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Apr 01, 2020

Xylem Inc. (XYL)

$65.13 (As of 03/31/20)

Price Target (6-12 Months): **$55.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 02/11/20) Prior Recommendation: Neutral	**Underperform**
Short Term: 1-3 Months	**Zacks Rank:** (1-5)	**4-Sell**
	Zacks Style Scores:	VGM:C
	Value: D | Growth: A | Momentum: C	

Summary

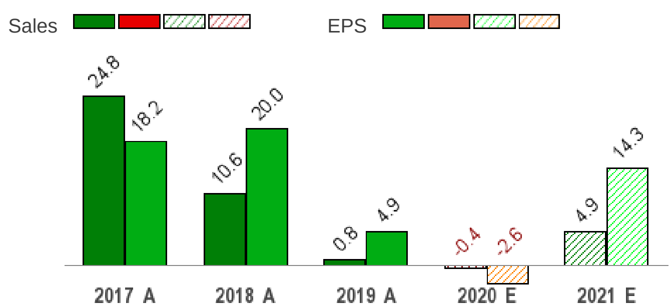
Over the past year, Xylem has underperformed the industry and also looks comparatively overvalued. The company has withdrawn its guidance for the first quarter and 2020 on end-market uncertainties, owing to the coronavirus outbreak. It noted that the pandemic has adversely impacted its commercial activity and the supply chain. Moreover, the company has been grappling with the increasing cost of sales and operating expenses. Further, due to its international presence, Xylem faces risks from geopolitical issues and forex woes. Notably, in the fourth quarter of 2019, forex woes adversely impacted its earnings by two cents per share. In the past 30 days, the company's earnings estimates for 2020 and 2021 have been revised downward.

Price, Consensus & Surprise

Data Overview

52 Week High-Low	**$89.34 - $54.62**
20 Day Average Volume (sh)	**1,750,699**
Market Cap	**$11.7 B**
YTD Price Change	**-17.3%**
Beta	**1.12**
Dividend / Div Yld	**$1.04 / 1.6%**
Industry	**Manufacturing - General Industrial**
Zacks Industry Rank	**Bottom 30% (177 out of 254)**
Last EPS Surprise	**0.0%**
Last Sales Surprise	**-0.6%**
EPS F1 Est- 4 week change	**-4.2%**
Expected Report Date	**05/07/2020**
Earnings ESP	**-6.0%**
P/E TTM	**21.6**
P/E F1	**22.2**
PEG F1	**1.3**
P/S TTM	**2.2**

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2021	1,260 E	1,403 E	1,395 E	1,479 E	5,484 E
2020	1,179 E	1,289 E	1,322 E	1,415 E	5,229 E
2019	1,237 A	1,345 A	1,296 A	1,371 A	5,249 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	$0.59 E	$0.85 E	$0.86 E	$1.02 E	$3.36 E
2020	$0.42 E	$0.70 E	$0.83 E	$0.95 E	$2.94 E
2019	$0.52 A	$0.79 A	$0.82 A	$0.89 A	$3.02 A

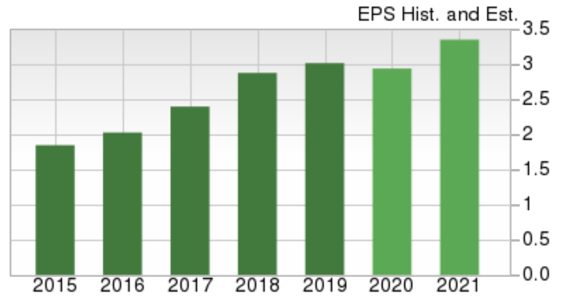
*Quarterly figures may not add up to annual.

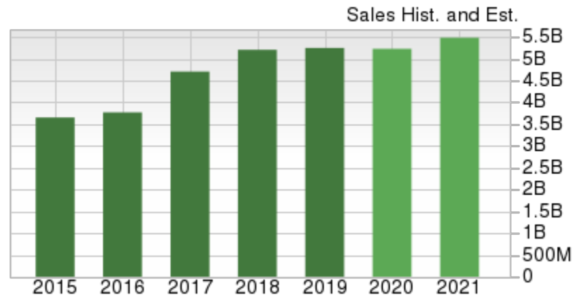
The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 03/31/2020. The reports text is as of 04/01/2020.

Overview

Headquartered in Rye Brook, NY, Xylem Inc. is one of the leading providers of water solutions worldwide. The company is involved in the full water-process cycle, including collection, distribution and returning of water to the environment. It has significant presence in the United States, the Asia Pacific, Europe and various other nations.

The company reports business operations under three segmental heads — Water Infrastructure, Sensus and Applied Water. Details of the company's segmental operations are discussed below:





- **Water Infrastructure** (44% of total revenues generated in the fourth quarter of 2019): This segment offers product range mainly used for transportation, treatment and testing of water. These products facilitate the process that involves collecting water from a source and distributing it to users while returning the wastewater to the environment. This process includes two applications — Transport and Treatment. The segment includes brands like Flygt, Godwin, Leopold, WEDECO and Sanitaire.

- **Applied Water** (28.6%): This segment offers various products that deal with the use of water. These products have a wide range of applications — including Building Services (commercial and residential) and Industrial Water. Brands like Goulds Water Technology, Lowara, Bell & Gossett, A-C Fire Pump, Standard, Jabsco, and Flojet form parts of this segment.

- **Measurement & Control Solutions** (27.4%):This segment includes consolidated results of Xylem's Analytics, Sensus and Visenti businesses. These products have a wide range of applications that include Water, Energy, Test and Software as a Service/Other. Brands like Pure, Sensus, EmNet, Visenti, Smith Blair, Valvor Water, YSI and WTW form parts of this segment.

Reasons To Sell:

> Weakness in industrial and commercial markets, headwinds from Coronavirus, and soft orders are likely to adversely influence results in the first half. Also, forex woes and high costs might play spoilsport.

- Xylem has withdrawn its guidance for the first quarter and 2020 on end-market uncertainties, owing to the coronavirus outbreak. Earlier, the company had anticipated an adverse impact of 3-4 cents on its first-quarter 2020 adjusted earnings per share from the initial, localized emergence of the coronavirus in China. Also, the company had anticipated that the outbreak would hurt its first-quarter organic revenues by 1-2%. Notably, the duration of the coronavirus pandemic, its geographic spread and the impacts of the governmental regulations imposed in response to the crisis will likely have a bearing on Xylem's results. This along with its impact on the demand for the company's products and services will likely get reflected in the yearly results.

- In the fourth quarter of 2019, Xylem's sales lagged estimates by 0.7% and declined 1.1% from the year-ago quarter. The quarterly results suffered from adverse impacts of forex woes, and a 3% decline in industrial organic sales, 5% in commercial and 2% in residential. Also, the company's commercial activity and the supply chain have been disrupted due to coronavirus pandemic. In the past 30 days, the consensus estimate for earnings per share has been lowered, reflecting bearish sentiments for the stock. Currently, the Zacks Consensus Estimate is pegged at $3.07 for 2020 and $3.42 for 2021, reflecting declines of 0.6% and 2% from the 30-day-ago figures. This makes us cautious about the stock.

- Over time, Xylem has been grappling with the increasing cost of sales and operating expenses. From 2017 till 2019, the company's cost of sales rose 3.8% (CAGR) and operating expenses grew 3% (CAGR). Notably, its cost of sales inched up 0.7% year over year in 2019. The company noted that cost inflation adversely impacted operating margin by 3 percentage points, while investments had a negative impact of 60 bps and acquisitions/divestments lowered margin by 10 bps. Also, mix, forex woes and others had a collective impact of 160 bps on operating margin. However, effective pricing actions were relief. Further, escalation in costs and operating expenses, if not controlled, can severely impact margins and profitability.

- Over the past year, Xylem's shares have dipped 18.7% compared with the industry's decline of 17.7%. Also, on a P/E (TTM) basis, the company's shares look a bit overvalued compared with the industry, with respective tallies of 21.57x and 17.07x. In addition, geographical diversification is reflective of a flourishing business of Xylem. However, the diversity exposed the company to headwinds arising from geopolitical issues and unfavorable movements in foreign currencies. In the fourth quarter of 2019, forex woes adversely impacted earnings by two cents per share.

Risks

- In the fourth quarter of 2019, Xylem's earnings increased 1.1%, gaining from productivity initiatives, pricing actions, favorable volumes and interest expenses. The company believes that emerging market exposure, new products, innovation, growth investments and focus on operational execution might be beneficial. In addition, it serves customers in various end markets — including industrial, commercial, residential and utilities. The diversification helps the company to deal with weakness in some markets, with strength in others.

- Strong cash flows allow Xylem to effectively deploy capital for repurchasing shares and dividend payouts. Notably, in 2019, the company generated net cash of $839 million from operating activities, reflecting growth of 43.2% from the year-ago period. Also, free cash flow in the year was $613 million, soaring 75.1% year over year. Also, in 2019, the company paid out dividends amounting to $174 million and repurchased shares worth $40 million. In addition, the company's board of directors approved an 8% hike in its quarterly dividend rate in February 2020.

Last Earnings Report

Xylem Earnings Meet Estimates in Q4

Quarter Ending	12/2019
Report Date	Feb 06, 2020
Sales Surprise	-0.63%
EPS Surprise	0.00%
Quarterly EPS	0.89
Annual EPS (TTM)	3.02

Xylem reported in-line earnings for the fourth quarter of 2019. This is the company's third consecutive quarter of in-line results.

Adjusted earnings in the quarter under review were 89 cents per share, meeting the Zacks Consensus Estimate. Meanwhile, the bottom line inched up 1.1% from the year-ago reported figure of 88 cents. Its bottom-line results included an adverse impact of two cents per share from unfavorable movements in foreign currencies.

For 2019, the company's earnings were $3.02, in line with the Zacks Consensus Estimate. Meanwhile, on a year-over-year basis, the bottom line increased 4.9%.

Segmental Revenues

Xylem's revenues of $1,371 million in the quarter under review were 1.1% down from the year-ago quarter. Organic sales were flat with the prior-year quarter. The results bore the brunt of weakness in commercial and industrial end markets.

The company's revenues lagged the Zacks Consensus Estimate of $1,380 million by 0.7%.

Orders in the reported quarter fell 7% year over year to $1,286 million. Organically, orders declined 6%.

The company reports net sales under three segments, such as Water Infrastructure, Applied Water, and Measurement & Control Solutions.

The segmental information is briefly discussed below:

Revenues in the **Water Infrastructure** segment were $603 million, down 1% year over year. Organic sales inched up 1% year over year. Results gained from improved demand in the utilities end market, especially in Europe and the emerging markets. However, softness in the industrial dewatering business (short-cycle) affected the segment.

The **Applied Water** segment generated revenues of $392 million in the fourth quarter, down 2.5% year over year. Organic sales dipped 2% on a year-over-year basis. Business in commercial and industrial markets was soft in the quarter.

Quarterly revenues of the **Measurement & Control Solutions** segment were $376 million, up 0.3% year over year. Organic sales improved 2% year over year. Results benefited from the solid metrology water business in international arena and growth in energy projects across the United States.

For 2019, the company's revenues of $5.25 billion increased 0.8% from the previous year. Also, full-year revenues missed the Zacks Consensus Estimate of $5.26 billion.

Margin Profile

Adjusted operating income in the fourth quarter slipped 1.4% year over year to $206 million. Also, adjusted operating margin slid 10 basis points (bps) to 15%. Interest expenses were $15 million compared with $19 million in the year-ago quarter.

In 2019, the company's cost of sales rose 0.7% year over year to $3,203 million. However, selling, general and administrative expenses dipped 0.3% to $1,158 million. Meanwhile, research and development expenses increased 1.1% to $191 million. Adjusted operating margin in the year was 13.9% compared with 13.7% in the preceding year.

Balance Sheet and Cash Flow

Exiting the fourth quarter, Xylem had cash and cash equivalents of $724 million, up 52.8% from $453 million at the end of the last reported quarter. Long-term debt balance inched up 0.5% sequentially to $2,040 million.

In 2019, the company generated net cash of $839 million from operating activities, reflecting growth of 43.2% from the year-ago period. Capital expenditure was $226 million, below $237 million in 2018. Free cash flow in the year was $613 million, soaring 75.1% year over year.

In 2019, the company paid out dividends amounting to $174 million and repurchased shares worth $40 million.

Outlook

For 2020, Xylem anticipates revenues of $5.3-$5.35 billion, indicating year-over-year growth of 1-3% from the year-ago reported figure.

Adjusted operating margin will likely be 14-14.5% while adjusted earnings are projected to be $2.96-$3.16 per share. The earnings guidance suggests growth of 1-8% from the year-earlier reported number. Restructuring and realignment costs are expected to be $35-$45 million.

Recent News

First-Quarter & Full Year Guidance Withdrawn

On **Mar 31, 2020**, Xylem announced the withdrawal of its guidance for the first quarter and 2020 on end-market uncertainties, owing to the coronavirus outbreak.

Dividend

On **Mar 26, 2020**, Xylem paid out a quarterly dividend of 26 cents per share to its shareholders of record as of Feb 27. Notably, on Feb 6, 2020, the company's board of directors approved an 8% hike in its quarterly dividend rate.

Valuation

Xylem shares are down 17.3% and 18.7% in the year-to-date and over the trailing 12-month period, respectively. Stocks in the Zacks sub-industry and the Zacks Industrial Products sector are down 25% and 27% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and the sector are down 17.7% and 23.6%, respectively.

The S&P 500 Index has moved down 18.5% year to date and 8.6% in the past year.

The stock is currently trading at 20.59x forward 12-month earnings, which compares to 17.33x for the Zacks sub-industry, 14.47x for the Zacks sector and 16.12x for the S&P 500 index.

Over the past five years, the stock has traded as high as 28.95x and as low as 15.28x, with a 5-year median of 21.9x. Our Underperform recommendation indicates that the stock will perform worse than the market. Our $55 price target reflects 17.39x forward 12-month earnings.

The table below shows summary valuation data for XYL.

Valuation Multiples - XYL

		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	20.59	17.33	14.47	16.12
	5-Year High	28.95	23.5	19.93	19.34
	5-Year Low	15.28	15.6	12.55	15.18
	5-Year Median	21.9	19.39	16.56	17.44
EV/EBITDA F12M	Current	14.47	10.8	16.38	12.28
	5-Year High	17.48	11.34	18.05	12.64
	5-Year Low	9.8	7.64	10.56	9.08
	5-Year Median	13.64	9.65	14.06	10.8
EV/Sales F12M	Current	2.49	2.41	2.31	2.58
	5-Year High	3.28	3.26	3.12	3.52
	5-Year Low	1.71	1.81	1.76	2.3
	5-Year Median	2.64	2.58	2.29	2.8

As of 03/31/2020

Industry Analysis **Zacks Industry Rank:** Bottom 30% (177 out of 254)

Top Peers

Badger Meter, Inc. **(BMI)**	Neutral
Danaher Corporation **(DHR)**	Neutral
Franklin Electric Co., Inc. **(FELE)**	Neutral
Chart Industries, Inc. **(GTLS)**	Neutral
Itron, Inc. **(ITRI)**	Neutral
MUELLER WATER PRODUCTS **(MWA)**	Neutral
Pentair plc **(PNR)**	Neutral
United Rentals, Inc. **(URI)**	Neutral

Industry Comparison Industry: Manufacturing - General Industrial

Industry Peers

	XYL Underperform	X Industry	S&P 500	DHR Neutral	MWA Neutral	URI Neutral
VGM Score	C	-	-	D	D	B
Market Cap	11.74 B	1.07 B	17.97 B	96.46 B	1.27 B	7.62 B
# of Analysts	9	3.5	13	7	7	6
Dividend Yield	1.60%	0.00%	2.37%	0.52%	2.62%	0.00%
Value Score	D	-	-	D	C	B
Cash/Price	0.06	0.11	0.06	0.21	0.11	0.01
EV/EBITDA	14.70	9.28	10.93	21.65	10.17	4.27
PEG Ratio	1.25	1.86	1.74	3.13	1.30	0.45
Price/Book (P/B)	3.95	1.66	2.39	3.47	2.12	2.00
Price/Cash Flow (P/CF)	12.32	8.11	9.48	22.27	8.37	2.14
P/E (F1)	20.57	14.20	14.84	25.71	13.01	5.30
Price/Sales (P/S)	2.24	0.89	1.91	4.84	1.28	0.82
Earnings Yield	4.51%	6.96%	6.65%	3.89%	7.74%	18.88%
Debt/Equity	0.69	0.52	0.70	0.75	0.75	2.72
Cash Flow ($/share)	5.29	2.49	7.01	6.21	0.96	47.99
Growth Score	A	-	-	C	F	B
Hist. EPS Growth (3-5 yrs)	12.91%	8.11%	10.89%	2.72%	10.93%	24.77%
Proj. EPS Growth (F1/F0)	-2.58%	-0.19%	1.29%	21.79%	0.94%	-0.47%
Curr. Cash Flow Growth	21.58%	3.36%	6.03%	1.84%	17.29%	17.38%
Hist. Cash Flow Growth (3-5 yrs)	13.56%	4.53%	8.55%	5.87%	7.36%	13.02%
Current Ratio	1.63	2.03	1.24	5.19	4.11	0.84
Debt/Capital	40.74%	34.35%	42.36%	41.54%	42.82%	73.14%
Net Margin	7.64%	6.24%	11.64%	15.09%	9.63%	12.56%
Return on Equity	18.90%	11.10%	16.74%	11.50%	17.09%	42.34%
Sales/Assets	0.69	0.77	0.54	0.35	0.76	0.49
Proj. Sales Growth (F1/F0)	-0.38%	-0.66%	1.61%	5.70%	3.75%	2.18%
Momentum Score	C	-	-	B	B	D
Daily Price Chg	-1.68%	0.00%	-2.05%	-1.71%	1.14%	8.13%
1 Week Price Chg	9.37%	12.34%	12.32%	11.93%	4.79%	28.60%
4 Week Price Chg	-18.47%	-19.56%	-18.09%	-6.19%	-29.80%	-20.01%
12 Week Price Chg	-18.08%	-27.15%	-24.90%	-11.35%	-32.63%	-37.67%
52 Week Price Chg	-18.63%	-30.24%	-18.55%	5.16%	-22.08%	-13.19%
20 Day Average Volume	1,750,699	64,031	4,222,189	5,166,857	1,420,619	2,649,700
(F1) EPS Est 1 week change	-4.02%	0.00%	-0.18%	0.00%	-2.49%	0.00%
(F1) EPS Est 4 week change	-4.16%	-3.31%	-3.16%	-1.19%	-2.49%	-5.80%
(F1) EPS Est 12 week change	-11.88%	-9.53%	-4.36%	-3.05%	-3.29%	-5.64%
(Q1) EPS Est Mthly Chg	-1.53%	-2.75%	-2.63%	-0.83%	-1.06%	-3.52%

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	D
Growth Score	A
Momentum Score	C
VGM Score	C

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

Disclosures

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