

Xylem Inc. (XYL)

\$89.13 (As of 02/12/20)

Price Target (6-12 Months): **\$75.00**

Long Term: 6-12 Months

Zacks Recommendation: Underperform

(Since: 02/11/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

5-Strong Sell

Zacks Style Scores:

VGM:D

Value: F

Growth: A

Momentum: F

Summary

Over the past six months, Xylem has underperformed the industry. The company expects softness in North American short-cycle markets in the first half, economic uncertainty and geopolitical issues in the Middle East, lack of business growth in Europe, and soft oil and gas market to affect business in industrial markets in 2020. Also, it expects the operating conditions to remain soft for commercial markets in the first half of 2020. Moreover, the company has been grappling with the increasing cost of sales and operating expenses. Given Xylem's extensive geographic presence, its financial performance is subject to headwinds from geopolitical issues and forex woes. In the past seven days, earnings estimates for the first and second quarters of 2020 have been revised downward.

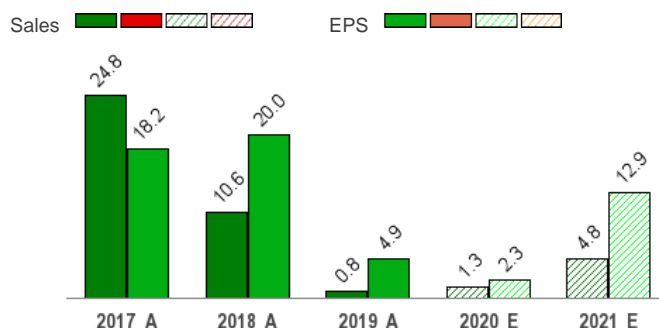
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$89.34 - \$72.15
20 Day Average Volume (sh)	1,423,219
Market Cap	\$16.1 B
YTD Price Change	13.1%
Beta	1.11
Dividend / Div Yld	\$1.04 / 1.1%
Industry	Manufacturing - General Industrial
Zacks Industry Rank	Bottom 17% (211 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	0.0%
Last Sales Surprise	-0.6%
EPS F1 Est- 4 week change	-8.0%
Expected Report Date	05/07/2020
Earnings ESP	0.0%
P/E TTM	29.5
P/E F1	28.8
PEG F1	1.8
P/S TTM	3.1

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	1,260 E	1,403 E	1,395 E	1,479 E	5,569 E
2020	1,182 E	1,329 E	1,353 E	1,439 E	5,315 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	\$0.58 E	\$0.91 E	\$0.92 E	\$1.08 E	\$3.49 E
2020	\$0.42 E	\$0.78 E	\$0.87 E	\$0.99 E	\$3.09 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.

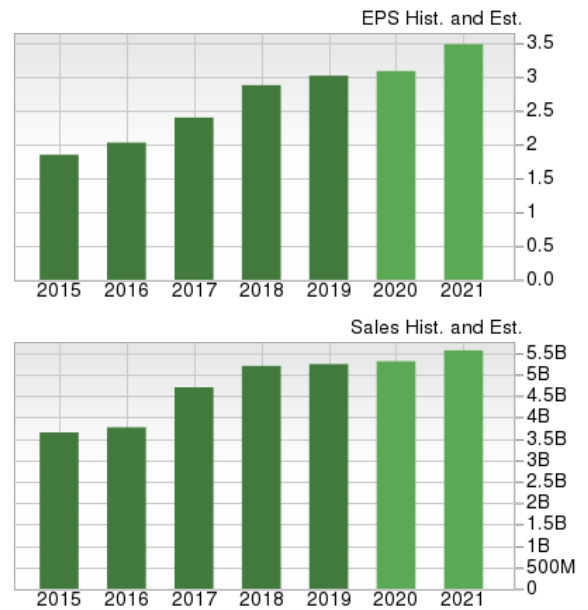
The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 02/12/2020. The reports text is as of 02/13/2020.

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:

- ▼ Xylem predicts that its earnings in the first half will be roughly 40% of the annual projection, suggesting a dip from 43% of annual earnings realized in the first half of 2019. Also, organic sales in the first half of this year will likely decline in low-single digits (with a 3-5% decline in the first quarter) on uncertainty over Coronavirus in China, strong comparisons in the year-ago period and soft orders. In the past seven days, the consensus estimates for earnings per share have been lowered, reflecting bearish sentiments for the stock. Currently, the Zacks Consensus Estimate is pegged at 42 cents per share for first-quarter 2020 and 78 cents for second-quarter 2020, declining 31.1% and 8.2% from the respective seven-day-ago figures. This makes us cautious about the stock.
- ▼ 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. The company expects softness in North American short-cycle markets in the first half, economic uncertainty and geopolitical issues in the Middle East, flattish business in Europe, and soft mining/oil and gas market to impact business in industrial markets in 2020. Organic sales in industrial will likely be flat year over year in 2020. Also, operating conditions will probably be soft for commercial markets in the first half of 2020.
- ▼ 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. For the first quarter of 2020, the company predicts adjusted operating margin of 8-9%, suggesting a dip from 10.8% reported in the previous-year quarter.
- ▼ In the past six months, Xylem's shares have gained 19.1% compared with the industry's growth of 22.4%. Also, on a P/E (TTM) basis, Xylem's shares look a bit overvalued compared with the industry, with respective tallies of 29.51x and 23.65x. Moreover, the stock is currently trading higher than the industry's six-month highest level of 23.65x. 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.

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.

Risks

- In the fourth quarter of 2019, Xylem's earnings increased 1.1%, gaining from productivity initiatives, pricing actions, favorable volumes and interest expenses. For 2020, the company anticipates adjusted earnings of \$2.96-\$3.16 per share, suggesting year-over-year growth of 1-8%. Organic sales are predicted to grow 1-3%. Capital expenditure in the year will likely be \$235-\$245 million. It believes that emerging market exposure, new products, innovation, growth investments and focus on operational execution might be beneficial.
 - Xylem 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. For 2020, organic sales are anticipated to increase in low-single digits in utilities, commercial and residential end markets. Also, organic growth in both the Water Infrastructure and Applied Water segments are anticipated to be flat to grow 2% in the year. Also, organic growth for the Measurement & Control Solutions segment is anticipated to increase 4-6%. In addition, the company stays committed to rewarding shareholders handsomely through dividend payments and share buybacks. 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. For 2020, it anticipates distributing dividends of \$185 million and witnessing share count of 181.2 million.
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Last Earnings Report

Xylem Earnings Meet Estimates in Q4, Dividend Rate Rises

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%.

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

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

Dividend Hike

On **Feb 6, 2020**, Xylem announced that its board of directors approved an 8% hike in its quarterly dividend rate. The new rate at 26 cents will be disbursed to its shareholders of record as of Feb 27. The payment will be made on Mar 26.

Valuation

Xylem shares are up 13.1% and 23% 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 up 5.3% and 0.7% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and the sector are up 25.3% and 9.9%, respectively.

The S&P 500 Index has moved up 4.2% year to date and 21.4% in the past year.

The stock is currently trading at 28.45x forward 12-month earnings, which compares to 22.1x for the Zacks sub-industry, 18.42x for the Zacks sector and 19.29x 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 21.77x. Our Underperform recommendation indicates that the stock will perform worse than the market. Our \$75 price target reflects 23.94x 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	28.45	22.1	18.42	19.29
	5-Year High	28.95	22.58	19.89	19.34
	5-Year Low	15.28	15.2	12.6	15.18
	5-Year Median	21.77	19	16.62	17.47
EV/EBITDA F12M	Current	15.15	12.81	17.81	12.66
	5-Year High	15.94	12.81	18.2	12.66
	5-Year Low	9.59	8.3	10.68	9.08
	5-Year Median	13.22	10.7	14.03	10.79
EV/Sales F12M	Current	3.12	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	2.79

As of 02/12/2020

Industry Analysis Zacks Industry Rank: Bottom 17% (211 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 Underperform	X Industry	S&P 500	DHR Neutral	MWA Neutral	URI Outperform
VGM Score	D	-	-	D	F	B
Market Cap	16.05 B	1.92 B	24.31 B	117.68 B	1.95 B	11.82 B
# of Analysts	9	2.5	13	8	7	7
Dividend Yield	1.08%	0.00%	1.78%	0.42%	1.70%	0.00%
Value Score	F	-	-	D	D	B
Cash/Price	0.05	0.05	0.04	0.17	0.07	0.00
EV/EBITDA	19.56	13.26	13.97	26.26	14.61	5.27
PEG Ratio	1.75	2.40	2.06	2.59	1.96	0.61
Price/Book (P/B)	5.41	2.52	3.24	4.10	3.28	3.09
Price/Cash Flow (P/CF)	16.86	12.86	13.65	26.36	12.93	3.31
P/E (F1)	28.84	19.69	19.12	30.07	19.59	7.76
Price/Sales (P/S)	3.06	1.39	2.67	5.90	1.98	1.26
Earnings Yield	3.47%	5.04%	5.23%	3.33%	5.09%	12.88%
Debt/Equity	0.69	0.54	0.70	0.75	0.75	2.72
Cash Flow (\$/share)	5.29	2.62	6.94	6.21	0.96	47.99
Growth Score	A	-	-	C	F	B
Hist. EPS Growth (3-5 yrs)	12.91%	6.49%	10.85%	2.72%	10.93%	24.77%
Proj. EPS Growth (F1/F0)	2.28%	7.20%	7.30%	23.25%	3.51%	4.89%
Curr. Cash Flow Growth	21.58%	10.71%	8.92%	-1.09%	17.29%	17.38%
Hist. Cash Flow Growth (3-5 yrs)	13.56%	7.04%	8.36%	5.87%	7.36%	13.02%
Current Ratio	1.63	2.03	1.22	5.19	4.11	0.84
Debt/Capital	40.74%	35.40%	42.90%	41.54%	42.82%	73.14%
Net Margin	7.64%	6.22%	11.81%	15.09%	9.63%	12.56%
Return on Equity	18.90%	12.98%	16.98%	11.50%	17.09%	42.34%
Sales/Assets	0.69	0.81	0.54	0.35	0.76	0.49
Proj. Sales Growth (F1/F0)	1.26%	1.52%	3.90%	6.62%	5.23%	2.59%
Momentum Score	F	-	-	B	F	F
Daily Price Chg	2.17%	0.44%	0.65%	0.09%	1.14%	3.13%
1 Week Price Chg	3.11%	1.25%	2.47%	0.70%	3.09%	10.36%
4 Week Price Chg	8.10%	0.00%	1.35%	1.88%	4.48%	2.57%
12 Week Price Chg	15.05%	6.61%	5.63%	14.60%	13.38%	6.97%
52 Week Price Chg	22.63%	7.82%	16.19%	47.30%	16.26%	20.23%
20 Day Average Volume	1,423,219	39,280	1,995,746	2,165,435	835,124	1,181,217
(F1) EPS Est 1 week change	-7.60%	0.00%	0.00%	0.00%	-1.34%	0.00%
(F1) EPS Est 4 week change	-8.05%	-0.12%	0.00%	0.69%	-1.12%	-0.52%
(F1) EPS Est 12 week change	-8.87%	-0.75%	-0.19%	-2.13%	-1.12%	-0.36%
(Q1) EPS Est Mthly Chg	-30.63%	0.00%	0.00%	5.64%	-1.26%	-0.56%

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	F
Growth Score	A
Momentum Score	D
VGM Score	D

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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