

Xylem Inc. (XYL)

\$63.80 (As of 06/11/20)

Price Target (6-12 Months): **\$54.00**

Long Term: 6-12 Months

Zacks Recommendation: Underperform

(Since: 05/24/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:F

Value: D

Growth: F

Momentum: D

Summary

In the past three months, Xylem's shares have underperformed the industry and also look comparatively undervalued. The company is wary about the adverse impacts of the pandemic on its operations, especially in its residential and commercial markets. Also, project execution and capital spending delays as well as tough labor conditions might hurt utilities, while challenges in beverage dispensing, applied water, marine and dewatering businesses might impact the industrial market. For 2020, Xylem refrained from reinstating its projections, which were suspended on Mar 31. Further, an organic sales decline of 20-30% is predicted for the second quarter. Moreover, cost inflation and strategic investments might adversely impact margins. Also, forex woes might be dragging. Its earnings estimates have decreased for 2020 and 2021 in the past 60 days.

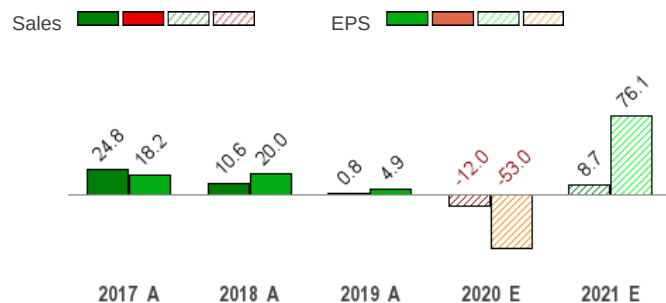
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$89.34 - \$54.62
20 Day Average Volume (sh)	1,144,853
Market Cap	\$11.5 B
YTD Price Change	-19.0%
Beta	1.02
Dividend / Div Yld	\$1.04 / 1.6%
Industry	Manufacturing - General Industrial
Zacks Industry Rank	Bottom 29% (179 out of 252)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-37.8%
Last Sales Surprise	-1.8%
EPS F1 Est- 4 week change	-13.7%
Expected Report Date	08/06/2020
Earnings ESP	14.3%
P/E TTM	23.4
P/E F1	44.9
PEG F1	2.7
P/S TTM	2.2

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	1,130 E	1,184 E	1,289 E	1,378 E	5,021 E
2020	1,123 A	993 E	1,128 E	1,265 E	4,620 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	\$0.44 E	\$0.66 E	\$0.79 E	\$0.88 E	\$2.50 E
2020	\$0.23 A	\$0.04 E	\$0.49 E	\$0.70 E	\$1.42 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.

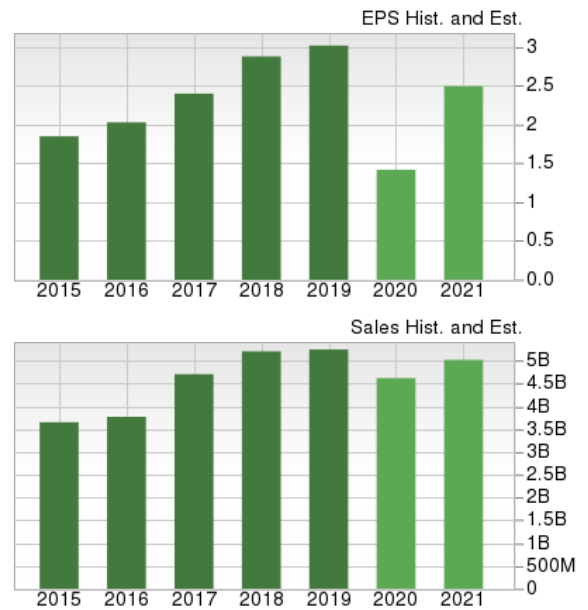
The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 06/11/2020. The reports text is as of 06/12/2020.

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** (39% of total revenues generated in the first 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** (30.1%): 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** (30.9%): 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 Sell:

- ▼ In the past three months, Xylem's shares have dipped 11.6% against the industry's growth of 5.5%. Also, on a P/E TTM basis, the company's shares presently seem overvalued compared with the industry, with respective tallies of 23.37x and 21.2x. Also, its multiple is higher than the industry's three-month highest levels of 21.2x. In first-quarter 2020, Xylem's earnings and sales lagged estimates by 37.8% and 1.7%, respectively. On a year-over-year basis, the bottom line declined 55.8% 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 second quarter, it expects year-over-year organic sales decline of 20-30%. In the past 60 days, the company's earnings estimates have declined 92.9% to 4 cents for the second quarter, 46.4% to \$1.42 for 2020 and 19.9% to \$2.50 for 2021.
- ▼ In first-quarter 2020, Xylem's businesses were weak in markets served, including commercial, utilities, residential and industrial. For 2020, the company believes that challenging labor conditions as well as delay in execution of existing projects and award of capital projects might hurt the utilities business. For the industrial market, the company is expected to face challenges in applied water, dewatering, beverage dispensing and marine businesses. Further, project delays caused by factory shutdowns might have short-term impact on the commercial market. For the residential market, weaknesses caused by the pandemic might be concerning.
- ▼ Over the past few quarters, Xylem has been grappling with the adverse impacts of cost inflation. In first-quarter 2020, the company's operating margin was lowered by 260 bps due to cost inflation. The same metric reduced the operating margin by 270 bps in the fourth quarter and 280 bps in the third quarter. In addition to costs inflation, the pandemic lowered operating margin by 150 bps and strategic investments had 60-bps adverse impacts in the first 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 first quarter of 2020, forex woes adversely impacted earnings by two cents per share and sales by 1%.

Weakness in end-markets caused by the coronavirus outbreak is predicted to impact Xylem's results in the second quarter. Also, forex woes, cost inflation and strategic investments might be dragging.

Risks

- In the quarters ahead, Xylem might benefit from new products, innovation, efforts to boost growth and focus on operational execution. In addition, the company's diversified businesses might be beneficial, helping it offset weakness in one or more markets, with gains in others. Notably, the company serves customers in industrial, commercial, residential and utilities markets. Further, the company seems to be working diligently to continue with its operations despite the uncertainties caused by the pandemic. Also, it has taken actions to control capital spending and operating expenses to offset some financial stress. The measures are likely to yield cost savings of \$100 million in 2020. Additionally, the company is planning on structural reduction in costs and investments.
 - Xylem believes in rewarding shareholders handsomely through share buybacks and dividend payments. In first-quarter 2020, it paid out dividends amounting to \$48 million, marking an increase of 9.1% from the year-ago quarter. Also, share buybacks grew 53.8% year over year to \$60 million in the quarter. Notably, the company's board of directors approved an 8% hike in its quarterly dividend rate in February 2020. In the wake of the coronavirus outbreak, it is reevaluating its abilities to pay the dividend.
 - Xylem has successfully lowered its debt level over the past few years. In the last three years (2017-2019), the company's long-term debt declined 2.5% (CAGR). At the end of first-quarter 2020, the metric was at \$2,031 million, which reflected a 0.4% decline from the prior quarter's figure. The sequential rise of 0.4% in debts is not a concern, especially when the company seems to have healthy liquidity position (of \$1.7 billion as disclosed recently). The company's interest expense decreased 11.1% year over year in the second quarter. Compared with the industry, the company's is less leveraged, with long-term debt-to-capital of 41.9% and 50.2% respectively.
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Last Earnings Report

Xylem Q1 Earnings Lag Estimates, Organic View Weak

Xylem reported weaker-than-expected results for first-quarter 2020. Its earnings in the quarter lagged estimates by 37.8%, while sales missed the same by 1.7%. Weak earnings results came in after three consecutive quarters of in-line results.

Adjusted earnings in the quarter under review were 23 cents per share, lagging the Zacks Consensus Estimate of 37 cents. Also, the bottom line decreased 55.8% from the year-ago figure of 52 cents. It is worth noting that unfavorable movements in foreign currencies had an adverse impact of 2 cents per share on earnings.

Quarter Ending **03/2020**

Report Date	May 05, 2020
Sales Surprise	-1.79%
EPS Surprise	-37.84%
Quarterly EPS	0.23
Annual EPS (TTM)	2.73

Revenue Details

Xylem's revenues of \$1,123 million in the quarter under review moved down 9.2% from the year-ago quarter. Organic sales in the quarter declined 8%. The results bore the brunt of the coronavirus outbreak that lowered sales by 5%. Also, the company's revenues lagged the Zacks Consensus Estimate of \$1,143 million by 1.7%.

Geographically, organic sales fell 7% in the United States, 19% in emerging markets and 2% in Western Europe. Based on end-markets, organic sales in utilities fell 5%, while that in industrial declined 10%. Also, commercial and residential organic sales fell 11% and 14%, respectively.

Orders in the reported quarter fell 4% year over year to \$1,261 million. Organically, orders declined 2%.

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 \$438 million, down 9.1% year over year. Organic sales in the quarter decreased 7% year over year. Results suffered from weakness in utilities and emerging markets. Business in China recorded a double-digit decline.

The **Applied Water** segment generated revenues of \$338 million in the first quarter, down 10.8% year over year. Organic sales dipped 10% on a year-over-year basis. Business in commercial, residential and industrial markets was weak in the quarter. Geographically, businesses fell in the United States as well as declined in emerging markets and Western Europe.

Quarterly revenues of the **Measurement & Control Solutions** segment were \$347 million, down 7.7% year over year. Organic sales decreased 7% year over year. Results suffered from weakness in water, test, energy and SaaS/other end markets. While businesses in the United States and emerging markets declined, it increased in Western Europe.

Margin Profile

In the quarter, the company's cost of sales decreased 6.4% year over year to \$714 million. As a percentage of revenues, it represented 63.6% versus 61.7% in the year-ago quarter. Gross profit decreased 13.7% year over year to \$409 million, while margin dipped 190 basis points (bps) to 36.4%. Selling, general and administrative expenses dipped 2% to \$297 million. Meanwhile, research and development expenses decreased 3.9% to \$49 million.

Adjusted operating income in the quarter was \$70 million, down 47.4% year over year. Operating margin was down 460 bps to 6.2%.

Balance Sheet and Cash Flow

Exiting the first quarter, Xylem had cash and cash equivalents of \$739 million, up 2.1% from \$724 million at the end of the last reported quarter. Long-term debt balance slipped 0.4% sequentially to \$2,031 million.

In the quarter, the company used net cash of \$2 million for its operating activities against cash flow generation of \$83 million in the year-ago quarter. Capital expenditure was \$51 million, down 26.1% from the year-ago figure of \$69 million. Free cash outflow in the quarter was \$53 million against the inflow of \$14 million in the year-ago quarter.

Shareholder-Friendly Policies

In the quarter, the company paid out dividends amounting to \$48 million, reflecting an increase of 9.1% from the year-ago quarter. Share repurchased in the quarter amounted to \$60 million, up 53.8% year over year.

Outlook

In the quarters ahead, Xylem anticipates gaining from cost-reduction efforts (of about \$100 million in 2020), solid liquidity and investments.

Due to the pandemic-related uncertainties, the company refrained from reinstating its projections for 2020. Notably, it withdrew its yearly forecast on Mar 31. However, it expects organic sales to decline 20-30% year over year in the second quarter.

Recent News

Dividend

On **May 14, 2020**, Xylem's board of directors approved payment of a quarterly cash dividend of 26 cents per share to shareholders of record as of May 28, 2020. The payment will be made on Jun 25.

Expansion of Partner Community Grants Program

On **Apr 27, 2020**, Xylem announced to augment Partner Community Grants Program, which is an initiative of the company's corporate social responsibility program — Xylem Watermark. The expansion has been primarily undertaken to address the essential needs of the communities in response to COVID-19 pandemic. Notably, the non-profit organizations working with Xylem will focus on matters like infection mitigation, water-related education programs and community sustainability with utmost support for front line personnel.

Partnership with AmeriCares

On **Apr 22, 2020**, Xylem's corporate social responsibility program, Xylem Watermark, announced its decision to collaborate with AmeriCares to combat the spread of the coronavirus. The partnership will focus on delivering personal protective equipment, water and sanitation infrastructure repairs to frontline healthcare workers throughout the world.

Valuation

Xylem shares are down 19% and 21.4% 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 17.1% and 15.5% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and the sector are down 9.6% and 9.7%, respectively.

The S&P 500 index has moved down 6.7% year to date and increased 3.9% in the past year.

The stock is currently trading at 30.65x forward 12-month earnings, which compares to 26.06x for the Zacks sub-industry, 22.73x for the Zacks sector and 23.03x for the S&P 500 index.

Over the past five years, the stock has traded as high as 35.27x and as low as 15.28x, with a 5-year median of 22.12x. Our Underperform recommendation indicates that the stock will perform worse than the market. Our \$54 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	30.65	26.06	22.73	23.03
	5-Year High	35.27	26.53	22.73	23.03
	5-Year Low	15.28	15.6	12.55	15.23
	5-Year Median	22.12	19.48	16.66	17.49
EV/EBITDA F12M	Current	20.16	18.89	20.66	14.17
	5-Year High	20.16	18.89	20.66	14.17
	5-Year Low	9.8	8.2	10.6	9.01
	5-Year Median	13.88	11.12	14.15	10.94
EV/Sales F12M	Current	3.09	3.94	3.4	3.38
	5-Year High	3.28	3.94	3.4	3.51
	5-Year Low	1.71	1.81	1.76	2.28
	5-Year Median	2.69	2.6	2.32	2.82

As of 06/11/2020

Industry Analysis Zacks Industry Rank: Bottom 29% (179 out of 252)



Top Peers

Company (Ticker)	Rec	Rank
Badger Meter, Inc. (BMI)	Neutral	3
Danaher Corporation (DHR)	Neutral	3
Franklin Electric Co., Inc. (FELE)	Neutral	3
Chart Industries, Inc. (GTLS)	Neutral	3
Itron, Inc. (ITRI)	Neutral	4
MUELLER WATER PRODUCTS (MWA)	Neutral	3
Pentair plc (PNR)	Neutral	3
United Rentals, Inc. (URI)	Neutral	3

Industry Comparison Industry: Manufacturing - General Industrial				Industry Peers		
	XYL	X Industry	S&P 500	DHR	MWA	URI
Zacks Recommendation (Long Term)	Underperform	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	3	3	3
VGM Score	F	-	-	D	B	A
Market Cap	11.48 B	1.12 B	21.32 B	115.02 B	1.42 B	10.23 B
# of Analysts	8	3	14	9	6	7
Dividend Yield	1.63%	0.00%	1.99%	0.44%	2.34%	0.00%
Value Score	D	-	-	D	B	A
Cash/Price	0.06	0.09	0.06	0.04	0.07	0.04
EV/EBITDA	14.38	11.31	12.31	29.32	11.31	4.86
PEG Ratio	2.75	3.21	2.88	3.72	2.03	0.99
Price/Book (P/B)	4.08	1.53	2.92	3.90	2.34	2.82
Price/Cash Flow (P/CF)	12.07	8.97	11.24	26.54	9.38	2.96
P/E (F1)	45.39	25.66	20.84	33.78	20.33	11.91
Price/Sales (P/S)	2.24	1.04	2.24	5.93	1.40	1.09
Earnings Yield	2.23%	3.58%	4.64%	2.96%	4.90%	8.39%
Debt/Equity	0.72	0.50	0.76	0.77	0.74	2.96
Cash Flow (\$/share)	5.29	2.49	7.01	6.21	0.96	47.99
Growth Score	F	-	-	C	B	C
Hist. EPS Growth (3-5 yrs)	12.81%	11.57%	10.87%	2.50%	10.57%	25.81%
Proj. EPS Growth (F1/F0)	-53.02%	-34.06%	-10.81%	10.43%	-27.60%	-38.91%
Curr. Cash Flow Growth	21.58%	5.37%	5.46%	1.84%	17.29%	17.38%
Hist. Cash Flow Growth (3-5 yrs)	13.56%	5.59%	8.55%	5.87%	7.36%	13.02%
Current Ratio	1.55	2.19	1.29	1.32	3.87	1.11
Debt/Capital	41.86%	33.61%	44.75%	42.26%	42.39%	74.72%
Net Margin	7.01%	4.65%	10.54%	16.85%	10.68%	12.52%
Return on Equity	17.08%	11.37%	16.08%	11.52%	17.67%	41.15%
Sales/Assets	0.67	0.76	0.55	0.32	0.77	0.49
Proj. Sales Growth (F1/F0)	-11.98%	-9.37%	-2.60%	2.71%	-4.02%	-12.74%
Momentum Score	D	-	-	D	D	A
Daily Price Chg	-6.87%	-6.50%	-6.44%	-4.51%	-6.85%	-8.71%
1 Week Price Chg	9.66%	10.45%	7.51%	3.97%	9.74%	16.18%
4 Week Price Chg	8.23%	12.92%	8.40%	2.00%	13.10%	22.39%
12 Week Price Chg	-1.02%	30.76%	25.04%	32.78%	16.17%	82.79%
52 Week Price Chg	-21.32%	-21.01%	-6.33%	18.28%	-8.09%	14.76%
20 Day Average Volume	1,144,853	90,344	2,634,935	2,863,010	874,902	1,455,507
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	2.47%
(F1) EPS Est 4 week change	-13.67%	0.00%	0.00%	-0.09%	-4.87%	2.47%
(F1) EPS Est 12 week change	-53.72%	-34.72%	-15.86%	-9.97%	-28.93%	-41.76%
(Q1) EPS Est Mthly Chg	-18.61%	0.00%	0.00%	-0.37%	-25.25%	1.86%

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	D
Growth Score	F
Momentum Score	D
VGM Score	F

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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