UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2019

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	**45-2080495**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

1 International Drive, Rye Brook, NY 10573
(Address of principal executive offices) (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	Trading Symbol(s)	Name of each exchange of which registered
Common Stock, par value $0.01 per share	XYL	New York Stock Exchange
2.250% Senior Notes due 2023	XYL23	New York Stock Exchange

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, every Interactive Data File required to be submitted 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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company” and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	☑	Accelerated filer	☐
Non-accelerated filer	☐	Smaller reporting company	☐
		Emerging growth company	☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☑

As of July 26, 2019, there were 180,029,106 outstanding shares of the registrant’s common stock, par value $0.01 per share.

Xylem Inc.

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PART I

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

XYLEM INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED INCOME STATEMENTS (Unaudited)
(in millions, except per share data)

	Three Months		Six Months	
For the period ended June 30,	**2019**	2018	**2019**	2018
Revenue	**$ 1,345**	$ 1,317	**$ 2,582**	$ 2,534
Cost of revenue	**819**	798	**1,582**	1,555
Gross profit	**526**	519	**1,000**	979
Selling, general and administrative expenses	**294**	293	**597**	589
Research and development expenses	**47**	50	**98**	91
Restructuring and asset impairment charges	**14**	5	**25**	15
Operating income	**171**	171	**280**	284
Interest expense	**18**	21	**36**	42
Other non-operating income, net	**3**	2	**5**	5
Gain (loss) from sale of business	**—**	(2)	**1**	(2)
Income before taxes	**156**	150	**250**	245
Income tax expense	**17**	35	**32**	51
Net income	**$ 139**	$ 115	**$ 218**	$ 194
Earnings per share:				
Basic	**$ 0.77**	$ 0.64	**$ 1.21**	$ 1.08
Diluted	**$ 0.77**	$ 0.64	**$ 1.20**	$ 1.07
Weighted average number of shares:				
Basic	**180.0**	179.8	**179.9**	179.8
Diluted	**181.2**	181.0	**181.1**	181.2

See accompanying notes to condensed consolidated financial statements.

XYLEM INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)
(in millions)

	Three Months		**Six Months**	
For the period ended June 30,	**2019**	2018	**2019**	2018
Net income	**$ 139**	$ 115	**$ 218**	$ 194
Other comprehensive income, before tax:				
Foreign currency translation adjustment	**(18)**	(60)	**11**	(52)
Net change in derivative hedge agreements:				
Unrealized loss	**—**	(9)	**(9)**	(9)
Amount of loss (gain) reclassified into net income	**2**	(1)	**4**	(2)
Net change in postretirement benefit plans:				
Amortization of prior service credit	**(1)**	(1)	**(2)**	(2)
Amortization of net actuarial loss into net income	**3**	4	**6**	7
Settlement/Curtailment	**—**	—	**—**	1
Other comprehensive (loss) income, before tax	**(14)**	(67)	**10**	(57)
Income tax (benefit) expense related to items of other comprehensive income	**(3)**	20	**1**	10
Other comprehensive (loss) income, net of tax	**(11)**	(87)	**9**	(67)
Comprehensive income	**$ 128**	$ 28	**$ 227**	$ 127

See accompanying notes to condensed consolidated financial statements.

XYLEM INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)
(in millions, except per share amounts)

	June 30, 2019	December 31, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 383**	$ 296
Receivables, less allowances for discounts and doubtful accounts of $31 and $35 in 2019 and 2018, respectively	**1,096**	1,031
Inventories	**604**	595
Prepaid and other current assets	**175**	172
Total current assets	**2,258**	2,094
Property, plant and equipment, net	**661**	656
Goodwill	**2,999**	2,976
Other intangible assets, net	**1,211**	1,232
Other non-current assets	**545**	264
Total assets	**$ 7,674**	$ 7,222
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	**$ 539**	$ 586
Accrued and other current liabilities	**596**	546
Short-term borrowings and current maturities of long-term debt	**402**	257
Total current liabilities	**1,537**	1,389
Long-term debt	**2,051**	2,051
Accrued postretirement benefits	**396**	400
Deferred income tax liabilities	**305**	303
Other non-current accrued liabilities	**479**	297
Total liabilities	**4,768**	4,440
Commitments and contingencies (Note 19)		
Stockholders' equity:		
Common Stock – par value $0.01 per share:		
Authorized 750.0 shares, issued 193.8 shares and 192.9 shares in 2019 and 2018, respectively	**2**	2
Capital in excess of par value	**1,975**	1,950
Retained earnings	**1,770**	1,639
Treasury stock – at cost 13.7 shares and 13.2 shares in 2019 and 2018, respectively	**(526)**	(487)
Accumulated other comprehensive loss	**(327)**	(336)
Total stockholders' equity	**2,894**	2,768
Non-controlling interests	**12**	14
Total equity	**2,906**	2,782
Total liabilities and stockholders' equity	**$ 7,674**	$ 7,222

See accompanying notes to condensed consolidated financial statements.

XYLEM INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
(in millions)

For the six months ended June 30,	**2019**	2018
Operating Activities		
Net income	**$ 218**	$ 194
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	**58**	58
Amortization	**69**	74
Share-based compensation	**16**	16
Restructuring and asset impairment charges	**25**	15
(Gain) loss from sale of businesses	**(1)**	2
Other, net	**4**	(7)
Payments for restructuring	**(12)**	(12)
Changes in assets and liabilities (net of acquisitions):		
Changes in receivables	**(68)**	(68)
Changes in inventories	**(10)**	(87)
Changes in accounts payable	**(23)**	54
Other, net	**(70)**	(38)
Net Cash – Operating activities	**206**	201
Investing Activities		
Capital expenditures	**(129)**	(111)
Acquisitions of businesses, net of cash acquired	**(18)**	(430)
Proceeds from sale of business	**(2)**	—
Other, net	**3**	4
Net Cash – Investing activities	**(146)**	(537)
Financing Activities		
Short-term debt issued, net	**257**	437
Short-term debt repaid	**(113)**	(54)
Repurchase of common stock	**(39)**	(58)
Proceeds from exercise of employee stock options	**8**	4
Dividends paid	**(87)**	(76)
Other, net	**(1)**	(1)
Net Cash – Financing activities	**25**	252
Effect of exchange rate changes on cash	**2**	(9)
Net change in cash and cash equivalents	**87**	(93)
Cash and cash equivalents at beginning of year	**296**	414
Cash and cash equivalents at end of period	**$ 383**	$ 321
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest	**$ 45**	$ 46
Income taxes (net of refunds received)	**$ 74**	$ 51

See accompanying notes to condensed consolidated financial statements.

Note 1. Background and Basis of Presentation

Background

Xylem Inc. (“Xylem” or the “Company”) is 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.

Xylem operates in three segments, Water Infrastructure, Applied Water and Measurement & Control Solutions. See Note 20, "Segment Information" to the condensed consolidated financial statements for further segment background information.

Except as otherwise indicated or unless the context otherwise requires, "Xylem," "we," "us," "our" and the "Company" refer to Xylem Inc. and its subsidiaries.

Basis of Presentation

The interim condensed consolidated financial statements reflect our financial position and results of operations in conformity with accounting principles generally accepted in the United States of America ("GAAP"). All intercompany transactions between our businesses have been eliminated.

The unaudited interim condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") and, in the opinion of management, reflect all adjustments (which include normal recurring adjustments) considered necessary for a fair presentation of the financial position and results of operations for the periods presented. Certain information and note disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such SEC rules. We believe that the disclosures made are adequate to make the information presented not misleading. We consistently applied the accounting policies described in our Annual Report on Form 10-K for the year ended December 31, 2018 ("2018 Annual Report") in preparing these unaudited condensed consolidated financial statements, with the exception of accounting standard updates described in Note 2. These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes included in our 2018 Annual Report.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Estimates are revised as additional information becomes available. Estimates and assumptions are used for, but not limited to, postretirement obligations and assets, revenue recognition, income tax contingency accruals and valuation allowances, goodwill and indefinite lived intangible impairment testing, contingent liabilities and lease accounting. Actual results could differ from these estimates.

Our quarterly financial periods end on the Saturday closest to the last day of the calendar quarter, except for the fourth quarter which ends on December 31. For ease of presentation, the condensed consolidated financial statements included herein are described as ending on the last day of the calendar quarter.

Note 2. Recently Issued Accounting Pronouncements

Pronouncements Not Yet Adopted

In June 2016, the FASB issued guidance amending the accounting for the impairment of financial instruments, including trade receivables. Under current guidance, credit losses are recognized when the applicable losses have a probable likelihood of occurring and this assessment is based on past events and current conditions. The amended guidance eliminates the “probable” threshold and requires an entity to use a broader range of information, including forecast information when estimating expected credit losses. Generally, this should result in a more timely recognition of credit losses. This guidance is effective for interim and annual periods beginning after December 15, 2019 with early adoption permitted for interim and annual periods beginning after December 15, 2018. The requirements of the amended guidance should be applied using a modified retrospective approach except for debt securities, which require a prospective transition approach. We are evaluating the impact of the guidance on our financial condition and results of operations.

Recently Adopted Pronouncements

In August 2018, the Financial Accounting Standards Board (“FASB”) issued guidance regarding the accounting for implementation costs of a hosting arrangement that is a service contract. The guidance establishes the requirement to capitalize certain implementation costs incurred in a hosting arrangement that is a service contract, effectively aligning with the requirement to capitalize certain implementation costs incurred to develop or obtain internal-use software. This guidance is effective for interim and annual periods beginning after December 15, 2019 with early adoption permitted. The requirements of the amended guidance may be applied using either a retrospective or prospective approach. We adopted this guidance prospectively as of April 1, 2019. This guidance did not have a material impact on our financial condition and results of operations.

In February 2016, the FASB issued guidance amending the accounting for leases. Specifically, the amended guidance requires all lessees to record a lease liability at lease inception, with a corresponding right of use ("ROU") asset, except for short-term leases. Lessor accounting is not fundamentally changed. This amended guidance is effective for interim and annual periods beginning after December 15, 2018 using a modified retrospective approach. Early adoption was permitted. We adopted this guidance as of January 1, 2019 using the modified retrospective approach whereby prior comparative periods were not retrospectively restated in the condensed consolidated financial statements. The adoption of the standard resulted in the recognition of ROU assets and lease liabilities of $267 million and $265 million, respectively, as well as deferred tax assets and deferred tax liabilities of $68 million, as of January 1, 2019, the date of initial application. The guidance did not have a material impact on our Condensed Consolidated Income Statements and Statements of Cash Flow. See Note 9, "Leases" for further details.

Note 3. Acquisitions and Divestitures

2019 Acquisitions

During the three and six months ended June 30, 2019 we spent approximately $13 million and $18 million net of cash received on acquisition activity, respectively.

2018 Acquisitions and Divestitures

Pure Technologies Ltd.

On January 31, 2018, we acquired all the issued and outstanding shares of Pure Technologies Ltd. (“Pure”), a leader in intelligent leak detection and condition assessment solutions for water distribution networks for approximately $420 million, net of cash received. Acquisition costs of $4 million were reflected as a component of selling, general and administrative expenses in our Condensed Consolidated Income Statement for the year ended December 31, 2018.

Pure’s results of operations were consolidated with the Company effective February 1, 2018 and are reflected in the Measurement & Control Solutions segment.

The Pure purchase price allocation as of January 31, 2018 is shown in the following table:

(in millions)		Amount
Cash	$	14
Receivables		23
Inventories		4
Prepaid and other current assets		2
Property, plant and equipment		22
Intangible assets		149
Other long-term assets		1
Accounts payable		(3)
Accrued and other current liabilities		(12)
Deferred income tax liabilities		(25)
Other non-current accrued liabilities		(2)
Total identifiable net assets		173
Goodwill		261
Total consideration	$	434

The fair values of Pure's assets and liabilities were determined based on estimates and assumptions which management believes are reasonable.

Goodwill arising from the acquisition consists largely of synergies and economies of scale expected from combining the operations of Pure and Xylem. All of the goodwill was assigned to the Measurement & Control Solutions segment and is not deductible for tax purposes.

The estimate of the fair value of Pure identifiable intangible assets was determined primarily using the “income approach,” which requires a forecast of all of the expected future cash flows either through the use of the multi-period excess earnings method or the relief-from-royalty method. Some of the more significant assumptions inherent in the development of intangible asset values include: the amount and timing of projected future cash flows, the discount rate selected to measure the risks inherent in the future cash flows, the assessment of the intangible asset’s life cycle, as well as other factors. The following table summarizes key information underlying identifiable intangible assets related to the Pure acquisition:

Category	Life		Amount (in millions)
Customer Relationships	17 - 18 years	$	84
Technology	3 - 10 years		38
Tradenames	20 years		21
Internally Developed Software	3 years		6
Total		$	149

The following table summarizes, on an unaudited pro forma basis, the condensed combined results of operations of the Company for the three and six month periods ended June 30, 2018 assuming the acquisition of Pure was made on January 1, 2017:

(in millions)	Three Months Ended June 30, 2018		Six Months Ended June 30, 2018
Revenue	N/A	$	2,539
Net income	N/A	$	191

The foregoing unaudited pro forma results are for informational purposes only and are not necessarily indicative of the actual results of operations that might have occurred had the acquisition occurred on January 1, 2017, nor are they necessarily indicative of future results. The pro forma financial information includes the impact of purchase accounting and other nonrecurring items directly attributable to the acquisition, which include:

- Amortization expense of acquired intangibles
- Adjustments to the depreciation of property, plant and equipment reflecting the impact of the calculated fair value of those assets in accordance with purchase accounting
- Adjustments to interest expense to remove historical Pure interest costs and reflect Xylem's current debt profile
- The related tax impact of the above referenced adjustments

The pro forma results do not include any cost savings or operational synergies that may be generated or realized due to the acquisition of Pure.

During the three months ended June 30, 2018 Pure had revenue and operating income of $26 million and less than $1 million, respectively. During the five months ended June 30, 2018 Pure had revenue and an operating loss of $42 million and $2 million, respectively.

Other Acquisition Activity

During the three months ended June 30, 2018 we had no acquisition activity. During the six months ended June 30, 2018 we spent approximately $10 million net of cash received on other acquisition activity.

Note 4. Revenue

Disaggregation of Revenue

The following table illustrates the sources of revenue:

	Three Months Ended June 30,		Six Months Ended June 30,	
(in millions)	2019	2018	2019	2018
Revenue from contracts with customers	$ 1,281	$ 1,258	$ 2,459	$ 2,420
Lease Revenue	64	59	123	114
Total	$ 1,345	$ 1,317	$ 2,582	$ 2,534

The following table reflects revenue from contracts with customers by application:

	Three Months Ended June 30,		Six Months Ended June 30,	
(in millions)	2019	2018	2019	2018
Water Infrastructure				
Transport	$ 396	$ 387	$ 742	$ 734
Treatment	101	100	178	178
Applied Water				
Building Services	216	206	429	400
Industrial Water	178	182	344	354
Measurement and Control Solutions				
Water	195	175	394	347
Energy	85	84	158	164
Software as a Service/Other	25	35	49	69
Test	85	89	165	174
Total	$ 1,281	$ 1,258	$ 2,459	$ 2,420

The following table reflects revenue from contracts with customers by geographical region:

	Three Months Ended June 30,		Six Months Ended June 30,	
(in millions)	2019	2018	2019	2018
Water Infrastructure				
United States	$ 160	$ 135	$ 293	$ 248
Europe	179	191	339	368
Emerging Markets & Other	158	161	288	296
Applied Water				
United States	212	198	413	386
Europe	92	100	186	198
Emerging Markets & Other	90	90	174	170
Measurement and Control Solutions				
United States	252	230	488	436
Europe	64	71	136	155
Emerging Markets & Other	74	82	142	163
Total	$ 1,281	$ 1,258	$ 2,459	$ 2,420

Contract Balances

We receive payments from customers based on a billing schedule as established in our contracts. Contract assets relate to costs incurred to perform in advance of scheduled billings. Contract liabilities relate to payments received in advance of performance under the contracts. Changes in contract assets and liabilities are due to our performance under the contract.

The table below provides contract assets, contract liabilities, and significant changes in contract assets and liabilities:

(in millions)	Contract Assets (a)	Contract Liabilities
Balance at January 1, 2018	$ 89	$ 107
Additions, net	51	86
Revenue recognized from opening balance	—	(74)
Billings	(54)	—
Other	(3)	(5)
Balance at June 30, 2018	$ 83	$ 114
Balance at January 1, 2019	$ 96	$ 113
Additions, net	55	84
Revenue recognized from opening balance	—	(66)
Billings	(50)	—
Other	10	—
Balance at June 30, 2019	$ 111	$ 131

(a) Excludes receivable balances which are disclosed on the balance sheet

Performance obligations

Delivery schedules vary from customer to customer based upon their requirements. Typically, large projects require longer lead production cycles and delays can occur from time to time. As of June 30, 2019, the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied for contracts with performance obligations, amount to $340 million. We expect to recognize the majority of revenue upon the completion of satisfying these performance obligations in the following 60 months. The Company elects to apply the practical expedient to exclude from this disclosure revenue related to performance obligations that are part of a contract whose original expected duration is less than one year.

Note 5. Restructuring Charges

From time to time, the Company will incur costs related to restructuring actions in order to optimize our cost base and more strategically position ourselves based on the economic environment and customer demand. During the three and six months ended June 30, 2019, we recognized restructuring charges of $14 million and $22 million, respectively. We incurred these charges primarily as a continuation of our efforts to reposition our European and North American businesses to optimize our cost structure and improve our operational efficiency and effectiveness. The charges included the reduction of headcount and consolidation of facilities within our Measurement & Control Solutions and Water Infrastructure segments, as well as headcount reductions within our Applied Water segment.

During the three and six months ended June 30, 2018, we recognized restructuring charges of $5 million and $15 million, respectively. We incurred these charges primarily as a continuation of our efforts to reposition our European and North American businesses to optimize our cost structure and improve our operational efficiency and effectiveness. The charges included the reduction of headcount and consolidation of facilities within our Measurement & Control Solutions and Water Infrastructure segments, as well as headcount reductions within our Applied Water segment.

The following table presents the components of restructuring expense and asset impairment charges:

(in millions)	Three Months Ended June 30, 2019	Three Months Ended June 30, 2018	Six Months Ended June 30, 2019	Six Months Ended June 30, 2018
By component:				
Severance and other charges	**$ 13**	$ 5	**$ 20**	$ 14
Lease related charges	**—**	—	**1**	1
Other restructuring charges	**1**	—	**1**	—
Total restructuring charges	**$ 14**	$ 5	**$ 22**	$ 15
Asset impairment	**—**	—	3	—
Total restructuring and asset impairment charges	**$ 14**	$ 5	$ 25	$ 15
By segment:				
Water Infrastructure	**$ 7**	$ 3	**$ 11**	$ 6
Applied Water	**2**	—	**2**	1
Measurement & Control Solutions	**5**	2	**12**	8

The following table displays a rollforward of the restructuring accruals, presented on our Condensed Consolidated Balance Sheets within accrued and other current liabilities, for the six months ended June 30, 2019 and 2018:

(in millions)	2019	2018
Restructuring accruals - January 1	**$ 5**	$ 7
Restructuring charges	**22**	15
Cash payments	**(12)**	(12)
Foreign currency and other	**(1)**	—
Restructuring accruals - June 30	**$ 14**	$ 10
By segment:		
Water Infrastructure	**$ 4**	$ 2
Applied Water	**2**	1
Measurement & Control Solutions	**5**	4
Regional selling locations (a)	**3**	2
Corporate and other	**—**	1

(a) Regional selling locations consist primarily of selling and marketing organizations that incurred restructuring expense which was allocated to the segments. The liabilities associated with restructuring expense were not allocated to the segments.

The following is a rollforward for the six months ended June 30, 2019 and 2018 of employee position eliminations associated with restructuring activities:

	2019	2018
Planned reductions - January 1	**69**	47
Additional planned reductions	**350**	155
Actual reductions and reversals	**(298)**	(103)
Planned reductions - June 30	**121**	99

The following table presents expected restructuring spend for actions commenced as of June 30, 2019:

(in millions)	Water Infrastructure	Applied Water	Measurement & Control Solutions	Corporate	Total
Actions Commenced in 2019:					
Total expected costs	$ 17	$ 4	$ 8	$ —	$ 29
Costs incurred during Q1 2019	3	—	3	—	6
Costs incurred during Q2 2019	7	2	5	—	14
Total expected costs remaining	**$ 7**	**$ 2**	**$ —**	**$ —**	**$ 9**
Actions Commenced in 2018:					
Total expected costs	$ 8	$ 1	$ 7	$ —	$ 16
Costs incurred during 2018	7	1	7	—	15
Costs incurred during Q1 2019	1	—	—	—	1
Costs incurred during Q2 2019	—	—	—	—	—
Total expected costs remaining	**$ —**	**$ —**	**$ —**	**$ —**	**$ —**
Actions Commenced in 2017:					
Total expected costs	$ 16	$ 8	$ 4	$ —	$ 28
Costs incurred during 2017	5	4	2	—	11
Costs incurred during 2018	2	1	1	—	4
Costs incurred during Q1 2019	—	—	1	—	1
Costs incurred during Q2 2019	—	—	—	—	—
Total expected costs remaining	**$ 9**	**$ 3**	**$ —**	**$ —**	**$ 12**

The Water Infrastructure, Applied Water, and Measurement & Control Solutions actions commenced in 2019 consist primarily of severance charges and are expected to continue through the end of 2019. The Water Infrastructure, Applied Water, and Measurement & Control Solutions actions commenced in 2018 consist primarily of severance charges and are complete. The Water Infrastructure, Applied Water and Measurement & Control Solutions actions commenced in 2017 consist primarily of severance charges and are expected to continue through the fourth quarter of 2020.

Asset Impairment

During the first quarter of 2019 we determined that certain assets within our Measurement and Control Solutions segment, including a customer relationship, were impaired. Accordingly we recognized an impairment charge of $3 million. Refer to Note 10, "Goodwill and Other Intangible Assets," for additional information.

Note 6. Income Taxes

Our quarterly provision for income taxes is measured using an estimated annual effective tax rate, adjusted for discrete items within periods presented. The comparison of our effective tax rate between periods is significantly impacted by the level and mix of earnings and losses by tax jurisdiction and discrete items.

The income tax provision for the three months ended June 30, 2019 was $17 million resulting in an effective tax rate of 10.5%, compared to $35 million resulting in an effective tax rate of 23.2% for the same period in 2018. The income tax provision for the six months ended June 30, 2019 was $32 million resulting in an effective tax rate of 12.8%, compared to $51 million resulting in an effective tax rate of 20.8% for the same period in 2018. The effective tax rate for the three and six month periods ended June 30, 2019 is lower than the same periods in 2018 primarily due to changes in tax law in Switzerland in 2019 offset in part by the settlement of tax examinations in 2018.

Unrecognized Tax Benefits

We recognize tax benefits from uncertain tax positions only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities or litigation, based on the technical merits of the position. The tax benefits recognized in the condensed consolidated financial statements from such positions are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate resolution. The amount of unrecognized tax benefits at June 30, 2019 was $127 million, as compared to $136 million at December 31, 2018, which if ultimately recognized will reduce our effective tax rate. We believe that it is reasonably possible that the unrecognized tax benefits will be reduced by approximately $3 million within the next 12 months as a result of the expiration of certain statutes of limitations. We classify interest expense relating to unrecognized tax benefits as a component of other non-operating expense, net, and tax penalties as a component of income tax expense in our Condensed Consolidated Income Statements. As of June 30, 2019, we had $8 million of interest accrued for unrecognized tax benefits.

In June 2019, Xylem's Swedish subsidiary received a tax assessment for the 2013 tax year related to the tax treatment of an intercompany transfer of certain intellectual property that was made in connection with a reorganization of our European businesses. The assessment asserts an aggregate amount of approximately $80 million for tax, penalties and interest. In July 2019, Xylem filed an appeal with the Administrative Court of Stockholm. Management, in consultation with external legal advisors, believes it is more likely than not that Xylem will prevail on the proposed assessment and intends to vigorously defend our position through litigation. At this time, we have not recorded any unrecognized tax benefits related to this uncertain tax position.

Note 7. Earnings Per Share

The following is a reconciliation of the shares used in calculating basic and diluted net earnings per share:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	**2019**	2018
Net income (in millions)	**$ 139**	$ 115	**$ 218**	$ 194
Shares (in thousands):				
Weighted average common shares outstanding	**179,964**	179,770	**179,842**	179,814
Add: Participating securities (a)	**35**	35	**30**	29
Weighted average common shares outstanding — Basic	**179,999**	179,805	**179,872**	179,843
Plus incremental shares from assumed conversions: (b)				
Dilutive effect of stock options	**832**	886	**834**	907
Dilutive effect of restricted stock units and performance share units	**322**	351	**427**	453
Weighted average common shares outstanding — Diluted	**181,153**	181,042	**181,133**	181,203
Basic earnings per share	**$ 0.77**	$ 0.64	**$ 1.21**	$ 1.08
Diluted earnings per share	**$ 0.77**	$ 0.64	**$ 1.20**	$ 1.07

(a) Restricted stock unit awards containing rights to non-forfeitable dividends that participate in undistributed earnings with common shareholders are considered participating securities for purposes of computing earnings per share.

(b) Incremental shares from stock options, restricted stock units and performance share units are computed by the treasury stock method. The weighted average shares listed below were not included in the computation of diluted earnings per share because to do so would have been anti-dilutive for the periods presented or were otherwise excluded under the treasury stock method. The treasury stock method calculates dilution assuming the exercise of all in-the-money options and vesting of restricted stock units and performance share units, reduced by the repurchase of shares with the proceeds from the assumed exercises and unrecognized compensation expense for outstanding awards. Performance share units will be included in the treasury stock calculation of diluted earnings per share upon achievement of underlying performance or market conditions at the end of the reporting period. See Note 16, "Share-Based Compensation Plans" to the condensed consolidated financial statements for further detail on the performance share units.

(in thousands)	Three Months Ended June 30, 2019	Three Months Ended June 30, 2018	Six Months Ended June 30, 2019	Six Months Ended June 30, 2018
Stock options	**1,418**	1,360	**1,406**	1,289
Restricted stock units	**382**	385	**365**	339
Performance share units	**455**	517	**463**	527

Note 8. Inventories

The components of total inventories are summarized as follows:

(in millions)	June 30, 2019	December 31, 2018
Finished goods	**$ 243**	$ 248
Work in process	**54**	45
Raw materials	**307**	302
Total inventories	**$ 604**	$ 595

Note 9. Leases

As discussed in Note 2, "Recently Issued Accounting Pronouncements," Xylem adopted the new guidance on accounting for leases.

Leasing Arrangements

We lease certain offices, manufacturing buildings, transportation equipment, machinery, computers and other equipment. Our most significant lease liabilities relate to real estate leases. These leases include renewal, termination or purchase options, and we have assessed these to determine whether it is reasonably certain for us to exercise any of the previously mentioned options. All periods relating to options that are reasonably certain to be exercised have been included in the lease term of the respective leases.

We have recorded ROU assets for lease arrangements that are reasonably certain to extend beyond 12 months. ROU assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments under the lease. ROU assets and liabilities are recognized at lease commencement date based on the present value of lease payments over the lease term. The implicit rate within our leases is generally not determinable, and we use our incremental borrowing rate at the lease commencement date to determine the net present value of lease payments. The determination of the appropriate incremental borrowing rate requires judgment. We determine the appropriate incremental borrowing rate for each lease using our current borrowing rate, adjusted for various factors including geographic region, level of collateralization and term, to align with the term of the underlying lease.

Many of our leases are subject to payment adjustments to reflect annual changes in price indexes, such as the Consumer Price Index. While associated lease liabilities are not re-measured as a result of changes in the applicable price indexes, changes to required lease payments are treated as variable lease payments and recognized in the period in which the obligation for those payments was incurred.

Leases with a lease term of 12 months or less, including renewal options that are reasonably certain to be exercised, that also do not include an option to purchase the underlying asset that is reasonably certain of exercise, are not recorded on the balance sheet. Instead, lease payments for these leases are recognized as a lease cost on a straight-line basis over the lease term.

We elected the package of practical expedients, which among other things, does not require reassessment of lease classification. Additionally, we have made an accounting policy election whereby we chose not to separate non-lease components from lease components in agreements in all leases which we are the lessee.

We did not identify any events or conditions during the three and six month periods ended June 30, 2019 to indicate that a reassessment or re-measurement of our existing leases was required. There were also no impairment indicators identified during the three and six month periods ended June 30, 2019 that required an impairment test for the Company's ROU assets or other long-lived assets in accordance with ASC 360-10.

Our current lease liabilities of $63 million are included in "Accrued and other current liabilities" and our non-current lease liabilities of $193 million are included in "Other non-current accrued liabilities" as of June 30, 2019. Our ROU asset balances are included in "Other non-current assets". The net balance of our ROU assets as of June 30, 2019 was $257 million. These balances include an immaterial amount related to finance leases.

The components of our lease cost were as follows:

(in millions)	Three Months Ended June 30, 2019	Six Months Ended June 30, 2019
Lease cost		
Operating lease cost	$ 20	$ 38
Short-term lease cost	2	5
Variable lease cost	4	10
Total lease cost	$ 26	$ 53

The supplemental cash flow information related to leases are as follows:

(in millions)	Six Months Ended June 30, 2019
Cash paid for amounts included in the measurement of lease liabilities:	
Operating cash flows from operating leases	$ 37
Right-of-use assets obtained in exchange for lease obligations:	
Operating leases	$ 16

Information relating to the lease term and discount rate are as follows:

	Six Months Ended June 30, 2019
Weighted-average remaining lease term (years)	
Operating leases	6
Weighted-average discount rate	
Operating leases	2.7%

As of June 30, 2019, the maturities of operating lease liabilities were as follows:

(in millions)		
2019	$	36
2020		61
2021		45
2022		33
2023		25
2024		20
Thereafter		57
Total lease payments		277
Less: Imputed interest		(22)
Total	$	255

Disclosures related to periods prior to adoption of the New Lease Standard as reported and provided in our December 31, 2018 Form 10-K.

As of December 31, 2018, we were obligated to make minimum future rental payments under operating leases as follows:

(in millions)		
2019	$	76
2020		61
2021		43
2022		33
2023		22
Thereafter		64
Total lease payments		299

Lessor arrangements

In addition to manufacturing and selling equipment, we also lease out equipment to customers in exchange for consideration. These arrangements are generally short term in nature and predominantly involve the rental of pumps and accessories within the Water Infrastructure segment. Rental arrangements generally do not provide the customer the right to purchase the equipment as Xylem’s strategy is to rent these items over their useful lives. Customers may be billed based on daily, weekly or monthly rates depending on the expected rental period. We assessed that these arrangements constitute a lease under ASC 842, and have recognized them as operating leases. In situations where arrangements contain both the sale of products and a leasing component, contract consideration is allocated based on relative standalone selling price.

Total revenue from lease arrangements were $64 million and $123 million for the three and six month periods ended June 30, 2019. Our gross assets available for rent and related accumulated amortization were $262 million and $169 million, respectively, as of June 30, 2019. Depreciation expense for these assets were $7 million and $14 million for the three and six month periods ended June 30, 2019.

Note 10. Goodwill and Other Intangible Assets

Goodwill

Changes in the carrying value of goodwill by reportable segment for the six months ended June 30, 2019 are as follows:

(in millions)	Water Infrastructure	Applied Water	Measurement & Control Solutions	Total
Balance as of January 1, 2019	$ 653	$ 516	$ 1,807	$ 2,976
Activity in 2019				
Divested/Acquired	—	—	19	19
Foreign currency and other	—	—	4	4
Balance as of June 30, 2019	**$ 653**	**$ 516**	**$ 1,830**	**$ 2,999**

Other Intangible Assets

Information regarding our other intangible assets is as follows:

	June 30, 2019			December 31, 2018		
(in millions)	**Carrying Amount**	**Accumulated Amortization**	**Net Intangibles**	Carrying Amount	Accumulated Amortization	Net Intangibles
Customer and distributor relationships	**$ 947**	**$ (318)**	**$ 629**	$ 951	$ (286)	$ 665
Proprietary technology and patents	**205**	**(101)**	**104**	198	(93)	105
Trademarks	**149**	**(46)**	**103**	148	(41)	107
Software	**392**	**(185)**	**207**	355	(164)	191
Other	**21**	**(19)**	**2**	24	(19)	5
Indefinite-lived intangibles	**166**	**—**	**166**	159	—	159
Other Intangibles	**$ 1,880**	**$ (669)**	**$ 1,211**	$ 1,835	$ (603)	$ 1,232

Amortization expense related to finite-lived intangible assets was $34 million and $69 million for the three and six months ended June 30, 2019, respectively, and $36 million and $74 million for the three and six months ended June 30, 2018, respectively.

During the first quarter of 2019 we determined that the intended use of a finite lived customer relationship within our Measurement and Control Solutions segment had changed. Accordingly we recorded a $3 million impairment charge. The charge was calculated using the income approach, which is considered a Level 3 input for fair value measurement, and is reflected in “Restructuring and asset impairment charges” in our Condensed Consolidated Income Statements.

Note 11. Derivative Financial Instruments

Risk Management Objective of Using Derivatives

We are exposed to certain risks arising from both our business operations and economic conditions, and we principally manage our exposures to these risks through management of our core business activities. Certain of our foreign operations expose us to fluctuations of foreign interest rates and exchange rates that may impact revenue, expenses, cash receipts, cash payments, and the value of our stockholders' equity. We enter into derivative financial instruments to protect the value or fix the amount of certain cash flows in terms of the functional currency of the business unit with that exposure and reduce the volatility in stockholders' equity.

Cash Flow Hedges of Foreign Exchange Risk

We are exposed to fluctuations in various foreign currencies against our functional currencies. We use foreign currency derivatives, including currency forward agreements, to manage our exposure to fluctuations in the various exchange rates. Currency forward agreements involve fixing the foreign currency exchange rate for delivery of a specified amount of foreign currency on a specified date.

Certain business units with exposure to foreign currency exchange risks have designated certain currency forward agreements as cash flow hedges of forecasted intercompany inventory purchases and sales. Our principal currency exposures relate to the Euro, Swedish Krona, British Pound, Canadian Dollar, Polish Zloty and Australian Dollar. We had foreign exchange contracts with purchased notional amounts totaling $247 million and $506 million as of June 30, 2019 and December 31, 2018, respectively. As of June 30, 2019, our most significant foreign currency derivatives included contracts to sell U.S. Dollar and purchase Euro, purchase Swedish Krona and sell Euro, sell British Pound and purchase Euro, purchase Polish Zloty and sell Euro, purchase U.S. Dollar and sell Canadian Dollar, and to sell Canadian Dollar and purchase Euro. The purchased notional amounts associated with these currency derivatives are $97 million, $77 million, $25 million, $18 million, $15 million and $11 million, respectively. As of December 31, 2018, the purchased notional amounts associated with these currency derivatives were $191 million, $168 million, $52 million, $37 million, $29 million and $22 million, respectively.

Hedges of Net Investments in Foreign Operations

We are exposed to changes in foreign currencies impacting our net investments held in foreign subsidiaries.

Cross Currency Swaps

Beginning in 2015, we entered into cross currency swaps to manage our exposure to fluctuations in the Euro-U.S. Dollar exchange rate. During the second quarter of 2019 we entered into additional cross currency swaps. The total notional amount of derivative instruments designated as net investment hedges was $729 million and $426 million as of June 30, 2019 and December 31, 2018, respectively.

Foreign Currency Denominated Debt

On March 11, 2016, we issued 2.250% Senior Notes of €500 million aggregate principal amount due March 2023. We designated the entirety of the outstanding balance, or $565 million and $566 million as of June 30, 2019 and December 31, 2018, respectively, net of unamortized discount, as a hedge of a net investment in certain foreign subsidiaries.

The table below presents the effect of our derivative financial instruments on the Condensed Consolidated Income Statements and Statements of Comprehensive Income:

	Three Months Ended June 30,		Six Months Ended June 30,	
(in millions)	**2019**	2018	**2019**	2018
Cash Flow Hedges				
Foreign Exchange Contracts				
Amount of (loss) recognized in OCI (a)	**$ —**	$ (9)	**$ (9)**	$ (9)
Amount of (gain) loss reclassified from OCI into revenue (a)	**1**	(1)	**2**	(2)
Amount of loss reclassified from OCI into cost of revenue (a)	**1**	—	**2**	—
Net Investment Hedges				
Cross Currency Swaps				
Amount of gain (loss) recognized in OCI (a)	**$ (8)**	$ 36	**$ (1)**	$ 13
Amount of income recognized in Interest Expense	**4**	—	**$ 7**	$ —
Foreign Currency Denominated Debt				
Amount of gain (loss) recognized in OCI (a)	**$ (6)**	$ 42	**$ 1**	$ 19

(a) Effective portion

As of June 30, 2019, $6 million of net losses on cash flow hedges are expected to be reclassified into earnings in the next 12 months. The ineffective portion of a cash flow hedge is recognized immediately in Selling, general and administrative expenses in the Condensed Consolidated Income Statements and was not material for the three and six months ended June 30, 2019 and 2018.

As of June 30, 2019, no gains or losses on the net investment hedges are expected to be reclassified into earnings over their duration. The net investment hedges did not experience any ineffectiveness for the three and six months ended June 30, 2019.

The fair values of our derivative assets and liabilities are measured on a recurring basis using Level 2 inputs and are determined through the use of models that consider various assumptions including yield curves, time value and other measurements.

The fair values of our foreign exchange contracts currently included in our hedging program designated as hedging instruments were as follows:

(in millions)	**June 30, 2019**	December 31, 2018
Derivatives designated as hedging instruments		
Assets		
Cash Flow Hedges		
Other current assets	**$ —**	$ 3
Liabilities		
Cash Flow Hedges		
Other current liabilities	**$ (5)**	$ (1)
Net Investment Hedges		
Other non-current accrued liabilities	**$ (45)**	$ (46)

The fair value of our long-term debt, due in 2023, designated as a net investment hedge was $608 million and $599 million as of June 30, 2019 and December 31, 2018, respectively.

Note 12. Accrued and Other Current Liabilities

The components of total accrued and other current liabilities are as follows:

(in millions)	**June 30, 2019**	December 31, 2018
Compensation and other employee benefits	**$ 177**	$ 194
Customer-related liabilities	**144**	129
Accrued taxes	**77**	85
Lease liabilities	**63**	—
Accrued warranty costs	**37**	44
Other accrued liabilities	**98**	94
Total accrued and other current liabilities	**$ 596**	$ 546

Note 13. Credit Facilities and Debt

Total debt outstanding is summarized as follows:

(in millions)	June 30, 2019	December 31, 2018
4.875% Senior Notes due 2021 (a)	**$ 600**	$ 600
2.250% Senior Notes due 2023 (a)	**569**	570
3.250% Senior Notes due 2026 (a)	**500**	500
4.375% Senior Notes due 2046 (a)	**400**	400
Commercial paper	**259**	—
Term loan	**143**	257
Debt issuance costs and unamortized discount (b)	**(18)**	(19)
Total debt	**2,453**	2,308
Less: short-term borrowings and current maturities of long-term debt	**402**	257
Total long-term debt	**$ 2,051**	$ 2,051

(a) The fair value of our Senior Notes was determined using quoted prices in active markets for identical securities, which are considered Level 1 inputs. The fair value of our Senior Notes due 2021 was $632 million and $620 million as of June 30, 2019 and December 31, 2018, respectively. The fair value of our Senior Notes due 2023 was $608 million and $599 million as of June 30, 2019 and December 31, 2018, respectively. The fair value of our Senior Notes due 2026 was $506 million and $476 million as of June 30, 2019 and December 31, 2018, respectively. The fair value of our Senior Notes due 2046 was $421 million and $397 million as of June 30, 2019 and December 31, 2018, respectively.

(b) The debt issuance costs and unamortized discount are recognized as a reduction in the carrying value of the Senior Notes in the Condensed Consolidated Balance Sheets and are being amortized to interest expense in our Condensed Consolidated Income Statements over the expected remaining terms of the Senior Notes.

Senior Notes

On September 20, 2011, we issued 4.875% Senior Notes of $600 million aggregate principal amount due October 2021 (the "Senior Notes due 2021"). On March 11, 2016, we issued 2.250% Senior Notes of €500 million aggregate principal amount due March 2023 (the "Senior Notes due 2023"). On October 11, 2016, we issued 3.250% Senior Notes of $500 million aggregate principal amount due October 2026 (the “Senior Notes due 2026”) and 4.375% Senior Notes of $400 million aggregate principal amount due October 2046 (the “Senior Notes due 2046” and, together with the Senior Notes due 2021, the Senior Notes due 2023 and the Senior Notes due 2026, the “Senior Notes”).

The Senior Notes include covenants that restrict our ability, subject to exceptions, to incur debt secured by liens and engage in sale and leaseback transactions, as well as provide for customary events of default (subject, in certain cases, to receipt of notice of default and/or customary grace and cure periods). We may redeem the Senior Notes, as applicable, in whole or in part, at any time at a redemption price equal to the principal amount of the Senior Notes to be redeemed, plus a make-whole premium. We may also redeem the Senior Notes in certain other circumstances, as set forth in the applicable Senior Notes indenture.

If a change of control triggering event (as defined in the applicable Senior Notes indenture) occurs, we will be required to make an offer to purchase the Senior Notes at a price equal to 101% of their principal amount plus accrued and unpaid interest to the date of repurchase.

Interest on the Senior Notes due 2021 is payable on April 1 and October 1 of each year. Interest on the Senior Notes due 2023 is payable on March 11 of each year. Interest on the Senior Notes due 2026 and the Senior Notes due 2046 is payable on May 1 and November 1 of each year beginning on May 1, 2017. As of June 30, 2019, we are in compliance with all covenants for the Senior Notes.

Credit Facilities

2015 Five-Year Revolving Credit Facility

Effective March 27, 2015, Xylem entered into a Five-Year Revolving Credit Facility (the "2015 Credit Facility") with Citibank, N.A., as Administrative Agent, and a syndicate of lenders. The 2015 Credit Facility provided for an aggregate principal amount of up to $600 million of: (i) revolving extensions of credit (the "revolving loans") outstanding at any time and (ii) the issuance of letters of credit in a face amount not in excess of $100 million outstanding at any time. The 2015 Credit Facility provided for increases of up to $200 million for a maximum aggregate principle amount of $800 million in aggregate principal amount at our request and with the consent of the institutions providing such increased commitments. On March 5, 2019 Xylem terminated the 2015 Credit Facility among the Company, certain lenders and Citibank, N.A. as Administrative Agent.

2019 Five-Year Revolving Credit Facility

On March 5, 2019, Xylem entered into a Five-Year Revolving Credit Facility (the “2019 Credit Facility”) with Citibank, N.A., as administrative agent, and a syndicate of lenders. The 2019 Credit Facility provides for an aggregate principal amount of up to $800 million (available in U.S. Dollars and in Euros), with an accordion option for increases of up to $200 million for a maximum aggregate principal amount of $1 billion at the request of Xylem and with the consent of the institutions providing such increased commitments.

Interest on all loans under the 2019 Credit Facility is payable either quarterly or at the expiration of any LIBOR or EURIBOR interest period applicable thereto. Borrowings accrue interest at a rate equal to, at Xylem's election, a base rate or an adjusted LIBOR or EURIBOR rate plus an applicable margin. The 2019 Credit Facility includes customary provisions for implementation of replacement rates for LIBOR-based and EURIBOR-based loans. The 2019 Credit Facility also includes a pricing grid that determines the applicable margin based on Xylem's credit rating, with a further adjustment depending on Xylem's annual Sustainalytics Environmental, Social and Governance score. Xylem will also pay quarterly fees to each lender for such lender’s commitment to lend accruing on such commitment at a rate based on our credit rating, whether such commitment is used or unused, as well as a quarterly letter of credit fee accruing on the letter of credit exposure of such lender during the preceding quarter at a rate based on the credit rating of Xylem.

The 2019 Credit facility requires that Xylem maintain a consolidated total debt to consolidated EBITDA ratio, which will be based on the last four fiscal quarters, and in addition a number of customary covenants, including limitations on the incurrence of secured debt and debt of subsidiaries, liens, sale and lease-back transactions, mergers, consolidations, liquidations, dissolutions and sales of assets. The 2019 Credit Agreement also contains customary events of default. Finally, Xylem has the ability to designate subsidiaries that can borrow under the 2019 Credit Facility, subject to certain requirements and conditions set forth in the 2019 Credit Agreement. As of June 30, 2019, the 2019 Credit Facility was undrawn and we are in compliance with all covenants.

Commercial Paper

U.S. Dollar Commercial Paper Program

Our U.S. Dollar commercial paper program generally serves as a means of short-term funding with a $600 million maximum issuing balance and a combined limit of $800 million inclusive of the 2019 Five-Year Revolving Credit Facility. As of June 30, 2019 and December 31, 2018, none of the Company's $600 million U.S. Dollar commercial paper program was outstanding. We have the ability to continue borrowing under this program going forward in in future periods.

Euro Commercial Paper Program

On June 3, 2019 Xylem entered into a Euro commercial paper program with ING Bank N.V., as administrative agent, and a syndicate of dealers. The Euro commercial paper program provides for a maximum issuing balance of up to €500 million (approximately $569 million) which may be denominated in a variety of currencies. The maximum issuing balance may be increased in accordance with the Dealer Agreement. As of June 30, 2019, $259 million of the Company's Euro commercial paper program was outstanding at a weighted average interest rate of (0.22)%. We have the ability to continue borrowing under this program going forward in in future periods.

Term Loan Facility

On January 26, 2018, the Company’s subsidiary, Xylem Europe GmbH (the “borrower”) entered into a 12-month €225 million (approximately $256 million) term loan facility (the “Term Facility”) at an interest rate of 0.45% in which the terms are set forth in a Term Loan Agreement, among the borrower, the Company, as parent guarantor and ING Bank. The Company entered into a parental guarantee in favor of ING Bank also dated January 26, 2018 to secure all present and future obligations of the borrower under the Term Loan Agreement. The Term Facility was used to partially fund the acquisition of Pure Technologies Ltd in 2018 and the maturity date has since been extended through February 2020. As of June 30, 2019 and December 31, 2018, $143 million and $257 million were outstanding under the Term Facility, respectively.

Note 14. Postretirement Benefit Plans

The components of net periodic benefit cost for our defined benefit pension plans are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
(in millions)	**2019**	2018	**2019**	2018
Domestic defined benefit pension plans:				
Service cost	**$ —**	$ 1	**$ 1**	$ 2
Interest cost	**1**	1	**2**	2
Expected return on plan assets	**(2)**	(1)	**(4)**	(3)
Amortization of net actuarial loss	**1**	—	**1**	1
Net periodic benefit cost	**$ —**	$ 1	**$ —**	$ 2
International defined benefit pension plans:				
Service cost	**$ 2**	$ 3	**$ 5**	$ 5
Interest cost	**5**	5	**10**	10
Expected return on plan assets	**(9)**	(10)	**(18)**	(19)
Amortization of net actuarial loss	**2**	3	**4**	5
Settlement/Curtailment	**—**	—	**—**	1
Net periodic benefit cost	**$ —**	$ 1	**$ 1**	$ 2
Total net periodic benefit cost	**$ —**	$ 2	**$ 1**	$ 4

The components of net periodic benefit cost other than the service cost component are included in the line item "Other non-operating income, net" in the Condensed Consolidated Income Statements.

The total net periodic benefit cost for other postretirement employee benefit plans was less than $1 million for both the three and six months ended June 30, 2019, including net credits recognized into other comprehensive income ("OCI") of $1 million for both the three and six months ended June 30, 2019. The total net periodic benefit cost for other postretirement employee benefit plans was less than $1 million for both the three and six months ended June 30, 2018, including net credits recognized in OCI of less than $1 million and $1 million, respectively, for the three and six months ended June 30, 2018.

We contributed $9 million and $12 million to our defined benefit plans during the six months ended June 30, 2019 and 2018, respectively. Additional contributions ranging between approximately $8 million and $14 million are expected during the remainder of 2019.

Note 15. Equity

The following table shows the changes in stockholders' equity for the six months ended June 30, 2019:

	Common Stock	Capital in Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Non-Controlling Interest	Total
Balance at January 1, 2019	$ 2	$ 1,950	$ 1,639	$ (336)	$ (487)	$ 14	$ 2,782
Sale of business						(2)	(2)
Net income			79				79
Other comprehensive income, net				20			20
Dividends declared ($0.24 per share)			(44)				(44)
Stock incentive plan activity		12			(14)		(2)
Repurchase of common stock					(25)		(25)
Balance at March 31, 2019	$ 2	$ 1,962	$ 1,674	$ (316)	$ (526)	$ 12	$ 2,808
Net income			139				139
Other comprehensive loss, net				(11)			(11)
Dividends declared ($0.24 per share)			(43)				(43)
Stock incentive plan activity		13			—		13
Balance at June 30, 2019	$ 2	$ 1,975	$ 1,770	$ (327)	$ (526)	$ 12	$ 2,906

The following table shows the changes in stockholders' equity for the six months ended June 30, 2018:

	Common Stock	Capital in Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Non-Controlling Interest	Total
Balance at January 1, 2018	$ 2	$ 1,912	$ 1,227	$ (210)	$ (428)	$ 16	$ 2,519
Cumulative effect of change in accounting principle			14	(17)			(3)
Net income			79				79
Other comprehensive income, net				20			20
Dividends declared ($0.21 per share)			(38)				(38)
Stock incentive plan activity		13			(8)		5
Repurchase of common stock					(25)		(25)
Balance at March 31, 2018	$ 2	$ 1,925	$ 1,282	$ (207)	$ (461)	$ 16	$ 2,557
Net income			115				115
Other comprehensive loss, net				(87)			(87)
Dividends declared ($0.21 per share)			(38)				(38)
Stock incentive plan activity		7					7
Repurchase of common stock					(25)		(25)
Balance at June 30, 2018	$ 2	$ 1,932	$ 1,359	$ (294)	$ (486)	$ 16	$ 2,529

Note 16. Share-Based Compensation Plans

Share-based compensation expense was $7 million and $16 million during the three and six months ended June 30, 2019, respectively, and $7 million and $16 million during the three and six months ended June 30, 2018, respectively. The unrecognized compensation expense related to our stock options, restricted stock units and performance share units was $9 million, $29 million and $23 million, respectively, at June 30, 2019 and is expected to be recognized over a weighted average period of 2.1, 2.1 and 2 years, respectively. The amount of cash received from the exercise of stock options was $8 million and $4 million for the six months ended June 30, 2019 and 2018, respectively.

Stock Option Grants

The following is a summary of the changes in outstanding stock options for the six months ended June 30, 2019:

	Share units (in thousands)	**Weighted Average Exercise Price / Share**	**Weighted Average Remaining Contractual Term (Years)**	**Aggregate Intrinsic Value** (in millions)
Outstanding at January 1, 2019	2,125	$ 43.08	6.5	
Granted	330	74.07		
Exercised	(244)	35.47		
Forfeited and expired	(5)	58.96		
Outstanding at June 30, 2019	**2,206**	**$ 48.53**	**6.7**	**$ 78**
Options exercisable at June 30, 2019	**1,533**	**$ 39.53**	**5.8**	**$ 68**
Vested and expected to vest as of June 30, 2019	**2,130**	**$ 47.66**	**6.6**	**$ 77**

The total intrinsic value of options exercised (which is the amount by which the stock price exceeded the exercise price of the options on the date of exercise) during the six months ended June 30, 2019 was $10.3 million.

Stock Option Fair Value

The fair value of each option grant was estimated on the date of grant using the binomial lattice pricing model which incorporates multiple and variable assumptions over time, including assumptions such as employee exercise patterns, stock price volatility and changes in dividends. The following are weighted-average assumptions for 2019 grants:

Volatility	**24.10 %**
Risk-free interest rate	**2.56 %**
Dividend yield	**1.30 %**
Expected term (in years)	**5.4**
Weighted-average fair value / share	**$ 17.06**

Expected volatility is calculated based on a weighted analysis of historic and implied volatility measures for a set of peer companies and Xylem. We use historical data to estimate option exercise and employee termination behavior within the valuation model. Employee groups and option characteristics are considered separately for valuation purposes. The expected term represents an estimate of the period of time options are expected to remain outstanding. The risk-free rate is based on the United States Treasury yield curve in effect at the time of option grant.

Restricted Stock Unit Grants

The following is a summary of restricted stock unit activity for the six months ended June 30, 2019. The fair value of the restricted share unit awards is determined using the closing price of our common stock on date of grant.

	Share units (in thousands)	**Weighted Average Grant Date Fair Value /Share**
Outstanding at January 1, 2019	537	$ 59.41
Granted	253	74.28
Vested	(237)	55.05
Forfeited	(25)	66.82
Outstanding at June 30, 2019	**528**	**$ 68.05**

ROIC Performance Share Unit Grants

The following is a summary of Return on Invested Capital ("ROIC") performance share unit grants for the six months ended June 30, 2019. The fair value of the ROIC performance share units is equal to the closing share price on the date of the grant.

	Share units (in thousands)		**Weighted Average Grant Date Fair Value /Share**
Outstanding at January 1, 2019	274	$	52.11
Granted	76		74.07
Adjustment for Performance Condition Achieved (a)	74		37.86
Vested	(173)		37.86
Forfeited	(2)		60.76
Outstanding at June 30, 2019	**249**	**$**	**64.45**

(a) Represents an increase in the number of original ROIC performance share units awarded based on the final performance criteria achievement at the end of the performance period of such awards.

TSR Performance Share Unit Grants

The following is a summary of our Total Shareholder Return ("TSR") performance share unit grants for the six months ended June 30, 2019:

	Share units (in thousands)		**Weighted Average Grant Date Fair Value /Share**
Outstanding at January 1, 2019	274	$	61.04
Granted	76		89.62
Adjustment for Market Condition Achieved (a)	74		37.86
Vested	(173)		37.86
Forfeited	(2)		60.76
Outstanding at June 30, 2019	**249**	**$**	**75.67**

(a) Represents an increase in the number of original TSR performance share units awarded based on the final market condition achievement at the end of the performance period of such awards.

The fair value of TSR performance share units was calculated on the date of grant using a Monte Carlo simulation model utilizing several key assumptions, including expected Company and peer company share price volatility, correlation coefficients between peers, the risk-free rate of return, the expected dividend yield and other award design features. The following are weighted-average assumptions for 2019 grants:

Volatility	**20.9 %**
Risk-free interest rate	**2.52 %**

Note 17. Capital Stock

For the three and six months ended June 30, 2019 the Company repurchased common stock of less than 0.1 million shares for less than $1 million and approximately 0.5 million shares for $39 million, respectively. Repurchases include both share repurchase programs approved by the Board of Directors and repurchases in relation to settlement of employee tax withholding obligations due as a result of the vesting of restricted stock units. The details of repurchases by each program are as follows:

On August 24, 2015, our Board of Directors authorized the repurchase of up to $500 million in shares with no expiration date. The program's objective is to deploy our capital in a manner that benefits our shareholders and maintains our focus on growth. There were no shares repurchased under this program for the three months ended June 30, 2019. For the six months ended June 30, 2019, we repurchased approximately 0.3 million shares for $25 million. For the three and six months ended June 30, 2018, we repurchased approximately 0.4 million shares for $25 million and 0.7 million shares for $50 million, respectively. There are up to $338 million in shares that may still be purchased under this plan as of June 30, 2019.

Aside from the aforementioned repurchase program, we repurchased less than 0.1 million shares and approximately 0.2 million shares for less than $1 million and approximately $14 million for the three and six months ended June 30, 2019, respectively, in relation to settlement of employee tax withholding obligations due as a result of the vesting of restricted stock units. Likewise, we repurchased less than 0.1 million shares and approximately 0.1 million shares for less than $1 million and approximately $8 million for the three and six months ended June 30, 2018, respectively.

Note 18. Accumulated Other Comprehensive Loss

The following table provides the components of accumulated other comprehensive loss for the six months ended June 30, 2019:

(in millions)	Foreign Currency Translation	Postretirement Benefit Plans	Derivative Instruments	Total
Balance at January 1, 2019	$ (121)	$ (214)	$ (1)	$ (336)
Foreign currency translation adjustment	29	—	—	29
Tax on foreign currency translation adjustment	(4)	—	—	(4)
Amortization of prior service cost and net actuarial loss on postretirement benefit plans into other non-operating income (expense), net	—	2	—	2
Income tax impact on amortization of postretirement benefit plan items	—	(1)	—	(1)
Unrealized loss on derivative hedge agreements	—	—	(9)	(9)
Income tax benefit on unrealized loss on derivative hedge agreements	—	—	1	1
Reclassification of unrealized loss on foreign exchange agreements into revenue	—	—	1	1
Reclassification of unrealized loss on foreign exchange agreements into cost of revenue	—	—	1	1
Balance at March 31, 2019	$ (96)	$ (213)	$ (7)	$ (316)
Foreign currency translation adjustment	(18)	—	—	(18)
Tax on foreign currency translation adjustment	3	—	—	3
Amortization of prior service cost and net actuarial loss on postretirement benefit plans into other non-operating income (expense), net	—	2	—	2
Income tax impact on amortization of postretirement benefit plan items	—	—	—	—
Reclassification of unrealized loss on foreign exchange agreements into revenue	—	—	1	1
Reclassification of unrealized loss on foreign exchange agreements into cost of revenue	—	—	1	1
Balance at June 30, 2019	$ (111)	$ (211)	$ (5)	$ (327)

The following table provides the components of accumulated other comprehensive loss for the six months ended June 30, 2018:

(in millions)	Foreign Currency Translation		Postretirement Benefit Plans		Derivative Instruments		Total	
Balance at January 1, 2018	$	(15)	$	(198)	$	3	$	(210)
Cumulative effect of change in accounting principle		(11)		(6)		—		(17)
Foreign currency translation adjustment		8		—		—		8
Tax on foreign currency translation adjustment		11		—		—		11
Changes in postretirement benefit plans		—		1		—		1
Amortization of prior service cost and net actuarial loss on postretirement benefit plans into other non-operating income (expense), net		—		2		—		2
Income tax impact on amortization of postretirement benefit plan items		—		(1)		—		(1)
Reclassification of unrealized gain on derivative hedge agreements into revenue		—		—		(1)		(1)
Balance at March 31, 2018	$	(7)	$	(202)	$	2	$	(207)
Foreign currency translation adjustment		(60)		—		—		(60)
Tax on foreign currency translation adjustment		(19)		—		—		(19)
Amortization of prior service cost and net actuarial loss on postretirement benefit plans into other non-operating income (expense), net		—		—		—		—
Other non-operating income		—		3		—		3
Income tax impact on amortization of postretirement benefit plan items		—		(1)		—		(1)
Unrealized loss on derivative hedge agreements		—		—		(9)		(9)
Reclassification of unrealized gain on derivative hedge agreements into revenue		—		—		(1)		(1)
Balance at June 30, 2018	$	(86)	$	(200)	$	(8)	$	(294)

Note 19. Commitments and Contingencies

Legal Proceedings

From time to time we are involved in legal and regulatory proceedings that are incidental to the operation of our businesses (or the business operations of previously owned entities). These proceedings may seek remedies relating to environmental matters, tax, intellectual property matters, acquisitions or divestitures, product liability and personal injury claims, privacy, employment, labor and pension matters, government contract issues and commercial or contractual disputes.

From time to time claims may be asserted against Xylem alleging injury caused by any of our products resulting from asbestos exposure. We believe there are numerous legal defenses available for such claims and would defend ourselves vigorously. Pursuant to the Distribution Agreement among ITT Corporation (now ITT LLC), Exelis and Xylem, ITT Corporation (now ITT LLC) has an obligation to indemnify, defend and hold Xylem harmless for asbestos product liability matters, including settlements, judgments, and legal defense costs associated with all pending and future claims that may arise from past sales of ITT’s legacy products. We believe ITT Corporation (now ITT LLC) remains a substantial entity with sufficient financial resources to honor its obligations to us.

See Note 6. "Income Taxes", of our condensed consolidated financial statements for a description of a pending tax litigation matter.

Although the ultimate outcome of any legal matter cannot be predicted with certainty, based on present information, including our assessment of the merits of the particular claims, we do not believe it is reasonably possible that any asserted or unasserted legal claims or proceedings, individually or in aggregate, will have a material adverse effect on our results of operations, or financial condition. We have estimated and accrued $6 million and $7 million as of June 30, 2019 and December 31, 2018, respectively, for these general litigation matters.

Indemnifications

As part of our 2011 spin-off from our former parent, ITT Corporation (now ITT LLC), Exelis Inc. and Xylem will indemnify, defend and hold harmless each of the other parties with respect to such parties' assumed or retained liabilities under the Distribution Agreement and breaches of the Distribution Agreement or related spin agreements. The former parent's indemnification obligations include asserted and unasserted asbestos and silica liability claims that relate to the presence or alleged presence of asbestos or silica in products manufactured, repaired or sold prior to October 31, 2011, the Distribution Date, subject to limited exceptions with respect to certain employee claims, or in the structure or material of any building or facility, subject to exceptions with respect to employee claims relating to Xylem buildings or facilities. The indemnification associated with pending and future asbestos claims does not expire. Xylem has not recorded a liability for material matters for which we expect to be indemnified by the former parent or Exelis Inc. through the Distribution Agreement and we are not aware of any claims or other circumstances that would give rise to material payments from us under such indemnifications. On May 29, 2015, Harris Inc. acquired Exelis. As the parent of Exelis, Harris Inc. is responsible for Exelis' indemnification obligations under the Distribution Agreement.

Guarantees

We obtain certain stand-by letters of credit, bank guarantees, surety bonds and insurance letters of credit from third-party financial institutions in the ordinary course of business when required under contracts or to satisfy insurance related requirements. As of June 30, 2019 and December 31, 2018, the amount of stand-by letters of credit, bank guarantees and surety bonds was $305 million and $275 million, respectively.

Environmental

In the ordinary course of business, we are subject to federal, state, local, and foreign environmental laws and regulations. We are responsible, or are alleged to be responsible, for ongoing environmental investigation and remediation of sites in various countries. These sites are in various stages of investigation and/or remediation and in many of these proceedings our liability is considered de minimis. We have received notification from the United States Environmental Protection Agency, and from similar state and foreign environmental agencies, that a number of sites formerly or currently owned and/or operated by Xylem or for which we are responsible under the Distribution Agreement, and other properties or water supplies that may be or have been impacted from those operations, contain disposed or recycled materials or wastes and require environmental investigation and/or remediation. These sites include instances where we have been identified as a potentially responsible party under federal and state environmental laws and regulations.

Accruals for environmental matters are recorded on a site-by-site basis when it is probable that a liability has been incurred and the amount of the liability can be reasonably estimated, based on current law and existing technologies. Our accrued liabilities for these environmental matters represent our best estimates related to the investigation and remediation of environmental media such as water, soil, soil vapor, air and structures, as well as related legal fees. These estimates, and related accruals, are reviewed quarterly and updated for progress of investigation and remediation efforts and changes in facts and legal circumstances. Liabilities for these environmental expenditures are recorded on an undiscounted basis. We have estimated and accrued $3 million and $4 million as of June 30, 2019 and December 31, 2018, respectively, for environmental matters.

It is difficult to estimate the final costs of investigation and remediation due to various factors, including incomplete information regarding particular sites and other potentially responsible parties, uncertainty regarding the extent of investigation or remediation and our share, if any, of liability for such conditions, the selection of alternative remedial approaches, and changes in environmental standards and regulatory requirements. We believe the total amount accrued is reasonable based on existing facts and circumstances.

Warranties

We warrant numerous products, the terms of which vary widely. In general, we warrant products against defect and specific non-performance. The table below provides the changes in our product warranty accrual:

(in millions)	2019	2018
Warranty accrual – January 1	**$ 60**	$ 82
Net charges for product warranties in the period	**11**	13
Settlement of warranty claims	**(23)**	(24)
Foreign currency and other	**—**	1
Warranty accrual - June 30	**$ 48**	$ 72

Note 20. Segment Information

Our business has three reportable segments: Water Infrastructure, Applied Water and Measurement & Control Solutions. When determining the reportable segments, the Company aggregated operating segments based on their similar economic and operating characteristics. The Water Infrastructure segment focuses on the transportation and treatment of water, offering a range of products including water and wastewater pumps, treatment equipment, and controls and systems. The Applied Water segment serves many of the primary uses of water and focuses on the residential, commercial and industrial markets. The Applied Water segment's major products include pumps, valves, heat exchangers, controls and dispensing equipment. The Measurement & Control Solutions segment focuses on developing advanced technology solutions that enable intelligent use and conservation of critical water and energy resources as well as analytical instrumentation used in the testing of water. The Measurement & Control Solutions segment's major products include smart metering, networked communications, measurement and control technologies, critical infrastructure technologies, software and services including cloud-based analytics, remote monitoring and data management, leak detection and pressure monitoring solutions and testing equipment.

Additionally, we have Regional selling locations, which consist primarily of selling and marketing organizations and related support services, that offer products and services across our reportable segments. Corporate and other consists of corporate office expenses including compensation, benefits, occupancy, depreciation, and other administrative costs, as well as charges related to certain matters, such as environmental matters, that are managed at a corporate level and are not included in the business segments in evaluating performance or allocating resources.

The accounting policies of each segment are the same as those described in the summary of significant accounting policies (see Note 1 in the 2018 Annual Report). The following tables contain financial information for each reportable segment:

(in millions)	Three Months Ended June 30, 2019	Three Months Ended June 30, 2018	Six Months Ended June 30, 2019	Six Months Ended June 30, 2018
Revenue:				
Water Infrastructure	$ 561	$ 546	$ 1,043	$ 1,026
Applied Water	394	388	773	754
Measurement & Control Solutions	390	383	766	754
Total	$ 1,345	$ 1,317	$ 2,582	$ 2,534
Operating Income:				
Water Infrastructure	$ 98	$ 92	$ 149	$ 141
Applied Water	62	61	118	111
Measurement & Control Solutions	26	31	42	64
Corporate and other	(15)	(13)	(29)	(32)
Total operating income	$ 171	$ 171	$ 280	$ 284
Interest expense	$ 18	21	$ 36	$ 42
Other non-operating income, net	3	2	5	5
Gain (loss) from sale of business	—	(2)	1	(2)
Income before taxes	$ 156	$ 150	$ 250	$ 245
Depreciation and Amortization:				
Water Infrastructure	$ 16	$ 16	$ 31	$ 33
Applied Water	6	6	12	11
Measurement & Control Solutions	35	36	71	73
Regional selling locations (a)	4	5	8	10
Corporate and other	2	2	5	5
Total	$ 63	$ 65	$ 127	$ 132
Capital Expenditures:				
Water Infrastructure	$ 21	$ 17	$ 51	$ 40
Applied Water	4	5	10	14
Measurement & Control Solutions	29	22	53	46
Regional selling locations (b)	5	3	9	8
Corporate and other	1	3	6	3
Total	$ 60	$ 50	$ 129	$ 111

(a) Depreciation and amortization expense incurred by the Regional selling locations was included in an overall allocation of Regional selling location costs to the segments; however, a certain portion of that expense was not specifically identified to a segment. That expense is captured in this Regional selling location line.

(b) Represents capital expenditures incurred by the Regional selling locations not allocated to the segments.

ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the condensed consolidated financial statements, including the notes, included elsewhere in this report on Form 10-Q (this "Report"). Except as otherwise indicated or unless the context otherwise requires, "Xylem," "we," "us," "our" and the "Company" refer to Xylem Inc. and its subsidiaries.

This Report contains information that may constitute “forward-looking statements" within the meaning of the Private Securities Litigation Act of 1995. Forward-looking statements by their nature address matters that are, to different degrees, uncertain. Generally, the words “anticipate,” “estimate,” “expect,” “project,” “intend,” “plan,” “forecast,” “believe,” “target,” “will,” “could,” “would,” “should” and similar expressions identify forward-looking statements. However, the absence of these words or similar expressions does not mean that a statement is not forward-looking. These forward-looking statements include any statements that are not historical in nature, including any statements about the capitalization of the Company, the Company’s restructuring and realignment, future strategic plans and other statements that describe the Company’s business strategy, outlook, objectives, plans, intentions or goals. All statements that address operating or financial performance, events or developments that we expect or anticipate will occur in the future - including statements relating to orders, revenues, operating margins and earnings per share growth, and statements expressing general views about future operating results - are forward-looking statements. Forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause actual results to differ materially from those expressed or implied in, or reasonably inferred from, such forward-looking statements.

Factors that could cause results to differ materially from those anticipated include: overall economic and business conditions, political and other risks associated with our international operations, including military actions, economic sanctions or trade barriers including tariffs and embargoes that could affect customer markets and our business, and non-compliance with laws, including foreign corrupt practice laws, export and import laws and competition laws; potential for unexpected cancellations or delays of customer orders in our reported backlog; our exposure to fluctuations in foreign currency exchange rates; competition and pricing pressures in the markets we serve; the strength of housing and related markets; weather conditions; ability to retain and attract talent and key members of management; our relationship with and the performance of our channel partners; our ability to successfully identify, complete and integrate acquisitions; our ability to borrow or to refinance our existing indebtedness and availability of liquidity sufficient to meet our needs; uncertainty from the expected discontinuance of LIBOR and transition to any other interest rate benchmark; changes in the value of goodwill or intangible assets; risks relating to product defects, product liability and recalls; claims or investigations by governmental or regulatory bodies; security breaches or other disruptions of our information technology systems; litigation and contingent liabilities; and other factors set forth under “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2018 ("2018 Annual Report") and with subsequent filings we make with the Securities and Exchange Commission ("SEC").

All forward-looking statements made herein are based on information currently available to the Company as of the date of this Report. 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.

Our quarterly financial periods end on the Saturday closest to the last day of the calendar quarter, except for the fourth quarter which ends on December 31. For ease of presentation, the reporting periods included herein are described as ending on the last day of the calendar quarter.

Overview

Xylem is a leading global water technology company. We design, manufacture and service highly engineered products and solutions ranging across a wide variety of critical applications in utility, industrial, residential and commercial building services settings. Our broad portfolio of solutions addresses customer needs across the water cycle, from the delivery, measurement and use of drinking water to the collection, test and treatment of wastewater to the return of water to the environment. Our product and service offerings are organized into three reportable segments that are aligned around the critical market applications they provide: Water Infrastructure, Applied Water and Measurement & Control Solutions.

- *Water Infrastructure* serves the water infrastructure sector with pump systems that transport water from aquifers, lakes, rivers and seas; with filtration, ultraviolet and ozone systems that provide treatment, making the water fit to use; and pumping solutions that move the wastewater to treatment facilities where our mixers, biological treatment, monitoring and control systems provide the primary functions in the treatment process. We also provide sales and rental of specialty dewatering pumps and related equipment and services. Additionally, our offerings use monitoring & control, smart and connected technologies to allow for remote monitoring of performance and enable products to self-optimize pump operations maximizing energy efficiency and minimizing unplanned downtime and maintenance for our customers. In the Water Infrastructure segment, we provide the majority of our sales directly to customers along with strong applications expertise, while the remaining amount is through distribution partners.

- *Applied Water* serves the usage applications sector with water pressure boosting systems for heating, ventilation and air conditioning, and for fire protection systems to the residential and commercial building services markets. In addition, our pumps, heat exchangers and controls provide cooling to power plants and manufacturing facilities, circulation for food and beverage processing, as well as boosting systems for agricultural irrigation. In the Applied Water segment, we provide the majority of our sales through long-standing relationships with many of the leading independent distributors in the markets we serve, with the remainder going directly to customers.

- *Measurement & Control Solutions* primarily serves the utility infrastructure solutions and services sector by delivering communications, smart metering, measurement and control technologies and critical infrastructure technologies that allow customers to more effectively use their distribution networks for the delivery, monitoring and control of critical resources such as water, electricity and natural gas. We also provide analytical instrumentation used to measure water quality, flow and level in clean water, wastewater, surface water and coastal environments. Additionally, we offer software and services including cloud-based analytics, remote monitoring and data management, leak detection, condition assessment, asset management and pressure monitoring solutions. We also offer smart lighting solutions that improve efficiency and public safety efforts across communities. In the Measurement & Control Solutions segment, we generate our sales through a combination of long-standing relationships with leading distributors and dedicated channel partners as well as direct sales depending on the regional availability of distribution channels and the type of product.

Executive Summary

Xylem reported revenue for the second quarter of 2019 of $1,345 million, an increase of 2.1% compared to $1,317 million reported in the second quarter of 2018. On a constant currency basis, revenue increased by $60 million, or 4.6%, primarily consisting of organic revenue growth of $69 million, or 5.2%, driven by growth across all segments and in all end markets. A decrease from revenue related to divestitures of $9 million partially offset the revenue growth during the quarter.

We generated operating income of $171 million (margin of 12.7%) during the second quarter of 2019, as compared to $171 million (margin of 13.0%) in 2018. Operating income in the second quarter of 2019 included an unfavorable impact from increased restructuring and realignment costs of $11 million, partially offset by a decrease in special charges of $1 million during the period. Excluding the impact of these items, adjusted operating income was $192 million (adjusted margin of 14.3%) during the second quarter of 2019 as compared to $182 million (adjusted margin of 13.8%) in 2018. The increase in adjusted operating margin was primarily due to cost reductions from our global procurement and productivity initiatives, price realization and favorable volume impacts, which were partially offset by cost inflation, increased spending on strategic investments and unfavorable mix.

Additional financial highlights for the quarter ended June 30, 2019 include the following:

- Orders of $1,392 million, up 1.0% from $1,378 million in the prior year, up 3.9% on an organic basis

- Earnings per share of $0.77, up 20.3% when compared to the prior year ($0.79, up 8.2% on an adjusted basis)

- Cash flow from operating activities of $206 million for the six months ended June 30, 2019, up 2.5% from the prior year. Free cash flow, excluding Sensus acquisition related costs, of $77 million decreased $14 million over the prior year, as increased spending on capital investments was partially offset by higher operating cash flows.

Key Performance Indicators and Non-GAAP Measures

Management reviews key performance indicators including revenue, gross margins, segment operating income and margins, orders growth, working capital and backlog, among others. In addition, we consider certain non-GAAP (or "adjusted") measures to be useful to management and investors evaluating our operating performance for the periods presented, and provide a tool for evaluating our ongoing operations, liquidity and management of assets. This information can assist investors in assessing our financial performance and measures our ability to generate capital for deployment among competing strategic alternatives and initiatives, including, but not limited to, dividends, acquisitions, share repurchases and debt repayment. Excluding revenue, Xylem provides guidance only on a non-GAAP basis due to the inherent difficulty in forecasting certain amounts that would be included in GAAP earnings, such as discrete tax items, without unreasonable effort. These adjusted metrics are consistent with how management views our business and are used to make financial, operating and planning decisions. These metrics, however, are not measures of financial performance under GAAP and should not be considered a substitute for revenue, operating income, net income, earnings per share (basic and diluted) or net cash from operating activities as determined in accordance with GAAP. We consider the following items to represent non-GAAP measures as well as the related reconciling items to the most directly comparable measure calculated and presented in accordance with GAAP. The non-GAAP measures may not be comparable to similarly titled measures reported by other companies, to be key performance indicators:

- "organic revenue" and "organic orders" defined as revenue and orders, respectively, excluding the impact of fluctuations in foreign currency translation and contributions from acquisitions and divestitures. Divestitures include sales of insignificant portions of our business that did not meet the criteria for classification as a discontinued operation. The period-over-period change resulting from foreign currency translation impacts is determined by translating current period and prior period activity using the same currency conversion rate.

- "constant currency" defined as financial results adjusted for foreign currency translation impacts by translating current period and prior period activity using the same currency conversion rate. This approach is used for countries whose functional currency is not the U.S. Dollar.

- "adjusted net income" and "adjusted earnings per share" defined as net income and earnings per share, respectively, adjusted to exclude, as applicable, restructuring and realignment costs, special charges, gains and losses from the sale of a business and tax-related special items. A reconciliation of adjusted net income is provided below.

	Three Months Ended June 30,		Six Months Ended June 30,	
(In millions, except for per share data)	**2019**	2018	**2019**	2018
Net income	**$ 139**	$ 115	**$ 218**	$ 194
Earnings per share - diluted	**$ 0.77**	$ 0.64	**$ 1.20**	$ 1.07
Restructuring and realignment, net of tax of $4 and $8 for 2019 and $3 and $7 for 2018	**17**	7	**33**	19
Special charges, net of tax of $0 for 2019 and net of tax of $0 and $1 for 2018	**—**	1	**4**	6
Tax-related special items	**(13)**	6	**(17)**	3
(Gain) loss from sale of business, net of tax of $0 for 2019 and $0 for 2018	**—**	2	**(1)**	2
Adjusted net income	**$ 143**	$ 131	**$ 237**	$ 224
Adjusted earnings per share	**$ 0.79**	$ 0.73	**$ 1.31**	$ 1.24

- "adjusted operating expenses" defined as operating expenses adjusted to exclude restructuring and realignment costs and special charges.

- "adjusted operating income" defined as operating income, adjusted to exclude restructuring and realignment costs and special charges, and "adjusted operating margin" defined as adjusted operating income divided by total revenue.

- “realignment costs” defined as costs not included in restructuring costs that are incurred as part of actions taken to reposition our business, including items such as professional fees, severance, relocation, travel, facility set-up and other costs.

- "Sensus acquisition related costs" defined as costs incurred by the Company associated with the acquisition of Sensus that are being reported within operating income. These costs include integration costs, acquisition costs, costs related to the recognition of the backlog intangible asset amortization recorded in purchase accounting.

- “special charges" defined as costs incurred by the Company, such as acquisition and integration related costs not included in "Sensus acquisition related costs", non-cash impairment charges and other special non-operating items.

- "tax-related special items" defined as tax items, such as tax return versus tax provision adjustments, tax exam impacts, tax law change impacts, significant reserves for cash repatriation, excess tax benefits/losses and other discrete tax adjustments.

- "free cash flow" defined as net cash from operating activities, as reported in the Statement of Cash Flows, less capital expenditures as well as adjustments for other significant items that impact current results which management believes are not related to our ongoing operations and performance. Our definition of "free cash flow" does not consider certain non-discretionary cash payments, such as debt. The following table provides a reconciliation of free cash flow.

	Six Months Ended June 30,	
(In millions)	**2019**	2018
Net cash provided by operating activities	**$ 206**	$ 201
Capital expenditures	**(129)**	(111)
Free cash flow	**$ 77**	$ 90
Cash paid for Sensus acquisition related costs	**$ —**	$ (1)
Free cash flow, excluding Sensus acquisition related costs	**$ 77**	$ 91

- “EBITDA” defined as earnings before interest, taxes, depreciation and amortization expense and "Adjusted EBITDA" reflects the adjustment to EBITDA to exclude share-based compensation, restructuring and realignment costs, special charges and gain or loss from sale of businesses.

	Three Months Ended June 30,		Six Months Ended June 30,	
(in millions)	**2019**	2018	**2019**	2018
Net Income	**$ 139**	$ 115	**$ 218**	$ 194
Income tax expense	**17**	35	**32**	51
Interest expense (income), net	**18**	20	**35**	40
Depreciation	**29**	29	**58**	58
Amortization	**34**	36	**69**	74
EBITDA	**$ 237**	$ 235	**$ 412**	$ 417
Share-based compensation	**$ 7**	$ 7	**16**	16
Restructuring and realignment	**21**	9	**41**	25
Special charges	**—**	1	**4**	7
(Gain) loss from sale of business	**—**	2	**(1)**	2
Adjusted EBITDA	**$ 265**	$ 254	**$ 472**	$ 467

2019 Outlook

We anticipate total revenue growth in the range of 2% to 3% in 2019, with organic revenue growth anticipated to be in the range of 5% to 6%. The following is a summary of our organic revenue outlook by end market.

- Utilities increased approximately 7% organically through the first half of the year driven by strength in the United States and Asia Pacific, partially offset by weakness in Canada and western Europe. For 2019, we expect organic growth in the mid to high-single-digit range (versus mid-single digits) driven by healthy water and wastewater spending in the United States and smart meter and infrastructure analytics growth opportunities. We also anticipate that a healthy infrastructure investment focus in the emerging markets will continue in China and India, offset by softer than anticipated conditions in Europe.

- Industrial increased by approximately 3% organically through the first half of the year driven by strength in the United States and Asia Pacific. For 2019, we expect organic growth in the low-single-digits range (versus low-to-mid single digits) driven by continued solid industrial conditions in the United States as the oil and gas markets begin to stabilize after a strong 2018. We anticipate mixed market conditions outside of the United States with strength in Australia and India, offset by slowing growth in China and softer than anticipated conditions in Europe and the Middle East.

- In the commercial markets, organic growth was approximately 9% through the first half of the year driven by strength in the emerging markets and the United States. For 2019, we expect organic growth in the mid-single-digit range as the overall market will begin to moderate after two years of strong performance. Organic growth will be driven by continued strength in the United States, moderating slightly in the second half of the year, and the emerging markets led by initiatives in the China and India building markets, offset by softness in Europe.

- In residential markets, organic growth was approximately 3% through the first half of the year driven by strength in the United States and Asia Pacific, partially offset by weakness in western Europe and the Middle East and Africa. For 2019, we expect flat to low-single-digit growth (versus low-single digits) primarily driven by continued competition in the United States replacement market as the housing market begins to stabilize. We also anticipate modest growth opportunities in China and other Asia Pacific countries for secondary clean water sources, offset by soft performance in Europe from weaker than anticipated economic conditions.

We will continue to strategically execute restructuring and realignment actions primarily to reposition our European and North American businesses in an effort to optimize our cost structure and improve our operational efficiency and effectiveness. During 2019, we expect to incur between $60 million and $70 million in restructuring and realignment costs. We expect to realize approximately $7 million of incremental net savings in 2019 from actions initiated in 2018, and an additional $16 million of net savings from our 2019 actions.

We plan to continue to take actions and focus spending in 2019 on actions that allow us to make progress on our top strategic priorities. The priority of accelerating profitable growth encompasses our initiatives to drive commercial excellence, grow in emerging markets and strengthen innovation and technology through creation of new centers of excellence, a streamlined approach to product development and strategic acquisitions. The priority of driving continuous improvement is an area where we will continue to work to create new opportunities to unlock savings by eliminating waste and increasing efficiencies, which is supported by efforts to expand and further deepen our talent pool. We plan to continue to deploy capital in smart, disciplined ways to develop and acquire solutions to address our customers’ challenges. Finally, we continue to work to improve cash performance and generate capital to return to our shareholders.

Results of Operations

(In millions)	Three Months Ended June 30, 2019	2018	Change		Six Months Ended June 30, 2019	2018	Change	
Revenue	**$ 1,345**	$ 1,317	2.1	%	**$ 2,582**	$ 2,534	1.9	%
Gross profit	**526**	519	1.3	%	**1,000**	979	2.1	%
Gross margin	**39.1%**	39.4%	(30)	bp	**38.7%**	38.6%	10	bp
Total operating expenses	**355**	348	2.0	%	**720**	695	3.6	%
Expense to revenue ratio	**26.4%**	26.4%	—	bp	**27.9%**	27.4%	50	bp
Restructuring and realignment costs	**21**	10	110.0	%	**41**	26	57.7	%
Special charges	**—**	1	—	%	**4**	7	(42.9)	%
Adjusted operating expenses	**334**	337	(0.9)	%	**675**	662	2.0	%
Adjusted operating expenses to revenue ratio	**24.8%**	25.6%	(80)	bp	**26.1%**	26.1%	—	bp
Operating income	**171**	171	—	%	**280**	284	(1.4)	%
Operating margin	**12.7%**	13.0%	(30)	bp	**10.8%**	11.2%	(40)	bp
Interest and other non-operating expense, net	**15**	19	(21.1)	%	**31**	37	(16.2)	%
Gain (loss) from sale of business	**—**	(2)	NM	%	**1**	(2)	(150.0)	%
Income tax expense	**17**	35	(51.4)	%	**32**	51	(37.3)	%
Tax rate	**10.5%**	23.2%	(1,270)	bp	**12.8%**	20.8%	(800)	bp
Net income	**$ 139**	$ 115	20.9	%	**$ 218**	$ 194	12.4	%

NM - Not meaningful percentage change

Revenue

Revenue generated during the three and six months ended June 30, 2019 was $1,345 million and $2,582 million, reflecting increases of $28 million, or 2.1%, and $48 million, or 1.9%, respectively, compared to the same prior year periods. On a constant currency basis, revenue grew 4.6% and 5.2% for the three and six months ended June 30, 2019. The increases at constant currency consisted primarily of increases in organic revenue of $69 million and $145 million, respectively, reflecting strong organic growth in the United States and Asia Pacific, particularly in China and India, for both periods, and in Australia for the quarter. This growth was partially offset by organic declines in western Europe, particularly in the United Kingdom, and Latin America for both periods. There was a decrease in revenue related to divestitures of $9 million during the second quarter of 2019 and a net decrease in revenue related to acquisition and divestiture impacts of $14 million for the six months ended June 30, 2019.

The following tables illustrate the impact from organic growth, recent acquisitions and divestitures, and foreign currency translation in relation to revenue during the three and six months ended June 30, 2019:

	Water Infrastructure		Applied Water		Measurement & Control Solutions		Total Xylem	
(In millions)	$ Change	% Change	$ Change	% Change	$ Change	% Change	$ Change	% Change
2018 Revenue	$ 546		$ 388		$ 383		$ 1,317	
Organic growth	31	5.7 %	14	3.6 %	24	6.3 %	69	5.2 %
Acquisitions/Divestitures	—	— %	—	— %	(9)	(2.3)%	(9)	(0.6)%
Constant currency	31	5.7 %	14	3.6 %	15	3.9 %	60	4.6 %
Foreign currency translation (a)	(16)	(2.9)%	(8)	(2.1)%	(8)	(2.1)%	(32)	(2.5)%
Total change in revenue	15	2.7 %	6	1.5 %	7	1.8 %	28	2.1 %
2019 Revenue	**$ 561**		**$ 394**		**$ 390**		**$ 1,345**	

(a) Foreign currency translation impact for the quarter due to the weakening in value of various currencies against the U.S. Dollar, the largest being the Euro, the Chinese Yuan, the British Pound, the Australian Dollar and the Swedish Krona.

	Water Infrastructure		Applied Water		Measurement & Control Solutions		Total Xylem	
	$ Change	% Change	$ Change	% Change	$ Change	% Change	$ Change	% Change
2018 Revenue	$ 1,026		$ 754		$ 754		$ 2,534	
Organic growth	63	6.1 %	39	5.2 %	43	5.7 %	145	5.7 %
Acquisitions/Divestitures	—	— %	—	— %	(14)	(1.9)%	(14)	(0.5)%
Constant currency	63	6.1 %	39	5.2 %	29	3.8 %	131	5.2 %
Foreign currency translation (a)	(46)	(4.4)%	(20)	(2.7)%	(17)	(2.2)%	(83)	(3.3)%
Total change in revenue	17	1.7 %	19	2.5 %	12	1.6 %	48	1.9 %
2019 Revenue	**$ 1,043**		**$ 773**		**$ 766**		**$ 2,582**	

(a) Foreign currency translation impact for the year due to the weakening in value of various currencies against the U.S. Dollar, the largest being the Euro, the Chinese Yuan, the British Pound, the Swedish Krona and the Australian Dollar.

Water Infrastructure

Water Infrastructure revenue increased $15 million, or 2.7%, for the second quarter of 2019 (5.7% increase at constant currency) compared to 2018. Revenue growth was negatively impacted by $16 million of foreign currency translation, with the change at constant currency coming entirely from organic growth of $31 million. Organic growth for the quarter was driven by strength in the utility end market, particularly in United States, where we benefited from healthy order intake and strong market conditions across all applications, as well as growth in Asia Pacific and across western Europe. Organic growth for the quarter was also driven by strength in the industrial end market, particularly in Asia Pacific and the United States. Organic growth in the industrial end market was partially offset by declines in western Europe primarily due to the timing of project deployments in the prior year. Price realization contributed to the organic growth in both end markets during the quarter.

From an application perspective, organic revenue growth for the second quarter was driven primarily by our transport application. The transport application had strong revenue growth in the United States and Asia Pacific driven by healthy order intake and price realization during the quarter as well as continued growth in the global dewatering rental business, coming from strength in mining and construction. Organic revenue from our treatment application also contributed to the segment's growth with strong project deliveries in the United States and China. Organic growth for the treatment application was partially offset by declines in Latin America, primarily due to a large treatment project delivery in the prior year, as well as softness in the Middle East.

For the six months ended June 30, 2019, revenue increased $17 million, or 1.7% (6.1% increase at constant currency) as compared to 2018. Revenue growth was negatively impacted by $46 million of foreign currency translation, with the change at constant currency coming entirely from organic growth of $63 million. Organic growth for the six month period was primarily driven by strength in the utility end market, particularly in the United States, where we benefited from healthy order intake and strong market conditions across all applications. The utility end market also saw growth in Asia Pacific from strong project delivery. Organic growth during the six month period was also driven by strength in the industrial end market, particularly in Asia Pacific, where rental business grew, and in the United States where we benefited from strong market conditions in construction. Organic growth in the industrial end market was partially offset by declines in western Europe due to the timing of project deployments in the prior year. Organic growth in both end markets also benefited from price realization year over year.

From an application perspective, organic revenue growth for the six months ended June 30, 2019 was driven primarily by our transport application. The transport application had strong organic revenue growth from the global dewatering rental business, coming from strength in mining and construction, particularly in the United States and Australia. Transport also had strong organic revenue growth driven by strong project deliveries and price realization in the United States and the Emerging Markets. Organic revenue from our treatment application also contributed to the segment's growth with project deliveries in the United States and China where we benefited from healthy order intake coming into the year. This organic growth was partially offset by declines in Europe, the Middle East and Latin America, primarily due to the timing of large treatment project deliveries in the prior year.

Applied Water

Applied Water revenue increased $6 million, or 1.5%, for the second quarter of 2019 (3.6% increase at constant currency) as compared to the prior year. Revenue was negatively impacted by $8 million of foreign currency translation for the quarter. Revenue growth at constant currency consisted of organic growth of $14 million, or 3.6%, which was driven by strength in the commercial end market, as well as modest growth in the industrial and residential end markets. From an application perspective, organic revenue growth in the second quarter was led by strength in the commercial building services application, primarily driven by price realization and healthy demand in North America and China. The industrial water application revenue also grew organically, primarily driven by price realization and healthy market conditions in the United States, as well as project deliveries across western Europe. Modest organic growth in residential building services came primarily from price realization in the United States and strong second water supply business in China, which was partially offset by declines in western Europe during the quarter.

For the six months ended June 30, 2019, revenue increased $19 million, or 2.5% (5.2% increase at constant currency) as compared to the prior year period. Revenue was negatively impacted by $20 million of foreign currency translation for the period. Revenue growth at constant currency consisted of organic growth of $39 million, or 5.2%, which was primarily driven by strength in the commercial end market, as well as growth in the industrial and residential end markets. From an application perspective, organic revenue growth during the six month period was led by growth in the commercial building services application, primarily driven by strong price realization and healthy industry demand in the United States, as well as continued benefits of product localization in China. The industrial water application revenue also grew organically, primarily driven by market growth in western Europe coupled with customers stocking orders due to political concerns and strength in the United States. Organic growth in residential building services for the first half was driven by similar dynamics as the second quarter.

Measurement & Control Solutions

Measurement & Control Solutions revenue increased $7 million, or 1.8%, for the second quarter of 2019 (3.9% at constant currency) as compared to the prior year. Revenue was negatively impacted by $8 million of foreign currency translation for quarter. Revenue growth at constant currency was made up of organic revenue growth of $24 million, or 6.3%, which was partially offset by $9 million of divestiture activity. Organic revenue growth for the quarter was driven by strength in the utility end market, primarily in the United States. From an application perspective, organic revenue from the water application contributed very strong organic growth for the segment, led by the Sensus business which had order strength in the United States and project deployments in western Europe during the quarter. Organic growth in the water application in these same regions was partially offset by organic declines in the newer, Advanced Infrastructure Analytics ("AIA") business. The energy application also contributed modest organic growth, driven by gas project deployments during the quarter which more than offset the lapping of large electric project deployments in the prior year. Organic revenue growth during the quarter was partially offset by a slight decline in the software as a service ("SaaS") and other application in the United Kingdom, while the test application had modest organic growth as compared to the prior year.

For the six months ended June 30, 2019, revenue increased $12 million, or 1.6% (3.8% at constant currency) as compared to the prior year. Revenue was negatively impacted by $17 million of foreign currency translation during the six month period. Revenue growth at constant currency was made up of organic revenue growth of $43 million, or 5.7%, partially offset by $14 million of reduced revenue related to the net acquisition and divestiture activity. Organic revenue growth for the period was driven by strength in the utility end market, primarily in the United States and India, partially offset by declines in the United Kingdom and Canada. From an application perspective, organic revenue from the water application contributed very strong organic growth for the segment, with project deployments in the United States and India during the period. The strong organic growth in water was partially offset by declines in the software as a service ("SaaS") and other application primarily due to the timing of a large software sale in the prior year in the United Kingdom. The energy application also had a modest decline in revenue, with gas project deployments being more that offset by lower revenues in electric in the United States due to the timing of a large project deployment. The test application remained relatively flat as compared to the prior year.

Orders / Backlog

The following tables illustrate the impact from organic growth, recent acquisitions and divestitures, and foreign currency translation in relation to orders during the three and six months ended June 30, 2019:

	Water Infrastructure		**Applied Water**		**Measurement & Control Solutions**		**Total Xylem**	
(in millions)	$ Change	% Change	$ Change	% Change	$ Change	% Change	$ Change	% Change
2018 Orders	$ 580		$ 401		$ 397		$ 1,378	
Organic Growth	22	3.8 %	6	1.5 %	26	6.5 %	54	3.9 %
Acquisitions/(Divestitures)	—	— %	—	— %	(7)	(1.7)%	(7)	(0.5)%
Constant Currency	22	3.8 %	6	1.5 %	19	4.8 %	47	3.4 %
Foreign currency translation (a)	(16)	(2.8)%	(8)	(2.0)%	(9)	(2.3)%	(33)	(2.4)%
Total change in orders	6	1.0 %	(2)	(0.5)%	10	2.5 %	14	1.0 %
2019 Orders	**$ 586**		**$ 399**		**$ 407**		**$ 1,392**	

(a) Foreign currency translation impact for the quarter due to the weakening in value of various currencies against the U.S. Dollar, the largest being the Euro, the Chinese Yuan, the British Pound, the Australian Dollar and the Swedish Krona.

	Water Infrastructure		**Applied Water**		**Measurement & Control Solutions**		**Total Xylem**	
(in millions)	$ Change	% Change	$ Change	% Change	$ Change	% Change	$ Change	% Change
2018 Orders	$ 1,134		$ 785		$ 779		$ 2,698	
Organic Growth	35	3.1 %	28	3.6 %	44	5.6 %	107	4.0 %
Acquisitions/(Divestitures)	—	— %	—	— %	(9)	(1.1)%	(9)	(0.4)%
Constant Currency	35	3.1 %	28	3.6 %	35	4.5 %	98	3.6 %
Foreign currency translation (a)	(51)	(4.5)%	(20)	(2.6)%	(18)	(2.3)%	(89)	(3.3)%
Total change in orders	(16)	(1.4)%	8	1.0 %	17	2.2 %	9	0.3 %
2019 Orders	**$ 1,118**		**$ 793**		**$ 796**		**$ 2,707**	

(a) Foreign currency translation impact for the year due to the weakening in value of various currencies against the U.S. Dollar, the largest being the Euro, the Chinese Yuan, the British Pound, the Swedish Krona and the Australian Dollar.

Orders received during the second quarter of 2019 were $1,392 million, an increase of $14 million, or 1.0%, over the prior year (3.4% increase at constant currency). Orders received during the six months ended June 30, 2019 were $2,707 million, an increase of $9 million, or 0.3%, over the prior year (3.6% increase at constant currency). The order growth was negatively impacted by $33 million and $89 million of foreign currency translation for the three and six months ended June 30, 2019, respectively. The order growth at constant currency primarily consisted of organic order growth of 3.9% and 4.0% for the three and six months ended June 30, 2019, respectively. Orders related to divestitures of $7 million reduced order growth during the second quarter of 2019 and net acquisition and divestiture activity of $9 million reduced order growth during the six months ended June 30, 2019.

Water Infrastructure segment orders increased $6 million, or 1.0%, to $586 million (3.8% increase at constant currency) for the quarter as compared to the prior year. Order growth for the segment was negatively impacted by $16 million of foreign currency translation for the second quarter. The order increase on a constant currency basis was driven by organic order growth in the transport application. Transport organic order growth was primarily driven by strong pump order intake in India and China, as well as dewatering rental order strength in Europe. Organic orders for the treatment application declined during the quarter, primarily driven by project timing comparisons in North America and India.

For the six months ended June 30, 2019, orders decreased $16 million, or 1.4%, to $1,118 million (3.1% increase at constant currency) as compared to the same prior year period. Order growth for the segment was negatively impacted by $51 million of foreign currency translation for the six months. The order increase on a constant currency basis was driven by organic order growth in the transport application. Transport organic order growth was primarily driven by strong market conditions, coupled with some price realization, in Europe, North America, China and India. Organic orders for the treatment application declined during the period, primarily driven by project timing in North America, China and India due to the timing of large project orders in the prior year.

Applied Water segment orders decreased $2 million, or 0.5%, to $399 million (1.5% increase at constant currency) for the second quarter of 2019 as compared to the prior year. Order growth for the quarter was negatively impacted by $8 million of foreign currency translation. The order increase on a constant currency basis was driven by strong industrial and residential order intake in China and the United States, which were partially offset by a reduction of orders in Europe during the quarter.

For the six months ended June 30, 2019, orders increased $8 million, or 1.0%, to $793 million (3.6% increase at constant currency) as compared to the same prior year period. Order growth for the period was negatively impacted by $20 million of foreign currency translation. The order increase on a constant currency basis was driven by strong industrial and residential order intake in the United States, China and Europe, which were partially offset by a reduction of orders in the Middle East during the period.

Measurement & Control Solutions segment orders increased $10 million, or 2.5%, to $407 million (4.8% increase at constant currency) for the second quarter of 2019 as compared to the prior year. Order growth in the quarter was negatively impacted by $9 million of foreign currency translation. The order increase at constant currency included organic order growth of $26 million, or 6.5%, which was partially offset by $7 million of divestiture activity. Organic order growth was driven by large deployment orders within the Sensus business in western Europe and India for water, which more than offset the impact of strong order intake during the prior year in North America and Asia Pacific. Organic order growth from the water application was partially offset by organic declines in order intake within the AIA business during the quarter. The energy application also contributed to the organic growth during quarter as gas order growth in North America was partially offset by the lapping of large electric project deployments in the prior year. SaaS and other also experienced organic growth during the quarter, driven by order strength in North America, while organic orders for the test application remained relatively consistent with the prior year.

For the six months ended June 30, 2019, orders increased $17 million, or 2.2%, to $796 million (4.5% increase at constant currency) as compared to the same prior year period. Order growth during the period was negatively impacted by $18 million of foreign currency translation. The order increase at constant currency included organic order growth of $44 million, or 5.6%, which was partially offset by $9 million from the net acquisition and divestiture activity during the period. Organic order growth was driven by large deployment orders within our Sensus business in western Europe and India for water, which was partially offset by organic declines in the orders within our AIA business. SaaS and other also contributed to the organic growth, driven by order strength in North America, while the energy application experienced modest organic growth during period as gas order strength in North America was partially offset by the lapping of large electric project deployments in the prior year. Organic orders for the test application during the period remained relatively consistent with the prior year.

Backlog includes orders on hand as well as contractual customer agreements at the end of the period. Delivery schedules vary from customer to customer based on their requirements. Annual or multi-year contracts are subject to rescheduling and cancellation by customers due to the long-term nature of the contracts. As such, beginning total backlog, plus orders, minus revenues, will not equal ending total backlog due to contract adjustments, foreign currency fluctuations, and other factors. Typically, large projects require longer lead production cycles and deployment schedules and delays can occur from time to time. Total backlog was $1,865 million at June 30, 2019, an increase of $158 million or 9.3%, as compared to June 30, 2018 backlog of $1,707 million, and an increase of $176 million or 10.4%, as compared to December 31, 2018 backlog of $1,689 million. We anticipate that over 50% of the backlog at June 30, 2019 will be recognized as revenue in the remainder of 2019.

Gross Margin

Gross margin as a percentage of revenue decreased 30 and increased 10 basis points to 39.1% and 38.7%, respectively, for the three and six months ended June 30, 2019 as compared to 39.4% and 38.6%, respectively, for comparative 2018 periods. The gross margin decrease for the quarter was primarily driven by cost inflation and unfavorable mix, which were partially offset by cost reductions from global procurement and productivity improvement initiatives and price realization. The slight gross margin increase for six month period was primarily driven by cost reductions from global procurement and productivity improvement initiatives and price realization, which were partially offset by cost inflation, unfavorable mix and lower overhead cost absorption.

Operating Expenses

The following table presents operating expenses for the three and six months ended June 30, 2019 and 2018:

	Three Months Ended June 30,			Six Months Ended June 30,		
(In millions)	**2019**	2018	Change	**2019**	2018	Change
Selling, general and administrative expenses ("SG&A")	**$ 294**	$ 293	0.3 %	**$ 597**	$ 589	1.4 %
SG&A as a % of revenue	**21.9%**	22.2%	(30) bp	**23.1%**	23.2%	(10) bp
Research and development expenses ("R&D")	**47**	50	(6.0) %	**98**	91	7.7 %
R&D as a % of revenue	**3.5%**	3.8%	(30) bp	**3.8%**	3.6%	20 bp
Restructuring and asset impairment charges	**14**	5	180.0 %	**25**	15	66.7 %
Operating expenses	**$ 355**	$ 348	2.0 %	**$ 720**	$ 695	3.6 %
Expense to revenue ratio	**26.4%**	26.4%	— bp	**27.9%**	27.4%	50 bp

Selling, General and Administrative ("SG&A") Expenses

SG&A expenses increased by $1 million to $294 million, or 21.9% of revenue, in the second quarter of 2019, as compared to $293 million, or 22.2% of revenue, in the comparable 2018 period; and increased $8 million to $597 million, or 23.1% of revenue, in the six months ended June 30, 2019, as compared to $589 million or 23.2% of revenue for the six months ended in 2018. The improvement in SG&A as a percent of revenue for both periods was primarily driven by cost reductions from global procurement and productivity improvement initiatives, which were partially offset by cost inflation and additional investment in strategic growth initiatives.

Research and Development ("R&D") Expenses

R&D spending was $47 million or 3.5% of revenue in the second quarter of 2019, as compared to $50 million or 3.8% of revenue in the comparable period of 2018; and was $98 million or 3.8% of revenue in the six months ended June 30 2019, as compared to $91 million or 3.6% of revenue in the comparable period of 2018. Additionally, we capitalized R&D on external sale software of $16 million and $33 million for the three and six months ended June 30, 2019, as compared to $13 million and $33 million in the prior year periods. Our overall increased spending on R&D for the year is driven by development needs to drive new product growth.

Restructuring Charges and Asset Impairment

Restructuring

During the three and six months ended June 30, 2019, we recognized restructuring charges of $14 million and $22 million, respectively. We incurred these charges primarily as a continuation of our efforts to reposition our European and North American businesses to optimize our cost structure and improve our operational efficiency and effectiveness. The charges included the reduction of headcount and consolidation of facilities within our Measurement & Control Solutions and Water Infrastructure segments, as well as headcount reductions in our Applied Water segment. Included in the charges recorded during the three and six months ended June 30, 2019 were $0 million and $2 million, respectively, related to actions commenced in prior years.

During the three and six months ended June 30, 2018, we recognized restructuring charges of $5 million and $15 million, respectively. We incurred these charges related to actions taken in 2018 primarily as a continuation of our efforts to reposition our European and North American businesses to optimize our cost structure and improve our operational efficiency and effectiveness. The charges included the reduction of headcount and consolidation of facilities within our Measurement & Control Solutions and Water Infrastructure segments, as well as headcount reductions within our Applied Water segment. Included in the charges recorded during the three and six months ended June 30, 2018 were $1 million and $3 million, respectively, related to actions commenced in prior years.

The following table presents expected restructuring spend for actions commenced as of June 30, 2019:

(in millions)	Water Infrastructure	Applied Water	Measurement & Control Solutions	Corporate	Total
Actions Commenced in 2019:					
Total expected costs	$ 17	$ 4	$ 8	$ —	$ 29
Costs incurred during Q1 2019	3	—	3	—	6
Costs incurred during Q2 2019	7	2	5	—	14
Total expected costs remaining	**$ 7**	**$ 2**	**$ —**	**$ —**	**$ 9**
Actions Commenced in 2018:					
Total expected costs	$ 8	$ 1	$ 7	$ —	$ 16
Costs incurred during 2018	7	1	7	—	15
Costs incurred during Q1 2019	1	—	—	—	1
Costs incurred during Q2 2019	—	—	—	—	—
Total expected costs remaining	**$ —**	**$ —**	**$ —**	**$ —**	**$ —**
Actions Commenced in 2017:					
Total expected costs	$ 16	$ 8	$ 4	$ —	$ 28
Costs incurred during 2017	5	4	2	—	11
Costs incurred during 2018	2	1	1	—	4
Costs incurred during Q1 2019	—	—	1	—	1
Costs incurred during Q2 2019	—	—	—	—	—
Total expected costs remaining	**$ 9**	**$ 3**	**$ —**	**$ —**	**$ 12**

The Water Infrastructure, Applied Water, and Measurement & Control Solutions actions commenced in 2019 consist primarily of severance charges and are expected to continue through the end of 2019. The Water Infrastructure, Applied Water, and Measurement & Control Solutions actions commenced in 2018 consist primarily of severance charges and are complete. The Water Infrastructure, Applied Water and Measurement & Control Solutions actions commenced in 2017 consist primarily of severance charges and are expected to continue through the fourth quarter of 2020.

We currently expect to incur between $35 million and $45 million in restructuring costs for the full year. Included in these costs are costs to implement our Global Business Services platform, which will enable us to simplify, standardize and centralize many of our transactional processes. As a result of all of the actions taken and expected to be taken in 2019, we anticipate approximately $15 million of total net savings to be realized during 2019.

Asset Impairment

During the first quarter of 2019 we determined that certain assets within our Measurement and Control Solutions segment, including a customer relationship, were impaired. Accordingly we recognized an impairment charge of $3 million. Refer to Note 10, "Goodwill and Other Intangible Assets," for additional information.

Operating Income

Operating income during the second quarter of both 2019 and 2018 was $171 million. Operating margin was 12.7% for 2019 versus 13.0% for 2018, a decrease of 30 basis points. The decrease in operating margin was primarily due to cost inflation, increased spending on strategic investments, an increase in restructuring and realignment costs and unfavorable mix. These unfavorable impacts on operating margin were largely offset by cost reductions from our global procurement and productivity initiatives, improved price realization and favorable volume impacts.

Adjusted operating income was $192 million with an adjusted operating margin of 14.3% in 2019 as compared to adjusted operating income of $182 million with an adjusted operating margin of 13.8% in the second quarter of 2018. The increase in adjusted operating margin was primarily due to cost reductions from our global procurement and productivity initiatives, improved price realization and favorable volume impacts. These impacts were partially offset by cost inflation, increased spending on strategic investments and unfavorable mix.

Operating income for the six months ended June 30, 2019 was $280 million, reflecting a decrease of 1.4% compared to $284 million in 2018. Operating margin was 10.8% for 2019 versus 11.2% for 2018, a decrease of 40 basis points. The decrease in operating margin was primarily due to cost inflation, increased spending on strategic investments, an increase in restructuring and realignment costs, unfavorable mix and lower overhead cost absorption. These unfavorable impacts on operating margin were largely offset by cost reductions from our global procurement and productivity initiatives, improved price realization and favorable volume impacts.

Adjusted operating income was $325 million with an adjusted operating margin of 12.6% for the six months ended June 30, 2019 as compared to adjusted operating income of $317 million with an adjusted operating margin of 12.5% in 2018. The slight increase in adjusted operating margin was primarily due to cost reductions from our global procurement and productivity initiatives, improved price realization and favorable volume impacts. These impacts were partially offset by cost inflation, increased spending on strategic investments, unfavorable mix and lower overhead cost absorption.

The table below provides a reconciliation of the total and each segment's operating income to adjusted operating income, and a calculation of the corresponding adjusted operating margin:

	Three Months Ended June 30,			Six Months Ended June 30,		
(In millions)	**2019**	2018	Change	**2019**	2018	Change
Water Infrastructure						
Operating income	**$ 98**	$ 92	6.5 %	**$ 149**	$ 141	5.7 %
Operating margin	***17.5%***	*16.8%*	*70 bp*	***14.3%***	*13.7%*	*60 bp*
Restructuring and realignment costs	**9**	5	80.0 %	**18**	10	80.0 %
Adjusted operating income	**$ 107**	$ 97	10.3 %	**$ 167**	$ 151	10.6 %
Adjusted operating margin	***19.1%***	*17.8%*	*130 bp*	***16.0%***	*14.7%*	*130 bp*
Applied Water						
Operating income	**$ 62**	$ 61	1.6 %	**$ 118**	$ 111	6.3 %
Operating margin	***15.7%***	*15.7%*	*— bp*	***15.3%***	*14.7%*	*60 bp*
Restructuring and realignment costs	**4**	2	100.0 %	**7**	5	40.0 %
Adjusted operating income	**$ 66**	$ 63	4.8 %	**$ 125**	$ 116	7.8 %
Adjusted operating margin	***16.8%***	*16.2%*	*60 bp*	***16.2%***	*15.4%*	*80 bp*
Measurement & Control Solutions						
Operating income	**$ 26**	$ 31	(16.1) %	**$ 42**	$ 64	(34.4) %
Operating margin	***6.7%***	*8.1%*	*(140) bp*	***5.5%***	*8.5%*	*(300) bp*
Restructuring and realignment costs	***8***	3	166.7 %	***16***	11	45.5 %
Special charges	**—**	1	NM	***4***	3	33.3 %
Adjusted operating income	***$ 34***	$ 35	(2.9) %	***$ 62***	$ 78	(20.5) %
Adjusted operating margin	***8.7%***	*9.1%*	*(40) bp*	***8.1%***	*10.3%*	*(220) bp*
Corporate and other						
Operating loss	**$ (15)**	$ (13)	15.4 %	**$ (29)**	$ (32)	(9.4) %
Special charges	**—**	—	— %	**—**	4	NM
Adjusted operating loss	**$ (15)**	$ (13)	15.4 %	**$ (29)**	$ (28)	3.6 %
Total Xylem						
Operating income	**$ 171**	$ 171	— %	**$ 280**	$ 284	(1.4) %
Operating margin	***12.7%***	*13.0%*	*(30) bp*	***10.8%***	*11.2%*	*(40) bp*
Restructuring and realignment costs	**21**	10	110.0 %	**41**	26	57.7 %
Special charges	**—**	1	NM	**4**	7	(42.9) %
Adjusted operating income	**$ 192**	$ 182	5.5 %	**$ 325**	$ 317	2.5 %
Adjusted operating margin	***14.3%***	*13.8%*	*50 bp*	***12.6%***	*12.5%*	*10 bp*

NM - Not meaningful percentage change

Water Infrastructure

Operating income for our Water Infrastructure segment increased $6 million, or 6.5%, for the second quarter of 2019 compared to the prior year, with operating margin also increasing from 16.8% to 17.5%. Operating margin was negatively impacted by increased restructuring and realignment costs of $4 million in 2019. Excluding these restructuring and realignment costs, adjusted operating income increased $10 million, or 10.3%, with adjusted operating margin increasing from 17.8% to 19.1%. The increase in adjusted operating margin for the quarter was primarily due to cost reductions from our global procurement and productivity initiatives, price realization and favorable volume, which were partially offset by cost inflation, unfavorable mix impacts and increased spending on strategic investments.

For the six months ended June 30, 2019, operating income increased $8 million, or 5.7%, as compared to the prior year, with operating margin also increasing from 13.7% to 14.3%. Operating margin was negatively impacted by increased restructuring and realignment costs of $8 million in 2019. Excluding these restructuring and realignment costs, adjusted operating income increased $16 million, or 10.6%, with adjusted operating margin increasing from 14.7% to 16.0%. The increase in adjusted operating margin during the period was primarily due to cost reductions from our global procurement and productivity initiatives, price realization and favorable volume, which were partially offset by cost inflation, lower overhead cost absorption and increased spending on strategic investments.

Applied Water

Operating income for our Applied Water segment increased $1 million, or 1.6%, for the second quarter of 2019 compared to the prior year, with operating margin remaining flat at 15.7%. Operating margin was negatively impacted by increased restructuring and realignment costs of $2 million in 2019. Excluding these restructuring and realignment costs, adjusted operating income increased $3 million, or 4.8%, with adjusted operating margin increasing from 16.2% to 16.8%. The increase in adjusted operating margin was primarily due to improved price realization and cost reductions from our global procurement and productivity initiatives, which were partially offset by cost inflation, unfavorable mix, negative currency impacts, lower overhead cost absorption and increased spending on strategic investments.

For the six months ended June 30, 2019, operating income increased $7 million, or 6.3%, as compared to the prior year, with operating margin also increasing from 14.7% to 15.3%. Operating margin was negatively impacted by increased restructuring and realignment costs of $2 million in 2019. Excluding these restructuring and realignment costs, adjusted operating income increased $9 million, or 7.8%, with adjusted operating margin increasing from 15.4% to 16.2%. The increase in adjusted operating margin was primarily due to cost reductions from our global procurement and productivity initiatives and price realization, which were partially offset by cost inflation, negative currency impacts, lower overhead cost absorption and increased spending on strategic investments.

Measurement & Control Solutions

Operating income for our Measurement & Control Solutions segment decreased $5 million, or 16.1%, for the second quarter of 2019 compared to the prior year, with operating margin also decreasing from 8.1% to 6.7%. Operating margin was negatively impacted by increased restructuring and realignment costs of $5 million in 2019. This impact was partially offset by $1 million of special charges incurred during the quarter in 2018 that did not recur. Excluding these items, adjusted operating income decreased $1 million, or 2.9%, with adjusting operating margin decreasing from 9.1% to 8.7%. The decrease in adjusted operating margin was primarily due to increases in cost inflation, increased spending on strategic investments and unfavorable mix impacts. These impacts were partially offset by cost reductions from our global procurement and productivity initiatives, favorable volume impacts and price realization.

For the six months ended June 30, 2019, operating income decreased $22 million, or 34.4%, as compared to the prior year, with operating margin also decreasing from 8.5% to 5.5%. Operating margin was negatively impacted by increased restructuring and realignment costs of $5 million and special charges of $1 million during the period. Excluding these items, adjusted operating income decreased $16 million, or 20.5%, with adjusting operating margin decreasing from 10.3% to 8.1%. The decrease in adjusted operating margin was primarily due to increases in cost inflation, increased spending on strategic investments and unfavorable mix impacts. Purchase accounting impacts from prior year acquisitions also negatively affected operating margin. These impacts were partially offset by cost reductions from our global procurement and productivity initiatives, favorable volume impacts and price realization.

Corporate and other

Operating loss for corporate and other increased $2 million, or 15.4%, for the second quarter of 2019 compared to the prior year, primarily due to increased employee related costs. For the six months ended June 30, 2019, operating loss for corporate and other decreased $3 million, or 9.4%, compared to the same prior year period, primarily due to $4 million of special charges incurred during the quarter in 2018 that did not recur. Excluding these costs, adjusted operating loss increased $1 million, or 3.6%, compared to the prior year.

Interest Expense

Interest expense was $18 million and $36 million for the three and six months ended June 30, 2019, and $21 million and $42 million for the three and six months ended June 30, 2018. The decrease in interest expense for the both the three and six month periods ended June 30, 2019 is primarily driven by additional interest expense that was incurred during 2018 related to debt that was entered into to fund our acquisition of Pure Technologies Ltd.. See Note 13, "Credit Facilities and Debt", of our consolidated financial statements for a description of our credit facilities and long-term debt and related interest.

Income Tax Expense

The income tax provision for the three months ended June 30, 2019 was $17 million resulting in an effective tax rate of 10.5%, compared to $35 million resulting in an effective tax rate of 23.2% for the same period in 2018. The income tax provision for the six months ended June 30, 2019 was $32 million resulting in an effective tax rate of 12.8%, compared to $51 million resulting in an effective tax rate of 20.8% for the same period in 2018. The effective tax rate for the three and six month periods ended June 30, 2019 is lower than the same periods in 2018 primarily due to changes in tax law in Switzerland in 2019 offset in part by the settlement of tax examinations in 2018.

Other Comprehensive Income

Other comprehensive loss was $11 million for the three months ended June 30, 2019 compared to a loss of $87 million for the same period in 2018. Foreign currency translation contributed favorable impacts during the quarter of $42 million, driven by the strengthening of the Euro, the South African Rand, the Canadian Dollar and the Polish Zloty as compared to the U.S. Dollar in 2019 versus the weakening of these currencies in the same prior year period. Additionally, the weakening of the Great British Pound and the Chinese Yuan as compared to the U.S. Dollar was not as negative in 2019 versus the weakening of these currencies in the same prior year period. These favorable currency translation impacts were partially offset by the negative movement in our Euro net investment hedges during the quarter. In addition to net favorable foreign currency translation impacts, the tax impact on the movement in the net investment hedges as compared to the prior year of $23 million also contributed to the increase in other comprehensive income during the quarter. Changes in the impact of derivative instruments also contributed to the decrease in other comprehensive in the quarter.

For the six months ended June 30, 2019, other comprehensive income was $9 million compared to a loss of $67 million for the same period in 2018. Foreign currency translation contributed favorable impacts during the period of $63 million, driven by the strengthening of the Euro, the Canadian Dollar, the Great British Pound and the South African Rand as compared to the U.S. Dollar in 2019 versus the weakening of these currencies in the same prior year period. These favorable impacts were partially offset by the negative movement in our Euro net investment hedges during the period. In addition to net favorable foreign currency translation impacts, the tax impact on the movement in the net investment hedges as compared to the prior year of $9 million also contributed to the increase in other comprehensive income during the period.

Liquidity and Capital Resources

The following table summarizes our sources and (uses) of cash:

	Six Months Ended June 30,		
(In millions)	**2019**	2018	Change
Operating activities	**$ 206**	$ 201	$ 5
Investing activities	**(146)**	(537)	391
Financing activities	**25**	252	(227)
Foreign exchange (a)	**2**	(9)	11
Total	**$ 87**	$ (93)	$ 180

(a) The impact is primarily due to the strengthening of the Chinese Yuan, the Indian Rupee,the Canadian Dollar and various other currencies against the U.S. Dollar.

Sources and Uses of Liquidity

Operating Activities

During the six months ended June 30, 2019, net cash provided by operating activities was $206 million, an increase of $5 million as compared to the same prior year period. This increase was primarily driven by increased cash from earnings during the period, largely offset by an increase in cash paid for taxes in the period, primarily driven by the utilization of tax credit carryforwards in the prior year that did not repeat in 2019.

Investing Activities

Cash used in investing activities was $146 million for the six months ended June 30, 2019 as compared to $537 million in the comparable prior year period. This decrease was mainly driven by the $430 million spent on 2018 acquisitions, primarily for the acquisition of Pure Technologies Ltd., versus the $18 million spent for acquisition activity during the current year period. This decrease is partially offset by an $18 million increase related to the timing of capital spending on additional plant improvements, including the purchase of a building, and new software tools.

Financing Activities

Cash generated by financing activities was $25 million for the six months ended June 30, 2019 as compared to cash generated of $252 million in the comparable prior year period. The decrease in cash generated by financing activities during the period was primarily due to higher levels of short-term debt related to acquisition financing during the first quarter of 2018 and an increase in dividends paid of $11 million during the period as compared to the prior year. These drivers were partially offset by a decrease in share repurchase activity of $19 million.

Funding and Liquidity Strategy

Our ability to fund our capital needs depends on our ongoing ability to generate cash from operations, and access to bank financing and the capital markets. Historically, we have generated operating cash flow sufficient to fund our primary cash needs centered on operating activities, working capital, capital expenditures, strategic investments and dividend payments. If our cash flows from operations are less than we expect, we may need to incur debt or issue equity. From time to time, we may need to access the long-term and short-term capital markets to obtain financing. Our access to, and the availability of, financing on acceptable terms and conditions in the future will be impacted by many factors, including: (i) our credit ratings or absence of a credit rating, (ii) the liquidity of the overall capital markets, and (iii) the current state of the economy. There can be no assurance that such financing will be available to us on acceptable terms or that such financing will be available at all.

We monitor our global funding requirements and seek to meet our liquidity needs on a cost effective basis. Based on our current global cash positions, cash flows from operations and access to the commercial paper markets, we believe there is sufficient liquidity to meet our funding requirements. In addition, our newly expanded committed credit facilities and access to the public debt markets would provide further liquidity if required.

We anticipate that our present sources of funds, including funds from operations and additional borrowings, will provide us with sufficient liquidity and capital resources to meet our liquidity and capital needs both inside and outside of the United States over the next twelve months.

Credit Facilities & Long-Term Contractual Commitments

See Note 13, "Credit Facilities and Debt", of our consolidated financial statements for a description of our credit facilities and long-term debt.

Non-United States Operations

We generated approximately 50% and 50% of our revenue from non-United States operations for the three and six months ended June 30, 2019 and 54% and 55% for the three and six months ended June 30, 2018, respectively. As we continue to grow our operations in the emerging markets and elsewhere outside of the United States, we expect to continue to generate significant revenue from non-United States operations and we expect a substantial portion of our cash will be predominately held by our foreign subsidiaries. We expect to manage our worldwide cash requirements considering available funds among the many subsidiaries through which we conduct business and the cost effectiveness with which those funds can be accessed. We may transfer cash from certain international subsidiaries to the United States and other international subsidiaries when we believe it is cost effective to do so. We continually review our domestic and foreign cash profile, expected future cash generation and investment opportunities, and reassess whether there is a demonstrated need to repatriate funds held internationally to support our United States operations. As of June 30, 2019, we have provided a deferred tax liability of $11 million for foreign withholding taxes and state income taxes on $530 million expected to be repatriated to the United States parent as deemed necessary. Repatriation is not expected to have a material impact on liquidity. As of June 30, 2019, our foreign subsidiaries were holding $301 million in cash or marketable securities.

Critical Accounting Estimates

Our discussion and analysis of our results of operations and capital resources are based on our condensed consolidated financial statements, which have been prepared in conformity with GAAP. The preparation of these condensed consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses and the disclosure of contingent assets and liabilities. We believe the most complex and sensitive judgments, because of their significance to the condensed consolidated financial statements, result primarily from the need to make estimates about the effects of matters that are inherently uncertain. Management’s Discussion and Analysis of Financial Condition and Results of Operations in the 2018 Annual Report describes the critical accounting estimates used in preparation of the condensed consolidated financial statements. Actual results in these areas could differ from management’s estimates. There have been no significant changes in the information concerning our critical accounting estimates as stated in our 2018 Annual Report.

New Accounting Pronouncements

See Note 2, "Recently Issued Accounting Pronouncements," to the condensed consolidated financial statements for a complete discussion of recent accounting pronouncements. We are currently evaluating the impact of certain recently issued guidance on our financial condition and results of operations in future periods.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Effective July 1, 2018, Argentina was determined to be a highly inflationary economy, and as such we evaluated the impact of revaluing our monetary assets and liabilities under the applicable guidance and do not expect it to have a material impact.

There has been no other material change in the information concerning market risk as stated in our 2018 Annual Report.

ITEM 4. CONTROLS AND PROCEDURES

Our management, with the Chief Executive Officer and Chief Financial Officer of the Company, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this quarterly report. Any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. Based on such evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were effective at the reasonable assurance level.

In 2017, the Company undertook steps to advance a multi-year effort to transform many of our support functions and related technologies, including Finance, Human Resources and Procurement. In connection with these restructuring and transformation plans, we continue to centralize certain accounting functions within shared service centers operated by an outsourced provider. This initiative is not in response to any identified deficiency or weakness in the Company's internal control over financial reporting. In response to this initiative, the Company has and will continue to align and streamline the design and operation of its financial control environment.

Other than as described in the preceding paragraph, there have been no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the 1934 Act) during the fiscal quarter covered by this quarterly report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II

ITEM 1. LEGAL PROCEEDINGS

From time to time we are involved in legal and regulatory proceedings that are incidental to the operation of our businesses (or the business operations of previously owned entities). These proceedings may seek remedies relating to environmental matters, tax, intellectual property matters, acquisitions or divestitures, product liability and personal injury claims, privacy, employment, labor and pension matters, government contract issues and commercial or contractual disputes. See Note 19. "Commitments and Contingencies", to the condensed consolidated financial statements for further information and any updates.

ITEM 1A. RISK FACTORS

There have been no material changes from the risk factors previously disclosed in our 2018 Annual Report on Form 10-K under Item 1A. Risk Factors.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table presents information with respect to purchases of the Company's common stock by the Company during the three months ended June 30, 2019:

(IN MILLIONS, EXCEPT PER SHARE AMOUNTS) PERIOD	TOTAL NUMBER OF SHARES PURCHASED	AVERAGE PRICE PAID PER SHARE (a)	TOTAL NUMBER OF SHARES PURCHASED AS PART OF PUBLICLY ANNOUNCED PLANS OR PROGRAMS (b)	APPROXIMATE DOLLAR VALUE OF SHARES THAT MAY YET BE PURCHASED UNDER THE PLANS OR PROGRAMS (b)
4/1/19 - 4/30/19	—	—	—	**$338**
5/1/19 - 5/31/19	—	—	—	**$338**
6/1/19 - 6/30/19	—	—	—	**$338**

This table does not include shares tendered to satisfy the exercise price in connection with cashless exercises of employee stock options or shares tendered to satisfy tax withholding obligations in connection with employee equity awards.

(a) Average price paid per share is calculated on a settlement basis.

(b) On August 24, 2015, our Board of Directors authorized the repurchase of up to $500 million in shares with no expiration date. The program's objective is to deploy our capital in a manner that benefits our shareholders and maintains our focus on growth. There were no shares repurchased under this program during the three months ended June 30, 2019. There are up to $338 million in shares that may still be purchased under this plan as of June 30, 2019.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

See the Exhibit Index for a list of exhibits filed as part of this report and incorporated herein by reference.

XYLEM INC.

EXHIBIT INDEX

Exhibit Number	Description	Location
3.1	Fourth Amended and Restated Articles of Incorporation of Xylem Inc.	Incorporated by reference to Exhibit 3.1 of Xylem Inc.'s Form 8-K filed on May 15, 2017 (CIK No. 1524472, File No. 1-35229).
3.2	Fourth Amended and Restated By-laws of Xylem Inc.	Incorporated by reference to Exhibit 3.2 of Xylem Inc.'s Form 8-K filed on May 15, 2017 (CIK No. 1524472, File No. 1-35229).
31.1	Certification pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Filed herewith.
31.2	Certification pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Filed herewith.
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	This Exhibit is intended to be furnished in accordance with Regulation S-K Item 601(b) (32) (ii) and shall not be deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934 or incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except as shall be expressly set forth by specific reference.
32.2	Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	This Exhibit is intended to be furnished in accordance with Regulation S-K Item 601(b) (32) (ii) and shall not be deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934 or incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except as shall be expressly set forth by specific reference.
101.0	The following materials from Xylem Inc.'s Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2019, formatted in XBRL (Extensible Business Reporting Language): (i) Condensed Consolidated Income Statements, (ii) Condensed Consolidated Statements of Comprehensive Income, (iii) Condensed Consolidated Balance Sheets, (iv) Condensed Consolidated Statements of Cash Flows and (v) Notes to Condensed Consolidated Financial Statements	The instance document does not appear in the interactive data file because its XBRL tags are embedded within the Inline XBRL document.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

XYLEM INC.
(Registrant)

/s/ Geri McShane

Geri McShane

Vice President, Controller and Chief Accounting Officer

August 1, 2019

EXHIBIT 31.1

CERTIFICATION PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Patrick K. Decker, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Xylem Inc. for the period ended June 30, 2019;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
   a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
   a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 1, 2019

/s/ Patrick K. Decker

Patrick K. Decker

President and Chief Executive Officer

EXHIBIT 31.2

CERTIFICATION PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, E. Mark Rajkowski, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Xylem Inc. for the period ended June 30, 2019;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
    a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
    b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
    c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
    d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
    a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
    b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 1, 2019

/s/ E. Mark Rajkowski

E. Mark Rajkowski

Senior Vice President and Chief Financial Officer

EXHIBIT 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q of Xylem Inc. (the “Company”) for the period ended June 30, 2019 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Patrick K. Decker, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to 906 of the Sarbanes-Oxley Act of 2002, to my knowledge, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Patrick K. Decker

Patrick K. Decker
President and Chief Executive Officer
August 1, 2019

A signed original of this written statement required by Section 906 has been provided to Xylem Inc. and will be retained by Xylem Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

EXHIBIT 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q of Xylem Inc. (the “Company”) for the period ended June 30, 2019 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, E. Mark Rajkowski, Senior Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to 906 of the Sarbanes-Oxley Act of 2002, to my knowledge, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ E. Mark Rajkowski

E. Mark Rajkowski

Senior Vice President and Chief Financial Officer

August 1, 2019

A signed original of this written statement required by Section 906 has been provided to Xylem Inc. and will be retained by Xylem Inc. and furnished to the Securities and Exchange Commission or its staff upon request.