

Xylem Inc. (XYL)

\$75.79 (As of 08/07/20)

Price Target (6-12 Months): **\$81.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 06/22/20)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:C

Value: C

Growth: C

Momentum: B

Summary

In the past three months, Xylem's shares have outperformed the industry. The company is poised to benefit from solid product offerings, focus on innovation, diversified business structure and large contract wins. Also, the company's cost-saving measures, a healthy liquidity position and shareholder-friendly policy might be boons. In second-quarter 2020, the company's earnings and sales surprise was 2.6% and 2.1%, respectively. Its earnings declined 49.4% year over year on weak sales generation and a fall in margins. For 2020, Xylem refrained from reinstating its projections, which were suspended on Mar 31. Also, an organic sales decline of 8-12% is predicted for the third quarter. The company's shares look comparatively undervalued on P/E (TTM) basis. Also, its earnings estimates have increased for 2020 in the past 30 days.

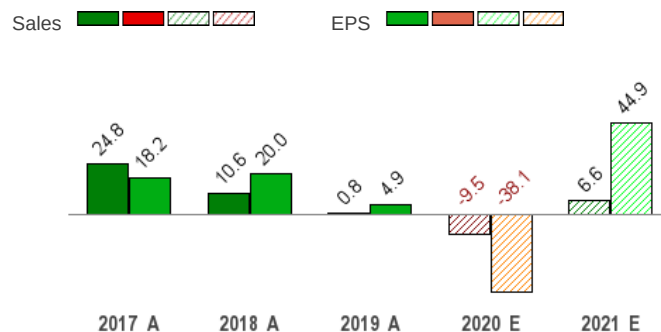
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$89.34 - \$54.62
20 Day Average Volume (sh)	1,128,017
Market Cap	\$13.9 B
YTD Price Change	-2.1%
Beta	1.06
Dividend / Div Yld	\$1.04 / 1.3%
Industry	Manufacturing - General Industrial
Zacks Industry Rank	Top 48% (121 out of 252)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	2.6%
Last Sales Surprise	0.5%
EPS F1 Est- 4 week change	30.8%
Expected Report Date	NA
Earnings ESP	0.6%
P/E TTM	33.0
P/E F1	40.5
PEG F1	2.5
P/S TTM	2.8

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	1,130 E	1,235 E	1,300 E	1,381 E	5,065 E
2020	1,123 A	1,160 A	1,166 E	1,275 E	4,751 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	\$0.45 E	\$0.76 E	\$0.77 E	\$0.88 E	\$2.71 E
2020	\$0.23 A	\$0.40 A	\$0.52 E	\$0.70 E	\$1.87 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.

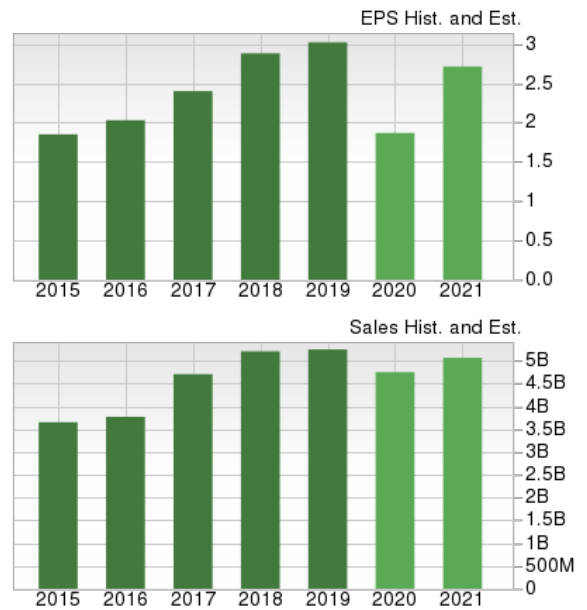
The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 08/07/2020. The reports text is as of 08/10/2020.

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** (43.2% of total revenues generated in the second quarter of 2020): 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** (29.1%): 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** (27.7%): 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, YSI and WTW form parts of this segment.



Reasons To Buy:

- ▲ In the past three months, Xylem's shares have gained 23.4% compared with the industry's growth of 21%. In second-quarter 2020, Xylem's earnings and sales surprise was 2.6% and 2.1%, respectively. Backlog at the end of the quarter was up 10%, pointing toward solid growth opportunities for 2021, stemming from large contract wins. In addition, the company might benefit from new products, innovation, efforts to boost growth and focus on operational execution in the quarters ahead. Its diversified business structure — with exposure in multiple end-markets, solid product offerings and others — might be beneficial, helping it offset weakness in one or more markets, with gains in others. Further, the company seems to be working diligently to continue with its operations despite the uncertainties caused by the pandemic. In the past 30 days, the company's earnings estimates have been increased by 32.6% for 2020 and 8% for 2021.
- ▲ Xylem has taken actions to control capital spending and operating expenses to offset some financial stress. For 2020, the company anticipates realizing structural cost savings of \$70 million, while the same are expected to be \$80 million in 2021. For the third quarter of 2020, it now anticipates operating margin of 11-11.5%, suggesting growth from 9.3% recorded in the second quarter. In addition, the company seems to have healthy liquidity position of \$2.4 billion at the end of the second quarter of 2020. This comprised of \$1.6 billion of available cash and liquidity available under credit facilities.
- ▲ Xylem believes in rewarding shareholders handsomely through share buybacks and dividend payments. In the first half of 2020, it paid out dividends amounting to \$95 million, marking an increase of 9.2% from the year-ago comparable period. Also, share buybacks grew 53.8% year over year to \$60 million in the first half of 2020 (no shares were repurchased in the second quarter). Notably, the company's board of directors approved an 8% hike in its quarterly dividend rate in February 2020.

Diversified business structure, solid product offerings and backlog level, and cost-reduction actions might benefit Xylem. Also, a healthy liquidity position and dividend payouts might work in the company's favour.

Reasons To Sell:

- ▼ On a P/E TTM basis, Xylem's shares presently seem overvalued compared with the industry, with respective tallies of 32.97X and 26.12X. Also, its multiple is higher than the industry's three-month highest levels of 26.12X. In second-quarter 2020, Xylem's earnings declined 49.4% year over year on weak sales generation (the pandemic adversely impacted the top line by 5%) and a fall in margins. For 2020, the company refrained from reinstating its projections, which were suspended on Mar 31. For the third quarter, it currently expects a year-over-year organic sales decline of 8-12% — including a mid- to high-single-digit decline in Water Infrastructure, a fall in low-teens in Applied Water, and mid- to high-teens decrease in Measurement & Control Solutions.
- ▼ Over the past few quarters, Xylem has been grappling with the adverse impacts of cost inflation. In second-quarter 2020, the company's operating margin was lowered by 270 bps due to cost inflation. The same metric reduced the operating margin by 260 bps in the first quarter of 2020. In addition to costs inflation, adverse impact of volume/mix/other lowered operating margin by 660 bps and strategic investments had a 60-bps adverse impacts in the second quarter of 2020. In the quarters ahead, the coronavirus pandemic might continue hurting the company's margins. Also, the persistence of headwinds related to cost inflation and strategic investments might be concerning. 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 second quarter of 2020, forex woes adversely impacted earnings by one cent per share and sales by 2%.
- ▼ A high debt level can be concerning for Xylem, as it raises financial obligations and might hurt profitability. At the end of second-quarter 2020, the company's long-term debt was \$3,031 million, reflecting a sequential increase of 49.2%. Proceeds from debt issuance totaled \$987 million in the first half of 2020. Its total debt to total capital stood at 53.1% in second-quarter end, higher than 46.9% in the previous quarter. In addition to rise in debts, the company's ability to meet the financial obligation have weakened; evident from a fall in times interest earned from 6.6X in the first quarter to 4.7X in the second quarter. Also, return on total capital has declined from 10% in the first quarter to 8.2% in the second quarter.

The uncertainties caused by the coronavirus outbreak remain concerning for Xylem. Also, forex woes, cost inflation, strategic investments and high debts might be dragging.

Last Earnings Report

Xylem Surpasses Q2 Earnings Estimates, Provides View

Xylem has reported better-than-expected results for second-quarter 2020. Its earnings surprise in the quarter was 2.6%.

Adjusted earnings in the quarter under review were 40 cents per share, surpassing the Zacks Consensus Estimate of 39 cents. However, the bottom line decreased 49.4% from the year-ago figure of 79 cents.

It is worth noting that unfavorable movements in foreign currencies had an adverse impact of 1 cent per share on earnings.

Quarter Ending 06/2020

Report Date	Jul 30, 2020
Sales Surprise	0.47%
EPS Surprise	2.56%
Quarterly EPS	0.40
Annual EPS (TTM)	2.34

Revenue Details

Xylem's revenues of \$1,160 million in the quarter under review moved down 13.8% from the year-ago quarter. Organic sales in the quarter declined 12% due mainly to the adverse impacts of the coronavirus outbreak.

Also, the company's revenues surpassed the Zacks Consensus Estimate of \$1,136 million.

Geographically, organic sales fell 15% in the United States, 15% in emerging markets and 4% in Western Europe. Based on end-markets, organic sales in utilities fell 9%, while that in industrial declined 16%. Also, commercial and residential organic sales fell 10% and 15%, respectively.

Orders in the reported quarter fell 11% year over year to \$1,232 million. Organically, orders declined 9%.

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

The segmental information is briefly discussed below:

Revenues in the Water Infrastructure segment were \$501 million, down 10.7% year over year. Organic sales in the quarter decreased 8% year over year. Results suffered from the weakness in utilities and industrial end markets. Business in the U.S. and emerging markets were down 15% and 9%, respectively.

The Applied Water segment generated revenues of \$337 million in the second quarter, down 14.5% year over year. Organic sales dipped 13% on a year-over-year basis. Business in commercial, residential and industrial markets was weak in the quarter. Geographically, businesses fell 14% in the United States as well as declined 14% in emerging markets and 12% in Western Europe.

Quarterly revenues of the Measurement & Control Solutions segment were \$322 million, down 17.4% year over year. Organic sales decreased 17% year over year. Results suffered from weakness in water, test, energy and SaaS/other end markets. While businesses in the United States declined 16%, that in emerging markets was down 29% and it decreased 5% in Western Europe.

Margin Profile

In the quarter, the company's cost of sales decreased 11.4% year over year to \$726 million. As a percentage of revenues, it represented 62.6% versus 60.9% in the year-ago quarter. Gross profit decreased 17.5% year over year to \$434 million, while margin dipped 170 basis points (bps) to 37.4%. Selling, general and administrative expenses dipped 2% to \$288 million. Meanwhile, research and development expenses decreased 6.4% to \$44 million.

Adjusted operating income in the quarter was \$108 million, down 43.8% year over year. Operating margin was down 500 bps to 9.3% due mainly to lower volumes caused by the pandemic.

Balance Sheet and Cash Flow

Exiting the second quarter, Xylem had cash and cash equivalents of \$1,577 million, surging 113.4% from \$739 million at the end of the last reported quarter. Long-term debt balance increased 49.2% sequentially to \$3,031 million.

In the first half of 2020, the company's proceeds from issuance of long-term debt instruments totaled \$987 million.

In the quarter, it generated net cash of \$181 million from its operating activities, reflecting an increase of 47.2% from the year-ago comparable quarter. Capital expenditure was \$44 million, down 26.7% from the year-ago figure of \$60 million. Free cash flow in the quarter was \$137 million, up 117.5% from the year-ago quarter.

Shareholder-Friendly Policies

In the first half of 2020, the company paid out dividends amounting to \$95 million, reflecting an increase of 9.2% from the year-ago comparable period. Share repurchased amounted to \$60 million, up 53.8% year over year.

Outlook

Due to the pandemic-related uncertainties, Xylem refrained from reinstating its projections for 2020. Notably, it withdrew its yearly forecast on Mar 31.

For the third quarter, it expects an organic sales decline of 8-12% year over year. Adjusted operating margin is expected to be 11-11.5%. The projections are better than the results recorded in the second quarter.

Recent News

Xylem Provides Update on Q2 results, Confirms Deal Wins

On **Jul 14, 2020**, Xylem provided its financial update for second-quarter results, considering the impacts of the coronavirus pandemic on its operational performance.

The company currently anticipates second-quarter adjusted earnings per share of 37-39 cents, whereas it reported 23 cents in the first quarter. Notably, on a reported basis, its quarterly earnings are likely to be 15-17 cents.

Also, for the second quarter, the company anticipates a year-over-year revenue decline of 14% (reported basis). Notably, for the quarter, the company's organic revenues are expected to fall 12% on a year-over-year basis compared with a decline of 20-30% predicted earlier. It is worth mentioning that it recorded \$1,123 million in the last reported quarter.

Moreover, Xylem communicated that it entered two significant contracts in the second quarter. Notably, it secured a large-scale irrigation project in India's Telangana region, valued at about \$115 million. The company anticipates realizing revenues from the deal over the next two to three years, commencing late in this year's fourth quarter. In addition, it clinched a deal from Anglian Water in the U.K. for the deployment of software, smart metering and network solutions. This \$90-million deal will yield revenue over the next five years, starting late this year.

Closing of Green Bond Offering

On **Jun 29, 2020**, Xylem announced the closing of its inaugural green bond offering of senior unsecured notes worth \$1 billion. Notably, the offering was comprised of \$500 million of 1.950% senior notes set to expire in January 2028 and \$500 million of 2.250% senior notes set to expire in January 2031.

Dividend

On **Jun 25, 2020**, Xylem paid out a quarterly cash dividend of 26 cents per share to shareholders of record as of May 28, 2020. Also, on the same day, the company announced that it invested in an OEM European Centre of Excellence in Axminster.

Valuation

Xylem shares are down 2.1% and up 1.8% 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 5.2% and 3.5% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and the sector are up 9% and 12.2%, respectively.

The S&P 500 index has moved up 3.9% year to date and increased 16.3% in the past year.

The stock is currently trading at 32.39x forward 12-month earnings, which compares to 27.13x for the Zacks sub-industry, 21.81x for the Zacks sector and 22.77x for the S&P 500 index.

Over the past five years, the stock has traded as high as 37.33x and as low as 15.28x, with a 5-year median of 22.32x. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$81 price target reflects 34x 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	32.39	27.13	21.81	22.77
	5-Year High	37.33	27.13	21.81	22.77
	5-Year Low	15.28	15.6	12.55	15.25
	5-Year Median	22.32	19.7	17.48	17.58
P/S F12M	Current	2.81	3.44	2.9	3.66
	5-Year High	2.99	3.44	2.9	3.66
	5-Year Low	1.47	1.58	1.52	2.53
	5-Year Median	2.34	2.25	2.04	3.05

As of 08/07/2020

Industry Analysis Zacks Industry Rank: Top 48% (121 out of 252)



Top Peers

Company (Ticker)	Rec	Rank
Danaher Corporation (DHR)	Outperform	2
Chart Industries, Inc. (GTLS)	Outperform	1
United Rentals, Inc. (URI)	Outperform	2
Franklin Electric Co., Inc. (FELE)	Neutral	3
MUELLER WATER PRODUCTS (MWA)	Neutral	3
Pentair plc (PNR)	Neutral	2
Badger Meter, Inc. (BMI)	Underperform	5
Itron, Inc. (ITRI)	Underperform	5

Industry Comparison Industry: Manufacturing - General Industrial				Industry Peers		
	XYL	X Industry	S&P 500	DHR	MWA	URI
Zacks Recommendation (Long Term)	Neutral	-	-	Outperform	Neutral	Outperform
Zacks Rank (Short Term)	3	-	-	2	3	2
VGM Score	C	-	-	D	B	A
Market Cap	13.88 B	1.26 B	23.30 B	145.71 B	1.78 B	12.51 B
# of Analysts	7	3	14	8	6	7
Dividend Yield	1.35%	0.00%	1.76%	0.35%	1.86%	0.00%
Value Score	C	-	-	D	C	A
Cash/Price	0.12	0.11	0.07	0.04	0.07	0.01
EV/EBITDA	17.27	12.67	13.32	36.02	13.65	5.22
PEG Ratio	2.55	3.31	2.94	3.25	2.69	0.95
Price/Book (P/B)	4.85	2.14	3.19	4.41	2.94	3.20
Price/Cash Flow (P/CF)	14.59	11.41	12.51	33.05	11.79	3.62
P/E (F1)	42.07	28.01	22.02	37.87	26.86	11.37
Price/Sales (P/S)	2.80	1.23	2.53	7.45	1.84	1.39
Earnings Yield	2.42%	3.11%	4.37%	2.64%	3.72%	8.79%
Debt/Equity	1.06	0.51	0.77	0.68	0.74	2.46
Cash Flow (\$/share)	5.29	2.49	6.94	6.21	0.96	47.99
Growth Score	C	-	-	C	B	C
Hist. EPS Growth (3-5 yrs)	11.31%	10.21%	10.46%	2.68%	10.57%	26.03%
Proj. EPS Growth (F1/F0)	181.24%	-24.63%	-6.80%	-21.96%	-31.15%	541.30%
Curr. Cash Flow Growth	21.58%	0.16%	5.39%	1.84%	17.29%	17.38%
Hist. Cash Flow Growth (3-5 yrs)	13.56%	7.29%	8.55%	5.87%	7.36%	13.02%
Current Ratio	2.40	2.06	1.33	2.20	3.87	0.84
Debt/Capital	51.41%	34.34%	44.50%	38.15%	42.39%	71.07%
Net Margin	5.09%	4.34%	10.13%	17.73%	8.85%	12.37%
Return on Equity	14.72%	10.81%	14.39%	11.88%	14.08%	37.16%
Sales/Assets	0.63	0.77	0.51	0.30	0.73	0.48
Proj. Sales Growth (F1/F0)	-9.49%	-7.71%	-1.51%	6.73%	-6.06%	-11.20%
Momentum Score	B	-	-	C	B	B
Daily Price Chg	1.79%	1.46%	0.90%	-0.14%	2.45%	2.93%
1 Week Price Chg	-1.71%	-1.68%	0.14%	4.37%	1.00%	-3.42%
4 Week Price Chg	15.98%	9.37%	8.95%	10.75%	26.32%	20.83%
12 Week Price Chg	30.87%	23.33%	18.90%	27.06%	42.07%	49.57%
52 Week Price Chg	-0.08%	-3.08%	1.18%	45.79%	11.13%	47.30%
20 Day Average Volume	1,128,017	67,224	2,057,775	2,450,252	656,892	904,575
(F1) EPS Est 1 week change	-0.52%	0.00%	0.00%	0.00%	0.00%	6.84%
(F1) EPS Est 4 week change	30.78%	0.28%	1.36%	10.94%	-4.56%	27.18%
(F1) EPS Est 12 week change	3.30%	1.03%	1.57%	13.70%	-16.33%	31.16%
(Q1) EPS Est Mthly Chg	7.32%	2.85%	0.54%	7.54%	0.00%	10.95%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

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	C
Momentum Score	B
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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