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Pentair plc (PNR)

Q3 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day and thank you for standing by. Welcome to the Q3 2021 Pentair Earnings Conference Call. At this time, all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions]

I would now like to hand the conference over to your speaker today, Jim Lucas. Thank you. Please go ahead.

Jim C. Lucas

Senior Vice President, Treasurer, Financial Planning & Analysis & Investor Relations, Pentair plc

Thank you, Stephanie, and welcome to Pentair's third quarter 2021 earnings conference call. We're glad you could join us. I'm Jim Lucas, Senior Vice President, Treasurer, FP&A and Investor Relations. And 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 other 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 limit your questions to one and a follow-up in order to ensure that everyone has an opportunity to ask their questions.

I will now turn the call over to John.

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. I would like to start by thanking our Pentair teams for delivering outstanding third quarter in the face of unprecedented material shortages and inflation. We are pleased to once again deliver strong double-digit sales and EPS gains. While it's easy to focus on the supply chain and the inflation challenges that we all currently face, it is also important to appreciate how strong 2021 has been for Pentair. Year-to-date, we have delivered 25% sales growth, nearly 40% segment income growth. We've expanded margins 170 basis points and grown EPS 40%. We have said that we view our businesses as more seasonal than cyclical and our robust backlogs give us further confidence in our ability to continue our strong momentum in Q4 and into 2022.

In addition to the strong sales and earnings growth, we have generated over \$500 million of free cash flow this year and our balance sheet is strong. We ended the quarter under one time levered and I am especially proud of our 19% ROIC. We have completed two acquisitions this year that further advanced our strategy. We acquired KBI earlier this year that added commercial services capabilities to our growing Water Treatment business. We

recently completed the Pleatco acquisition that brings strong aftermarket filtration products not only to our flagship Pool business but also to our Industrial Filtration business.

Given the strong third quarter performance, we are tightening our full-year guidance range which Bob will give additional color on shortly. There remains a lot of uncertainty as we end the year given the ongoing material shortages, logistical challenges and inflation. In fact, we experienced more inflation in the third quarter of 2021 than we did in the full-year of 2020.

We have gone out with multiple price increases across most of our businesses this year. There's a lag from when price increases are announced and when we recognize them, particularly given our strong sales and backlog growth this year. The good news however is we should have strong pricing tailwind entering next year. This has been a great year and we believe we have a lot more runway ahead to become an even stronger company.

Please turn to slide 5 labeled, Building a Track Record of Consistent Growth. We believe our strong performance over the past several quarters reinforces that we are in the right spaces for the future. Our portfolio of industry-leading products and our services help consumers move, improve and enjoy their water in addition to a growing Industrial Filtration business focused on faster growing niches such as sustainable gas.

We are building a track record of consistent growth. Our residential businesses have enjoyed robust growth and we believe there's more to come. Our commercial and industrial businesses have been recovering back to 2019 levels, and backlogs have been building in these longer cycle businesses. We're making great progress in building out our strategic growth initiatives. As I mentioned previously, we have completed two acquisitions this year that furthered our Pool and our Water Treatment strategies. We are also driving transformation to both unlock value and to fund growth. While some of our businesses are further along the journey, we have identified a strong funnel of opportunities to help us become more productive, better serve our customers and drive growth and margin expansion. Our balance sheet is another lever available that offers great flexibility to invest in our core, return cash to shareowners and to fund strategic acquisitions.

2021 has been a great year for Pentair. And we believe there's a lot more yet to come.

I would now like to turn the call over to Bob to discuss our performance and our financial results in more detail. After which, I will provide an update on our overall strategic position. Bob?

Robert P. Fishman

Executive Vice President, Chief Financial Officer & Chief Accounting Officer, Pentair plc

Thank you, John. Please turn to slide 6 labeled Q3 2021 Pentair Performance. Third quarter sales grew 21%, with core sales increasing 18%. Consumer Solutions grew core sales 26% and Industrial & Flow Technologies delivered core sales growth of 8%. Segment income was up 28% and return on sales expanded 90 basis points to 18.5%. Adjusted EPS increased 27% to \$0.89. Inflation continued to be a significant headwind but we saw price nearly offset it in the third quarter. Corporate expense was \$17 million in the quarter and our tax rate was 16% in the quarter. Overall, the third quarter was another solid performance across the enterprise as our teams continued to deliver in the face of material shortages, logistical challenges and inflation.

Please turn to slide 7, labeled Q3 2021 Consumer Solutions Performance. Consumer Solutions sales growth was 30% as both businesses continued to perform at record levels. Segment income increased 27% while return on sales contracted as price did not fully keep up with the significant inflation headwind. While we have implemented additional price increases, our record backlogs and strong double-digit growth create a lag from when the new prices read out.

We believe this creates a tailwind on price entering next year but inflation does not appear to be moderating. Pool experienced sales growth of 32% in the quarter and was up 5% sequentially. Demand in the industry remained strong even as the Pool fiscal year ends and activity begins to moderate. In fact, dealers are booked well into the third quarter of next year which we anticipate will result in another strong full season next year. Favorable mortgage rates, continued increases in home equity and the ongoing trend of suburban migration are all contributing to robust demand for the industry. We continue to see strong demand for our variable speed pumps as new efficiency regulations drive transition from single speed pumps. The majority of our mix has shifted to variable speed.

2021 has been a good year for new products including our IntelliBrite HD light and higher energy efficient heaters. We expect next year to be another strong year, including advancements in filtration and continued expansion of connected products. Demand for new pools remained strong with many builders reporting backlogs into the latter half of next year. Our record backlog and favorable demographic trends give us increased confidence and momentum as we look to next year.

Water Treatment delivered 28% sales growth as residential demand remained robust and commercial showed strong signs of post-pandemic recovery. We saw our direct-to-consumer business improving leads and closings in several new markets and we continue to evolve our business model. We've made great progress in rebranding the business and are also building out our service capabilities.

The commercial recovery continued and the integration of KBI is going well. We had a Total Water Management win in the quarter that was a great example of taking a product sale and adding installation and services with an existing KBI customer. While restaurant foot traffic is still not back to 2019 levels, average ticket prices are up and the result is continued improvement in orders and backlog for what has historically been a shorter cycle business. While Consumer Solutions has felt the biggest impact from inflation and material shortages in the short-term, we have successfully implemented multiple price increases that are yet to fully read out and strong backlog levels point to anticipated continued growth for the segment.

Please turn to slide 8 labeled Q3 2021 Industrial & Flow Technologies Performance. Industrial & Flow Technologies increased sales 8% in the quarter while segment income grew 23% and return on sales expanded 180 basis points to 14.8%. Residential flow grew at a double-digit rate for the fourth consecutive quarter. This growth was accomplished even in the face of supply chain constraints that are not showing signs of mitigating. Our customers have continued to experience strong sell-through which gives us confidence that we will continue to grow. Price is also beginning to read out further and should be a tailwind entering next year.

Commercial Flow increased sales 6% in the quarter. The focus in Commercial Flow continues to be on complexity reduction, better price realization and building out the aftermarket business given the large installed base.

Industrial Filtration delivered 8% sales growth that once again by recovery in the shorter cycle business of food and beverage. We continued to see strong orders and our sustainable gas business had strong backlog growth and a growing order funnel where we experienced an improvement in our win rate. IFT is building momentum on return on sales expansion and our transformation initiatives coupled with price realization improving we believe should drive more improvement going forward.

Please turn to slide 9 labeled Balance Sheet and Cash Flow. Free cash flow continued to be a great story as we have generated over \$500 million year-to-date. We have returned \$200 million to shareholders through dividends and share repurchase during 2021. The balance sheet ended the quarter exceptionally strong with leverage remaining under 1 times. Return on invested capital ended the quarter at 19%; a number we are particularly

proud of. We had a higher-than-average amount of cash on hand at the end of the quarter as we awaited the completion of the Pleatco acquisition which occurred last week. Our balance sheet gives us a great deal of flexibility to invest in our strategic growth initiatives, both organically and through strategic acquisitions like KBI and Pleatco.

Please turn to slide 10 labeled Q4 and Full Year 2021 Pentair Outlook. We are initiating fourth quarter and updating our full-year 2021 guidance. For the fourth quarter, we expect sales to grow 15% to 19%, segment income to grow 16% to 24%, and adjusted EPS to grow 16% to 24% to a range of \$0.81 to \$0.87. Our forecast reflects ongoing material availability headwinds and higher inflation.

For the full-year, we expect sales to grow 22% to 23%, segment income to increase 32% to 34%, and adjusted EPS to grow 34% to 36% to a range of \$3.34 to \$3.40. In addition to supply chain and logistics challenges, we would also remind investors that the fourth quarter historically incurs a seasonal slowdown for many of our residential business as the weather turns less favorable for outdoor activity in addition to fewer workdays around the holidays. Below the operating line, we continue to expect corporate expense to be around \$80 million. We now expect net interest to be around \$15 million and our tax rate assumption remains around 16%. We anticipate the share count to be around 167.5 million both for the quarter and the full-year. Capital expenditures are expected to be around \$60 million, while depreciation and amortization is anticipated to be about \$80 million. We continue to target free cash flow to be greater than net income.

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

QUESTION AND ANSWER SECTION

Operator: [Operating Instructions] Your first question comes from the line of Andrew Kaplowitz with Citi.

Eitan Buchbinder
Analyst, Citigroup Global Markets, Inc.

Q

Hi. This is Eitan Buchbinder on for Andy. Good morning.

John L. Stauch
President, Chief Executive Officer & Director, Pentair plc

A

Good morning.

Robert P. Fishman
Executive Vice President, Chief Financial Officer & Chief Accounting Officer, Pentair plc

A

Good morning.

Eitan Buchbinder
Analyst, Citigroup Global Markets, Inc.

Q

So inflation in IFT appears to have been balanced with price in the quarter. Should price cost for the segment impact positively in Q4 and what is your expectation for price cost positive in Consumer Solutions?

Robert P. Fishman

Executive Vice President, Chief Financial Officer & Chief Accounting Officer, Pentair plc

A

As we said in the prepared remarks, price is reading out nicely in both of our segments. Unfortunately, inflation continues to be a headwind as we look at the fourth quarter. I think that Consumer Solutions bears probably the bigger impact of the margin challenge with the bigger backlog and the fact that price is reading out a little bit more slowly in that business. I think we'll continue to see a challenged margin at least in the fourth quarter. For IFT, they have some really nice productivity improvements and so margins should continue to improve even though inflation continues to be a challenge.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

The other point I would make is and you saw a little of this in the quarter despite KBI being a very strategic acquisition, it is a services business. Services businesses don't have the large margin profile. And so it's not going to have the same margin profile as Consumer Solutions, so it is slightly dilutive to margins.

And as we bring Pleatco in as well, even though it's a really highly valuable asset and one that we think is going to have great runway in the aftermarket side, it will also have a lower margin profile than Consumer Solutions today. So both of those will be a slight drag in the margins, but both are very strategic tuck-ins that we think add significant value over the long time.

Eitan Buchbinder

Analyst, Citigroup Global Markets, Inc.

Q

That's helpful. Thank you. And you called out improving capacity in Pool as supporting results in this quarter as well as in Q2. Where would you say capacity utilization stands now relative to its potential within your existing Pool footprint?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

It's hard to answer that. I mean I think we're not capacity challenged, right? Our factories have capacity to meet the demand. We're still working to the supply chain and as we mentioned in Bob's remarks, I mean the supply chain is usually volatile right now. Even if when we can get supply, we have to worry about ports. We have to worry about freight. We have to worry about transportation. So we've got a real lumpiness as far as what's coming in each day and we're doing the best we can and the teams are – I'm really proud of the teams' agility to move forward and deliver again a really solid quarter in the wake of challenged supply chain areas.

So, we can't answer the capacity issue but we have plenty of capacity left within our buildings.

Eitan Buchbinder

Analyst, Citigroup Global Markets, Inc.

Q

Thank you. I'll pass it along.

Operator: Your next question comes from the line of Joe Giordano with Cowen.

Joseph Giordano

Analyst, Cowen & Co. LLC

Q

Hey, guys. Good morning.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

Good morning.

A

Joseph Giordano

Analyst, Cowen & Co. LLC

Hey. So, sorry, I joined on a couple minutes late so apologies if you covered this. But in our checks that we're doing with the pool sector, it seems like price into next year is comfortably in the double-digits. I think I saw you guys plus 8% or so in Consumer. Do you expect that to kind of like be a lagging indicator? Do you see that kind of going up with what's currently in the market?

Q

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

Yeah. I think we – obviously too early to guide on 2022 right now. But given where we are with inflation and as I said more inflation in Q3 than all of last year combined, and even though we planned for doubling inflation, we're in the quadrupling and quintupling range which is startling, right?

A

And so I do think with supply chain logistics, we should anticipate that inflation continues to grow into next year and therefore we would continue to price to hopefully offset that inflation. So, yes, I think that the ranges that you're suggesting are more the probable direction.

Joseph Giordano

Analyst, Cowen & Co. LLC

If I can sneak in one more just on Pool. If you were to categorize your business, I know we talked about like newbuild versus retrofit versus just your traditional kind of break-and-fix, like how would you categorize the growth that you're seeing now? Is there anything like in any one of those seemed like just way off of what you would expect or is it kind of balanced across those three verticals there?

Q

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

It's really balanced. I mean we're seeing new pool builds, which is obviously driving Pool growth. We're seeing expansion of the pad as we've mentioned all year, which is driving Pool growth and adoption and usage which is driving Pool growth. So, it's across the spectrum of both new pools and aftermarket consistently.

A

Joseph Giordano

Analyst, Cowen & Co. LLC

Thanks, guys.

Q

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

Thank you.

A

Operator: Your next question is from Mike Halloran with Baird.

Michael Patrick Halloran

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

Q

Good morning, gentleman. So on the comments that Bob made about some seasonal slowing which is normal going into fourth quarter, just digging on that a little bit, is the thought that you could get pretty normal sequentials across your business units going into the fourth quarter or is there some sense of any weakening or strengthening of demand in any of the areas you sell into or are there areas where the supply chain might be a greater headwind going into the fourth quarter than maybe what you would have saw in the third quarter?

Robert P. Fishman

Executive Vice President, Chief Financial Officer & Chief Accounting Officer, Pentair plc

A

The guide for Q4 from our perspective is roughly flat sequentially is kind of how we think about it. We have a little bit of challenges in terms of the seasonality of some of the residential businesses. But to be honest the backlog is so healthy going into the fourth quarter that it's really about the supply chain and the material challenges that we face. So, the business continues to be very healthy from a demand and backlog perspective. We are seeing some seasonality in the fourth quarter about residential but it really does come down to the supply chain.

Michael Patrick Halloran

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

Q

So in other words, there's nothing wonky that you're assuming in guidance versus normal seasonality?

Robert P. Fishman

Executive Vice President, Chief Financial Officer & Chief Accounting Officer, Pentair plc

A

Nothing. No.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

No.

Michael Patrick Halloran

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

Q

Okay. And then follow-up, balance sheet is in a great, sub-1 times levered. So twofold one, could you just talk about accessibility of pipeline. Obviously, you've done a couple of good deals so far this year. And then secondarily, what would the calculus be to increase the rate of share buyback at this point?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Yeah. Mike, it's John. I think – without a doubt you mentioned I think the funnel is healthy and there's a lot of M&A activity. While we're not going to necessarily accomplish everything, I think we want to be active and we want to be focused on our SGI activities. So that's where we're at right now. And if in fact the pricing gets too lofty or they're not the right deals for us, I think we'd lean back into utilizing the cash on the share buyback side in addition to our normalized targets that we publish as 150 million a year.

Michael Patrick Halloran

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

Q

Appreciate it. Thank you.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

Thank you.

A

Operator: Your next question is from Brian Lee with Goldman Sachs.

Brian Lee

Analyst, Goldman Sachs & Co. LLC

Hey, guys. Thanks for taking the questions. Maybe just a bit of a follow-up on the last one. The revenue guidance for the year is up \$15 million at the midpoint for 2021. I guess first question is does that include Pleatco now? And if so, how much are they adding? I think you said \$95 million in the press release when you announced the deal. So it does seem like something may be falling out or coming down, maybe about \$70 million, \$80 million if we're adding that relative to the original guide, so maybe about 2 percentage points. Can you help reconcile a bit what's going on with the guidance there?

Q

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

Yeah. Just to clarify, we have – just think of Pleatco as roughly \$20 million of contribution in Q4, so it's relatively modest. On a full-year basis, we think that's closer to \$100 million, but we're not going to have it this whole quarter. And it's about two-thirds Pool and it's about one-third Industrial Filtration. That's where I would share with you what that contribution is.

A

As Bob said, we don't think we see the supply chain ramping up between Q3 and Q4. While there is still strong demand, we don't think it's prudent to anticipate that we would ship more in Q4 given that there's holiday seasons that are also clamoring for the same ports and the same trade routes that we're trying to get to. So we're doing the best we can to sequentially improve every single quarter and I think we made great progress from last year into Q1 to Q2 to Q3. And now what we're suggesting is it's wise to think that we're flattish in our ability to get products out the door from Q4 to Q3.

The seasonality of the businesses which is normal is more of our service businesses, the businesses that go into people's homes to treat water treatment. And those businesses are seasonal. Not too many people look to do that over the holiday season. And as Bob mentioned, that's why we usually see a Q3 to Q4 dip in those particular offerings. So, normal seasonality with the belief that we're not going to raise our expectations beyond what we delivered in Q3.

Brian Lee

Analyst, Goldman Sachs & Co. LLC

Okay. Fair enough. And then I know you don't want to get into a 2022 guidance and quantifying the pricing here but can you maybe give us a sense of what recent or anticipated price actions are in terms of timing and then even into early next year and then when do you think those start to really read out as you say? Thank you, guys.

Q

Robert P. Fishman

Executive Vice President, Chief Financial Officer & Chief Accounting Officer, Pentair plc

Well, as we've mentioned in the prepared remarks, we have had multiple price increases this year to offset the inflation. We'll continue to follow that process into next year where as inflation trends higher, we would pass along the price of that headwind.

A

Brian Lee

Analyst, Goldman Sachs & Co. LLC

All right. Fair enough. Thanks, guys.

Q

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

Thank you.

A

Operator: Your next question comes from the line of Saree Boroditsky with Jefferies.

Saree Boroditsky

Analyst, Jefferies LLC

Good morning. Thanks for taking my question. Could you just talk through what you're seeing from an early order program and how you're thinking about those deliveries in the fourth quarter versus the first quarter? And then any commentary on what you're seeing in the channel from an inventory perspective?

Q

Robert P. Fishman

Executive Vice President, Chief Financial Officer & Chief Accounting Officer, Pentair plc

Yeah. We don't expect a significant early order program in the fourth quarter. There might be pockets but at this point nowhere near the size that it's been historically.

A

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

And a part of that is with the significant backlog we have, it's not prudent to think about adding more to it. So we work with our channel partners around certain stocking areas differently than we work with our channel partners around where they are, where they had significant demands on us and we're just trying to meet those demands. So that's the point that I want to make sure that we emphasize that that program is usually at the level of the factories and there's no need to do that since we're trying to be full out on the supply chain right now.

A

Saree Boroditsky

Analyst, Jefferies LLC

Thanks. That's helpful. And obviously you've had strong sales in the quarter and you've talked a lot about the supply chain headwinds. Could you quantify any lost sales that occurred in the third quarter that you expect to occur in the fourth quarter that are being pushed out to 2022?

Q

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

I would suggest that the incremental backlog over last year that we've now reported would be the gap that we're trying to get through, right? I mean, we have typical backlog businesses than we have more book-and-ship businesses. And in the book-and-ship businesses which is primarily the residential, we're not able to get everything out that our customers want every quarter. And so we start the quarter off in a backlog situation, continue to add orders to it, ship as much as we can. And then we're still having those rich backlogs which are a combination of demand and the inability of the supply chain to meet that demand.

A

Saree Boroditsky
Analyst, Jefferies LLC

Q

Great. Thanks for taking my questions.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Thank you.

Operator: Your next question comes from the line of Bryan Blair with Oppenheimer.

Bryan F. Blair

Analyst, Oppenheimer & Co., Inc.

Q

Thanks. Good morning, guys.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Good morning.

Robert P. Fishman

Executive Vice President, Chief Financial Officer & Chief Accounting Officer, Pentair plc

A

Good morning.

Bryan F. Blair

Analyst, Oppenheimer & Co., Inc.

Q

So, sort of follow-up on Joe's question, I guess to ask more directly is there anything that you can see today or are there any meaningful launch items that would prevent Pool from posting solid growth again next year?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

No.

Bryan F. Blair

Analyst, Oppenheimer & Co., Inc.

Q

All right. Expected that.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

So no.

Bryan F. Blair

Analyst, Oppenheimer & Co., Inc.

Q

No, that's what I wanted to hear. And it looks like Pleatco will be essentially paid for by your second-half cash flow, so that's a pretty good setup. Is there anything you can offer in 2022 base case outlook, growth rate relative to the \$95 million ROS level? Anything else that would help us to gauge a reasonable accretion range for year one?

Robert P. Fishman

Executive Vice President, Chief Financial Officer & Chief Accounting Officer, Pentair plc

A

Again, we're not in a position today to provide the 2022 guidance but we do have a number of tailwinds in place. We've talked about that the strong backlog entering the year. We've also, as you'd expect with the supply chain challenges, having a number of inefficiencies this year and that will help the P&L. And then probably, most importantly, the transformation initiative that we talked about should be a tailwind as well for 2022.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Yeah. And just on Pleatco specifically which you asked, just think about a roughly \$100 million of revenue give-or-take, on a rounding think about roughly 20% and a little bit of interest headwind given the fact that most of that is cash and you can get yourself into what you think accretion might be. Obviously, we'll be doing some integration work which will offset that slightly but that gives you a general direction of that asset.

Bryan F. Blair

Analyst, Oppenheimer & Co., Inc.

Q

Okay. Appreciate the detail. Thanks again.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Thanks.

Operator: Your next question is from Jeff Hammond with KeyBanc Capital.

Jeffrey D. Hammond

Analyst, KeyBanc Capital Markets, Inc.

Q

Hey. Good morning, guys.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Good morning, Jeff.

Robert P. Fishman

Executive Vice President, Chief Financial Officer & Chief Accounting Officer, Pentair plc

A

Good morning.

Jeffrey D. Hammond

Analyst, KeyBanc Capital Markets, Inc.

Q

I noticed that both businesses you got productivity was in the green. And I'm just wondering what's driving that just given all the crosscurrents and headwinds on supply chain that would be I guess eating into that?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Operating leverage, I mean these are some pretty significant growth rates, Jeff. And when you leverage your fixed cost factories and generally what's been a very productive variable labor and fixed cost labor in the factories that's where we're getting that productivity from.

Jeffrey D. Hammond

Analyst, KeyBanc Capital Markets, Inc.

Q

Okay. And then just on – a lot of questions on kind of price into next year and I think you guys mentioned how substantial the carryover is, is the thought that that price cost dynamic, it looks like it's a little bit negative, 3Q maybe into 4Q. But is there a point where you start to see that flip positive or should we continue to think about this trend those being pretty close as the trend into 2022?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Yeah, Jeff, I think it's fair to say that when you take a look at the rate that we're exiting at from an inflation standpoint, that creates an inflation headwind into Q1, right, and leveling off in Q2 and Q3. And that's where we got to get the incremental price to try to mitigate that. So, full-year next year, I think we would feel like we're in a position to offset it. There might be some lumpiness by quarter; some tailwinds and some headwinds, and that's what we're working through.

Jeffrey D. Hammond

Analyst, KeyBanc Capital Markets, Inc.

Q

Okay. And have you announced your Jan 1 price increase magnitude?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

No. Not yet.

Jeffrey D. Hammond

Analyst, KeyBanc Capital Markets, Inc.

Q

Okay. We'll stay tuned for that. Thanks.

Operator: Your next question is from Nathan Jones with Stifel.

Nathan Jones

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Good morning, everyone.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Good morning.

Robert P. Fishman

Executive Vice President, Chief Financial Officer & Chief Accounting Officer, Pentair plc

A

Good morning.

Nathan Jones

Analyst, Stifel, Nicolaus & Co., Inc.

Q

I'm going to attack this a little bit from the gross margin side. So the real inflation started reading through in the third quarter. Gross margins in the first-half were a little bit over 36%, about 34.5% in 3Q. Do you expect to be able to get those gross margins back to that kind of 36% range when you've offset all of the inflation increases with price, assuming inflation starts going up at some point here or will there be a – just sum of the math of adding the same number to the top and bottom that will keep you below that 36% level that we saw in the first-half?

Robert P. Fishman

Executive Vice President, Chief Financial Officer & Chief Accounting Officer, Pentair plc

A

No. That is our goal is to get back to that as quickly as we can. And certainly doing better from a price and inflation perspective is important but also the transformation is a key part of our margin expansion story.

Nathan Jones

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Is that...

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

And Nathan I would just like to use the opportunity to share that a little bit. I have desires to have a four in front of that gross margin as we exit the transformation period that we talked about. And most of the levers that we're pulling, we believe that pricing is a big initiative and we're leaning into that with outside help, more looking at our value-adds and looking at end-to-end cost and trying to think about even our partners' cost and how we help mitigate some of the expense we agree to that; logistics and end-to-end freight costs are pretty sizable not just for us but for our partners. So how do we get after that with price?

Second one, sourcing, how do we lean in on sourcing and really look at global supply chains on a total landed cost basis and make sure we're making the best choices and SKU rationalization is a big enabler there as well.

The third one is the manufacturing and distribution footprint. I think the distribution one gives us a big opportunity.

And the fourth one is the organizational enablement. And that's really about making sure that as we find new channel, new adjacencies, we're getting productivity from the old way of doing things to fund the new way that we want to do things. And so those are the four big pillars of transformation. We made a lot of progress and we hope to create tailwinds into 2022 from those initiatives.

Nathan Jones

Analyst, Stifel, Nicolaus & Co., Inc.

Q

I was actually going to ask about the transformation initiatives next. I know when you announced these things back in June, there was that period of planning that needed to be going through in order to finalize what exactly you needed to do. Can you talk about where you are in that process and when you should really start to see the benefits from these things?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Yeah. A really rich funnel. And I'm really proud of the way the teams drove the brainstorming, the ideation around what we could do and should do. And ultimately the opportunity is significant and I want to make sure we reset those targets against those new gross margin levels that you mentioned because we have gone slightly backwards here which means we have more that we have to go get.

And then we also have to look at it pre-inflation, currently in the inflation environment and post-inflation to make sure that these are really contributing to the end state of Pentair. So, really pleased with the progress and the team. And as I mentioned we expect it to start contributing in 2022.

Nathan Jones

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Great. Thanks for taking my questions.

Operator: Your next question is from Ryan Connors with Boeing and Scatter [Boenning & Scattergood]

Ryan Michael Connors

Analyst, Boenning & Scattergood, Inc.

Q

Boenning & Scattergood is the name of our firm. Thank you. So, yeah, I don't want to jump across the valley prematurely here but obviously, we've seen what a difference a year can make so kind of a big picture structural question around price costs. You've gotten a lot of price to pass all this stuff through. So, let's just say, hypothetically, the Fed does tap the brakes early next year, inflation pretty quickly comes down, some of your raws go down and your freight goes down, how should we think about price in that scenario? Do you keep a lot of that price in that scenario and realize the margin upside at least for a while and how long could that be? Or do you think that the competitive dynamics in that kind of a scenario would dictate that the price is given back pretty quickly? And I know the answer might differ by business, but just interested in your perspective on it from that kind of point of view.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Yeah. I mean the way I look at it is if you think of that decision tree, you take that scenario or do you take the scenario where the inflation continues to go forward. I'm going to choose the one where inflation continues to grow because if that happens and we're out in front because we've been trying to catch up on price all year long, but if we can get out in front of it, then the worst case scenario is that we start to turn back pricing through our channel to basically reflect the lower inflation rate that we have. That's an easier mitigation strategy than trying to get new price in an area where people are anticipating the inflationary pressures to subside.

So, I think that's the scenario planning that we're going through which is why we're not ready to share 2022 with you yet. But I'm going to lean towards that we think inflation and supply chain challenges continue and the worst case scenario is we dial back from there.

Ryan Michael Connors

Analyst, Boenning & Scattergood, Inc.

Q

Okay. But in terms of different businesses I mean which would be the ones where based on the competitive dynamics you think you could hold price and which are the ones where you think it would be a little more competitive and – that give back would be quicker?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Well, I mean, we've always said that we've got three general business models at Pentair. And our manufacturing build the stock, make the stock that goes to dealer distributors are the most responsive to inflationary pressures and price increases normally. This year is a little unique in the sense that we've had these large backlogs and it's hard – we're not going to go back and reprice backlog, right? So, there's a little timing delay related to that backlog.

The other business model we have is project-based and you've got to predict where your price increases need to be to reflect the inflationary pressures that are out there six to nine months in advance. And that's always the hardest to get right and especially in these environments.

And then the third one would be more OEM or larger customer base business models where again you're in a process of negotiation and before those price increases go in you've got to get both sides to agree on what that partnership looks like. And so those are the three basic premises. And so, obviously that makes the stock a little easier in most normal times. But project, you have to be more careful and the OEM is just a negotiation of ensuring that everybody got the best productivity in the cycle.

Ryan Michael Connors

Analyst, Boenning & Scattergood, Inc.

Q

Got it. No, that's really helpful perspective. Thanks for your time.

Operator: Your next question is from Rob Wertheimer with Melius Research.

Rob Wertheimer

Analyst, Melius Research LLC

Q

Hi. Good morning, everybody. Thanks for the informative responses and I'm sorry for one more on price cost but it's obviously a hot topic and I'm just curious on a couple of things. Is the volatility and variability in the supply chain getting more predictable? I mean can you get your hands around what the endpoints might be on where it is or is it still kind of unpredictable into next year?

Have you changed the way you price? You just mentioned not repricing the backlog which I understand. If you change the way you – the cadence or anything else about the way you do pricing for a more inflationary environment?

Robert P. Fishman

Executive Vice President, Chief Financial Officer & Chief Accounting Officer, Pentair plc

A

The headlights into the business on material challenges and inflation could continue to really be a challenge. I would say getting the material in that we need to drive the demand that we're seeing is as much a challenge in Q4 as it was in Q3. Inflation continues to trend higher and maybe a little bit more visibility on that but not a whole lot better in Q4 than Q3.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Yeah. I think this has taken our entire skill set which is one of the reasons I want outside help on this. When you think you got the raw material side right, which I think we've got closer to more accurate throughout the year, the

surprises have been more on the freight and logistics cost of the availability. And oil is continuing to be volatile right now and then there's actual cost to the routes. And so that's been a little trickier to get right.

And then on – I think when you get into these ranges it's retraining everybody that these are the appropriate coverage ranges because these are not ranges in price increases that we have historically sought. So it's been a journey and a lot of learnings and I think we're getting better at it. And I'm really proud of the way the teams are leaning in.

Rob Wertheimer

Analyst, Melius Research LLC

Q

Okay. That's helpful. Thank you. And then just for clarification, when you're looking at sell-through and the dealers are taking orders in the 3Q, et cetera and one assumes volume is up next year then, right? I guess maybe that's partly ability, what you can deliver, and then price ought to be up, what? mid high-singles? Sorry if that's going too far and I'll stop there.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

It is going a little too far. I mean I think it's – we're not ready yet to commit to anything next year other than we do believe that demand is relatively strong. We do believe that inflation is going to continue and we do believe we got to put price increases out there to cover inflation, and not just the raw materials I mentioned but covering the freight, covering the raw material and also covering anticipated wage inflation as well. So, that's the work we're going through right now and we want to get as close to accurate as possible.

Rob Wertheimer

Analyst, Melius Research LLC

Q

Thank you.

Operator: Your next question is from Julian Mitchell with Barclays.

Trish Gorman

Analyst, Barclays Capital, Inc.

Q

Hey. Good morning, guys. This is Trish Gorman on for Julian. So a lot of questions around price costs, maybe looking at the other side to some productivity I know you guys have made some investments here and you've got the transformation savings coming, and it's stepped up nicely in Q3. So just wondering how we should think about this kind of moving forward? Is this Q3 rate sustainable or does it step-up further from here?

Robert P. Fishman

Executive Vice President, Chief Financial Officer & Chief Accounting Officer, Pentair plc

A

Yeah. As John mentioned, a lot of the productivity improvements that we've seen in Q3 and we'll see in Q4 are related to the operating leverage. As 2022 plays out, it's really seeing some of the benefits around the pricing, the sourcing, the manufacturing and distribution efficiencies and the organization as John described it. So those would continue to be the levers as we move into 2022.

Trish Gorman

Analyst, Barclays Capital, Inc.

Q

Okay. Great. And then just at the Investor Day, you guys had talked about some higher investment spending to support these strategic growth initiatives. I'm just wondering if you can give us an update on kind of how that spending has trended to-date and what we should expect for that in 2022?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Yeah. As I've said we'll continue to invest in these throughout 2021. And as we lean into 2022 I think it's fair to assume that as I mentioned in the organizational enablement side that we would expect that some of the traditional ways that we did things would be the funding mechanism for the new ways that we need to do things. So, I don't see it stepping up significantly from here and I think we have to find a way to self-fund it as we look into next year and into 2023.

Trish Gorman

Analyst, Barclays Capital, Inc.

Q

Great. That's very helpful. Thanks, guys.

John L. Stauch

President, Chief Executive Officer & Director, Pentair Plc

A

Thank you.

Operator: Your next question is from Deane Dray with RBC Capital Markets.

Tyler Voigt

Analyst, RBC Capital Markets LLC

Q

Hi. This is Tyler Voigt on for Deane Dray. Could you guys just give us a quick update on some of the new IoT product launches and how those have gone and more specifically the app launch in Pool?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Yeah. Okay. So we're excited. I think, first of all, we've got 12 connected solutions out there on the market today, and we're starting to see the ramping up of the downloads of our applications and use of those products. They cross all of our residential streams from – also including R&I flow, our small pump lines and as well as our Water Treatment and our Pool applications.

So I think one of the bright spots I've seen this year is that we continue to see the automation penetration in Pool in addition to the upgrades that we saw across the pad, flow from new pool builds and in the aftermarket side. Sometimes in the busy seasons you don't see people also upgrading to those solutions and so that was very positive. And we're starting to make progress on our IoT-related salt valves for Water Treatment and also our pressure treatment in our small pumps.

So, really good progress and I think we're getting good feedback on that capability into usage from our channel and we're excited about the momentum we're really building. And not to mention that we've also got the BrewAssist on the large F&B side within IFT. We're making great momentum as well as building out a services model for our partners regarding the filtration of beer.

Tyler Voigt

Analyst, RBC Capital Markets LLC

Q

Very cool. And then just getting back to the supply chain, I know you've mentioned resins and motors have been kind of in short supply in the past. Is there more that's been added to that list or where does that stand?

Robert P. Fishman

Executive Vice President, Chief Financial Officer & Chief Accounting Officer, Pentair plc

A

Yeah. We would say that we would have freight in some of the challenges that we mentioned adding to the inflation headwind. But you're right that the resins, the electronics, those type of products continue to be higher inflation.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Yeah. Those chips are what we're all seeking, right, as products become smarter. And you mentioned it with the IoT initiative. So we're not the only company putting in IoT-enabled initiatives. Everybody needs chips that, in our case, goes into drives or electronics, which then go into – it becomes subcomponents into the assemblies that we're trying to produce. So that's where the catch-up in the supply chain really is.

Tyler Voigt

Analyst, RBC Capital Markets LLC

Q

Great. Thank you.

John L. Stauch

President, Chief Executive Officer & Director, Pentair Plc

A

Thank you.

Operator: Your next question is from Josh Pokrzywinski with Morgan Stanley.

Joshua C. Pokrzywinski

Analyst, Morgan Stanley & Co. LLC

Q

Hey. Good morning, guys.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Good morning.

Joshua C. Pokrzywinski

Analyst, Morgan Stanley & Co. LLC

Q

John, you mentioned something in the opening remarks about dealers being booked through 3Q of next year, so just wondering if you can unpack that a little bit more? I mean I guess for a mostly replacement-oriented business that's an awful lot of lead time. Like is that just on new pool construction or something maybe a bit more discretionary? Like what should we actually like read into that?

Robert P. Fishman

Executive Vice President, Chief Financial Officer & Chief Accounting Officer, Pentair plc

A

Those were – yeah, and those were in my prepared remarks so I will take the lead on this particular question. The dealers booked into Q3 of next year includes both the new and remodeled pool, so seeing strong demand in those two areas.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

I mean Josh similar to the construction industry, the constraint is really labor and/or material availability for the larger builds or remodels, right? So that is a longer lead time item than even our equipment. So those demands on the channel are out there. The channel is trying to meet the demands and we're trying to then meet the equipment demands over those remodels and the new pool builds.

Joshua C. Pokrzywinski

Analyst, Morgan Stanley & Co. LLC

Q

Got it. And would you still say kind of the majority of the strength you're seeing today is on kind of sweeping the pool pad and like the broader upgrade versus the kind of one-for-one replacement? Like how would you characterize – even growth in the quarter if you wanted to break that down if that's the level of detail you guys have?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Yeah. I think it's a good way to look at it, Josh. I mean I think traditionally we would look at the new pool builds as getting an opportunity to expand – do the whole pad and that's why we enjoy that newbuild. The remodels, we have that same opportunity, right, to talk to the consumers and share with them the possibilities and upgrade that pool pad. And then we always had the break-and-fix. And you don't get this type of growth from just break-and-fix. So the predominance of the incremental demand over what we've historically seen, call it, mid- to high-single digits is likely penetration into the aftermarket pool pads or into the new pool pads from a – adding out to the pad.

Joshua C. Pokrzywinski

Analyst, Morgan Stanley & Co. LLC

Q

Got it. That's helpful. Yeah. If it's break-and-fix, Bob, it's out there too much with the wrenches being on pool pumps in Florida. Appreciate this. It's a good color. Thanks, guys.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Thank you.

Operator: Your next question is from Patrick Baumann with JPMorgan.

Patrick Baumann

Analyst, JPMorgan Securities LLC

Q

Oh, hi. Good morning, everyone. Thanks for taking my questions. Just had a – I think – so price in Consumer was up high single-digit in the quarter. I think people have asked this every which way but I just want to ask one more time like can that accelerate next year given kind of what you're seeing as things exit the year and does it need to accelerate to offset kind of what you're seeing in cost inflation?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Yeah. I think the way to think about it is when you look at it year-over-year, you have to add would it also increase the previous year. And so when we think about adding to the price increases next year I mean it's important to realize how inflation is compounded from 2020 and 2021 and then how much more will be added as we go into 2022.

So obviously when you look at it year-over-year, it's a piece. But when you go back and look at the start of this which for us was Q2 of 2020, we've seen the significant demand and that demand is turned into supply pressures. And then we've seen the corresponding inflation across the freight and all the other components here.

So I mean I'm not going to give an exact answer because I know you – everybody has asked me in every single way but we got to price appropriately to cover the anticipated inflation that we see coming to us in 2022. We don't yet have that number and when we do, we'll share it, but we're going to price appropriately.

Patrick Baumann

Analyst, JPMorgan Securities LLC

Q

Okay. And can you talk about maybe the competitive landscape in pumps around the variable speed transition? We've seen Hayward pitching this mid-range product of compliant pumps that's like lower-priced than their variable speed but it's compliant with the new regs and you're hoping to gain some share with it. Just curious if you have any thoughts on that and if you're hearing any customer interest on that type of product and what your response could be if there was?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Yeah. There are some small markets or some small regions I should say where a non-variable speed, and we still have a non-variable speed line is appropriate to meet the standards around certain horsepower levels and certain output. So you're always going to see a couple of substitutes in this couple of small regions. But the truth is most of the energy-efficiency standards are driving to a higher level of efficiency. And we all got to advance our products as we try to keep up with sustainability goals and less electricity usage. So that's where really where the future is and currently there's a few small markets or small regions where a substitute could be appropriate.

Patrick Baumann

Analyst, JPMorgan Securities LLC

Q

Got it. Okay. Thank you. And then last one really quick if I could fit one more in, could you size for us kind of the percentage of your business that is like I guess infrastructure-related where you might see some benefit from stimulus if it moves forward?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Yeah. I'd say less than a couple hundred million is what I would say, our exposure is, where we might see some benefit from some stimulus. So not a large number for Pentair.

Patrick Baumann

Analyst, JPMorgan Securities LLC

Q

Is that like the muni pump business or is there something beyond that?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

Yes. It's the muni pump business and then possibly the pumps that connect the muni to the subdivisions.

A

Patrick Baumann

Analyst, JPMorgan Securities LLC

Got it. Okay. Helpful color. Really appreciate the time. Thanks, guys. Good luck.

Q

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

Thank you.

A

Operator: There are no additional questions at this time. I would like to turn it back over to John for closing remarks.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

Thank you everybody for joining us today. We have delivered on commitments in 2021, whether measured by sales, income, EPS or cash flow. And the good news is we believe there's still more to come for Pentair.

Since becoming a pure-play, sustainability-focused company in 2018, we have been building a track record of consistent growth while also driving our commitment to creating longer-term shareholder value. We have focused our portfolio and aligned around attractive secular trends and we believe our strategic growth initiatives should contribute to us growing at rates even faster than the markets we serve. Our focus on transformation should help us not only unlock additional value but also fund these growth initiatives. Our balance sheet provides us a lot of flexibility and our 19% ROIC demonstrates our focus on being disciplined with our capital.

Stephanie, you can conclude the call. Thank you.

Operator: Thank you. This concludes today's conference call. You may now disconnect.

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