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# Pentair plc

Q4 2023 Pentair plc Earnings Conference Call

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## CORPORATE SPEAKERS:

**Shelly Hubbard**

*Pentair plc; Vice President, Investor Relations*

**John Stauch**

*Pentair plc; President and Chief Executive Officer*

**Bob Fishman**

*Pentair plc; Chief Financial Officer*

## PARTICIPANTS:

**Grace Zhou**

*Goldman Sachs; Analyst*

**Julian Mitchell**

*Barclays; Analyst*

**Nathan Jones**

*Stifel; Analyst*

**Michael Halloran**

*Baird; Analyst*

**Scott Graham**

*Seaport Research; Analyst*

**Jeffrey Hammond**

*KeyBanc Capital Markets Inc.; Analyst*

**Brett Linzey**

*Mizuho; Analyst*

**Andrew Krill**

*Deutsche Bank; Analyst*

**Joseph Giordano**

*TD Cowen; Analyst*

**Andrew Kaplowitz**

*Citigroup; Analyst*

**Deane Dray**

*RBC Capital Markets; Analyst*

**Stephen Tusa**

*JPMorgan; Analyst*

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### **PRESENTATION:**

Operator^ Welcome to the Pentair Fourth Quarter 2023 Earnings Conference Call. (Operator Instructions) This event is being recorded. I would now like to turn the conference over to Shelly Hubbard, Vice President, Investor Relations. Please go ahead.

Shelly Hubbard^ Thank you, [Drew]. And welcome to Pentair's Fourth Quarter 2023 Earnings Conference Call. On the call with me are 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 fourth quarter and full year performance as outlined in this morning's press release.

On the Pentair Investor Relations website, you can find our earnings release and slide deck which is intended to supplement our prepared remarks during today's call, and provide a reconciliation of differences between GAAP and non-GAAP financial measures that we will reference.

The non-GAAP financial measures provided should not be considered as a substitute for or superior to the measures of financial performance prepared in accordance with GAAP.

They are included as additional clarifying items to aid investors in further understanding the company's performance in addition to the impact these items and events have on the financial results.

Before we begin let me remind you that during our presentation today, we will make forward-looking statements, which are predictions, projections or other statements about future events.

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 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.

Following our prepared remarks, we will open the call up for questions. Please note that we will limit your questions to two, after which we ask you to then reenter the queue in order to allow everyone an opportunity to ask questions.

Similar to previous quarters in 2023, we have included Slides 4 through 7 in our earnings slide deck which provides a brief overview of Pentair as well as our investment thesis. I will now turn the call over to John.

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John Stauch^ Thank you, Shelly. And good morning, everyone. Our record performance in 2023 demonstrates the power of our balanced water portfolio and our focused growth strategy post the separation of nVent. We completed year one with our three-segment structure -- Flow, Water Solutions and Pool. And we finished our first full year with Manitowoc Ice.

Our Flow segment, which moves water where it's needed and removes water where it's not wanted, along with our Water Solutions segment, which improves water, both posted a record year for sales in ROS. And our Pool segment, which enables people to enjoy water delivered record ROS despite significant volume headwinds.

I'm extremely proud of our approximately 10,500 global employees for their solid execution in a challenging macroeconomic environment.

As we enter 2024, we are leveraging our balanced portfolio for continued growth and profitability with expectations for new records of financial performance. Additionally, we look forward to sharing more about our strategy and 3-year outlook at our Investor Day on March 6.

Now let's begin with our executive summary, Q4 2023 on Slide 8. We finished Q4 with record performance in the fourth quarter post the separation of nVent in 2018, specifically record segment income and ROS, marking the seventh consecutive quarter of ROS expansion. This is important to note with strong comparables in Q4 2022.

In the fourth quarter, sales were down 2%, which included slightly better-than-expected Pool performance. Segment income increased 8% and ROS expanded by 190 basis points. Adjusted EPS was \$0.87, up 6%, and we generated \$97 million of free cash flow in the quarter.

Let's move to Slide 9 titled Executive summary, full year '23. 2023 was a record year for segment income, ROS and adjusted EPS post the nVent separation, as previously mentioned despite sales ending the year flat. In full year '23, we delivered sales of \$4.1 billion, record segment income of \$855 million, up 11%, record annual ROS of 20.8%, expanding 220 basis points and record adjusted EPS of \$3.75.

Flow and Water Solutions set new sales records in 2023 and we delivered significant margin expansion across all three segments, setting a new annual record ROS for each.

Transformation and solid execution across all three segments continue to drive operational efficiencies throughout the year.

Lastly, we generated significant free cash flow of \$550 million and increased our dividend for the 48th consecutive year, further solidifying our status as a dividend [aristocrat].

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Let's turn to Slide 10 titled Balanced Water Portfolio. We are helping the world sustainably move, improve enjoy water through our three segments, each with over \$1 billion in sales in 2023 and together, creating a balanced water portfolio. Our strategy is working, and we have been delivering on the expectations that we have shared with you. I will now pass the call over to Bob, who will discuss our performance and financial results in more detail. Bob?

Bob Fishman^ Thank you, John. And good morning, everyone. Let's start on Slide 11, titled Q4 2023 Pentair performance. I will also be discussing our full year performance on Slide 12. We delivered another strong quarter of earnings and significant margin expansion despite sales being down 2% year-over-year. Volume continued to improve sequentially with substantial progress in Q4 as compared to Q2 and Q3, driven primarily by improvement in Pool volume.

Sales for Q4 were down 2%, which was slightly better than we guided. Core sales across all three segments were down slightly as compared to last year's record Q4 when our lead times began to improve from a recovering global supply chain, enabling us to ship more backlog orders.

As we move into 2024, we expect to see a more normalized operating environment. Fourth quarter segment income increased 8% to \$198 million and return on sales expanded 190 basis points year-over-year to 20.1%. This improvement was driven primarily by our transformation initiatives. Adjusted EPS of \$0.87 was up 6% versus the prior year.

For the full year, sales were flat at \$4.1 billion with core sales down 5%, driven by growth in Flow and Water solutions, which were offset by lower Pool volumes. Segment income grew 11% and return on sales expanded 220 basis points to a record 20.8%. All three segments significantly expanded margins and set new records. Adjusted EPS increased to a record \$3.75.

Turning to Slide 13, labeled Flow at a Glance. You can see the impressive 5-year financial performance. Sales rose over 4% compounded annually and margin expanded 300 basis points since 2019. In 2023, flow continued to reach new records in sales and ROS. We have also provided a sales view by region, channel and solutions, reflecting 2023 sales and the diversified nature of the business.

We have eight iconic brands, some over 100 years old, and we rank first in quality, technical support and customer service.

Please turn to Slide 14, labeled Q4 2023 Flow performance. In addition to the fourth quarter performance for Flow, I will also be referencing the full year performance on Slide 15. Note that we have recently renamed our Industrial & Flow Technologies segment to Flow. In Q4, Flow grew sales 1% in the quarter to \$379 million, a record fourth quarter. Industrial Solutions was up 9% and commercial was up 2% with residential down 7%.

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Segment income was flat and return on sales decreased 20 basis points to 17.2% due to a return to more normal seasonality following a record Q4 2022 and an unfavorable mix from our residential business.

For the year, slow sales increased 5% to \$1.58 billion, primarily due to double-digit growth in Commercial and Industrial Solutions. Residential was down 4%, showing improvements sequentially from Q3. Full year segment income grew 17% and return on sales increased 170 basis points to 17.8%, a record margin for Flow, driven by transformation and price more than offsetting inflation.

Turning to Slide 16, titled Water Solutions at a Glance. You can see the strong 5-year financial record with a compounded annual sales growth rate of 17% and over 400 basis points margin expansion since 2019. Our iconic brands include Everpure and Manitowoc Ice. Our residential water solutions products have helped reduce the need for 7 billion single-use water bottles in 2023.

Please turn to Slide 17, labeled Q4 2023 Water Solutions Performance. In addition to the fourth quarter performance for Water Solutions, I will also be referencing the full year performance on Slide 18. In Q4, Water Solutions sales decreased 5% to \$270 million following a record Q4 2022. Commercial sales were down 4%, primarily due to the timing of projects within our services business, partially offset by growth in Manitowoc Ice and filtration. In Residential, Q4 sales were down 6%, but reflects significant improvement sequentially from Q3 of this year in which Residential sales were down 14%.

Segment income grew 15% to \$52 million and return on sales expanded 320 basis points to 19.1%, a new Q4 record driven primarily by productivity from our transformation initiatives and Manitowoc Ice.

For the year, Water Solutions sales grew 19%. Segment income grew 66% and return on sales increased 590 basis points to 21%, a new full year record. Commercial sales increased 54%, driven by the acquisition of Manitowoc Ice and growth in filtration. Manitowoc Ice had a record sales year with growth of 23% versus the prior year.

Please turn to Slide 19, titled Pool at a Glance. Looking at the 5-year financial performance, Pool was able to grow the top line significantly and increase margins to a record 31% or up 320 basis points since 2019. Our Pool business benefits from a very large installed base with roughly 80% of sales coming from remodel and break and fix.

Please turn to Slide 20 labeled Q4 2023 Pool Performance. In addition to the fourth quarter performance for Pool, I'll also be referencing the full year performance on Slide 21. In Q4, Pool sales declined 2% to \$336 million, driven by a 6-point drop in volume, which was partially offset

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by four points of price. Note that volume improved significantly compared to the 28-point decline in Pool volume in Q3.

For the year, pool sales were down 18%. Segment income decreased 10% and return on sales increased 270 basis points to 31%, driven by price in our transformation initiatives.

Please turn to Slide 22, labeled Transformation Initiatives. Similar to last quarter, we believe this slide provides a good illustration of our transformation initiatives and our ultimate goal of driving margin expansion. We have been targeting ROS of approximately 23% by the end of fiscal 2025, expanding margins over 400 basis points as compared to fiscal 2022. In 2023, we delivered ROS of 20.8% as transformation began to read out in Q3 and Q4, and we expect to deliver roughly 22% by the end of full year '24 which we believe puts us on track with our transformation initiatives.

Please turn to Slide 23, labeled Transformation Runway. We have kept this slide as a reference to illustrate the staggered nature of each of the four initiatives and the various stages of each. We are pleased to note that we believe we are executing well on these initiatives going into 2024.

Please turn to Slide 24, labeled Balance Sheet and Cash Flow. In Q4, we generated \$97 million in free cash flow, up nearly 100% year-over-year, reflecting another strong quarter. For the year, our free cash flow was \$550 million, up nearly 94% year-over-year. Our net debt leverage ratio was 2x, down from 2.6x in Q1. Our total debt was less than \$2 billion, and the average interest rate was approximately 5.2%.

Our ROIC was 14.3% which includes the full impact from the Manitowoc Ice acquisition. With the focus on being good stewards of capital, we continue to target high teens ROIC. We plan to remain disciplined with our capital and continue to focus on debt reduction amid the higher interest rate environment with the potential for share buybacks.

Moving to Slide 15 (sic) [25], titled Q1 and Full Year 2024 Pentair Outlook. For the full year, we are introducing our adjusted EPS guidance of approximately \$4.15 to \$4.25 which represents a year-over-year range of up 11% to up 13%. We expect total Pentair sales in fiscal 2024 to be up approximately -- to be approximately \$4.2 billion or up about 2% to 3%. We expect Flow sales to be up low single digits, reflecting low to mid-single-digit growth in our commercial and industrial businesses, offset slightly by a low single-digit decline in residential.

Water Solutions sales are expected to be essentially flat, comping record 2023 performance driven by our commercial water business. Commercial sales in full year '24 are expected to be up low single digits and residential to be down low to mid-single digits.

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Pool sales are expected to increase approximately 7% in full year 2024, which aligns the historical compound annual growth rates of mid-single digits pre-pandemic. We expect Pool sales to increase, driven primarily by inventory headwinds in 2023 that we do not expect to repeat in 2024 and some benefit of price. We expect this growth to be slightly offset by the uncertainty that still exists regarding the macroeconomic environment, higher interest rates, the potential impact of financing for new and remodeled pools and potential repair deferrals in the aftermarket.

We believe Pool remains a highly attractive market for us, and we look to deliver strong growth in 2024 while being mindful of macroeconomic dynamics.

We expect segment income to increase approximately 10% with ROS expansion of roughly 150 basis points. Also for the full year, we expect corporate expense of approximately \$95 million, net interest expense of roughly \$100 million, an adjusted tax rate of approximately 16.5% which is inclusive of changes in the global tax standards for a total impact to Pentair of about \$0.07 per share and a share count of approximately 166 million to 167 million.

Lastly, we expect to deliver approximately \$1 billion in EBITDA in full year 2024, a milestone we are very proud of. For the first quarter, we expect sales to be down approximately 2% to 3%.

As a reminder many of our businesses were working down large backlogs in Q1 last year, as supply chains improved, and we were able to ship more backlog orders. In 2024, we expect more normalized seasonality in our businesses.

We expect first quarter segment income to be flat to down 3%, primarily due to lower sales with corporate expense of approximately \$25 million, net interest expense of roughly \$29 million, an adjusted tax rate of approximately 16.5% and a share count of approximately 167 million.

We expect Q1 to drive ROS expansion, both sequentially and year-on-year. We are also introducing adjusted EPS guidance for the first quarter of approximately \$0.88 to \$0.91.

For the first time since 2020, we believe we are seeing a return to a more normalized operating environment globally. Thus, we expect to see seasonality resume to historical norms across all three of our segments in 2024 with transformation driving margin expansion.

In the first half of 2024, we expect adjusted EPS to be slightly less than 50% of our full year adjusted EPS guide. Q1 is expected to be the lowest quarter for sales, segment income, ROS and adjusted EPS as compared to the remaining three quarters and full year '24. We have continued to accelerate transformation funnels and remain focused on investing in the long-term growth of our company.

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Turning to Slide 16, titled 2023 Reflection. Our business continued to execute well and delivered what we said we would do. We drove margins as a result of our balanced water portfolio and transformation initiatives. Manitowoc Ice posted a record year, exceeding expectations. We drove performance accountability across the organization, ended the year with an even stronger balance sheet and free cash flow and maintained a disciplined capital allocation strategy.

We believe we are well positioned going into full year '24. I would now like to turn the call over to the operator for Q&A, after which John will have a few closing remarks. [Drew], please open the line for questions.

Operator^ (Operator Instructions) The first question comes from Brian Lee with Goldman Sachs.

Grace Zhou^ This is Grace on for Brian. First question on margin. Kudos on a margin execution. Just a quick question on the margin expansion trajectory here. So if I do the math correct here, your full year guide imply kind of like 140 basis point expansion while your 1Q guide imply like 20 basis points at the midpoint.

So how should we think about the margin expansion trajectory moving the year? And which segment should we see the most margin expansion?

John Stauch^ Yes. Let me just take the first part, and I'll hand it to Bob. I just want to remind everybody that last year's Pool inventory correction didn't happen fully until Q2. So we're up against one more quarter of Pool compare from a Q1 perspective. And if you actually look at the performance exiting Q4 and compare it to our Q1 guide, you'll see that the continued operating performance is there.

And the last point I'll just make before handing over to Bob is our Q1 EPS guidance is back to our normal seasonality as a percentage of the overall full year. So what you're really seeing is a reflection that we're back to our normal seasonality contribution. And therefore, the year-over-year compares are harder, one last time in Q1. Bob?

Bob Fishman^ Yes. I would agree with your numbers. ROS expansion will continue in the first quarter as we drive approximately 150 basis points of ROS expansion for the full year. As you'd expect, with Q2 being our largest quarter, the ROS expansion will be significant in Q2 and will also play out well as we close out the year in Q3 and Q4.

Grace Zhou^ Great. And then my second question is more on Pool. So you're up 7% year-over-year. That's about like \$90 million of revenue incremental. I think -- I believe you talked about like the destocking was about \$150 million in '23.

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I assume the delta is driven by -- you're cautious around -- you called out like uncertainty in the macro, high interest rates. Is that correct? And second, how much visibility do you have on that 7% growth and can you talk about like the early [volatility]? Is that -- does that give you enough confidence to guide 7% year-over-year growth?

John Stauch^ There's two questions with a lot of subparts, but let me see if I can summarize that. I mean, first of all, we have given two numbers on the inventory piece. We've given \$150 million and \$120 million. I just want to remind everybody it's about \$150 million for Pentair from the end of Q1 to the end of Q4 2023. On a year-over-year basis, it's actually closer to \$120 million which is -- then if you think about exactly what you're saying, if you take our reported sales, add the \$120 million, you'll get to the conclusion that price and volume is down. And I think that reflects several factors.

One is that we expect new pool builds to decline only modestly. But then we are not so sure what's going to happen with remodel pools. And we're also expecting some level of discretionary purchases in the aftermarket in the first half for sure, as people are maybe a little more cautionary depending on where the interest rates are. Net-net, it's still a fundamentally good growth rate for us as we set up the year and we're expecting really good conversion of ROS on that contribution.

Operator^ The next question comes from Julian Mitchell with Barclays.

Julian Mitchell^ Just wanted to circle back to the sort of profit bridge numbers and maybe looking at Slide 12 to try and understand what's embedded for 2024. Any help you could give us around the sort of that inflation bucket, what you're dialing in. It was that sort of [190] number in '23? And when we look at productivity, very good exit rate in terms of \$30 million or so tailwind in Q4. How are we thinking about that number for full year '24 as well, please? So yes, inflation and productivity, any finer points on the guide assumption?

Bob Fishman^ Yes, understand. Thank you for the question, Julian. As we look at 2024 in the context of the [walks], we're thinking that price will offset inflation. So think roughly two points of price offsetting inflation. That would mean that in order to grow to the midpoint of our guidance, we'll have roughly \$40 million of volume.

That \$40 million is compared to the negative [\$460 million] that we saw in 2023. So when we talk about moving to a more normalized environment, we are very pleased that the challenging years are behind us, and we can start to grow. That's really how you bridge the revenue piece.

When you move over to segment income, the price of, call it, two points will offset inflation. We'll get some drop through, call it, in the 30% range of that \$40 million of income and that leaves you with roughly \$75 million of transformation to drive the 150 basis points of ROS expansion.

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That \$75 million compares to the \$67 million that we did in 2023, but it also includes our -- us making investments back into the business. So as we drive innovation in places like commercial water and Flow and Pool, as we look to drive opportunities to improve and make life easier for our dealers and distributors, that's all included in that net \$75 million number. And that's the bridge that would take you from the \$855 million of income in 2023 to the midpoint guide of around \$940 million. I hope that's helpful.

Julian Mitchell^ That's extremely helpful. And maybe just a quick follow-up on the top line outlook. So you start out Q1 down a couple of points. The full year is up a couple of points. How are you thinking about the sort of rate of improvement in that year-on-year sales line through the year?

Is it just each quarter year-on-year get slightly better and is that true across all three segments kind of moving in a synchronized way from down slightly to up slightly. Any clarity on that, please?

Bob Fishman^ That's really how we do view it. We expect growth to return in Q2. Again, Q2 is historically our largest quarter. We had a big Q2 in 2023, but we still expect growth and then we continue to grow in Q3 and Q4.

Operator^ The next question comes from Nathan Jones with Stifel.

Nathan Jones^ Let me start with a follow-up on the transformation initiatives. I think you guys have some pretty good visibility to the savings that you're going to generate over the next more than one year, two, three, maybe in four years. Can you talk about the linearity of savings realization there out of transformation, kind of when do those savings peak and start to level off? Just any color you can give us on the longer-term outlook?

Bob Fishman^ Yes. We're pleased with what we're seeing in terms of transformation reading out. It was \$29 million in both Q3 and Q4 of 2023. And as I just mentioned, we're looking at roughly a net \$75 million number in 2024. When we look at the funnel, we would expect those type of transformation numbers to continue over the next couple of years.

We think the funnel supports the various waves, whether it's pricing, sourcing, the operations or the org excellence. So we think it's going to create runway for us over the next couple of years, for sure.

Nathan Jones^ And then I guess my follow-up on the Water Quality business. I think Manitowoc burned some backlog off that had built up during supply chain challenges. Is it possible -- excuse me, possible to quantify the tailwind that was there in 2023, that maybe is a bit of a headwind in 2024 and then what the underlying expectations are for growth for Manitowoc Ice in '24 and beyond?

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John Stauch^ Yes. Let me just give some color and then I'll let Bob close out. I mean, I think we enter 2024, especially in the Q1 phase with much more normalized backlog levels. We still grew nicely in Q4 in Manitowoc, and we expect to grow again in Q1. So I think we're at normal levels.

Just as a reminder, this business was only taking 60 to 75 days of orders. So the backlog was more relative to what the nearer-term dynamics were, Nathan, not some level of large backlog that wouldn't be used in the future.

So obviously, we're -- had a great 2023. This business contributed nicely to overall Water Solutions and overall Pentair, and we couldn't be more pleased with where we are. In 2024, it's more about getting the filtration synergies lined up along with the Manitowoc Ice acquisition.

They're the same business unit. And when we gave the numbers of what we expected this business to achieve and the longer term of '25, it was inclusive of those revenue synergies on both the services side and the filtration side. So very pleased where we are and very excited about the contribution we'll see in '24 and beyond.

Bob Fishman^ Yes. I would just add that historically, Ice is a mid-single-digit grower when we look back at the CAGR, that's historically what they've grown. The 23% increase in 2023 included some nice wins in China and working down the backlog. So as we look to 2024, we would expect that business to take a little bit of a breather down mid-single digits. But good news is that the business unit commercial water will actually grow low single digits.

So you're seeing some benefit of filtration business as well as some of the synergies coming from the Ice acquisition, but being captured within services and filtration. So overall, I could not be more pleased with how Ice is performing and continue to -- once we get through 2024, be back on that mid-single-digit type trajectory.

Operator^ The next question comes from Mike Halloran with Baird.

Michael Halloran^ Can we just continue on the Water Solutions side and round out the residential piece? Easy comps, still expecting some pressure, I'm guessing the cadencing improves through the year, but any context on that piece would be helpful.

John Stauch^ Yes. They're easier comps, but it's also the most global of the businesses inside that portfolio, Mike. So we're balancing off Europe, China and North America. And while the comps are easier in North America, we do expect some return to growth. We're not yet seeing the interest rate environment propel new housing starts and/or a lot more movements, which is usually key indicators to drive that business.

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But we're at levels now where we're definitely growing off of these compares in North America but we're anticipating a little bit more choppy outcomes in China and Europe in that business. So net-net, probably slightly down, but getting closer to flat.

Michael Halloran^ Makes sense. Appreciate that. And then a quick clarification as you said earlier, John, the expectation was for volume and price to be down. I'm assuming you mean that on a net basis and pricing is slightly up and volume as the majority of the downside. I just wanted to clarify.

John Stauch^ That's correct. With respect to net price benefit and a contribution in line with the way that Bob shared it across the total Pentair portfolio. And the offset to that would be the volume, which would be the market challenges.

Operator^ The next question comes from Scott Graham with Seaport Research.

Scott Graham^ Just two quickly. The fourth quarter price cost on the order side, I was just kind of wondering what happened there. That looks like there was some slippage. And does that reverse maybe in the first quarter or second quarter of this year?

John Stauch^ Yes. So a couple of dynamics there. I mean just as a reminder, price in Q4 does also reflect some of our early buy. So it's not the largest contribution to price in the quarter. Absent that, we were pretty much signaling that we would get closer to price offsetting cost versus having benefited substantially from price being much higher than costs in the first half of the year.

So it came in line with expectations and I think as you head forward, as Bob said, we now expect it to be offsetting throughout 2024.

Operator^ The next question comes from Jeff Hammond with KeyBanc Capital Markets Inc.

Jeffrey Hammond^ So just on the early buy, I think there was some question on kind of how you're going to spread it 4Q, 1Q. I'm just wondering if you have more to go in 1Q? And then just I'm kind of the -- maybe just speak to break fix, kind of how you're thinking about that market within the guide.

Bob Fishman^ Yes. Early buys came back to more normal levels in the fourth quarter. But again, as we typically do, that gets spread between Q4 and Q1. So in line with historically how it's done. In fact, the early buy component in terms of shipment in Q4 was probably a little bit less than historically what we've done.

John Stauch^ Yes. And on the brake fix, Jeff, I will concede that we probably have what I'd call a more cautious outlook. I would not call it conservatism, I call it more realistic. And we just don't

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know how the interest rate environment is going to affect the consumer being more thoughtful on what's discretionary, not discretionary in the pad. Clearly, we expect products like pumps and filters to be replaced as needed to keep the pool running.

But some of your heaters, especially on the high end and/or some of your lighting could see some consumer discretion, push those off a quarter or two. That's just our outlook. I don't say that that's right. I think it's better to take that slant and maybe air to the fact that if that doesn't happen, we're going to see a higher level of growth versus taking a more optimistic view and then having to reset the guide again to the lower end of Pool. So I would be very clear, I don't know. It's just what we have in our particular view.

Operator^ Next question comes from Brett Linzey with Mizuho.

Brett Linzey^ Wanted to come back to the capital allocation priorities. You noted the continued deleveraging path, but also the potential for share repurchase. I guess, what would be the gating factor there to drive that decision? And what would be the optimal leverage you'd be willing to flex for repurchases?

Bob Fishman^ Yes, based into the assumptions that we gave, the \$100 million of interest expense and the share count, we have assumed share buyback resumes to offset dilution. So typically, Q1 is a negative free cash flow quarter, but we would also start a share buyback later in the year is what's based into our assumptions currently.

John Stauch^ And again, that's just to offset dilution at the moment. I think where we're at from a debt-to-EBITDA is prudent. I think at these particular interest rate levels, I think the focus still is on debt reduction. And the way we're going to look at incremental buyback or M&A is what long-term value to create for the share owner and therefore, which one is the best course of action.

Brett Linzey^ Got it. And then I just wanted to circle back on the \$75 million of transformation that's planned this year. Curious how that feathers across the individual segments as we model '24 and is this primarily from the Wave 1 measures and actions taken last year? Or are you doing more on the operational side in 2024?

Bob Fishman^ Primarily, the Wave 1 on the sourcing side, again, just as a reminder, Wave 1 last year, looked at electronics, motors, maintenance, repair and operations, packaging, logistics. So we're at the point where that will start making its way into the P&L and very early stages of Wave 2.

Wave 2 looked at metals, moldings, resins, ocean rate and purchased finished goods. So I think we've got a nice cadence there of the Wave 1 reading out in 2024, and Wave 2 will straddle '24

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and '25. We'll also start to see some benefits from both the pricing excellence and the operations.

On the pricing excellence, we've now rolled the strategic playbook out to almost all of the different categories and [GMs]. So again, good cadence there from a transformation perspective.

John Stauch^ Brett, we've got to leave some information for Analyst Day to make sure everybody attends, comes and listens to us. And we'll go in a lot more detail as to how we see all of those ways working and connect it to what the segment expectations will be as well.

Operator^ The next question comes from Andrew Krill with Deutsche Bank.

Andrew Krill^ So I go back to pricing. I wonder -- I know you said about two points net for the company. But just wondering, do any of the three segments kind of benefit more or less relative to that 2%? And are these pricing increases, those base are to put through? Or does it require more price kind of midyear or at some point in the year?

John Stauch^ It doesn't vary greatly across the segments as far as the expectation. And yes, they are all announced and implemented at this stage.

Operator^ The next question comes from Joe Giordano with TD Cowen.

Joseph Giordano^ So on the [mass] walkouts, obviously, the growth there on an organic basis, like looks a lot different than the Water Solutions business as a whole. Can you kind of go through, as best you can, [buckets] of what drove that?

Like how much was just backlog? How much was like -- was priced in Manitowoc different versus like the underlying Water Solutions, three points for the year? Like how much were there like revenue synergies with the filtration reading out already into '23. Just if you can kind of just break those into large buckets for growth there.

John Stauch^ Yes. Let me simplify it. I mean, right now, we're seeing great traction, especially with Manitowoc and also then the filtration of Everpure through distributors into key accounts and also working our way through synergies there.

I just want to mention that our services business had a very large project that it worked in 2022, which was for a large customer, the install of frozen carbonated beverages, and we ran up against a year-over-year headwind in that business in Q4. But if you actually look at the filtration and the Manitowoc contributing nicely and it's just offset slightly by the headwind of the services business.

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Operator^ The next question comes from Andy Kaplowitz with Citigroup.

Andrew Kaplowitz^ John, could you give us a little more color into your industrial CapEx exposed businesses within Flow? I think you have the segment up low single digits for '24. Industrial businesses look good in Q4. So what are you seeing in Flow? And then how are you thinking about commercial businesses there as well?

John Stauch^ Yes. So thank you for the question. I mean, we've had pretty nice steady order rates and steady deliveries. And what we do is very, very important because we're turning waste in the value for a lot of our key customers. And we're seeing continued investment in that because it drives productivity for them.

It's also a big sustainability play for them. So it's an area where doing the right thing for the plan, it also means a really good value for the customer.

And so we've seen a steady order view there, and we feel like we're well positioned heading into 2024. On the commercial side, our larger pump business has benefited from expansion, what I call mainly infrastructure types of projects and the continued build-out in North America related to data centers, warehouses, et cetera, and we continue to see that trend as we enter 2024, holding up nicely as well.

Operator^ The next question comes from Deane Dray with RBC Capital Markets.

Deane Dray^ Just want to follow up there while we're talking about the formerly known as industrial flow technology, is there anything -- might just be cosmetic, but is there anything to read into the renaming as Flow?

And just in answering Andy's question, the point of the business today for Pentair is more the focus on residential, commercial, and the opportunities in Pool. And it seems less about industrial and data centers and so forth. And maybe I'm just reading too much into it. But my sense is, are you still the natural owner for this business? And is there any potential that you'd consider a separation?

John Stauch^ Yes. I -- no, I appreciate the question, Deane. And we'll spend a little bit of time on this at the Analyst Day in March, but just to share with you how I'm thinking. The relabeling of Flow was actually more of a branding exercise. We want to have a web presence where we could tell our story and Flow represents 99.99% of everything we do in the formal industrial flow technologies.

We just didn't think it worked as a naming nomenclature. So that's all it was. It's also shorter, which makes producing reports easier, and that's a big deal, right?

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But ultimately, Deane, the way I think of the company is we're \$1.5 billion in separations and membrane technologies. We're about \$1.5 billion of pumps across the enterprise. And then even some of our specialty applications like heating and cooling of ice, a rising \$800 million, which leaves you a couple of \$100 million of lighting and \$100 million of other.

So when you think of the portfolio, we're not geared to residential other than that's where our dealer base is, and that's where our strength and our presence has been generally accepted around our brands. But as a reminder, we do a couple of \$100 million of industrial wastewater today, and that's in the Flow side and we'll continue to build out that capability and technology to continually take advantage of water reuse projects around the world.

So we are -- we believe this business naturally fits and we're going to demonstrate that we use those membranes that get -- that are used for industrial wastewater applications, we're bringing those back into the residential applications, and we think it's going to give us a differentiated technology advantage as we do so.

So really excited about the cross-pollination of technology and really excited about how the segments are working together while also maximizing what we think is the revenue opportunities within their individual swim lanes.

Operator^ The next question comes from Steve Tusa with JPMorgan.

Stephen Tusa^ The -- just on this productivity number, can you just quantify how much investments you're throwing in there? Just roughly.

John Stauch^ Not a lot. I just -- if you thought about \$10 million to \$20 million of reinvestment into the areas of sales and marketing, innovation, digitization, capturing data upstream and bringing that data to help our dealers be successful and then really just automating the experience between our dealers and our distributors and us are the two biggest opportunities we have.

And then we've got some excitement around three or four of these innovation projects that we'll talk about further, Steve, at the Analyst Day. And I want to continue to invest in them because I think they could be game changers in the long haul. So I'm really pleased with the level of [transformation] we're realizing, and these are good businesses that we want to add a little bit of investment back into.

Stephen Tusa^ You should have thrown AI in there. You missed the opportunity. But on that number, so again...

John Stauch^ Well you answered it for me, Steve. Now it's in the transcript so thank you.

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Stephen Tusa^ I guess though, I thought that the messaging around productivity was more bullish than I guess, a \$90 million growth number, if I just add back \$20 million. Am I missing something there? Is there just like conservatism on the way some of that's coming through? I thought the productivity number you were messaging was higher than that.

John Stauch^ Yes. I hate ever using the word conservatism. I think we definitely have a funnel that would suggest we could realize more. And certainly at the upper end of the range, we would be realizing more. So I think right now, as we sit here and we don't see any definitive movement in interest rates for the rest of the year, we haven't planned on any in this forecast. We think we're well balanced in the way we're positioning this.

Operator^ This concludes our question-and-answer session. I would like to turn the conference back over to John Stauch, President and Chief Executive Officer, for any closing remarks.

John Stauch^ Well, thank you for joining the call today. In closing, I want to reiterate some key themes on Slide 27. First, our balanced water portfolio and transformation initiatives continue to drive significant margin expansion in 2023.

Second, we initiated 2024 guidance with expected growth in sales and profitability, reflecting confidence in our strategy and execution across the company. Third, our transformation initiatives have gained momentum in 2023 with expectations to drive further margin expansion in 2024.

And finally, we believe our focused growth strategy and solid execution are building a solid foundation for long-term growth, profitability and shareholder value. [Drew], that does conclude the call.

Operator^ Thank you. The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.