

Xylem Inc.  
Form 10-K  
February 27, 2014

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-K  
(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2013  
or  
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number: 1-35229

Xylem Inc.  
(Exact name of registrant as specified in its charter)  
Indiana  
(State or other jurisdiction of incorporation or  
organization)

45-2080495  
(I.R.S. Employer Identification No.)

1 International Drive, Rye Brook, NY 10573  
(address of principal executive offices and zip code)  
(914) 323-5700  
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, par value \$0.01 per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer  Smaller reporting company   
(Do not check if a smaller reporting company)

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No   
The aggregate market value of the common stock of the registrant held by non-affiliates of the registrant as of June 30, 2013 was approximately \$5.0 billion. As of January 31, 2014, there were 184,681,473 outstanding shares of the registrant's common stock, par value \$0.01 per share.

**DOCUMENTS INCORPORATED BY REFERENCE**

The information required by Part III of this Report is incorporated herein by reference from the registrant's definitive proxy statement relating to its annual meeting of shareholders to be held in May 2014.

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Xylem Inc.  
 ANNUAL REPORT ON FORM 10-K  
 For the fiscal year ended December 31, 2013  
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\* Included pursuant to Instruction 3 of Item 401(b) of Regulation S-K.

## PART I

The following discussion should be read in conjunction with the consolidated and combined financial statements, including the notes thereto, included in this Annual Report on Form 10-K (this "Report"). Xylem Inc. was incorporated in Indiana on May 4, 2011. Except as otherwise indicated or unless the context otherwise requires, "Xylem," "we," "us," "our" and "the Company" refer to Xylem Inc. and its subsidiaries. References in the consolidated and combined financial statements to "ITT" or "parent" refers to ITT Corporation and its consolidated subsidiaries (other than Xylem Inc.), former parent of Xylem.

### Forward-Looking Statements

This Report contains "forward-looking statements" within the meaning of the Private Securities Litigation Act of 1995 that are based on our current expectations and assumptions. Forward-looking statements by their nature address matters that are, to different degrees, uncertain. Generally, the words "anticipate," "estimate," "expect," "project," "intend," "p", "strategy," "may," "will," "believe," "target" and similar expressions identify forward-looking statements, which generally are not historical in nature. However, the absence of these words or similar expressions does not mean that a statement is not forward-looking.

Forward-looking statements include, but are not limited to, statements about the capitalization of the Company, the Company's restructuring and realignment, our future strategic plans and other statements that describe the Company's business strategy, outlook, objectives, plans, intentions or goals, and any discussion of future operating or financial performance. All statements that address performance, events or developments that we expect or anticipate will occur in the future - including statements relating to orders, sales, operating margins and earnings per share growth, cash flows, and statements expressing general views about future operating results - are forward-looking statements. Caution should be taken not to place undue reliance on any such forward-looking statements because they involve risks, uncertainties and other factors that could cause actual results to differ materially from those expressed or implied in, or reasonably inferred from, such statements. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law. In addition, forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from the Company's historical experience and its present expectations or projections. These risks and uncertainties include, but are not limited to, those set forth below under "Item 1A. Risk Factors" and those described from time to time in subsequent filings with the U.S. Securities and Exchange Commission ("SEC").

## ITEM 1. BUSINESS

### Business Overview

Xylem, with 2013 revenue of \$3.8 billion and more than 12,500 employees, is a world leader in the design, manufacturing, and application of highly engineered technologies for the water industry. We are a leading equipment and service provider for water and wastewater applications with a broad portfolio of products and services addressing the full cycle of water, from collection, distribution and use to the return of water to the environment. We have leading market positions among equipment and service providers in the core application areas of the water equipment industry: transport, treatment, test, building services, industrial processing and irrigation. Our Company's brands, such as Bell & Gossett and Flygt, are well known throughout the industry and have served the water market for many years.

We serve a global customer base across diverse end markets while offering localized expertise. We sell our products in more than 150 countries through a balanced distribution network consisting of our direct sales force and independent channel partners. In 2013, 62% of our revenue was generated outside the United States, with 36% of revenue generated in Europe.

We initiated an organizational redesign during the fourth quarter of 2013, shifting from individually managed businesses to an integrated approach within geographical regions. We expect that this will enable us to leverage the breadth of the Company's product and services portfolio to better serve our customers and address market opportunities as well as effectively utilize internal support organizations to realize economies of scale and efficient use of resources. This organizational redesign has implications on how we will manage the business and the



related measurement system by which we will hold our management team accountable. We are in the process of changing our measurement system, including our underlying accounting system, which we expect to complete by the middle of 2014.

#### Our Industry

Our planet faces a serious water challenge. Less than 1% of the total water available on earth is fresh water, and this percentage is declining due to factors such as the draining of aquifers, increased pollution and climate change. In addition, demand for fresh water is rising rapidly due to population growth, industrial expansion, and increased agricultural development, with consumption estimated to double every 20 years. By 2025, more than 30% of the world's population is expected to live in areas without adequate water supply. Even in developed countries with sufficient supply, existing infrastructure for water supply is relatively underfunded and aging. In the United States, degrading pipe systems leak one out of every six gallons of water, on average, on its way from a treatment plant to the customer. These challenges are driving opportunities for growth in the global water industry, which we estimate to have a total market size of approximately \$550 billion.

The water industry supply chain is comprised of Equipment and Services companies, Design and Build service providers, and Water Utilities. Equipment and Service providers serve distinct customer types. The utilities type supply water through an infrastructure network. Companies that operate on this side of the supply chain provide single, or sometimes combined, functions from equipment manufacturing and services to facility design (engineering, procurement and construction, or "EPC" firms) to plant operations (utilities), as depicted below in Figure 1. The utility and EPC customers are looking for technology and application expertise from their Equipment and Services providers, due to trends such as rising pollution, stricter regulations, and the increased outsourcing of process knowledge. The customer type serves the end users of water and comprises a wide array of entities, including farms, mines, power plants, industrial facilities and residential homes. These customers are predominately served through specialized distributors and original equipment manufacturers ("OEMs").

#### Figure 1: Water Industry Supply Chain

Our business focuses on the beginning of the supply chain by providing technology-intensive equipment and services. We sell our equipment and services via direct and indirect channels that serve the needs of each customer type. On the utility side, we provide the majority of our sales direct to customers with strong application expertise, with the remaining amount going through distribution partners. To end users of water, we provide the majority of our sales through long-standing relationships with the world's leading distributors, with the remainder going direct to customers.

The Equipment and Services market addresses the key processes of the water industry, which are best illustrated through the cycle of water, as depicted in Figure 2, below. We believe this industry has two distinct sectors within the cycle of water: Water Infrastructure and Usage Applications. The key processes of this cycle begin when raw water is extracted by pumps, which provide the necessary pressure and flow, to move, or transport, this water from natural sources, such as oceans, ground water, lakes and rivers, through pipes to treatment facilities. Treatment facilities can provide many forms of treatment, such as filtration, disinfection and desalination, to remove solids, bacteria, and salt, respectively. Throughout each of these stages, analytical instruments test the treated water to ensure regulatory requirements are met so that it can be utilized by end-use customers. A network of pipes and pumps again transports this clean water to where it is needed, such as to crops for irrigation, to power plants to provide cooling in industrial water, or to an apartment building as drinking water in residential and commercial buildings. After usage, the wastewater is collected by a separate network of pipes and pumps and transported to a wastewater treatment facility, where processes such as digestion deactivate and reduce the volume of solids, and disinfection purifies effluent water. Once treated, analytical instruments test the treated water to ensure regulatory requirements are met so that it can be discharged back to the environment, thereby completing the cycle.

Figure 2: Cycle of Water

In the Water Infrastructure sector, two primary end markets exist: public utility and industrial. The public utility market comprises public, private and public-private institutions that handle water and wastewater for mostly residential and commercial purposes. The industrial market involves the supply of water and removal of wastewater for industrial facilities. We view the main macro drivers of this sector to be water quality, the desire for energy-efficient products, water scarcity, regulatory requirements and infrastructure needs, for both the repair of aging systems in developed countries as well as new installations in emerging markets.

In the Usage Applications sector, end-use customers fall into four main markets: residential, commercial, industrial and agricultural. Homeowners represent the end users in the residential market. Owners and managers of properties such as apartment buildings, retail stores, restaurants, hospitals, and hotels are examples of end users in the commercial market. The industrial market is wide ranging, involving developers and managers of facilities operated by electrical power generators, chemical manufacturers, machine shops, clothing manufacturers, beverage production and dispensing firms, and car washes. The agricultural market end users are owners and operators of businesses such as crop and livestock farms, aquaculture, golf courses, and other turf applications. We believe population growth, urbanization and regulatory requirements are the primary macro drivers of these markets, as these trends drive the need for housing, food, community services and retail goods within growing city centers. Water reuse and conservation are driving the need for new technologies.

## Business Strategy

Our strategy is to enhance shareholder value by providing distinctive solutions for our customers' most important water challenges, enabling us to grow revenue, organically and through strategic acquisitions, as we streamline our cost structure. Key elements of our strategy are summarized below:

**Advance our High Performance Organization.** We plan to continue to operate with an emphasis on speed, simplicity and accountability. We focus on attracting, developing and managing talent within the Company. Further, we align individual performance to the objectives of the Company in order to ensure accountability, standardization and alignment of all key business processes, and to ensure a seamless transition from strategy to execution.

**Drive Profitable Growth.** To achieve our goal of accelerating growth, we have identified the following four priorities:

**Leverage Integrated Front End Resources** - We plan to drive more sales growth through our regionally integrated sales organization. We will enhance our marketing and sales capabilities with the assistance of digital marketing and automation. We will implement technologies we believe will accelerate our growth, including a customer relationship management system that will enable us to have a view of all customer touch points and to share leads and expertise.

**Accelerate Innovation and Product Renewal** - We plan to focus our research and development on products designed to offer specialized advantages to customers; multi-product packages; and integrated offers that leverage Xylem's intelligent analytics and monitoring and control technologies.

**Accelerate International Expansion** - We plan to target fast-growing markets for additional investment and resource allocation, including the expansion of distribution and sales channels. We plan to customize product offerings based upon local needs.

**Expand Industrial End-Market Presence** - We plan to build upon our current capabilities to serve industrial end-markets through the development of key vertical strategies, including channel development and market-specific offerings.

**Improve Operational Excellence.** We will focus on growth in our operating margins to make the Company more profitable. To accomplish this, we will build on our global strategic sourcing capability to maximize leverage from global spend and reinvigorate lean capabilities. We are committed to optimizing our cost structure by eliminating unnecessary costs and inefficient overhead, as well as by simplifying the business by streamlining product relationships across our businesses. We have been executing our plan to simplify our business through restructuring and realignment actions which we believe will better position the Company for the future and enable us to re-prioritize investments to high-priority areas. We will also continue to align the Company to leverage our existing cost structure and broad product portfolio into a greater competitive advantage. We will implement additional cost reductions in an effort to further reduce manufacturing, selling and general and administrative costs.

**Optimize Capital Deployment.** We plan to continue to allocate capital strategically in an effort to drive strong returns for shareholders, taking decisive action to pivot our portfolio composition and future growth investments in order to create the greatest value. These investments include share repurchases, dividend payments and acquisitions. We intend to continue to execute on our share repurchase programs. We recently announced a 10% increase in our quarterly dividend to shareholders. Finally, although we announced a slow down in acquisitions during 2013 as we focused on growth and operational efficiency, we will continue to selectively evaluate and pursue acquisitions that will broaden our core product portfolio, expand our geographic footprint and enhance our position in strategic markets.

## Business Segments

We operate in two business segments that are aligned with the cycle of water and the key strategic market applications they provide: Water Infrastructure (collection, distribution, return) and Applied Water (usage). See Note 21, "Industry Segment and Geographic Data," in our consolidated and combined financial statements for financial information about segments and geographic areas.



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The table and descriptions below provide an overview of our business segments.

	Market Applications	2013 Revenue	% Revenue	Major Products	Primary Brands
Water Infrastructure	Transport	\$1,812	74	%	
	Treatment	329	14	%	
	Test	298	12	%	
		\$2,439	100	%	<ul style="list-style-type: none"> <li>• Water and wastewater pumps</li> <li>• Filtration, disinfection and biological treatment equipment</li> <li>• Test equipment</li> <li>• Controls</li> </ul>
Applied Water	Building Services	\$696	50	%	
	Industrial Water	600	43	%	
	Irrigation	102	7	%	
		\$1,398	100	%	<ul style="list-style-type: none"> <li>• Pumps</li> <li>• Valves</li> <li>• Heat exchangers</li> <li>• Controls</li> <li>• Dispensing equipment systems</li> </ul>

**Water Infrastructure**

Water Infrastructure involves the process that collects water from a source and distributes it to users, and then returns the wastewater responsibly to the environment. Within the Water Infrastructure segment, our pump systems transport water from oceans, groundwa