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Pentair, Inc. (PNR) CEO John Stauch on Q3 2019 Results - Earnings Call Transcript

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Q3: 10-23-19 Earnings Summary

SEC *10-Q* *Slides*

EPS of $0.58 beats by $0.03 | Revenue of $713.6M (0.31% Y/Y) misses by $-5.33M

Earning Call Audio

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Pentair plc (NYSE:PNR) Q3 2019 Earnings Conference Call October 23, 2019 9:00 AM ET

Company Participants

Jim Lucas - SVP, IR & Treasurer

John Stauch - President & CEO

Mark Borin - CFO

Conference Call Participants

Steve Tusa - JPMorgan

Nathan Jones - Stifel

Joe Giordano - Cowen & Company

Mike Halloran - Baird

Jeff Hammond - KeyBanc Capital Markets

Deane Dray - RBC Capital Markets

Josh Pokrzywinski - Morgan Stanley

Saree Boroditsky - Jefferies

Julian Mitchell - Barclays

Walter Liptak - Seaport Global

Brian Lee - Goldman Sachs

Brett Linzey - Vertical Research Partners

Operator

Ladies and gentlemen, thanking for standing by. And welcome to the Q3 2019 Pentair Earnings Conference Call. At this time, all participants are in a listen-only mode. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] I would now like to hand the conference over to your speaker today, Jim Lucas. Thank you. He may begin.

Jim Lucas

Thanks, Dorothy. And welcome to Pentair's third quarter 2019 earnings conference call. We're glad you could join us. I'm Jim Lucas, Senior Vice President of Investor Relations and Treasurer, and with me today is John Stauch, our President and Chief Executive Officer; and Mark Borin, our Chief Financial Officer.

On today's call, we will provide details on our third quarter 2019 performance as well as our fourth quarter and full year 2019 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 is accompanied by a presentation, which can 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 limit your questions to one and a follow-up in order to ensure everyone an opportunity to ask their questions.

I will now turn the call over to John.

John Stauch

Thank you, Jim and good morning, everyone. Please turn to Slide 4 titled, executive summary. We are pleased to deliver solid third quarter performance. In particular, our return to segment income growth and ROS expansion. And building on our performance from the second quarter. We are maintaining our full year EPS guidance. We've seen price cost stabilized and we are encouraged to see further signs of top line stabilization in our important aquatics business. We continue to invest in our two key strategic growth priorities. Advancing pool growth and accelerating residential and commercial water treatment.

These investments are centered on building out a consumer experience inclusive of our brand, channel, innovative products and services. We continue to believe we are well positioned to return the core sales and income growth in 2020. And I'll talk little more later in the call about our optimism about long-term strategy an prospects.

I'll now turn the call over to Mark to discuss our third quarter results and updated full year outlook. Mark?

Mark Borin

Thank you, John. Please turn to Slide 5 labeled Q3'19 Pentair performance. For the third quarter, overall sales increased slightly and we saw core sales declined 2%. Segment income grew 1% and adjusted EPS increased 7%. We'll provide more color on individual segment performance shortly. Below the line we saw an adjusted tax rate of 15%, net interest, other expenses of $7.7 million and our average shares in the quarter were $168.6 million. The tax rate in the quarter reflects our long-term strategy spread across a lower income base in 2019 resulting in an expected full year adjusted tax rate of 17%.

Finally, free cash flow was just over $150 million and in line with normal seasonal patterns. We were pleased to see segment income grow and ROS expand despite the softer top line and we believe this is a reflection of price cost stabilizing following the headwinds of significant inflation we discussed in prior quarters.

Please turn to Slide 6 labeled Q3'19 Pentair Segment Performance. This slide lays out the third quarter performance of our three segments. As expected our Aquatic segment experienced a 5% core sales decline against an extremely tough comparison. Following rather abnormal weather during the first half of the year, it appeared that weather in much of the country was more normal during the quarter and a result was an improved sell-through. Aquatic saw segment income declined 9% and ROS contracted 60 basis points but still came in north of 25%.

As we have repeated throughout the year, we remained focused on exiting 2019 with channel inventories more in line with historical levels. Filtration Solutions reported core sales growth of 4% with solid contribution across all business lines but particularly within the smaller food and beverage business as we shipped out some of our improved backlog in both beer and sustainable gas. The integration of both Aquion and Pelican remain on track and both businesses performed in line with our expectations. Segment income grew 17% for Filtration and ROS expanded 50 basis points to 16.5%.

In Flow Technologies, core sales declined 5% during the quarter. We continue to see strong headwinds in our Ag business both OEM and after market. Despite the soft top line performance, segment income grew 4% and ROS expanded 170 basis points to 17.1%. As a reminder, Flow Technologies was hit hardest by tariffs and broader inflation in the segment half of 2018 and a comparison in the quarter was its easiest of the year.

While we continue to see mix results across the three segments, we are most encouraged by size of stabilization and price cost as well as only one more quarter of tough top line comparisons for our products.

Please turn to Slide 7 labeled Balance Sheet and Cash Flow. Our balance sheet continues to strengthen and third quarter delivered another seasonally strong quarter of free cash flow. During the third quarter we had one bond matured and we have another maturing in the fourth quarter. As a reminder, we successfully issued a 10 year note during the second quarter. Between our healthy free cash flow and improved leverage ratios, our balance sheet remains well positioned to fund both organic and inorganic growth opportunities.

Please turn to Slide 8 labeled Q4'19 Pentair Outlook. For the fourth quarter, we anticipate core sales to be roughly flat. We expect Aquatic Systems to be down approximately 1% to 3% as we continue to focus on making sure channel inventories return to more normalized levels by the end of the year. We expect core sales growth in both Filtration Solutions and Flow Technologies to be essentially flat. We anticipate segment income to be up approximately 6% to 8% as we expect price cost to further stabilized and we continue to drive productivity. We expected adjusted EPS to be in a range of $0.64 to $0.66 per share.

Below the line we expect corporate expense to be approximately $14 million to $15 million. We expect our fourth quarter adjusted tax rate to be around 17%. WE expect net interest and other expense of roughly $8 million and shares to be approximately 169 million.

Please turn to Slide 9 labeled Full Year 2019 Pentair Outlook. For the full year, we expect core sales to be down roughly 1%. We expect total sales to be essentially flat with roughly 2% contribution from our two acquisitions offset by 1% headwinds from FX. We anticipate segment income to be down around 3%. We continue to expect our full year adjusted EPS to be approximately $2.35 per share. Other items embedded in our guidance include expected corporate expense of $60 million to $63 million and adjusted tax rate of 17%, net interest other expense of $35 million and an average share count for the year of roughly 170 million shares.

While there are undoubtedly many moving pieces to our 2019 pack to expected flat EPS, we continue to be encouraged by signs top line stabilization and further price cost improvement. We are encouraged by the performance our businesses are delivering in light of the top line challenges faced this year.

I would now like to turn the call back to John.

John Stauch

Thank you, Mark. Please turn to Slide 10, labeled Executing a Consistent Strategy. We continue to be focused on driving our long-term strategy and we believe there is a lot of evidence at the focused investment we are making is the right investments and driving results. Most people would agree that global water quality is a challenge. While many companies are participating in offering to solve this global issue, we've chosen to focus primarily on the residential and commercial markets. There is little argument that consumers can benefit from taking ownership of their water experience.

They can do it to their own taste and with solutions that meet their individual needs and preferences. And Pentair has a variety of solutions to help consumers treat, move and enjoy water. In fact, Pentair is one of the few total solution providers to residential customers. Also, when we aligned on our strategy nearly two years ago, it started with our leading Aquatic franchise. With over 5 million pools installed in the US, and over half of them being over decade old, there is large and installed base to serve. We've built the strong business focus on new product development and strong dealer loyalty.

The introduction of the Variable Speed Pump nearly a decade ago created awareness around energy savings and the results has compounded with other product categories from LED lightly to hybrid heaters. We believe the continued adoption of automation which is small today, roughly 275,000 pools versus an opportunity north of 2.5 million pools in the US, creates a new avenue of growth where we have leading position.

Within residential Filtration market, the acquisition of Aquion and Pelican earlier this year moved us being leading component suppliers to now being a provider of systems and solutions. We've learned quite a lot in our short time owning both of these businesses, and we believe there are many paths to create value as we help consumers solve their water challenges in their homes.

On the commercial side of the business, we've historically enjoyed a strong position in food service area. Increasingly, we are focusing on total water management with customers and we believe this presents an opportunity, better positions us with many our existing and potential customers. Within the commercial office water space, customers are increasingly looking at opportunities to decrease the use of plastic bottles. And we've a number of technologies today that can serve this space. And we believe there are opportunities to further expand in this area.

Outside of the residential and commercial verticals, we've a number of technologies we've developed around nano and ultra filtration. As we develop new IoT products, we see even more opportunities to solve customer challenges. For instance, within the beer industry, we've approximately 150 plants globally that use our digital BMS system, enable our customers to become more sustainable, lower cost, move from static to dynamic live reporting and improved overall operating performance. We've transition this technology into the sustainable gas industry and we believe there are opportunities to expand this technology to other parts of our portfolio over time.

We also continue to believe there are multiple paths to drive consistent, sustainable growth especially in our core residential and commercial businesses. And our recent acquisition allowed us to move closer to the consumer. And while we have built stronger aquatic business, we believe that by better focusing on the consumer not only the dealer, it will enable us to maintain an already healthy growth rate in one of our best businesses.

We believe that we have the right portfolio, the right strategy, the right culture and the right technologies to further our positions as a leading water treatment company. With the strong core to build from and healthy balance sheet to support both our organic and inorganic opportunities, we look forward to demonstrating our strategy to our shareholders in Q4, and in 2020 and beyond.

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

Question-and-Answer Session

Operator

[Operator Instructions]

Your first question comes from the line of Steve Tusa with JP Morgan.

SteveTusa

Hi guys, good morning. Hey, can you just breakdown a little more like what's going on in the Flow business? The revenues were way off versus our model, but the profits kind of held in. and I know this dispersion in the margin profile of some of those businesses, so and that was one. I think, in the first quarter that was tougher to kind of figure out. What's going on in that segment? I think the other two are pretty straight forward. What's going on in this segment?

JohnStauch

Yes, Steve, let me speak to the revenue miss and I'll let Mark to give the details. But during the end of Q2, we saw a little both positive in some of the Ag orders. And right out of the gate in Q3, we just saw that Ag did not recover at all, so we had anticipated a little more recovery sequentially in Q3. And it just slide out, didn't happen.

So now we've adjusted heading into Q4 next year the fact that we don't see Ag recovering at all. And I think the lot of the global data would suggest that, and we'd probably figured it out right now. But that was a little bit of a bounce in Q3 that we had expected that didn't happen.

SteveTusa

How big is Ag? It isn't that relatively profitable? Shouldn't that had a -- shouldn't that have had a kind of more negative impact on the margin like? What am I missing on that front?

MarkBorin

Yes, Steve it's Mark, and it's a great question. What we saw positive signs here were two things really, you'll see price cost getting better. As I said in my prepared comments, Flow was hit hardest by the inflation pressure so we see price cost turning positive in Q3. And then also productivity, we touched on that in Q2 that, that although we weren't, we didn't see the productivity reading out in Q2 we saw signs that gave us a high degree of confidence that we would start to see that in Q3 and that's really what happened.

So, you're right that, being down in Ag from a mix perspective would push margins down and income down but, that was --we were benefited by better productivity and improved price cost. And Steve--

SteveTusa

And how big is Ag, for you guys?

MarkBorin

Ag would be somewhere in the $200 million range.

JohnStauch

Per year.

SteveTusa

Okay, and then one last one just on the Aquatics, pool made some pretty positive comments that their channel is clear. Can you kind of validate that comment or are there other considerations and thinking about next year a little bit, I would think you guys have some easy comps here coming up in the first half of '20 or is there something else that we should keep in mind when thinking about kind of the trajectory in the next year?

JohnStauch

Yes Steve, so I think you're right. I mean we do track a lot of our largest customer's earnings calls and we agree that inventory is definitely getting more normalized here. And our goal is in between now and the end of the year and make sure that it gets into that normalized pattern.

I do think though that, the pricing this year is relatively more normal which we'll not suggest that any of the channel would reach to do the buy heads that we saw last year with a much more elevated pricing levels so, Mark, I don't know if you want to add anything more?

MarkBorin

Yes. I agree, I mean, we've said we continue to believe that by the end of the year, we'll exit with normal levels and we think of 2020 more in line with historical normal seasonal stabilized perspective.

Operator

Your next question comes from the line of Nathan Jones with Stifel.

NathanJones

Good morning, everyone. Just maybe thinking a little bit about where the returns organic growth comes from in 2020. I think we have probably being in the pool business thinking kind of understand why that should return to growth. But I mean look if I'm having a look at the last couple of quarter's results; organic sales have been down with positive impacts from price. This quarter, you're down to with 3 points to price, and volume down 5. Outside of the pool business with -- what I would imagine are moderating price tailwinds and some negative volume trends here, where would you expect the growth to come from in 2020 outside of pool?

JohnStauch

Well. I mean it's good question, and I thank you for asking. But I mean, I think first of all, we beyond pool, we also had some channel inventory in both Filtration and Flow. That was built up for some of the same buy ahead patterns that happened in last year's Q3 and Q4. So this year's Q3 and Q4 have those difficult comparisons and then Q1 and Q2 of next year have much easier comparisons across Filtration, Flow and Aquatics.

NickStokes

Okay. So some tough comp issues this year for the same reasons is pool latest ones next year. That makes sense. Can you maybe talk a little bit more about some of these? You talked about focused investments being the right investments and driving results. Maybe talk a little bit more about where those investments and what kind of results you're seeing them drive? And maybe specifically a little bit more about building out the channel for the commercial and residential filtration.

JohnStauch

Yes, so we have three specific growth priorities in both pool and residential and commercial filtration. It’s really about having, I’ll start with commercial first, and it’s about having the best commercial systems and capabilities. And we’re really excited about the technology that we’re building to sell at commercial office water opportunities, as you know, people are seeking carbonated water and they’re also seeking flavored carbonated water.

So really excited about the investments we made on technology side, while we’re more than a year away from launching that product that our product is really better solution that we think that the market will benefit from. So excited there. We are also through both the acquisitions and also internally within Pentair; we’re having the best residential systems. Smarter, more innovative valves technology, smarter water softener systems technology, I am hooking those to automation and then having the services piece to the Pelican acquisition to complete that last mile.

And we’re really excited about the progress of that in home sales capability, and the build out of what we call our mobile resource centers which are our brands that we go out and sell with. So huge progress there. On the pool side, we continue to see technology advancement, new technologies around filtration, new technologies around automation, so we’re excited that that penetration rate will show up.

When you look at the sell-through rates of pool in both Q2 and Q3, they’re back to the high single-digits again. So once we get through this inventory channel issue and the pool business normalizes, I think we’re very positive that we’ll see that return to growth next year.

NathanJones

On the commercial water filtration product, the flavored and bubbly water, have you guys done enough work to kind of talk about what you think the size of that opportunity is for you?

JohnStauch

I think it's really fragmented. I think the overall momentum is there. I think what we wanted to do is make sure that we have the systems that can give you chilled, heated, sparkling and as you know our other peer filtration is a big part of that overall component. So we want to be talked about in the space, and we want to make sure we have the right systems that can solve any solution, that basically a commercial customer has.

Operator

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

JoeGiordano

Hey guys, good morning. John, I just wanted to clarify something you said earlier on Steve's question regarding Ag, Flow. I think you mentioned that there was some headwinds kind of exiting Q2 about Ag, that didn't materialize in the quarter. I was under the impression that once Ag that when we have that bad weather in the first half that like any recovery in Ag was taken out of guidance. So I'm just a little confused about, can you kind of square that for me?

+

JohnStauch

Yes, there are two forms of Ag. We have a precision Ag spray business and that we did address earlier and that is a very-very high margin offering. The other part of Ag is more of the pivot Ag spray in the irrigation side of the business, that's specifically what I was referring to.

JoeGiordano

Okay, so this is the irrigation not the precision, okay cool. Okay, can you talk about maybe some of the impacts you're having with some of just the internal cost that you shared? Because clearly, I mean, particularly in Flow, I mean, you're seeing the margins come through on weak number on a weak growth number, so may be you talk about some at a high level maybe there's a couple of examples you can kind of take us through or sort of some things that are being done differently today than maybe a year ago, across the enterprise maybe?

JohnStauch

Yes, sure. One of the things we talk a lot about is we separated with optimization and really looking at where did we have complexity and how can we get after complexity reduction and into the Flow Technology segment was certainly one of those businesses where we saw high degree of that skew rationalization things, that inherently drives up cost and drive down margins.

And the team really got after that in as we exited 2017 and throughout 2018, and so we started to see those activities and actions pay off here in 2019. And also, we've also talked about some of the factories where we had some challenges. We've been investing in automation and other technology to replace and improve some of the older equipment and machinery that's used in some of those factories that's also starting to readout early stages. So there's more of that to comments, we think about 2020 but we're again seeing favorable signs and encouraged by what we're seeing.

JoeGiordano

And one last for me on, if we look and it's too early to talk 2020, but if we just think about the situation where there is inventory cleaned up through your partners, and we can start ramping a little bit. When I think about free cash flow, there's nice performance here in the quarter. Is that going to be, how much of the headwind do you see that being into '20 as things kind of ramp up and start producing at higher rates?

JohnStauch

I think we still have opportunity to really focus on cash flow and we continue to view cash flow targeting at approximating adjusted net income, so we wouldn't change that point of view even though as we grow to your point, there maybe some working capital type things that we need to invest. But there are opportunities in other places that we would manage and balance out to have that long -term target still maintained.

Operator

Your next question comes from the line of Mike Halloran with Baird.

MikeHalloran

Hey, good morning everyone. So a couple ones first, just on capital usage here, any thoughts to bring back being more aggressive on the buyback side again? And then secondarily related to that, how's the M&A pipeline look? What's the willingness, ability to bring something in and how are the evaluations looking out there?

JohnStauch

Yes, I mean I think clearly we're focusing on execution right now Mike and part of that was making sure that we're delivering on our commitments, Q2, Q3, and Q4 so that's our first focus area. I think there are the growing opportunities to invest in the platforms that I mentioned. And we're continuing to look at those tuck-in acquisitions I would say that feed more what we've done already.

But you can never time those. We have no idea where they're going, and we just want to make sure that we're protecting the balance sheet heading into next year and giving ourselves flexibility to do what we think is going to drive most amount of value.

MikeHalloran

The pipeline on that side, John?

JohnStauch

Good.

MikeHalloran

MikeHalloran

All right, and then just some thoughts on the price cost side, you talked --it seemed like you're implying the price cost side should be a little bit more favorable moving forward from here. Maybe talk about puts and takes on the pricing side? Is that kind of flattened out a little bit relatively to the commodity side? And how you're thinking about that moving into next year?

JohnStauch

Yes, so maybe the way to think about it is, we had significant price cost headwinds as we talked about coming out of last year and into the beginning of this year. Now what I referenced in Q3 in particular was favorability because we've got favorable price and we have inflation moderating. As you move forward that favorable year-over-year price will start to be a little bit more than normal, at a more normalized level versus the unusually high price increases that we had in 2018 that spilled over into 2019.

So, I don't -- it's more of a stabilization story rather than a benefit. It's just mitigation of what had been a pretty significant headwind. And on the inflation side, one thing to always kind of keep in mind is inflation is not just the material or commodity inflation, but we certainly also have labor inflation and we don't see that going away or moderating. So that will continue to be part of how we think about what our 2020 will look like.

Operator

Your next question comes from the line of Jeff Hammond with KeyBanc Capital Markets.

JeffHammond

Hey, good morning guys. Just on, can you just talk about what is in forming the lower growth rate in filtration and then just as you look forward here a lot about our macro-slowing and just where and just where are you seeing some signs of slowing in your business outside of that Ag space?

MarkBorin

Sure. As we-- as I talked about in Q3, we saw pretty, pretty improved performance in the food and beverage part of the filtration business. That moderates a little bit in Q4, so that's part of the story. We do see continued stabilization and incremental improvement on the important residential and commercial side. Both the systems and components businesses, where those -- the investments in those acquisitions took place. So overall, just more of a moderated view given their performance in Q3, and then would expect to kind of as we think about moving into 2020. A similar level of performance and starting to see some of the investments that John talked about reading out and improve core sales growth.

JeffHammond

Okay, and then just on pool. What are you assuming and what are customers telling you about kind of the normal early buy situation? And then just, if we look into 2020, certainly you've got some easy comps and typically this business grows mid-to-high single digits. Should we think of 2020 is kind of an easy comp and you can get back to those levels or above? Thanks.

MarkBorin

So on the first question and from an early buy perspective, we're seeing kind of a consistent early buy pattern, of last year was a little bit unusual because of the blend of the impact of the price increase. But what we're seeing this year is more in line with kind of the historical trends. In terms of next year, as we said, we're exiting Q4, you see that the Q4 guide is what I would think of as back to a little bit more level of normalization improved income performance, flattening of the top line, which had been decreasing, and as we think about 2020, we're just going really focus on getting back to what we believe would be performance in line with our long term objectives.

Operator

Your next question comes from the line of Deane Dray with RBC Capital Markets.

DeaneDray

Thanks. Good morning, everyone. Hey, very well, thank you. How about, can we put a little finer point on the working down the excess channel inventory and pool? If we had been thinking it was around a $60 million excess it just based on commentary about expected 4Q normalizing. How much should we think about that $60 million haven't been worked up so far?

MarkBorin

So as we talked, and we worked down some of that inventory in line with sort of our expectations and we continue to see that coming down further in Q4 and exiting the year at levels that are in line with more historical seasonal patterns.

DeaneDray

Okay, and then on pool, John, you talk about some of the new product development in filtration and pool and automation are just to set expectations, might you have some new automation offerings for the 2020 season?

JohnStauch

Yes, we do already. And I think we're learning how to sell it better. We believe everybody can benefit from that automation capability. It's a different type of sale though. And we have that we believe the right products that can really help the user along, and we have to tweak our ability to sell technology. It's not like selling a product. It's more like selling a service or capability. And so we learned a lot this year. And I think we're encouraged by the progress we're making in Q3 and Q4. And I think those products can really accelerate as they head into next year.

DeaneDray

When you say sell a service, is that something that Pentair would benefit from on a recurring basis or is that a pool dealer that would be part of their revenue stream?

MarkBorin

Well, clearly the vision would be that everybody would benefit, right? And that at the end of the day, most people buy technology on more rented basis because they believe whatever they have is going to be obsolete. We'd have to line the channel that way, Deane but ultimately, we think that's going to be the right answer. We're launching in this quarter, the new Pentair Home App, which basically is a broad umbrella that takes all of the suite of products that Pentair offers and allows you to be connected into that Home App. And we're hopeful that as the consumer sees more and more things that are available to either connecting with Alexa or Google Home or Apple or whatever your devices that you start to see the benefits of, some of the monitoring your water quality, and then starting to buy some of the products and services that would attach to that.

DeaneDray

That's good to hear. And just last one for me when you talk about the commercial office water opportunity, are you thinking and still we agree that it's still very fragmented. Are you thinking of a rental opportunity or would this be equipment sales or both?

MarkBorin

Today, it's about having the right systems and likely out selling them, Deane, as you know the market does rent them. The end solution providers do rent units. Don't know yet if that's the space that we want to be in. But we were -- we introduced carbonated water some 8 to 10 years ago. We were probably early in the market. We have all the technology and we deliver that for food service and so how do we bring that into a commercial office environment in a productive way, if that's what people want. As you guys know, there's a lot of fickle drinkers. The first one is get tea and coffee.

Most all tea and coffee needs to be filtered, so you don't scale the units or cause damage to those units. And our filtration plays a big part in that. And if we expand that filtration into other forms of water, we think there's a huge opportunity for Pentair. And look, this is forward thinking, we believe we have the technology where it's probably not a 2020 launch, it's probably somewhere in 2021.

Operator

Your next question comes from a line of Josh Pokrzywinski from Morgan Stanley.

JoshPokrzywinski

Good morning, guys. Quick question on price cost, I guess, with working down channel inventory and kind of generalized market weakness, some of that related weather earlier in the year. I would imagine it's harder to get price certainly, probably more room for incentives than to try to raise prices in the channel. Is that something we should expect to start expanding more rapidly from this point now that we've kind of cleared the season, cleared the channel overhang from an inventory perspective?

JohnStauch

I think the best way to think about it is, as I said before, it's just more of a normalized level of price, as you know a big chunk of the price that we see overall comes from the pool business that they had unusually high price last year in response to inflation. This year, they had a price increase that would have gone into effect in September, which is the normal timeframe that those price increases go into place. And I call that a more in a more normal historical level and something similar in the other businesses. So we are not seeing --we didn't see any unusual reaction to price this year as a result of channel inventories and but we do see just going to a more normalized level given that last year's higher price was really driven by that incremental inflation.

JoshPokrzywinski

Got it. And then I guess as it pertains to the aquatic season, just as we kind of round it down there in the third quarter, obviously you had a slow start with weather and particularly in some of the warmer regions that would have been bigger contributors in the first quarter. Did any of that get made up later in the year just with the season, maybe stretching out longer, not even weather related, but just thinking of folks are always going to be busy kind of May through August, but maybe they do an extra job in September. Is that something that you guys noticed and maybe sets up, accomplish and think about and sell through next year?

MarkBorin

Yes, I think some of it will. I don't think first of all, the comp is meaningful enough. But yes, those pool builders will continue to work as long as they can in those areas. And they'll fill in jobs in the slower season that they would have otherwise not done. But they will also probably likely celebrate the holidays that exists in Q4. And so you're not going to see that same level of build that you tend to see in the more summer seasons.

Operator

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

SareeBoroditsky

Good morning. Could you provide some color on what you saw geographically? I believe last quarter you talked about Europe and China being positive. Did that continue? And any expectations as we look forward towards the end of the year?

JohnStauch

Sure, that -- it did continue. So we had commented earlier in the year that we saw some weakness in Europe, particularly on the filtration side, as we move through the year in Q2, and then again in Q3, and we really see to the balance of the year, we saw improvement there. So Europe now has -- is back to moderating growth and China as well is returned to a reasonably good growth level.

SareeBoroditsky

And then just a more longer term question on aquatic. How should we think about the impact from the Variable Speed Pump Legislation that goes into effect into 2021?

JohnStauch

We believe in 2021 it should help our overall sales. Variable Speed Pumps for us today are probably just over half of our total pumps sold. They do sell at a higher sell through value. So we do believe as the transition happens. Those of us who've been through these transitions before always have to go question, one of those dates going to really happen and will there be slippage and also, how does the inventory work its way through. And so we're not putting anything into 2020, obviously, and, we'll see if there's a relative bump in 2021, but overall should be positive to our business.

Operator

Your next question comes from the line of Julian Mitchell with Barclays.

JulianMitchell

Thank you. Good morning. Maybe just following up on that geographic point, you had emphasized some of the weakness in Ag. We've talked a lot already about residential trends in the US in the past few months. Just wondered if you could give any detail around what you've seen in some of the more commercial or industrial markets in the US? If there's been any particular shift in demand from month-to-month since July?

JohnStauch

Nothing significant from a month-to-month perspective, our -- 80% of our businesses overall is driven by the residential and commercial end markets and as we move through the balance of the year, we've talked about sort of the inventory impact, but beyond that the underlying demand has remained positive and we continue to see that kind of reading out through the balance of the year.

JulianMitchell

Thanks. And then on your sort of segment Income Bridge I guess on slide 5, when we're thinking about the productivity portion of that in aggregate, it looks like it's probably a maybe a $20 million tailwind or something for the year as a whole. If you could just sort of clarify that sounds about right and then when thinking about next year, do we think about some of those measures that you've accelerated around productivity pushing that number up or is that a pretty good run rate for the current demand environment?

MarkBorin

Yes, I think what you're seeing in Q3 is more in line with the level that we would anticipate. And I think to remember kind of what makes that up. There are multiple elements. So there's material productivity which is we're working on trying to mitigate some of the inflation headwinds. There's operating costs productivity that would think about that as you're looking at opportunities to reduce G&A costs. And then there's factory productivity, but then what's offsets that is also the investments we're making in the growth areas around R&D and selling, marketing investments and technology and things like that.

So as we think about this year and into next year, we will continue to look for increasing levels of productivity but utilizing some of that to continue to invest in the areas where we see the biggest growth opportunities.

JulianMitchell

Thanks very much. And one last quick one for me. Looking at the filtration operating performance, you had pretty healthy sales growth there in Q3. The incremental margin was around 20% or so. Is that a reasonable sort of placeholder for that business with its current mix or do you see anything sort of one time within that figure?

MarkBorin

I wouldn't call it one time but with this, this is where we do have the residential systems and also the consumer services and we are significantly investing in those businesses, right. So we're very encouraged by the top line growth we have and we continue to add back digital marketing, advertising, branding and R&D spend to really accelerate the long-term growth there. So I think this is a more normalized pattern, as we head into 2020 is benefiting from the growth and then reinvesting a portion of that income back into fuel more growth.

Operator

Your next question comes from a line of Walter Liptak with Seaport Global.

WalterLiptak

Hi. Thanks, good morning. I want to ask a geographic question, and understand the comments about the EU filtration kind of moving up from moderating growth in China doing okay, now. I wonder if we could just get a little bit more detail about why that as we look at macro numbers, Europe continues to get worse. China, the GDP numbers continue to weaken. What's going on with your sectors or the market share that's helping those regions?

JohnStauch

Yes, so let me talk about China, first. In our China business, we said before in China, Southeast Asia overall is residential and commercial filtration primarily. And think about that being just north of 100 and some million dollars on an annual basis. So the growth rates we're talking about are really about starting from a relatively low base in a very enormous market in which we have a dedicated China team and we have a dedicated factory dedicated R&D lab. And we really invested a lot of new product growth and marketing.

So, we're winning in a space that may or may not overall be growing, but we have a lot of runway left in that area. In Europe, Mark gave the overall numbers and that is appropriate. Within those overall numbers, those things that are doing well in Europe, and there's things that aren't doing so well in Europe. So as we look at you know, some of the global industrial product lines, we definitely saw slow downs. And when you take a look at some of the more installed base, residential and commercial aftermarket businesses they're doing okay. Than no way would we call a robust market environment.

WalterLiptak

Okay. Can you help us with the size of the EU industrial business?

MarkBorin

Yes, I think it's roughly $100 million.

WalterLiptak

$100 million total for the year.

MarkBorin

For the year, right. Not in a quarter.

WalterLiptak

Okay, great. And then just switch gears over to the R&D, hearing about the investments in 2020, or is it similar levels of R&D, but more focused around some of these growth opportunities, or should we expect some kind of a step up in R&D spends?

JohnStauch

Yes, I think you're going to expect a step up. I've said many times that we have the ability to invest a lot more in R&D. And we'll feel better about that investment when we feel marketing has done the work to produce the roadmap of where our R&D will be best utilized. And we're really excited about our automation platforms and we have a global innovation center around automation, one Pentair solution that would work across the enterprise, really excited about that roadmap.

And then around our treatment, and water treatment Innovation Center, really excited about the nano and ultra filtration technologies out of the CPT acquisition our X flow business, and expanding those into both residential and commercial, very excited.

And then as I mentioned earlier building systems capability that takes that technology and gives the overall solution. Those are the double downs for me and the team, and I'm going to accelerate that investment in 2020 and probably 2021. And we're encouraged and excited by the products of the other end of that investment.

Operator

Your next question comes from the line of Brian Lee with Goldman Sachs.

BrianLee

Hey, guys, good morning. Thanks for taking the questions. Maybe just first one on price going back to that topic to clarify a bit. I know 2019 was a bit of normal with the three points here and I know it's early for 2020. But do you think it's reasonable to assume we just settle back to somewhere around the point in price for next year, like we've seen in past years, or was the pricing this year late enough in the year where there's still some spillover into the early part of next year?

JohnStauch

Yes. I think about it a slightly higher than that, 1% that we've seen, so prior to 2018 for the few years prior to that, it been right around 1%. But that was I call that like historically low, so something in the 2% range is probably a little bit more in line with what would be historically normal. With a rounded range on that 50 basis points. Okay. I mean, I think it's too early to say. The businesses that went out in September as Mark said, I mean, we were out in that range that Mark said and we saw those pricing stick, and we're generally well received by the overall customers, and there was a more normal, and then we'll see how the others do.

BrianLee

Okay, great. That's helpful. And then just a second question going back to Flow for a second. I know you, you kind of walk back to core growth outlook for that segment through the year and you sort of did the opposite last year and walking it up through the years. So how do you de-risk the view here for 4Q just given how lumpy it's been all year, and then as you think about 2020, is this a segment you'd expect to grow year-on-year along with the overall business? Thanks.

MarkBorin

I can't call it de-risk. I can just tell you that it represents the last multiple quarter trends, it doesn't produce any incremental upside sequentially from things growing off of how they did the previous quarter, and then there is some year-over-year benefit as you look at Q1 and Q2 in this business next year. And then we'll see how confident we are when we come up with the guide of being able to drive organic growth in Q3 and Q4 of next year.

Operator

Your next question comes from the line of Brett Linzey with Vertical Research Partners.

BrettLinzey

Hi, good morning, guys. Hey, I just wanted to come back to Aquatics. You talked about some of the technology and growth priorities you have there and pool. As we think about those incremental costs and price moderating, but also some relief on ROS and other spending. What's the right incremental margin range we should be thinking about next year as you maybe see a more normal top line?

JohnStauch

This business has a fairly sizable drop through. And because it's sales wise material and a really efficient manufacturing process. So good drop through. I'm not going to give you an answer because this is a huge value contributor to Pentair. I want to invest in this. And I think we have some really exciting technologies in the pipeline here as well. And we'd like to put some investment back into sales channel. Primarily around the aftermarket side, I think we do a really nice job with our dealer channel covering both new pools and remodel pools.

I think our opportunity is and being further down the aftermarket cycle with the services channel, and making sure we're the company of choice for consumers and that services play. And then also making sure that we go back to our roots and I'd still say we are the technology leader, but we used to be significantly more advanced than we are today. And we believe we have those technologies in the pipeline and need to drive them through a new product development phase, and that will be an investment thesis for 2020 as well.

BrettLinzey

Okay, great. And then shifting to restructuring, it took I think $6 million this quarter, $7 million last quarter. Are you budgeting more spending in Q4? And then just thinking about the payback? Did most of that get realized in the quarter? Do you see some of that rolling over into 2020 and from saving standpoint? Thanks.

JohnStauch

So we don't include in our guidance and expectation around restructuring, but I would anticipate there would be some incremental restructuring again in Q4. And the investments and restructuring that we've made in this year really wouldn't see those necessarily reading out now. But those would be part of how we think about 2020.

As Mark mentioned, we're attacking some of the factories and some of the efforts within the factories. Those tend to have a little bit longer payoff than just structural changes to the business. So we have a right investments, we do have a larger footprint than we need and it is always geographically perfect. So we've addressed some of that especially the flow side, as Mark mentioned. And while we're seeing the margin improvement, I think there's still an opportunity for more margin improvement down the road.

BrettLinzey

Okay. And geographically where those costs were focused restructuring?

JohnStauch

Little bit everywhere. Yes.

End of Q&A

Operator

And there are no further questions. At this time, I will turn the call back over to our speakers for closing remarks.

John Stauch

Thank you for joining us today. We are encouraged by our third quarter performance, and we continue to see further signs of stabilization in our core business. We saw further productivity improvement in the quarter and we continue to build on our strong culture. We've been investing and we'll continue to invest in our key growth strategies, as well as digital enterprise capabilities to better serve our customers. We have a strong capital structure, solid free cash flow and we will continue to invest in our strategy to be the leading residential commercial water treatment company. Thank you for your continued interest. Dorothy, you can conclude the call.

Operator

Thank you, ladies and gentlemen. That does conclude today's conference call. We thank you for your participation and ask that you please disconnect your lines.