

Xylem Inc. (XYL)

\$83.34 (As of 02/03/20)

Price Target (6-12 Months): **\$88.00**

Long Term: 6-12 Months

Zacks Recommendation:
Neutral

(Since: 01/01/20)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:C

Value: C

Growth: B

Momentum: D

Summary

In the quarters ahead, Xylem is poised to gain from business contracts. Notably, orders in the third quarter of 2019 were up 1% organically on a year-over-year basis. Also, its policy of rewarding shareholders handsomely through dividend payouts and share buybacks is a boon. However, the company expects to witness headwinds in industrial, commercial and utilities end markets in 2019. Further, forex woes are predicted to adversely impact earnings growth by 2-3% in 2019. The company now expects revenues of \$5.24-\$5.27 billion for 2019, down from \$5.29-\$5.38 billion mentioned earlier. Adjusted earnings per share will likely be \$3.01-\$3.03 compared with previously stated \$3.12-\$3.22. In the past 60 days, the company's earnings estimates have been lowered for 2020. Its shares have underperformed the industry in the past six months.

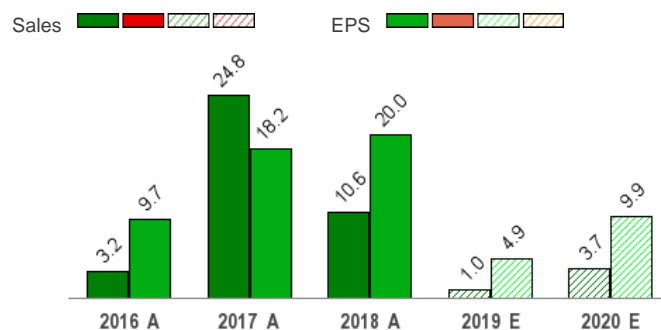
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$86.09 - \$69.71
20 Day Average Volume (sh)	1,058,035
Market Cap	\$15.0 B
YTD Price Change	5.8%
Beta	1.11
Dividend / Div Yld	\$0.96 / 1.2%
Industry	Manufacturing - General Industrial
Zacks Industry Rank	Bottom 16% (213 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	1,272 E	1,383 E	1,377 E	1,460 E	5,451 E
2019	1,237 A	1,345 A	1,296 A	1,380 E	5,258 E
2018	1,217 A	1,317 A	1,287 A	1,386 A	5,207 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$0.61 E	\$0.85 E	\$0.90 E	\$1.00 E	\$3.32 E
2019	\$0.52 A	\$0.79 A	\$0.82 A	\$0.89 E	\$3.02 E
2018	\$0.51 A	\$0.73 A	\$0.77 A	\$0.88 A	\$2.88 A

*Quarterly figures may not add up to annual.

Last EPS Surprise	0.0%
Last Sales Surprise	-2.5%
EPS F1 Est- 4 week change	-0.5%
Expected Report Date	02/06/2020
Earnings ESP	-0.4%
P/E TTM	27.7
P/E F1	25.1
PEG F1	1.5
P/S TTM	2.9

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 02/03/2020. The reports text is as of 02/04/2020.

Overview

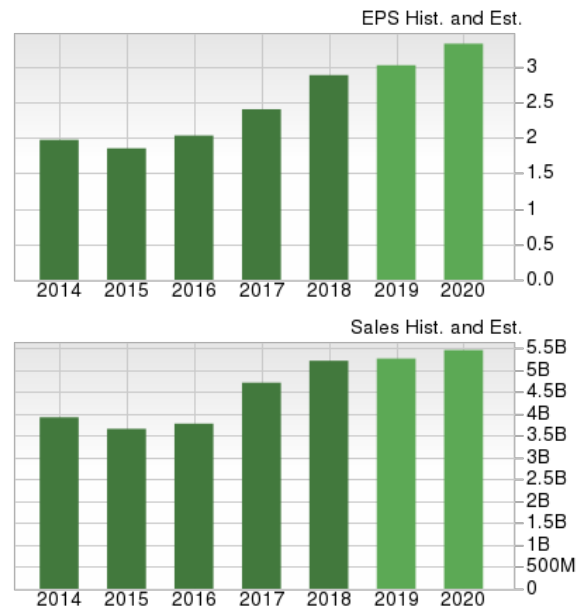
Headquartered in Rye Brook, NY, Xylem Inc. is one of the leading providers of water solutions worldwide. The company is involved in the full water-process cycle, including collection, distribution and returning of water to the environment.

It was created after the spin-off of the water equipment and services businesses of ITT Inc. in 2011. Its employee strength is currently roughly 17,000.

It is worth mentioning here that Xylem acquired Sensus in October 2016. Since then, it has started reporting its business operations under three segmental heads — Water Infrastructure, Sensus and Applied Water. Details of the company's segmental operations are discussed below:

- **Water Infrastructure (41% of total revenues generated in the third 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 (29%):** 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 (30%):** 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.

It has significant presence in the United States, the Asia Pacific, Europe and various other nations. In the third quarter of 2019, the company generated approximately 47.8% of revenues from operations in the United States.



Reasons To Buy:

▲ Xylem remains focused on becoming more competent on the back of business contracts. In the third quarter of 2019, the company's orders grew 1% organically on a year-over-year basis. It noted that orders in the Water Infrastructure segment gained from healthy business in India and China. Also, the utilities market in North America aided results. For the Applied Water segment, orders benefited from growth in the United States and emerging markets. We believe that solid orders will be beneficial in supporting Xylem's top line in the quarters ahead.

Solid business contracts and shareholder-friendly policies will likely drive Xylem's near-term profitability.

▲ The company stays committed to rewarding shareholders handsomely through dividend payments and share buybacks. In 2018, it paid out dividends amounting to \$152 million and repurchased shares worth \$59 million. Also, in the first three quarters of 2019, the company paid out dividends amounting to \$131 million (a hike of 14% in the quarterly dividend rate was announced in January 2019) and bought back shares worth \$39 million. For 2019, it anticipates distributing dividends of \$175 million and witnessing share count of 181.2 million.

▲ Xylem set some long-term targets (discussed at its investor day in 2017). By 2020, the company targets organic growth of 4-6% and adjusted operating margins of 17-18%. Adjusted earnings per share are likely to be in mid-teens and capital that can be used for deployment is expected to total \$3.5 billion. As noted, the company is on track to achieve most of targets, except for operating margin extending beyond 2020.

Reasons To Sell:

- ▼ In the past six months, Xylem's shares have increased 11.7% compared with the industry's growth of 15.2%. On a P/E (TTM) basis, the stock looks a bit overvalued compared with the industry, with respective tallies of 27.69x and 22.53x. Also, the stock is currently trading higher than the industry's six-month highest level of 22.53x. In the third quarter of 2019, Xylem's earnings were in line with estimates. For 2019, the company lowered its adjusted earnings per share guidance from \$3.12-\$3.22 to \$3.01-\$3.03, with the mid-point falling to \$3.02 from \$3.17. Bearish sentiments for the company are evident from lowered earnings estimates. Currently, the Zacks Consensus Estimate for its earnings is pegged at \$3.02 for 2019 and \$3.32 for 2020, which suggests no change and decline of 0.6% from the respective 60-day ago tallies. This makes us cautious about the stock.
- ▼ In the third quarter of 2019, Xylem's sales lagged estimates by 2.5%. The quarterly results suffered from adverse impacts of forex woes and weakness in commercial and industrial end markets. For 2019, the company predicts revenues of \$5.24-\$5.27 billion, down from previously stated \$5.29-\$5.38 billion. Organic sales are now predicted to rise 3-4%, down from earlier mentioned 5-6% growth. Notably, organic sales for the industrial end market are predicted to be flat year over year, down from low-single-digit growth mentioned earlier. The company noted that business in China, Europe and Latin America will be soft while that in India and Australia will strengthen. Business in general industrial in North America will likely be soft compared with previous expectation and that in oil & gas/mining markets will be weak. In addition, the company believes that organic sales in the utilities market will be up in mid-single digits, down from previously mentioned mid-to-high single digit growth. Organic growth is expected to be in low-to-mid single digit in the commercial market, down from mid- single digit increase stated earlier.
- ▼ Over time, Xylem has been grappling with increasing cost of sales and operating expenses. From 2016 till 2018, the company's cost of sales rose 11.3% (CAGR) and operating expenses grew 9.2% (CAGR). Notably, its cost of sales moved up 0.6% year over year in the third quarter of 2019. The company noted that cost inflation adversely impacted operating margin by 2.8 percentage points, while investments had a negative impact of 50 bps. However, effective pricing actions were relief. Further escalation in costs and operating expenses, if not controlled, can severely impact margins and profitability. For 2019, the company predicts adjusted operating margin of 13.8-14%, down from previously mentioned 14.3-14.5%. In addition, geographical diversification is reflective of a flourishing business of the company. However, this diversity exposed the company to headwinds arising from geopolitical issues and unfavorable movements in foreign currencies. In the third quarter of 2019, forex woes adversely impacted earnings by three cents per share. For 2019, forex woes will adversely influence earnings growth by 2-3%.

Weakness in utilities, industrial and commercial markets are likely to lower Xylem's organic sales in 2019. Forex woes, high debts and rise in costs might play spoilsport.

Last Earnings Report

Xylem Meets Q3 Earnings Estimates, Lowers '19 View

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

Adjusted earnings in the quarter under review were 82 cents per share, in line with the Zacks Consensus Estimate. The bottom line grew 6.5% from the year-ago figure of 77 cents. Its bottom-line results included an adverse impact of three cents per share from unfavorable movements in foreign currencies.

Quarter Ending **09/2019**

Report Date	Oct 31, 2019
Sales Surprise	-2.47%
EPS Surprise	0.00%
Quarterly EPS	0.82
Annual EPS (TTM)	3.01

Organic Growth Drives Revenues

Xylem's revenues were \$1,296 million in the quarter under review, reflecting growth of 0.7% from the year-ago quarter. Organic sales in the quarter expanded 3% on strengthening utility end markets, offset by weakness in commercial and industrial end markets.

The company's revenues lagged the Zacks Consensus Estimate of \$1,329 million by 2.5%.

Orders in the quarter under review were down 1% year over year at \$1,346 million. Organically, orders reflected growth of 1%.

The company reports net sales under three segments — Water Infrastructure, Applied Water, and Measurement & Control Solutions. The segmental information is briefly discussed below:

Revenues in the Water Infrastructure segment were \$531 million, down 1.8% year over year. Organic sales were up 1% year over year. Results gained from improved demand in the utilities end market, especially in the United States. However, weakness in the industrial market affected the segment.

The Applied Water segment generated revenues of \$376 million in the third quarter, down 0.5% year over year. Organic sales improved 1% 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 \$389 million, up 5.7% year over year. Organic sales improved 8% year over year. Results benefited from the solid metrology water business.

Operating Margin Improves Y/Y

In the quarter under review, Xylem's cost of sales rose 0.6% year over year to \$787 million, while selling, general and administrative expenses dipped 2.2% to \$273 million, and research and development expenses declined 4.3% to \$44 million.

Adjusted operating income in the quarter under review grew 4.3% year over year to \$196 million. Also, adjusted operating margin rose 50 basis points (bps) to 15.1%. Interest expenses were \$16 million versus \$21 million in the year-ago quarter.

Balance Sheet and Cash Flow

Exiting the third quarter, Xylem had cash and cash equivalents of \$453 million, up 18.3% from \$383 million at the end of the last reported quarter. Long-term debt balance was down 1% sequentially to \$2,030 million.

In the first three quarters of 2019, the company generated net cash of \$451 million from operating activities, reflecting growth of 16.2% from the year-ago period. Capital expenditure was \$175 million, above \$171 million in the year-ago period. Free cash flow in the first three quarters of 2019 was \$276 million.

In the first three quarters of 2019, the company paid out dividends amounting to \$131 million and repurchased shares worth \$39 million.

Outlook

For 2019, Xylem anticipates revenues of \$5.24-\$5.27 billion, down from the previously stated \$5.29-\$5.38 billion. Organic sales are predicted to rise 3-4% versus the earlier mentioned 5-6% growth.

Adjusted operating margin will likely be 13.8-14%, down from 14.3-14.5% stated previously. Adjusted earnings will likely be \$3.01-\$3.03 per share, down from \$3.12-\$3.22 mentioned earlier. The revised earnings projection suggests year-over-year growth of 5%. Excluding forex woes, earnings are likely to increase 7-8% in the year.

Recent News

Dividend

On **Dec 5, 2019**, Xylem paid out a quarterly cash dividend of 24 cents per share to shareholders of record as of Oct 31, 2019.

Valuation

Xylem shares are up 17.8% over the trailing 12-month period, respectively while stocks in the Zacks sub-industry and the Zacks Industrial Products sector are up 21.8% and 6.8% respectively.

The S&P 500 Index has moved up 17.8% in the past year.

The stock is currently trading at 24.81x forward 12-month earnings, which compares to 21.03x for the Zacks sub-industry, 17.52x for the Zacks sector and 18.61x 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 21.7x. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$88 price target reflects 26.05x 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	24.81	21.03	17.52	18.61
	5-Year High	28.95	22.58	19.91	19.34
	5-Year Low	15.28	15.2	12.6	15.18
	5-Year Median	21.7	18.98	16.58	17.46
EV/EBITDA F12M	Current	15.15	12.81	17.82	12.66
	5-Year High	15.94	12.81	18.22	12.66
	5-Year Low	9.59	8.3	10.69	9.08
	5-Year Median	13.22	10.7	14.04	10.78
EV/Sales F12M	Current	3.03	2.78	3.14	3.26
	5-Year High	3.18	2.78	3.14	3.37
	5-Year Low	1.71	1.67	1.76	2.3
	5-Year Median	2.56	2.31	2.28	2.78

As of 02/03/2020

Industry Analysis Zacks Industry Rank: Bottom 16% (213 out of 254)



Top Peers

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

Industry Comparison Industry: Manufacturing - General Industrial				Industry Peers		
	XYL Neutral	X Industry	S&P 500	DHR Neutral	MWA Neutral	URI Outperform
VGM Score	C	-	-	D	B	B
Market Cap	15.01 B	1.90 B	23.66 B	115.64 B	1.87 B	10.38 B
# of Analysts	8	3	13	8	7	7
Dividend Yield	1.15%	0.00%	1.82%	0.42%	1.77%	0.00%
Value Score	C	-	-	D	B	B
Cash/Price	0.03	0.05	0.04	0.17	0.10	0.01
EV/EBITDA	17.87	12.73	13.87	25.82	13.83	4.92
PEG Ratio	1.57	2.13	1.97	2.55	1.85	0.54
Price/Book (P/B)	5.18	2.37	3.24	4.03	3.15	2.71
Price/Cash Flow (P/CF)	19.13	12.08	13.40	25.91	12.40	2.91
P/E (F1)	25.88	18.97	18.48	29.62	18.55	6.85
Price/Sales (P/S)	2.85	1.38	2.60	5.80	1.94	1.11
Earnings Yield	3.98%	5.24%	5.40%	3.37%	5.39%	14.59%
Debt/Equity	0.70	0.54	0.72	0.75	0.75	2.72
Cash Flow (\$/share)	4.36	2.62	6.92	6.21	0.96	47.99
Growth Score	B	-	-	C	A	B
Hist. EPS Growth (3-5 yrs)	12.05%	7.61%	10.80%	2.72%	11.37%	24.77%
Proj. EPS Growth (F1/F0)	10.06%	8.64%	7.46%	22.96%	4.92%	4.28%
Curr. Cash Flow Growth	17.39%	10.71%	10.59%	-1.09%	17.29%	17.38%
Hist. Cash Flow Growth (3-5 yrs)	11.18%	7.04%	8.55%	5.87%	7.36%	13.02%
Current Ratio	1.55	2.03	1.21	5.19	3.18	0.84
Debt/Capital	41.22%	35.40%	42.91%	41.54%	42.92%	73.14%
Net Margin	9.65%	6.22%	11.76%	15.09%	6.59%	12.56%
Return on Equity	19.14%	13.11%	17.24%	11.50%	17.39%	42.34%
Sales/Assets	0.70	0.81	0.55	0.35	0.75	0.49
Proj. Sales Growth (F1/F0)	3.68%	1.94%	4.22%	6.52%	4.45%	2.48%
Momentum Score	D	-	-	C	F	D
Daily Price Chg	2.06%	0.00%	0.67%	0.08%	1.89%	2.82%
1 Week Price Chg	0.22%	-1.95%	-2.60%	-0.85%	-3.64%	-10.52%
4 Week Price Chg	4.44%	-4.18%	-0.76%	4.13%	-1.17%	-15.64%
12 Week Price Chg	9.93%	-0.35%	2.84%	19.68%	6.94%	-10.77%
52 Week Price Chg	18.51%	5.71%	13.93%	46.91%	19.78%	7.83%
20 Day Average Volume	1,058,035	54,234	1,915,782	2,355,823	735,885	1,173,848
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	-0.06%	0.00%	-1.45%
(F1) EPS Est 4 week change	-0.49%	0.00%	0.00%	-2.11%	0.22%	-1.14%
(F1) EPS Est 12 week change	-1.37%	-0.92%	-0.13%	-3.52%	-4.88%	-0.93%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	-5.21%	0.00%	-1.22%

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	C
Growth Score	B
Momentum Score	D
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.

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