PENTAIR INC
Form 10-Q
April 22, 2008

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly Period Ended March 29, 2008

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number 000-04689
Pentair, Inc.
(Exact name of Registrant as specified in its charter)

Minnesota	**41-0907434**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification number)**
5500 Wayzata Blvd, Suite 800, Golden Valley, Minnesota	**55416-1259**
(Address of principal executive offices)	**(Zip code)**

Registrant s telephone number, including area code: (763) 545-1730

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

On March 29, 2008, 99,090,432 shares of the Registrant s common stock were outstanding.

Pentair, Inc. and Subsidiaries

PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Pentair, Inc. and Subsidiaries

Condensed Consolidated Statements of Income (Unaudited)

	Three months ended	
	March 29	**March 31**
In thousands, except per-share data	**2008**	**2007**
Net sales	$840,404	$792,845
Cost of goods sold	589,073	556,914
Gross profit	251,331	235,931
Selling, general and administrative	138,646	139,482
Research and development	15,866	14,950
Operating income	96,819	81,499
Equity losses of unconsolidated subsidiary	(917)	(957)
Net interest expense	16,088	14,711
Income from continuing operations before income taxes	79,814	65,831
Provision for income taxes	27,170	23,202
Income from continuing operations	52,644	42,629
Loss from discontinued operations, net of tax	(1,217)	(499)
Gain (loss) on disposal of discontinued operations, net of tax	(7,137)	143
Net income	$ 44,290	$ 42,273
Earnings (loss) per common share		
Basic		
Continuing operations	$ 0.54	$ 0.43
Discontinued operations	(0.09)	
Basic earnings per common share	$ 0.45	$ 0.43
Diluted		
Continuing operations	$ 0.53	$ 0.42
Discontinued operations	(0.08)	
Diluted earnings per common share	$ 0.45	$ 0.42
Weighted average common shares outstanding		
Basic	98,280	98,966
Diluted	99,558	100,271
Cash dividends declared per common share	$ 0.17	$ 0.15

See accompanying notes to condensed consolidated financial statements.

Pentair, Inc. and Subsidiaries
Condensed Consolidated Balance Sheets (Unaudited)

In thousands, except share and per-share data	March 29 2008	December 31 2007	March 31 2007
Assets			
Current assets			
Cash and cash equivalents	$ 62,284	$ 70,795	$ 64,230
Accounts and notes receivable, net	616,705	466,675	525,213
Inventories	416,059	392,416	393,495
Deferred tax assets	54,275	50,511	51,178
Prepaid expenses and other current assets	43,245	35,908	40,990
Current assets of discontinued operations		21,716	29,199
Total current assets	1,192,568	1,038,021	1,104,305
Property, plant and equipment, net	368,293	365,990	349,768
Other assets			
Goodwill	2,030,281	2,004,720	1,813,552
Intangibles, net	497,799	491,263	384,763
Other	81,447	82,237	69,505
Non-current assets of discontinued operations		18,383	18,420
Total other assets	2,609,527	2,596,603	2,286,240
Total assets	$4,170,388	$4,000,614	$3,740,313
Liabilities and Shareholders Equity			
Current liabilities			
Short-term borrowings	$ 7,005	$ 13,586	$ 16,003
Current maturities of long-term debt	5,209	5,075	8,153
Accounts payable	235,798	229,937	200,649
Employee compensation and benefits	99,582	111,475	85,219
Current pension and post-retirement benefits	8,557	8,557	7,918
Accrued product claims and warranties	46,318	49,382	42,766
Income taxes	34,135	12,919	13,458
Accrued rebates and sales incentives	28,864	36,663	31,130
Other current liabilities	109,759	90,377	91,102
Current liabilities of discontinued operations		2,935	9,220
Total current liabilities	575,227	560,906	505,618
Other liabilities			
Long-term debt	1,119,105	1,041,925	1,056,116
Pension and other retirement compensation	169,790	161,042	213,512
Post-retirement medical and other benefits	36,179	37,147	47,401

Long-term income taxes payable	24,268	21,306	14,412
Deferred tax liabilities	166,558	167,633	108,903
Other non-current liabilities	105,041	97,086	85,912
Non-current liabilities of discontinued operations		2,698	2,582
Total liabilities	2,196,168	2,089,743	2,034,456
Commitments and contingencies			
Shareholders equity			
Common shares par value $0.16 2/3; 99,090,432, 99,221,831 and 99,777,660 shares issued and outstanding, respectively	16,515	16,537	16,629
Additional paid-in capital	468,930	476,242	484,376
Retained earnings	1,323,607	1,296,226	1,172,459
Accumulated other comprehensive income	165,168	121,866	32,393
Total shareholders equity	1,974,220	1,910,871	1,705,857
Total liabilities and shareholders equity	$4,170,388	$4,000,614	$3,740,313

See accompanying notes to condensed consolidated financial statements.

Pentair, Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows (Unaudited)

In thousands	Three months ended March 29 2008	March 31 2007
Operating activities		
Net income	$ 44,290	$ 42,273
Adjustments to reconcile net income to net cash used for operating activities		
Loss from discontinued operations	1,217	499
(Gain) loss on disposal of discontinued operations	7,137	(143)
Equity losses of unconsolidated subsidiary	917	957
Depreciation	15,081	15,436
Amortization	6,535	4,890
Deferred income taxes	(5,836)	(355)
Stock compensation	6,465	6,218
Excess tax benefits from stock-based compensation	(378)	(1,063)
Gain on sale of assets	(552)	
Changes in assets and liabilities, net of effects of business acquisitions and dispositions		
Accounts and notes receivable	(139,045)	(98,527)
Inventories	(16,096)	(2,010)
Prepaid expenses and other current assets	(5,657)	(8,625)
Accounts payable	5,542	2,711
Employee compensation and benefits	(17,038)	(12,845)
Accrued product claims and warranties	(3,336)	(1,403)
Income taxes	19,410	(1,699)
Other current liabilities	9,470	(7,734)
Pension and post-retirement benefits	1,885	4,033
Other assets and liabilities	2,588	289
Net cash used for continuing operations	(67,401)	(57,098)
Net cash used for operating activities of discontinued operations	(2,948)	(571)
Net cash used for operating activities	(70,349)	(57,669)
Investing activities		
Capital expenditures	(14,225)	(18,865)
Proceeds from sale of property and equipment	3,845	1,329
Acquisitions, net of cash acquired	165	(230,581)
Divestitures	29,959	
Net cash provided by (used for) investing activities	19,744	(248,117)
Financing activities		
Net short-term borrowings	(7,272)	1,234
Proceeds from long-term debt	159,405	345,190

Repayment of long-term debt	(82,766)	(10,250)
Excess tax benefits from stock-based compensation	378	1,063
Proceeds from exercise of stock options	851	1,762
Repurchases of common stock	(12,500)	(9,280)
Dividends paid	(16,908)	(15,022)
Net cash provided by financing activities	41,188	314,697
Effect of exchange rate changes on cash and cash equivalents	906	499
Change in cash and cash equivalents	(8,511)	9,410
Cash and cash equivalents, beginning of period	70,795	54,820
Cash and cash equivalents, end of period	$ 62,284	$ 64,230

See accompanying notes to condensed consolidated financial statements.

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Pentair, Inc. and subsidiaries
Notes to condensed consolidated financial statements (unaudited)

1. Basis of Presentation and Responsibility for Interim Financial Statements

We prepared the unaudited condensed consolidated financial statements following the requirements of the Securities and Exchange Commission (SEC) for interim reporting. As permitted under those rules, certain footnotes or other financial information that are normally required by accounting principles generally accepted in the United States can be condensed or omitted.

We are responsible for the unaudited financial statements included in this document. The financial statements include all normal recurring adjustments that are considered necessary for the fair presentation of our financial position and operating results. As these are condensed financial statements, one should also read our consolidated financial statements and notes thereto, which are included in our 2007 Annual Report on Form 10-K for the year ended December 31, 2007.

The 2007 Condensed Consolidated Statements of Income and the Condensed Consolidated Statements of Cash Flows has been reclassified from the 2007 presentation to conform to the 2008 presentation. The reclassification reflects the presentation of *Equity losses of unconsolidated subsidiary* of $1.0 million as a separate line item below *Operating income* in the Condensed Consolidated Statements of Income rather than as a component of *Selling, general and administrative*, and as a separate line in the *Adjustments to reconcile net income to net cash used for operating activities* in the Condensed Consolidated Statements of Cash Flows, rather than as a component of *Other assets and liabilities*. This reclassification corrects the previous presentation and was not material to the financial statements. It did not affect *Net income* within the Condensed Consolidated Statements of Income or net cash provided by (used in) operating, investing or financing activities within the Condensed Consolidated Statements of Cash Flows.

Revenues, expenses, cash flows, assets and liabilities can and do vary during each quarter of the year. Therefore, the results and trends in these interim financial statements may not be indicative of those for a full year.

Our fiscal year ends on December 31. We report our interim quarterly periods on a 13-week basis ending on a Saturday.

2. Recent Accounting Pronouncements

In March 2008, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 161, *Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB statement No. 133* (SFAS 161). SFAS 161 expands the disclosure requirements in Statement 133 about an entity s derivative instruments and hedging activities. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB 51* (SFAS 160). SFAS 160 changes the accounting and reporting for minority interests. Minority interests will be recharacterized as noncontrolling interests and will be reported as a component of equity separate from the parent s equity, and purchases or sales of equity interests that do not result in a change in control will be accounted for as equity transactions. In addition, net income attributable to the noncontrolling interest will be included in consolidated net income on the face of the income statement and upon a loss of control, the interest sold, as well as any interest retained, will be recorded at fair value with any gain or loss recognized in earnings. SFAS 160 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years, except for the presentation and disclosure requirements, which will apply retrospectively. Adoption of SFAS 160 will not have a material impact to our consolidated results of operations and financial condition.

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), *Business Combinations* (SFAS 141R). SFAS 141R replaces SFAS No. 141. SFAS 141R retains the purchase method of accounting for acquisitions, but requires a number of changes, including changes in the way assets and liabilities are recognized in the purchase accounting. SFAS 141R also changes the recognition of assets acquired and liabilities assumed arising from contingencies, requires the capitalization of in-process research and development at fair value, and requires the expensing of acquisition-related costs as incurred. SFAS 141R is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. We will apply SFAS 141R prospectively to business combinations completed on or after that date. There will be no impact upon adoption to our current consolidated results of operations and financial condition.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value (the Fair Value Option). SFAS 159 is effective for fiscal years beginning after November 15, 2007. We did not choose the Fair Value Option; therefore, the adoption of SFAS 159 did not have any impact on our consolidated results of operations and financial condition.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements, but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS 157 is effective for fiscal years beginning after November 15, 2007, with the exception of the application of the statement to the determination of fair value of nonfinancial assets and liabilities that are recognized or disclosed on a nonrecurring basis, which is effective for fiscal years beginning after November 15, 2008.

SFAS 157 establishes a valuation hierarchy for disclosure of the inputs to valuation used to measure fair value. This hierarchy prioritizes the inputs into three broad levels as follows. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities. Level 2 inputs are quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument. Level 3 inputs are unobservable inputs based on our own assumptions used to measure assets and liabilities at fair value. A financial asset or liability s classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

At March 29, 2008, our interest rate swaps (see note 11) are carried at fair value measured on a recurring basis. Fair values are determined through the use of models that consider various assumptions, including time value, yield curves, as well as other relevant economic measures, which are inputs that are classified as Level 2 in the valuation hierarchy.

3. Stock-based Compensation

Total stock-based compensation expense for the first quarter of 2008 and 2007 was $6.5 million and $6.2 million, respectively.

Pentair, Inc. and subsidiaries
Notes to condensed consolidated financial statements (unaudited)

Non-vested shares of our common stock were granted to eligible employees with a vesting period of two to five years after issuance. Non-vested share awards are valued at market value on the date of grant and are typically expensed over the vesting period. Total compensation expense for non-vested share awards during the first quarter of 2008 and 2007 was $3.2 million and $2.8 million, respectively.

During the first quarter of 2008 and 2007, option awards were granted under the Omnibus Stock Incentive Plan and the Outside Directors Nonqualified Stock Option Plan (together the Plans), each with an exercise price equal to the market price of our common stock on the date of grant. Total compensation expense for stock option awards was $3.3 and $3.4 million for the first quarter of 2008 and 2007, respectively.

We estimated the fair value of each stock option award on the date of grant using a Black-Scholes option pricing model, modified for dividends and using the following assumptions:

	March 29 2008	**March 31 2007**
Expected stock price volatility	27.0%	28.5%
Expected life	4.8 yrs	4.8 yrs
Risk-free interest rate	2.75%	4.66%
Dividend yield	2.13%	1.95%

The weighted-average fair value of options granted during the first quarter of 2008 and 2007 was $7.36 and $8.29 per share, respectively.

These estimates require us to make assumptions based on historical results, observance of trends in our stock price, changes in option exercise behavior, future expectations, and other relevant factors. If other assumptions had been used, stock-based compensation expense, as calculated and recorded under SFAS No. 123R (revised 2004), *Share Based Payment*, (SFAS 123R) could have been affected.

We based the expected life assumption on historical experience as well as the terms and vesting periods of the options granted. For purposes of determining expected volatility, we considered a rolling-average of historical volatility measured over a period approximately equal to the expected option term. The risk-free rate for periods that coincide with the expected life of the options is based on the U.S. Treasury Department yield curve in effect at the time of grant.

4. Earnings Per Common Share

Basic and diluted earnings per share were calculated using the following:

	Three months ended	
In thousands	**March 29 2008**	**March 31 2007**
Weighted average common shares outstanding basic	98,280	98,966
Dilutive impact of stock options and restricted stock	1,278	1,305
Weighted average common shares outstanding diluted	99,558	100,271
Stock options excluded from the calculation of diluted earnings per share because the exercise price was greater than the average market price of the common shares	4,612	3,675

In December 2007, the Board of Directors authorized the repurchase of shares of our common stock during 2008 up to a maximum dollar limit of $50 million. As of March 29, 2008, we had purchased 371,613 shares for $12.5 million pursuant to this authorization during 2008. This authorization expires on December 31, 2008.

5. Acquisitions

On May 7, 2007, we acquired as part of our Technical Products Segment the assets of Calmark Corporation (Calmark). Calmark s results of operations have been included in our condensed consolidated financial statements since the date of acquisition. We continue to evaluate the purchase price allocation for the Calmark acquisition, including intangible assets, contingent liabilities and property, plant and equipment. We expect to revise the purchase price allocation as better information becomes available.

Pentair, Inc. and subsidiaries
Notes to condensed consolidated financial statements (unaudited)

On April 30, 2007, we acquired as part of our Water Group all of the capital interests in Porous Media Corporation and Porous Media, Ltd. (together, Porous Media). Porous Media s results of operations have been included in our condensed consolidated financial statements since the date of acquisition. We continue to evaluate the purchase price allocation for the Porous Media acquisition, including intangible assets, contingent liabilities and property, plant and equipment. We expect to revise the purchase price allocation as better information becomes available.

On February 2, 2007, we acquired as part of our Water Group all of the outstanding shares of capital stock of Jung Pumpen GmbH (Jung Pump). Jung Pump s results of operations have been included in our condensed consolidated financial statements since the date of acquisition.

The following pro forma condensed financial results of operations are presented as if the acquisitions described above had been completed at the beginning of the period.

In thousands, except per-share data	March 31 2007
Pro forma net sales from continuing operations	$816,817
Pro forma net income from continuing operations	42,443
Income (loss) from discontinued operations, net of tax	(356)
Pro forma net income	42,087
Pro forma earnings per common share continuing operations	
Basic	$ 0.43
Diluted	$ 0.42
Weighted average common shares outstanding	
Basic	98,966
Diluted	100,271

These pro forma condensed consolidated financial results have been prepared for comparative purposes only and include certain adjustments, such as increased interest expense on acquisition debt. They do not reflect the effect of costs or synergies that would have been expected to result from the integration of these acquisitions. The pro forma information does not purport to be indicative of the results of operations that actually would have resulted had the combination occurred at the beginning of each period presented, or of future results of the consolidated entities.

6. Discontinued Operations

In February 2008, consistent with our strategy to refine our portfolio and more fully focus on our growing core pool equipment business globally within our Water Segment, we sold our National Pool Tile (NPT) business to Pool Corporation in a cash transaction for approximately $30.0 million subject to certain price adjustments. NPT is a wholesale distributor of pool tile and composite pool finishes serving professional contractors in the swimming pool refurbish and construction markets. The results of NPT have been reported as discontinued operations for all periods presented. The assets and liabilities of NPT have been reclassified as discontinued operations for all periods presented. Operating results of the discontinued operations for the first quarter of 2008 and 2007 are summarized below:

	Three months ended	
In thousands	March 29 2008	March 31 2007
Net sales	$ 7,085	$15,150
Loss from discontinued operations before income taxes	(1,965)	(798)
Income tax benefit	748	299

Loss from discontinued operations, net of income taxes	(1,217)	(499)
Gain (loss) on disposal of discontinued operations, before income taxes	(6,588)	225
Income tax expense	(549)	(82)
Gain (loss) on disposal of discontinued operations, net of income tax	$(7,137)	$ 143

Pentair, Inc. and subsidiaries
Notes to condensed consolidated financial statements (unaudited)
Net assets (liabilities) of discontinued operations consist of the following:

In thousands	Three months ended December 31 2007	March 31 2007
Accounts and notes receivable, net	$ 5,547	$ 7,579
Inventories	14,710	19,682
Other current assets	1,459	1,938
Current assets of discontinued operations	21,716	29,199
Property, plant and equipment, net	1,436	1,443
Goodwill	16,806	16,806
Other non-current assets	141	171
Non-current assets of discontinued operations	18,383	18,420
Total assets	$40,099	$47,619
Accounts payable	$ 1,712	$ 8,067
Other current liabilities	1,223	1,153
Current liabilities of discontinued operations	2,935	9,220
Deferred income tax	2,400	2,203
Other non-current liabilities	298	379
Non-current liabilities of discontinued operations	2,698	2,582
Total liabilities	5,633	11,802
Net assets of discontinued operations	$34,466	$35,817

7. Inventories
Inventories were comprised of:

In thousands	March 29 2008	December 31 2007	March 31 2007
Raw materials and supplies	$204,228	$199,330	$193,049

Work-in-process	56,293	51,807	56,978
Finished goods	155,538	141,279	143,468
Total inventories	$416,059	$392,416	$393,495

8. Comprehensive Income

Comprehensive income and its components, net of tax, were as follows:

	Three months ended	
In thousands	**March 29 2008**	**March 31 2007**
Net income	$44,290	$42,273
Changes in cumulative foreign currency translation adjustment	47,820	15,926
Changes in market value of derivative financial instruments classified as cash flow hedges	(4,518)	(237)
Comprehensive income	$87,592	$57,962

Pentair, Inc. and subsidiaries
Notes to condensed consolidated financial statements (unaudited)

9. Goodwill and Other Intangible Assets

Changes in the carrying amount of goodwill for the three months ended March 29, 2008 and March 31, 2007 by segment were as follows:

In thousands	**December 31, 2007**	**Acquisitions**	**Foreign Currency Translation**	**March 29, 2008**
Water	$ 1,712,227	$ 556	$ 23,633	$1,736,416
Technical Products	292,493	50	1,322	293,865
Consolidated Total	$ 2,004,720	$ 606	$ 24,955	$2,030,281

In thousands	**December 31, 2006**	**Acquisitions**	**Foreign Currency Translation**	**March 31, 2007**
Water	$ 1,432,653	$101,589	$ 5,584	$1,539,826
Technical Products	269,311	(198)	4,613	273,726
Consolidated Total	$ 1,701,964	$101,391	$ 10,197	$1,813,552

The increase in goodwill in the Water Group is related primarily to our acquisition of Jung Pump during 2007.

Intangible assets, other than goodwill, were comprised of:

	March 29, 2008	**December 31, 2007**