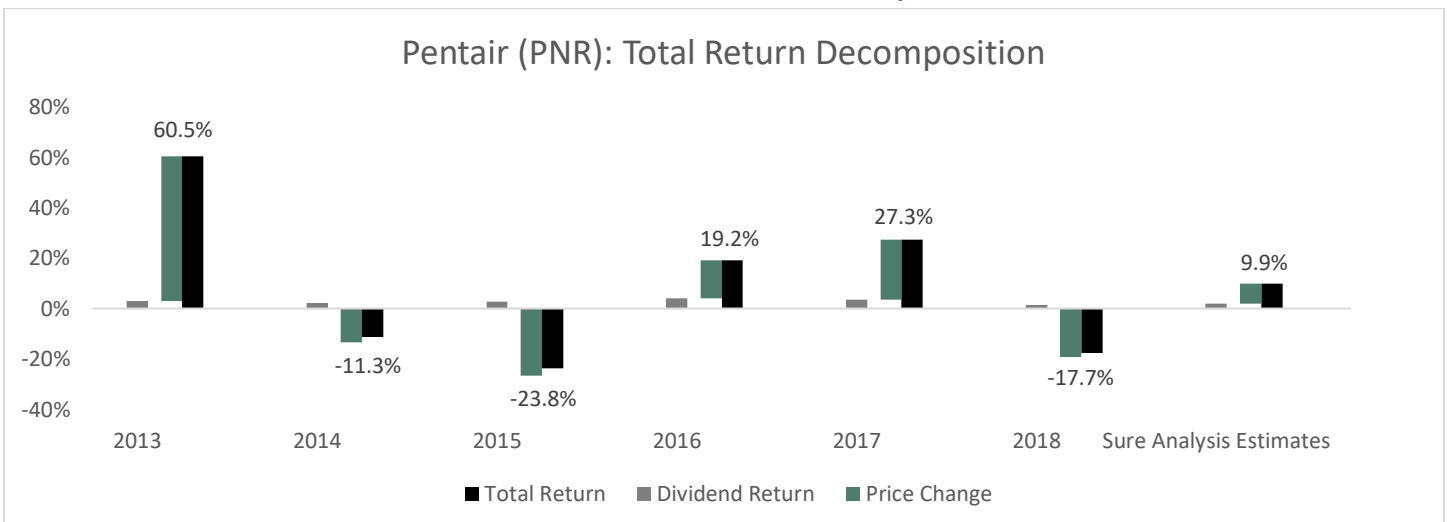
Pentair's dividend has grown consistently for decades, and during the last decade Pentair has grown its shareholder payouts at an attractive pace. When we adjust for the spin-off of nVent, Pentair's dividend growth track record remains intact. The payout ratio is not very high, which makes us believe that the dividend looks quite safe. Even an earnings decline such as the one during the last financial crisis would likely not result in a dividend cut.

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. Pentair is a leader in the niche markets it targets, and through tuck-in acquisitions, Pentair can grow its size and scale further.

Final Thoughts & Recommendation

Following the spin-off of other businesses, Pentair has become a pure-play water company that is a leader in its industry. Pentair plans to consolidate the space further by making tuck-in acquisitions whenever it sees a compelling target. We believe that Pentair should be able to grow its earnings-per-share at a solid pace going forward, although management's forecasts seem a bit aggressive. When we factor in the dividend and some tailwinds from multiple expansion, Pentair could deliver compelling total returns. We rate Pentair's shares a buy at the current price.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	2692	3031	3457	4307	7000	4667	4616	2781	2846	2965
Gross Profit	785	931	1074	1266	2370	1621	1599	959	988	1048
Gross Margin	29.2%	30.7%	31.1%	29.4%	33.9%	34.7%	34.6%	34.5%	34.7%	35.3%
SG&A Exp.	507	551	695	1118	1494	986	884	531	536	534
D&A Exp.	105	84	108	160	275	140	149	88	87	85
Operating Profit	220	313	301	56	754	539	616	354	378	437
Operating Margin	8.2%	10.3%	8.7%	1.3%	10.8%	11.5%	13.3%	12.7%	13.3%	14.7%
Net Profit	115	185	-8	-107	537	215	-76	522	667	347
Net Margin	4.3%	6.1%	-0.2%	-2.5%	7.7%	4.6%	-1.7%	18.8%	23.4%	11.7%
Free Cash Flow	204	211	247	-51	758	925	648	818	581	391
Income Tax	56	89	46	-67	177	114	115	43	59	58

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	3911	3974	4586	11883	11743	10655	11834	11535	8634	3807
Cash & Equivalents	33	46	50	261	256	110	126	239	86	74
Acc. Receivable	482	553	569	1275	1285	1206	773	764	483	488
Inventories	361	405	450	1334	1195	1130	565	524	357	388
Goodwill & Int.	2575	2520	2866	7038	6611	6350	6006	5849	2435	2349
Total Liabilities	1785	1769	2539	5395	5526	5991	7825	7280	3596	1970
Accounts Payable	208	262	295	567	577	583	404	437	322	379
Long-Term Debt	806	707	1309	2457	2550	3004	4686	4279	1441	788
Total Equity	2012	2093	1933	6371	6095	4664	4009	4254	5038	1836
D/E Ratio	0.40	0.34	0.68	0.39	0.42	0.64	1.17	1.01	0.29	0.43

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	2.9%	4.7%	-0.2%	-1.3%	4.5%	1.9%	-0.7%	4.5%	6.6%	5.6%
Return on Equity	5.9%	9.0%	-0.4%	-2.6%	8.6%	4.0%	-1.8%	12.6%	14.3%	10.1%
ROIC	3.9%	6.3%	-0.2%	-1.7%	6.1%	2.6%	-0.9%	6.1%	8.9%	7.6%
Shares Out.	99	98	99	206	197	183	181	182	180	177
Revenue/Share	27.33	30.52	35.20	33.81	34.21	24.09	25.28	15.19	15.49	16.72
FCF/Share	2.07	2.12	2.51	-0.40	3.70	4.77	3.55	4.47	3.16	2.20

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

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