

20-Oct-2020

Pentair plc (PNR)

Q3 2020 Earnings Call

CORPORATE PARTICIPANTS

Jim C. Lucas
*Treasurer & Senior Vice President-Investor Relations,
Pentair plc*

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

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

OTHER PARTICIPANTS

Brian Lee
Analyst, Goldman Sachs & Co. LLC

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Brett Logan Linzey
Analyst, Vertical Research Partners LLC

Joseph Giordano
Analyst, Cowen & Co. LLC

Rob Wertheimer
Analyst, Melius Research LLC

Deane Dray
Analyst, RBC Capital Markets LLC

Trish Gorman
Analyst, Barclays Capital, Inc.

Eitan Buchbinder
Analyst, Citi

Jeffrey D. Hammond
Analyst, KeyBanc Capital Markets, Inc.

Scott Graham
Analyst, Rosenblatt Securities, Inc.

Nathan Hardie Jones
Analyst, Stifel, Nicolaus & Co., Inc.

Emily Shu
Analyst, BofA Securities, Inc.

Saree Boroditsky
Analyst, Jefferies LLC

MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by. And welcome to the Q3 2020 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, Mr. Jim Lucas, Senior Vice President, Treasurer, and Investor Relations. Thank you. Please go ahead.

Jim C. Lucas

Treasurer & Senior Vice President-Investor Relations, Pentair Plc

Thanks, Mariama. And welcome to Pentair's third quarter 2020 earnings conference call. We're glad you could join us today. With me today is John, 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 2020 performance, as well as our full year 2020 outlook as outlined in this morning's press release.

Before we begin, let me remind you that any statements made about the company's anticipated financial results are forward-looking statements subject to future risks and uncertainties, such as the risks outlined in Pentair's most recent Form 10-Q, Form 10-K, and today's press release. Forward-looking statements included herein are made as of today and the company undertakes no obligation to update publicly such statements to reflect subsequent events or circumstances. Actual results could differ materially from anticipated results.

Today's webcast will be accompanied by a presentation which could be found in the Investor Relations section of Pentair's website. We will reference these slides throughout our prepared remarks. Any references to non-GAAP financials are reconciled in the appendix of the presentation. We will be sure to reserve time for questions and answers after our prepared remarks. I would like to request that you please 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. First and foremost, we hope that everyone is and remains healthy and safe. I'd like to start by expressing my sincere gratitude to all of our frontline employees for their continued commitment to our customers and shareholders. Our performance could not have happened without these teams and their dedication to the Pentair Win Right values and our customers.

While the world we live in continues to face much uncertainty, we were pleased to deliver strong third quarter results with double digit gains in sales and EPS while also delivering robust free cash flow. We'll discuss the details of the quarter shortly. But we believe our mix of residential focused businesses has helped differentiate our results in these uncertain times.

Despite the ongoing challenges and uncertainties that persist, we have continued to invest in our top growth priorities and digital transformation. We have successfully soft launched both the Pentair home and Pentair dealer

apps, and we expect 2021 to be a great year for a number of new connected products across many of our businesses. While our businesses are seasonally stronger during the second and third quarters, we're expecting a strong finish to 2020. I am proud of all of our businesses' commitment to strong execution in a continued challenging environment.

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'll 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 5 labeled Q3 2020 Pentair Performance. During the third quarter, we delivered sales growth of 12% and core sales growth of 10%. On a core basis, Consumer Solutions was up 23% while Industrial & Flow Technologies declined 4%. I will discuss the details for each segment on the subsequent slides.

Segment income grew 14%, while adjusted EPS increased 21%. Our tax rate of 13% was a true-up as we now expect our annual tax rate to be 15%. Price was minimal in the quarter as the elevated volumes we experienced in the quarter primarily in pool resulted in a higher than usual level of rebates with our channel partners. Likewise, our productivity was offset by additional expenses incurred, such as increased hiring to help keep up with demand and higher overall incentive compensation on a year-over-year basis.

Please turn to slide 6 labeled Q3 2020 Consumer Solutions performance. As a reminder, nearly 80% of Consumer Solutions service residential market. Many of our products have been in higher demand this year, given consumers staying at home. For the quarter, sales grew 25%, segment income increased 39%, and return on sales expanded 250 basis points to 24.2%. Pool was clearly a strong performer this quarter with a 46% increase in sales. This follows a flat performance in the second quarter, which is worth discussing for a moment.

In a normal year, the pool season starts in March or April. In 2019, we saw late start to the season due to cool wet weather in several key markets. This year, we saw a pause in business the first part of April as the industry tried to understand the impact of lockdowns in the US. By May, orders started to return. As June drew near, the industry was experiencing unprecedented demand as consumers sheltering at home were investing in their existing pools, upgrading their pools or seeking a new pool to be built. In fact, dealers across the country began to experience a backlog of activity that resulted in many quotes for new pools being delayed as dealers were struggling to keep up with demand.

As those events transpired, we experienced some delays in our supply chain and our own manufacturing plants in April as we adapted to a new normal that included social distancing within the plants. This had a negative impact on productivity and affected our usual ability to deliver quickly, which resulted in a higher-than-usual disparity between our sell-in rates and the industry sell-through rates.

As the third quarter began, we had our manufacturing ramped up and our supply chains in line, and we worked diligently to meet strong industry-wide demand. While the pool season officially ends in September, orders have remained healthy albeit not at third quarter levels.

Not only did pool see consistent linearity throughout the third quarter from a sales standpoint, but we saw strong demand across all product categories. Some products such as heaters have experienced above average demand as consumers are looking to open their pools earlier and closing later given we are all still at home for the foreseeable future. Despite the higher-than-usual demand and a delayed start to the season, we've continued to

invest appropriately in the business and have made good progress in furthering our automation offerings as well as expanding our overall product portfolio.

There has been focus around an upcoming DOE regulation that will see further adoption of variable speed pumps. We've been working closely with our channel partners on educating them on the upcoming regulation. We continue to optimize our variable speed pumps to exceed DOE requirements in addition to introducing new select models of single-speed pumps for categories that will still be able to use single-speed pumps in limited applications.

While the pool season has been far from normal for the second year in a row, we still believe in the long-term growth prospects for this attractive space. Further, we believe that the first half of next year should benefit from still solid demand in addition to an easier comparison. We will continue to build on our position as a leader in the pool industry and we expect 2021 to be a strong year for new product introductions for Pentair.

Water Treatment, which was formerly called Water Solutions, is more appropriately named given the breadth of our offering and the markets we serve within Consumer Solutions. Water treatment, as a reminder is comprised of components and systems for the residential and commercial markets. While Water Treatment overall was up 2%, it has two very different stories to tell.

To level set, Water Treatment revenue is derived from roughly 60% residential and 40% commercial market. Within the residential-facing businesses, we experienced near double-digit growth as consumers became more comfortable allowing dealers back into their homes to test their water and install new systems. We have seen an increase in demand for our brand as consumers continue to focus on the water quality in their homes.

On the commercial side, sales were down in the mid-teens, which is a dramatic improvement from the declines experienced in the second quarter. While restaurants are experiencing a slow recovery and traffic levels remain depressed, our portfolio and focus on the quick service restaurant market provided some relief to the depressed overall market.

We have had some success with new offerings like Total Water Management, which is a new seamless end-to-end service where we specify and install high-quality solutions and provide ongoing service to ensure consistent great quality water. While in the early days of offering this new service, we are seeing strong interest from new and existing customers.

We expect the food service sector to remain challenged for the near-term, but we are encouraged that we are not declining at the same rate as the industry and are identifying the new areas of growth despite the challenging environment currently.

Please turn to slide 7 labeled Q3 2020 Industrial & Flow Technologies performance. Industrial & Flow Technologies or IFT saw sales decline 3% as residential and irrigation flow grew in the quarter while the other two businesses continued to be negatively impacted by a global freeze in capital spending. Segment income decreased 24% and return on sales declined 360 basis points to 13%. Productivity was challenged in the quarter, principally as a function of a mix with lower margin backlog in addition to lower revenue spread across a higher fixed cost base.

Residential and Irrigation Flow grew 6% in the quarter following a 12% decline last quarter. While distributors are still not stocking across the board, demand for some of the higher moving items continue throughout the quarter.

The business experienced gains across all channels, particularly in the pro channel and at retail. Within agriculture, our OEM sales were flat while aftermarket returned to growth.

Commercial and Infrastructure Flow improved on a sequential basis as we continue to ship our lower margin infrastructure backlog. This mix negatively impacted the overall segment margin performance, particularly the drag on productivity. Orders in both commercial and infrastructure were down in the quarter but the quote funnel in infrastructure remains active.

Industrial Filtration continued to be negatively impacted by global capital spending freeze. But the business saw the rate of decline improve sequentially. In the larger Food and Beverage and Sustainable Gas businesses, we have experienced softness in both components and longer cycle projects. The other niches within Industrial Filtration have also experienced softness. Given this business overall is more exposed to capital spending, we would expect the order activity to resume in early 2021 as customers revisit their capital budgets.

Please turn to slide 8 labeled balance sheet and cash flow. While our sales and income performance were encouraging in this quarter, we were exceptionally pleased with our cash flow performance. For the first nine months of the year, we have generated over \$450 million of free cash flow. The third quarter benefited from strong pool sales spread evenly throughout the quarter and our ability to collect on those receivables.

We talked last quarter about the seasonality of our cash flow, with the second quarter historically being the strongest period. With a later start to the pool season and the shift of business to the third quarter, this contributed to higher than usual cash flow in the quarter.

We entered the quarter with a net debt adjusted EBITDA ratio of 1.3 times, which is at the lower range of where we have talked about our target levels longer term. Between our \$900 million revolver and no meaningful cash outlays outside of the dividend, we have more than adequate capacity to fund our growth initiatives both organic and inorganic. We are trying to remain disciplined with our capital, and we feel good about the strength of our balance sheet and expect to deliver free cash flow for the year greater than our net income.

Please turn to slide 9 labeled full year 2020 Pentair outlook. Following our strong third quarter performance, we have updated our full year sales outlook of approximately \$2.95 billion, and our adjusted EPS range is now approximately \$2.35 to \$2.40. Below the line, we expect corporate expense to be \$60 million to \$65 million. Net interest/other of approximately \$28 million, a full year tax rate of 15%, and average shares to be around \$167 million. We expect free cash flow to be greater than 100% of net income.

I'd now like to turn the call back to John to provide an update on some of our key strategies.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

Thank you, Bob. Please turn to slide 10, labeled our longer term aspirations. Our first two years are focused on developing our new standalone strategy, aligning our organization to our strategy, improving our new product pipeline and growth capabilities, and developing the right operating rhythm.

Growing the top line organically, consistently and predictably is our main area of focus. And this starts with growing the entire portfolio at least greater than GDP and delivering income from our core business. We've realized that not all businesses will contribute evenly, but we believe that our Consumer Solutions businesses are well positioned to drive above average growth and are important to building out additional legs of the business and creating our future.

In addition, we continue to focus on improving our commercialization process, investing in our digital transformation to deliver more effortless customer experiences, and building our brand. We are focused on accelerating fewer, larger growth actions including expanding our content in Pool and building out our residential Water Treatment offerings. Within IFT, we are exploring a few promising growth areas around Sustainable Gas and smart solutions with our Food and Beverage business unit.

In addition to growing organically, we believe that there are attractive areas to add tuck-in and bolt-on acquisitions. We expect this will primarily be within our residential commercial Water Treatment business and includes both products and services. The addition of Pelican and RainSoft to our portfolio have allowed us to both accelerate our learning and improve our growth performance. We are currently focused on building a robust opportunity funnel given many of the businesses we are looking at are smaller and privately owned.

We are also focused on driving productivity and cash flow while optimizing our ROIC. PIMS, the Pentair Integrated Management System is an extensive tool kit that we must continue to deploy effectively. This includes not just our existing businesses and employees but also future acquisitions and hires. We must ensure that PIMS is truly ingrained in our DNA.

We do not have a capital intensive business, and we believe this asset-light business model will help us further optimize our longer term investments. We also believe there are further opportunities in our G&A spend that can become sources of self-funding for our growth investments. Our aspiration to become a top quartile performer in our space is well within our control, and we believe we are well-positioned across our portfolio.

Please turn to slide 11 labeled Living Our Win Right Values Through ESG. One of the foundations of our culture is our longstanding commitment to our Win Right values. These values help guide our organization as we work to achieve our highest potential. We're dedicated to holding ourselves accountable to the highest ethical standards as we drive to deliver on our commitments. Our purpose and our mission help to empower employees to make a difference within and beyond the workplace.

As you've experienced in our recent 2019 Corporate Responsibility Report, sustainability is not an initiative but is core to how we operate, the products we create, and the customers we serve. Our goal is to demonstrate leadership as a responsible corporate citizen in every country and community where we conduct business and wherever our products are put into use. As we highlighted last quarter, over 60% of our solutions support water efficiency and roughly 75% of our solutions support energy efficiency. Our sustainable gas offerings are supporting CO2 reductions and reuse across the industry.

At Pentair, we are committed to building and advancing unity, equity, and inclusion in our company and in our communities. We have amplified our focus on diversity and leadership roles and bench strength. We are committed to safety and a healthy workplace. We are focused on philanthropy and we walk the talk as our efforts spanned 6 continents and reached more than 9.5 million people in 2019.

We have strong governance practices. We have a diverse board of directors, which includes three female directors. The majority of our board is independent and our board is led by an independent non-executive chairman. We also have an anonymous employee helpline to report compliance or other concerns with dedicated compliance and audit functions. We also have a code of conduct in place for employees and our suppliers to help align around responsible, sustainable business practices.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] We'll pause for a brief moment to compile the Q&A roster. Your first question comes from Andrew Kaplowitz with Citi. Your line is open.

Eitan Buchbinder
Analyst, Citi

Q

Hi. This is Eitan on for Andy.

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

A

Hey, good morning.

Q

With 46% growth in pool, could you give us more of a breakdown of what you're seeing? Did you see an uptick from the normal 20% original equipment business? And can you discuss any progress in capturing further share on the pool pad?

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

A

We were very pleased as we mentioned in the prepared remarks. Coming into the quarter, demand was high but making sure that we were able to fill that demand was extremely important. And we were able to ramp up manufacturing production significantly.

So again, pleased with the execution and very pleased with all of the work of our frontline workers. The 46% was really, as I mentioned, across the board, across all product categories. Demand remains strong going into the fourth quarter and we're optimistic heading into 2021 as well.

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

A

I would say that I think a good way to look at that would be to spread it over Q2 and Q3 because as we mentioned in Bob's remarks and talked openly in the last earnings call, we were catching up and we still are catching up to what the demand is in the industry.

As far as expansion in the pad, I mean Bob mentioned heaters. Heaters is a category that has substantially grown this year. That would be another product that we've probably added as far as the content on the pool. And we're very pleased with our automation pull through over the last couple of quarters as well. And we think we're getting an uptick in our automation sales as more homeowners enjoy the ability to manage their pool more remotely or utilize it as a control device through their iPhone. So, pleased with those two upticks. And as I mentioned, we ended the quarter even catching up as well.

Eitan Buchbinder
Analyst, Citi

Q

Thank you. And just as a follow-up. So, margin in IFT pulled back sequentially despite higher volumes you've been in the second quarter. Can you talk about some of the factors that impacted margin and what you see as the outlook for margin while rightsizing the segment going forward?

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

A

Yeah. From an overall margin perspective and I also mentioned this somewhat in the prepared remarks is that we did have a catch-up of items like compensation-related expenses in the quarter. Rebates were higher than typical as the pool revenue grew significantly. Again, ramping-up production, expediting inventory to make sure we kept up with the demand. But those were some of the headwinds that we saw in the quarter. I would say that Q4 from a drop through perspective does return to more normalized levels.

Eitan Buchbinder
Analyst, Citi

Q

Thank you. That's helpful. I'll pass it along.

Operator: Your next question comes from Steve Tusa with JPMorgan. Your line is open.

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

A

Steve?

Operator: Steve Tusa, your line is open.

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

A

Steve? You're on mute.

Operator Your next...

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

A

Steve?

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

Brian Lee
Analyst, Goldman Sachs & Co. LLC

Q

Hey, guys. Good morning. Thanks for taking the questions. Maybe as a follow up to the to the prior one a little bit if you guys could. Can you quantify a bit on some of the trends here heading into Q4? I know you got a point of pricing in Q2 but then nothing in Q3. And then productivity did swing from being kind of a good guy to a slight bad

guy as well in the quarter. Can you kind of talk about trends on those metrics in the context of Q4 expectations? And then I guess separately any early read on those two heading into 2021?

Robert P. Fishman

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

A

Yeah. I would say that from a pricing and productivity perspective, a lot of the benefits in those two areas were somewhat masked. Pricing by the rebates and then productivity by some of the compensation related costs and some of the expedited and ramp up costs relating to Pool. So below that, it was very much in line with kind of what we saw in Q2. And as I mentioned, price and productivity do return to more normalized levels in the fourth quarter.

Brian Lee

Analyst, Goldman Sachs & Co. LLC

Q

Okay. Fair enough. So, maybe not to put words in your mouth but a positive point on each if we're thinking about putting that into quantified terms for Q4 and heading into 2021.

Robert P. Fishman

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

A

That would make sense at this point.

Brian Lee

Analyst, Goldman Sachs & Co. LLC

Q

Okay. Fair enough. And then just a second question on the – the guidance here would imply a low single digit revenue decline implied in 4Q year-over-year. Can you give us a sense of how that breaks down between Consumer Solutions and IFT? And then also I know you guys just put up a very big 3Q. So was there some pull forward activity? Or just trying to get a sense for the sequential here into 4Q. Thanks, guys.

Robert P. Fishman

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

A

Okay. Yeah. I view last year's Q4 as having been a solid quarter. This year's Q4, Pool will continue to grow significantly. Demand is good. We satisfy the natural demand here in the fourth quarter. So Pool continues to do well. The residential businesses continue to grow. So outside of pool and the residential piece within IFT, we continue to face headwinds on volume within commercial and industrial.

And so that is what's bringing the overall growth rate down. We're hard at work in terms of addressing productivity challenges within the IFT business. And so as I mentioned again in my prepared remarks, we expect the demand to continue for Pool in the early part of the year. And we expect that IFT productivity will improve as well.

Brian Lee

Analyst, Goldman Sachs & Co. LLC

Q

All right. Thanks. I'll pass it on.

Operator: Your next question comes from Steve Tusa with JPMorgan. Your line is open.

C. Stephen Tusa

Analyst, JPMorgan Securities LLC

Q

Hey. Good morning, guys.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Hey, Steve. How are you doing?

Robert P. Fishman

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

A

Hi, Steve.

C. Stephen Tusa

Analyst, JPMorgan Securities LLC

Q

Sorry for missing the bell.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

No worries.

C. Stephen Tusa

Analyst, JPMorgan Securities LLC

Q

A little bit late this morning, I guess. Just getting out of bed here. So, just as we – I'm not going to ask you to make a call on the weather or COVID next year. But when you guys kind of look out to what's coming your way, in particular, on kind of the regulatory driver, when we turn the corner the next year, is this just like a really hard comp or is there something that kind of bridges you into future years and can kind of keep this growth rate at a reasonable level obviously for Pool? Not saying that 20% is sustainable, but maybe just curious as to how you kind of gauge next year.

Robert P. Fishman

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

A

Okay. This is Bob. Let me take a shot at it. And then I'll John add to it. He's probably better at predicting the weather than I am. But we mentioned that Q1, Q2, Steve, faces easier comparisons obviously within the Pool business. Demand is strong in the fourth quarter and we expect it will remain strong in the – as we go into 2021. So, feeling good about that.

As we face the tougher comparison, the back half next year, primarily in Q3, we should have a number of things going our way. We will have a number of new product introductions. We'll have the DOE regulation. We'll have an IFT business that's facing softer compares, and hopefully an improved capital spending outlook.

So, those are the things that, that could help us in the back half. But in terms of the first half of the year, again, much of it is Pool and residential-driven.

C. Stephen Tusa

Analyst, JPMorgan Securities LLC

Q

Got it.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Yeah. I think – Steve, I mean without guessing the weather and COVID, we're expecting Pool to have a very strong year next year as well based upon the dealer activity in the pools and the pent-up capacity. I don't know what it looks like by quarter yet. I think Bob is giving you a pretty good look that Q1 and Q2 will probably be easier compares, and Q3 obviously with this type of growth maybe slightly more challenged.

But at the same time, we'll probably have the same desires of the dealers in the channel to ensure the rebate is matched. And I think we're expecting a good year. And what we're doing now is how do we get the IFT margins rolling, how do we get the year-over-year contributions of IFT to produce a lot of value next year. That's how we're thinking about 2021, Steve. And we're excited about the way we expect to end.

C. Stephen Tusa

Analyst, JPMorgan Securities LLC

Q

And then, just on the earnings bridge, productivity was a little weak this quarter. Is there anything in kind of price and productivity in the fourth quarter that would influence the result there? Or is it really just kind of a function of the volumes?

Robert P. Fishman

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

A

It really is volume related. As was mentioned, our guide suggests down low-single digits in the fourth quarter, a strong Pool offset by continued challenge in commercial and industrial. But price and productivity will return to more normalized levels because they are facing the Q3 headwinds that we saw around rebates and catch-up compensation.

C. Stephen Tusa

Analyst, JPMorgan Securities LLC

Q

What I don't quite understand about the fourth quarter is that IFT wasn't that bad this quarter. I mean is there something that makes it worse next quarter year-over-year?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

I think we're starting to see the – we had the backlogs in – be carried in from Q2 into Q3, Steve, that we were able to ship through that backlog that we have. And now, we're trying to build the backlog. But most of the orders that we've taken in in Q3 are really shippable next year.

So, we're not seeing our customers step up and want most of their products to an IFT in Q4. And I think they're looking out in the horizon and trying to work more of their deliveries into next year. So, we'll weather the storm in Q4 with IFT, but I do think we're starting to build the order rates and coming off the bottom as we look at IFT going forward.

C. Stephen Tusa

Analyst, JPMorgan Securities LLC

Q

Right. So, a shift from kind of a weak 2Q into 3Q and then I guess a step back down it still seems like with the economy where it is to go from positive 10 to negative 5 or negative 4 even as – seems like a real kind of step back. I mean, it doesn't seem like the trends in the business support that step back.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Yeah. I hear you, Steve. I also just – I know we're unusual compared to the most of the industrial companies but Q4 is not a highly...

C. Stephen Tusa

Analyst, JPMorgan Securities LLC

Q

Yeah. That's right.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

...strong quarter for Pentair. What mitigates that a little bit is the pool early buy and the shipments of pool into the channel. Other than that, we tend to have a slightly weaker industrial end.

C. Stephen Tusa

Analyst, JPMorgan Securities LLC

Q

Yeah. Makes sense. All right. Thanks.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Hey, Steve, I know you've always been focused on cash. I did want to mention that I always felt that linearity of operations would drive great cash flow and I just want to make a note that that came through this quarter.

C. Stephen Tusa

Analyst, JPMorgan Securities LLC

Q

Got it. Got it. Sorry. Sorry. I meant to say great quarter guys. Great quarter on cash. I meant to say that earlier.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Thanks.

C. Stephen Tusa

Analyst, JPMorgan Securities LLC

Q

Thanks.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Cash matters.

Operator: Your next question comes from Brett Linzey with Vertical. Your line is open.

Brett Logan Linzey

Analyst, Vertical Research Partners LLC

Q

Hey. Good morning, guys. Congrats on the quarter.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Thank you.

Robert P. Fishman

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

A

Thank you.

Brett Logan Linzey

Analyst, Vertical Research Partners LLC

Q

Hey. Appreciate the color on the top line for next year but just want to focus on the cost side. You talked about some catch up here on incentive comp in the quarter. How does that roll into next year? And then as you think about the temporary costs that come back, some of the restructuring savings you're going to have that do roll over, what's sort of the netting effect of those next year, and what's that in form for incremental margins for the total company?

Robert P. Fishman

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

A

At this time, we continue to be hard at work driving those productivity improvements. I mean, the fact that we're booking compensation this year means there won't be a headwind next year, which to me is a good thing. I had talked earlier about opportunities within G&A. We had a benchmarking study done. And it's apparent that our G&A structure is really sized more for a much larger company that kind of post-spin. And so, we have called it a three to four-year runway here to not only improve how we spend our G&A dollars but to get back closer to benchmark.

That study suggested that our spend today is roughly 150 basis points to 200 basis points higher than our peers. And so, we've got an opportunity within G&A. We've got an opportunity within complexity reduction, within the IFT business primarily in SKU reduction. There's also opportunities within supply chain and procurement to become more efficient. So, plenty of things that we're working on now that should drive margin expansion next year.

Brett Logan Linzey

Analyst, Vertical Research Partners LLC

Q

Okay. Great. And just as a follow-up on the IFT margins. You mentioned the negative mix in backlog. Was that a one quarter year-over-year event or should we expect some drag there for another couple of quarters before it starts to normalize?

Robert P. Fishman

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

A

We're seeing a little bit of mix challenges within the Commercial and Infrastructure space. We're hopeful that that then normalizes going into 2021.

Brett Logan Linzey

Analyst, Vertical Research Partners LLC

Q

Okay. Great. I will leave it there and pass it along. Thanks, guys.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Thank you.

Operator: Your next question comes from Joe Giordano with Cowen. Your line is open.

Joseph Giordano

Analyst, Cowen & Co. LLC

Q

Hey, guys. 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.

Joseph Giordano

Analyst, Cowen & Co. LLC

Q

Hey, I just wanted to kind of follow up a little bit on the regulatory push into next year. And how do you think of the positive benefits on the price that you're going to get versus like maybe the volume benefits that you'll get ahead of that from pull through of single speed? But how do you – how should we think of all of this in totality? And maybe are you entering 2021 with a higher level of kind of visible backlog into the first half?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Well, two different answers. I mean, certainly we were heading into next year still catching up with the demand that we feel the dealer is trying to satisfy from the consumer. So, we feel like we're going to be catching up for several quarters on the demand pull through in Pool.

As far as it relates to DOE, I'm always cautious on these transitions as to how the industry reacts and smooths these transitions over time. So, I don't think there's a huge windfall necessarily in any one particular quarter. I think it plays out thoughtfully over time as people work around state by state and building out the inventory and still putting in the older product.

The margin – actually, the operating margin or the drop to margin on the variable speed is slightly lower. But the variable speed pumping itself is almost 1.8 times more expensive than the single speed. So, overall, from a content and a simplification of our business model and giving people quite frankly a better pump, we think those things will work their way out over 2021 and 2022. But I think it will be a smoother transition over those periods.

Joseph Giordano
Analyst, Cowen & Co. LLC

Q

Fair enough. And on IFT, as you look through your total company new product introduction being more focused – very focused on some of the resi applications and your capital deployment likely targeting there, like, what's the business evaluation process looking like on IFT? Like, how core are all these businesses? How are you thinking about them? Has that changed at all over the last two years?

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

A

Well, listen, I certainly understand that the margins in IFT at this point in time are not where we want them. They're definitely not where leadership wants them. But I do want to compliment the team. This is a truly global business. This is a hugely complex business. It's an engineering ornate business. And if COVID has been hard from the manufacturing standpoint across one part of the portfolio, it's certainly been really hard to the IFT team.

And I couldn't be more proud of how they stepped up, and they're answering the battle as far as getting their customers the products. There's a lot of inefficiencies in the way that you ship product or you deliver product in an engineer to order business when you've got challenges as we're experiencing with stay at home orders and COVID. So, again, I just want to say that I think some of this is going to work its way out over time naturally as we get better at working through the new rules.

The second piece is we're seeing the activity around the focus in the portfolio. We believe we have a really investable industrial business where we provide technology, especially smart technologies, the membrane technology to a lot of sophisticated customers around the world that we're getting a lot of momentum on IoT related to those products. We're also participating in CO2 recovery and CO2 use. That's getting a lot of push from regulatory. It's an environmentally-friendly product. So, really excited about some of those growth aspects.

We got a good R&I business. It's not going to be a rapid grower but it's got high margins and contributes nicely to the cash and the P&L. And we've got some project challenges in C&I but we've got a new leader there and we're focused on what we need to do to right the ship there and make sure that we're going more after the aftermarket products and less after the projects.

So, I think we're going to see recovery in 2021 in a meaningful way in margin in IFT. And I think over the longer haul, this is going to be a good contributor to Pentair's portfolio.

Joseph Giordano
Analyst, Cowen & Co. LLC

Q

And if I could just sneak one – last one in for Bob. You've been there about six months now, obviously interesting time to be starting a job anywhere. Just curious as to, as you look about what you thought going in in terms of how to budget and how to do this process, like what's gone most according to plan? What's been a little bit different? And what kind of changes do you – are you kind of adapting to?

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

A

Yeah. Thank you for asking that. It's been a great decision from my perspective to join Pentair. I could not be more pleased with the people that I work with on a day-to-day basis and the opportunity for the company. So for me that – I have joined the company that has a great foundation but there are opportunities for improvement.

The things that I'm probably more focused on is around helping to drive consistent organic growth. We've implemented a number of processes around driving growth on a category level. We're developing better analytics. So think of analytics of products and customers as opposed to necessarily just P&Ls. We have opportunities to drive efficiencies and margin expansion. And I'm excited about both Consumer Solutions and IFT. So, from my perspective, a really great future here at Pentair and look forward to the start of 2021.

Joseph Giordano
Analyst, Cowen & Co. LLC

Q

Thanks, guys.

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

Rob Wertheimer
Analyst, Melius Research LLC

Q

Thank you. Good morning, everyone.

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

A

Good morning.

Rob Wertheimer
Analyst, Melius Research LLC

Q

So you've touched on this in a number of different ways, but just to just to sort of get a broader overview. You mentioned just trying to catch up with the strong demand that's been going on with pool. Can you just sort of talk across the segment on backlog/channel inventory versus normal, whether you're mostly fully caught up or whether the channel has a bit much and some gain? Just sort of characterize that across segments. Thank you.

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

A

I would say that the catching up is generally a theme that applies across the portfolio. I think right now we believe that inventory levels are correctly right sized with the exception of what we think is still a channel that needs more inventory for Pool. But I think most of our distributors and dealers are being prudent even in areas like commercial filtration where there hasn't been any pre-stocking ahead of the expectation of restaurants opening or hospitality opening. So, I think right now we're seeing a really nice situation where the demand is equal to the shipments that we're experiencing.

Rob Wertheimer
Analyst, Melius Research LLC

Q

Okay. That's perfect. If I may just ask a little bit more of a structural question. You mentioned in consumer Water Treatment how dealers are able to get into homes again and sort of put stuff in. I know you're working on education and just making people aware of all the good solutions that there are for the home. Can you just touch a little bit on what the structural growth drivers are there, whether it's signing up dealers or how you're getting that education out and how you really sort of take advantage of a reasonably large opportunity? Thanks.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

There has been tremendous search demand, so people on the Internet searching for water filtration, water treatment needs. And Pentair isn't a brand yet that you recognize if you do that, and we are going to be. And the consumer poll and demand that we think people want is the right solution for their particular need.

Water is not consistent both from an input across the world, and it's certainly not consistent from the way that you desire your water. And Pentair has all the technology capability to take whatever input water you have and deliver the quality and the taste of the water that you want. And that's where we think the biggest opportunity for Pentair is.

And we think we have to build out the channel and the consumer pull and the demand. And we have a lot of new products we're launching next year to do that to make you aware. And the second piece would be to make sure that we're aligned with our service channel to be able to meet the demand and then give you the technology you need.

So, we've been at this for a couple of years. We've learned a lot from the Pelican and the Aquion acquisitions. And we're poised to really make a lot of progress in 2021 and 2022 around the residential water treatment side. So, we're excited. Excited about the progress, excited about the learnings, and excited about the future.

Rob Wertheimer

Analyst, Melius Research LLC

Q

Excellent. Thank you.

Operator: Your next question comes from Deane Dray with RBC Capital. Your line is open.

Deane Dray

Analyst, RBC Capital Markets LLC

Q

Thank you. Good morning, everyone.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Hello, Deane.

Robert P. Fishman

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

A

Hi, Deane.

Deane Dray

Analyst, RBC Capital Markets LLC

Q

It would be interesting hearing some more about this Total Water Management initiative you have in commercial water treatment. Just by the sound of it, it would seem to be similar to what you're doing at one of the major coffee chains globally. So, could you just size for us what the applications would be, what the opportunity is, what kind of investment? Thanks.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Yeah, Deane. I mean that – that's really in reference to there are franchises and/or restaurants mainly that don't necessarily the higher wealth or the company owned stores in which franchisees are buying a lot of equipment. And we're really giving them an expertise in allowing them to lease their solutions from us, right? And really building a connectivity between us and that end customer, and renting them or leasing them the solution instead of them buying the solution. That's what Total Water Management is about, Deane.

Deane Dray

Analyst, RBC Capital Markets LLC

Q

Great. And is there a – an investment – up-front investment that you need to be making, and can you give us an idea of that opportunity?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Yeah, we're obviously putting that unit into the field. And instead of collecting the revenue from that unit at once, we're collecting that revenue over time as a way to promote our solutions. So, I mean it's in its infancy right now, several million dollars of revenue, Deane. And we just want to make sure it's a solution that we have out there for our customers if they choose to rent that model.

And we're doing them in IoT-enabled. So, we know what they're being used and how they're being used. And we have the ability to work with that partner to make sure they're optimizing their water experience. So, we're excited about that.

Deane Dray

Analyst, RBC Capital Markets LLC

Q

Good to hear. And then, on capital allocation, just given the strength in the balance sheet, given the cash flow and the line of sight on your cash flow, where do buybacks fit in priority? You have the stock sitting right by our calculations at the low end of its relative PE range for the last three years. So, it really does look attractive if you want to make that case. So, just update us on buyback plans.

Robert P. Fishman

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

A

From a buyback perspective, we start most years with the goal of buying back roughly \$150 million of shares. This year, we have done \$115 million in the first quarter, and then we suspended our buyback period – our buybacks as we assessed free cash flow and liquidity. Obviously, as free cash flow has been robust the last two quarters, we – you'll see in the Q later today, we've removed the suspension around buybacks and certainly have that opportunity as we close out the year and move into next year.

Deane Dray

Analyst, RBC Capital Markets LLC

Q

Great. That makes sense. Thank you.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Thanks, Deane.

Operator: Your next question comes from Jeff Hammond with KeyBanc. Your line is open.

Jeffrey D. Hammond

Analyst, KeyBanc Capital Markets, Inc.

Q

Hey. Good morning, guys.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Hey, Jeff. How are you doing?

Jeffrey D. Hammond

Analyst, KeyBanc Capital Markets, Inc.

Q

Morning. Doing well. Just want to go back to Pool and kind of the momentum in the fourth quarter. I mean I think if I hear you, you're seeing strong underlying demand and you expect that next year and inventories are still low. So, just any read on further catch up on inventories in the fourth quarter and what your distributors are saying about early buy?

Robert P. Fishman

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

A

I'll start on that one. Again I view Q4 as being satisfying natural demand. So, really not dipping into early buys, which is a good situation as we get into 2021. So, Q4 is all about delivering on the orders that we have. That then sets ourselves up for a good start to 2021 as we deliver on early buys and more of the standard orders that will come.

Jeffrey D. Hammond

Analyst, KeyBanc Capital Markets, Inc.

Q

And is it fair to say like underlying demand is if you kind of put 2Q and 3Q together is like high single digit is kind of the order run rate into 4Q?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

I think it'd be higher than that, Jeff. I for sure believe it's double digit as far as the underlying demand, and absolutely double digit.

Jeffrey D. Hammond

Analyst, KeyBanc Capital Markets, Inc.

Q

And are you doing something different with early buy incentives to disincent early buy or?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

No.

Jeffrey D. Hammond

Analyst, KeyBanc Capital Markets, Inc.

Q

Okay. Okay. Then just quick on IFT. In your presentation you talked about growing the entire portfolio above GDP, which would obviously include IFT. But in the earlier question, the focus kind of continue to be more on the margin and margin improvement. So, just talk about what changes do kind of drive the – a better growth profile for that segment going forward.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Yeah. I think it's focus. I mean, there are some of these businesses that just doing the basics is going to generate 2% to 3% of growth. And that's okay. I think some of them have margin opportunity. And let's just do the 2% to 3% consistently and predictably every single quarter and let's do it well. There's other businesses, as I mentioned, Sustainable Gas and our IoT offerings in F&B that have an opportunity to be high-single digits over a cycle. And that's where we want to focus.

And so it's really discipline, Jeff. When you have projects in front of you, you could chase whatever projects you want. And by the time you realize the lower margins, you're challenged. And some of that still exist in this portfolio and we're working through that. And that's what we don't want to do anymore. So, we want each business to play its role in Pentair. And by choosing what that is and making sure they're focused on it, I think they can be a big contributor to Pentair's outcome.

Jeffrey D. Hammond

Analyst, KeyBanc Capital Markets, Inc.

Q

Okay. Thanks, guys.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Thank you.

Operator: Your next question comes from Scott Graham with Rosenblatt Securities. Your line is open.

Scott Graham

Analyst, Rosenblatt Securities, Inc.

Q

Hey. Good morning. Very nice quarter, guys.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Thanks, Scott. Appreciate that.

Robert P. Fishman

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

A

Good morning.

Scott Graham

Analyst, Rosenblatt Securities, Inc.

Q

So, I wanted to understand a little bit about – I guess maybe I'm just going to not – going to just put a finer point on this for the fourth quarter. The low end of the EPS guidance suggest a quarter very similar to the second quarter yet your highest margin businesses demand is up double-digit. You're saying productivity is going to be

better or the tax rate goes a little bit the other way perhaps. And maybe there's some cost to push things out the door because of COVID and bottlenecks. But is there something that I'm missing here? I mean truthfully, is there like a fudge factor in the fourth quarter?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

No. Scott, I mean it is simply this. The hardest thing for companies today is to produce a low end of the guidance range then incorporate what you think a hiccup related to COVID could be to you. That is it. We're guessing at that end of the range to how a second wave or a third wave, however you want to describe that COVID might impact Pentair. We know nothing today that would suggest it. But when you put a range out there, we want to have a range that we can address throughout the quarter. That's simply what it is, Scott.

Scott Graham

Analyst, Rosenblatt Securities, Inc.

Q

Understood. Thank you for that. So, a further question about your capital allocation but maybe more from the M&A side. You talked about water treatment being an area of potential targeting. Could 2021 now that the residential businesses are doing better, you have a better – you have a better understanding of what consumers are buying off of your kind of very long and elaborate study of consumer buying habits and desires. Could 2021 be a pretty big year for M&A with you guys in Water Treatment?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

I hope so. I mean we're continually looking at options, Scott. I definitely look at M&A as an accelerator to what we can do organically. Water treatment is definitely a focus area. I think we're – that's where the funnel is more robust and I certainly hope it's an accelerator.

Scott Graham

Analyst, Rosenblatt Securities, Inc.

Q

Got it. Last question. The productivity number obviously being a bit of a net number was depressed by the things that you guys talked about. What was the gross productivity for the quarter?

Robert P. Fishman

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

A

It was more in line with what you would have seen in Q2. So – and then, again, I imagine that that will return in the fourth quarter. So, productivity continues to be a consistent enhancer of the margins. It's just unfortunate that in Q3 we caught up on compensation and on the pricing side had higher rebates. But behind the scenes or underneath that, our gross number is very much in line with what we saw in the second quarter.

Scott Graham

Analyst, Rosenblatt Securities, Inc.

Q

Right. Which I also know I think includes some of your productivity, your cost out actions that you talked about two quarters – a quarter-and-a-half-ago. And I guess I'm wondering have we enacted any of those? Did we need to enact any of the, call it, \$80-plus-million that you had identified as the potential to lower costs this year?

Robert P. Fishman

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

A

Yeah. We – our goal was to take out cost in line with the volume drop. And we've done a reasonably good job there. A lot of hard work has gone on within manufacturing and supply chain. We continue to spend less on what we call purchase spend, discretionary spend. We've renegotiated. We took a hard look at policies across the board from travel and entertainment, all the way to how we train people, recruit, relocation. And so, those are finding their way through as well and on a full-year basis, will help 2021.

Scott Graham

Analyst, Rosenblatt Securities, Inc.

Q

Understood. Thanks. Appreciate it.

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

Nathan Hardie Jones

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Good morning, everyone.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Good morning.

Nathan Hardie Jones

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Great cash flow quarter there, John.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Thank you. Thanks for noticing.

Nathan Hardie Jones

Analyst, Stifel, Nicolaus & Co., Inc.

Q

No worries. A follow-up here on Pool. You guys got off to a slow start to the selling phase in 2Q 2019 around some of the bad weather in the Southern states and the big states where pool installations happen. And last year you were pretty cautious telling us that there was labor constraints. It was difficult to catch up with some of those things as the year went by.

This year in 2Q, 3Q of 2020, you're probably closer to 20% overall growth. Can you kind of square those comments from last year to this year, where you weren't expecting to be able to catch up because of labor constraints in the later parts of 2019 yet the industry has been able to support such fantastic growth this year over the last six months? I'm sure there was some inventory restocking. I know you said Pool Corp and others were selling out of their own inventory in 2Q. I'm sure you were catching up with some inventory refilling for them in 3Q, but just if you could square those comments.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Yeah. I can, Nathan. Let me just give you some – the way I think about it. I think, given the weather we know happened this year, because it was a good weather year. So let's say nothing abnormal happened against us. We

would've expected a double-digit whole year primarily because of the challenges we had last year and where we thought overall inventory was. I mean overall, double-digit. I think, let's we're closer to mid-teens.

I don't think we're seeing more than the five-point tailwind in my opinion from what would be the COVID order rates. Because I do think there's a constraint in the industry anyway. I think what we're hearing and feeling is the demand is going to extend and that extension will be managed through the capacity that you're mentioning. So that's why we are sitting here today relatively confident we're going to have a good year next year.

Nathan Hardie Jones

Analyst, Stifel, Nicolaus & Co., Inc.

Q

It does seem like there's still plenty of demand left going into next year to continue to see growth in the Pool business in 2021. I know it's a long way out to look at 2022, but do you think we are pulling some demand forward there and potentially maybe you're below average growth for a year or two after we get past COVID if that ever happens?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Nathan, I would not guess – I haven't figured out 2021 yet. So, to...

Nathan Hardie Jones

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Too far out?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

I got COVID, I got elections, there's all kinds of things that have unfold first.

Nathan Hardie Jones

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Fair enough.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

But I think what you're seeing is people – I think people are realizing vacations might not be on the horizon and they're choosing destinations for second homes that they can retreat to. And I think that has been a unique pull across the entire industry, and most of those states are where a pool is in the backyard.

Nathan Hardie Jones

Analyst, Stifel, Nicolaus & Co., Inc.

Q

I think that's a fair evaluation. I just want to follow up on Jeff's question about the grow all your business greater than GDP. There's a number of business, primarily the industrial businesses that over the last number of years have not been able to do that. Do you have different strategies that you're going to deploy there now to get those businesses up to growing GDP? And what are the plans for those businesses if they are – if you're unable to get those up to growing at GDP levels?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Yeah. I think – just to put in perspective, we have product categories that ship below our businesses and there's some 23 of them. And when we talk about that, we're talking about averaging. And if something's not able to grow, we would look at how it's doing across this cycle. Is it still doing well relative to the cycle that it's in? But we want to make sure predictably and consistently that we can deliver that core every single year and that it starts with a positive contribution to our shareowners.

The second piece is now let's talk about the strategic growth that we're going to put on top of it. And we're trying to get both. And that's not something we've done consistently over time, and I want to be consistent with both of those. You need a stable core growing and then a few incremental things you can put on top of it. And then if you could put M&A on top of that, now you're really lightening it up. And that's our goal.

Nathan Hardie Jones

Analyst, Stifel, Nicolaus & Co., Inc.

Q

And just one clarification. I think I heard you say you believe that the inventory levels in – per pool in the channel are balanced at the moment.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

No. I think we're still catching up. We're balanced across the rest of the portfolio, catching up in pool. Yeah.

Nathan Hardie Jones

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay. Thanks very much for taking my questions.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Thank you.

Operator: Your next question comes from Andrew Obin with Bank of America. Your line is open.

Emily Shu

Analyst, BofA Securities, Inc.

Q

Hey. Good morning. This is Emily Shu on for Andrew Obin. Thanks for squeezing me in.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

No problem.

Emily Shu

Analyst, BofA Securities, Inc.

Q

Were there any supply chain adjustments made in the quarter to deal with the outsized pool demand and the catch up? If you could just give some color on the overall state of your supply chain, that would be very helpful. Thanks.

Robert P. Fishman

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

A

I'll take that. We've talked about emerging from COVID stronger. I would say that's an example. We've added second suppliers where it made sense, closer to the markets we serve. But generally speaking, Q3 was a quarter of ramping up manufacturing productions, adding a second shift, adding more people. So I do think we've addressed the supply chain challenges but also given us more optionality around manufacturing production.

Emily Shu

Analyst, BofA Securities, Inc.

Q

Okay. Great. And then my last question is just with the federal election coming up and a potential change in administration, have you guys assessed if there could be any impact to the business from a potential green new deal? Thanks.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Well, we're – obviously, we were learning how to balance risks or opportunities all the time between tariffs and COVID and now, election. I think we are a sustainable solutions provider, so we would expect to benefit from any movement in green initiatives or societal changes that affect the environment in a positive way.

Emily Shu

Analyst, BofA Securities, Inc.

Q

Okay. Thanks so much, guys. And congrats on the quarter.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Thank you.

Robert P. Fishman

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

A

Thank you.

Operator: Your next question comes from Saree Boroditsky with Jefferies. Your line is open.

Saree Boroditsky

Analyst, Jefferies LLC

Q

Hey, thanks for squeezing me in.

John L. Stauch

President, Chief Executive Officer & Director, Pentair Plc

A

No problem.

Saree Boroditsky

Analyst, Jefferies LLC

Q

So with the implications that pool demand remains strong next year, how are you thinking about the opportunity to push through pricing since it was really not a contributor to sales in the quarter given rebates?

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Yeah, I think, listen, we – as Bob mentioned, we're deep in the planning cycle right now. And one of the key inputs to any pricing decision is what are you seeing with inflation and what's going on with suppliers and material. And we'll make those assessments. And based upon those assessments, we'll make sure that we're pricing effectively. So, this is the time we do that. And if we need to make adjustments, we'll make adjustments.

Saree Boroditsky

Analyst, Jefferies LLC

Q

Great. And then just following up on 150 basis points to 200 basis points in G&A opportunity, can you touch on how you're thinking about the timing on this and how we should think about if any benefit into next year?

Robert P. Fishman

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

A

We think of it as a three-year runway, more a less linear. So, not back-end loaded. So, improvement. And again, as the improvement in margins will come in two forms, there'll be some cost out but also avoiding costs as revenue ramps. So, I think it's good that we've got a three-year path here, and we're hard at work at operationalizing that improvement.

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 Julian Mitchell with Barclays. Your line is open.

Trish Gorman

Analyst, Barclays Capital, Inc.

Q

Hey. Good morning. This is Trish on for Julian. Maybe just one more follow-up on seasonality. I know you mentioned perhaps there's some contingency in the guide, but the implied Q4 guide suggests sales decline kind of high-single digit sequentially and then versus normal seasonality of mid-single-digit increases.

And so, you mentioned IFT kind of a normal seasonality is typically down into the fourth quarter versus the third. Should we expect consumer to follow normal seasonality as well? I know you said that will satisfy kind of natural demand, but I think that's typically up quarter-over-quarter into the fourth quarter.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

A

Yeah. So, simply stated, I think our normal seasonality is Q2 is our strongest quarter followed by Q3, Q4 and then Q1. And Pool is the strongest in Q2 and Q3 because of how it ramps for the season. And then, it usually has

what's called an early buy, which is a level loading of the distribution base so that we can maintain our employment levels and satisfy the industry demand.

Other than that, we tend to see a tail off with the Christmas season, meaning that we've only produced probably to mid-December and shipping products to mid-December. So, the natural tendency is for Q4 to be a little soft across to our particular lines. As Bob mentioned, we had a good Q4 last year. And so, our IFT businesses, they're still experiencing that headwind on a year-over-year basis, and that's simply what the challenge is in Q4.

Trish Gorman

Analyst, Barclays Capital, Inc.

Q

Okay. Got it. Thank you. And then, just maybe one follow-up on free cash flow. Given the strength to-date, as we look out, how should we think about working capital movements? And maybe free cash flow into 2021, do you think it's possible to grow free cash flow next year given new products to build some supply in pool?

Robert P. Fishman

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

A

For free cash flow, again, our starting point is 100% of net income and that will continue to be our goal. I mean to me it speaks to the quality of the earnings that we have here at Pentair.

One thing, as John alluded to, was there's nothing like linearity to improve free cash flow either from a quarterly perspective or from an end quarter perspective. So, with the strength that we're seeing in pool, our factories are busy from the start of the quarter to the end of the quarter. That revenue that comes in early in the quarter allows us to collect that by the end of the quarter.

So, I would say linearity will continue to be in our favor. We'll continue to drive free cash flow at or higher than net income and also remain disciplined around things like Capex.

Trish Gorman

Analyst, Barclays Capital, Inc.

Q

Got it. Thank you.

Operator: There are no further questions at this time. I will now turn the call back over to John Stauch for closing remarks.

John L. Stauch

President, Chief Executive Officer & Director, Pentair plc

Thank you for joining us today. We continue to believe that Pentair has a strong foundation and portfolio of businesses to build upon. We have a strong purpose, mission, and vision focused on delivering smart, sustainable solutions that empower our customers to make the most of life's most essential resources. We believe that we are an attractive spaces that are expanding. We are a leader in the pool industry and our Water Treatment business is helping us become an even more integral player in both residential and commercial Water Treatment.

We believe we have the right enterprise strategy, businesses, talent, and culture. With our Win Right values to our Pentair integrated management system, we are enabling all of our employees to continuously improve. Finally, we continue to prioritize providing superior customer experiences and delivering more predictable and consistent results.

Thank you for your continued interest. Mariama, you can conclude the call. Thank you.

Operator: Thank you. Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.

Disclaimer

The information herein is based on sources we believe to be reliable but is not guaranteed by us and does not purport to be a complete or error-free statement or summary of the available data. As such, we do not warrant, endorse or guarantee the completeness, accuracy, integrity, or timeliness of the information. You must evaluate, and bear all risks associated with, the use of any information provided hereunder, including any reliance on the accuracy, completeness, safety or usefulness of such information. This information is not intended to be used as the primary basis of investment decisions. It should not be construed as advice designed to meet the particular investment needs of any investor. This report is published solely for information purposes, and is not to be construed as financial or other advice or as an offer to sell or the solicitation of an offer to buy any security in any state where such an offer or solicitation would be illegal. Any information expressed herein on this date is subject to change without notice. Any opinions or assertions contained in this information do not represent the opinions or beliefs of FactSet CallStreet, LLC. FactSet CallStreet, LLC, or one or more of its employees, including the writer of this report, may have a position in any of the securities discussed herein.

THE INFORMATION PROVIDED TO YOU HEREUNDER IS PROVIDED "AS IS," AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, FACTSET CALLSTREET, LLC AND ITS LICENSORS, BUSINESS ASSOCIATES AND SUPPLIERS DISCLAIM ALL WARRANTIES WITH RESPECT TO THE SAME, EXPRESS, IMPLIED AND STATUTORY, INCLUDING WITHOUT LIMITATION ANY IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, ACCURACY, COMPLETENESS, AND NON-INFRINGEMENT. TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, NEITHER FACTSET CALLSTREET, LLC NOR ITS OFFICERS, MEMBERS, DIRECTORS, PARTNERS, AFFILIATES, BUSINESS ASSOCIATES, LICENSORS OR SUPPLIERS WILL BE LIABLE FOR ANY INDIRECT, INCIDENTAL, SPECIAL, CONSEQUENTIAL OR PUNITIVE DAMAGES, INCLUDING WITHOUT LIMITATION DAMAGES FOR LOST PROFITS OR REVENUES, GOODWILL, WORK STOPPAGE, SECURITY BREACHES, VIRUSES, COMPUTER FAILURE OR MALFUNCTION, USE, DATA OR OTHER INTANGIBLE LOSSES OR COMMERCIAL DAMAGES, EVEN IF ANY OF SUCH PARTIES IS ADVISED OF THE POSSIBILITY OF SUCH LOSSES, ARISING UNDER OR IN CONNECTION WITH THE INFORMATION PROVIDED HEREIN OR ANY OTHER SUBJECT MATTER HEREOF