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EDITED TRANSCRIPT

XYL - Xylem 2017 Investor and Analyst Day

EVENT DATE/TIME: APRIL 04, 2017 / 1:00PM GMT

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PRESENTATION

Matt Latino

Good morning, everybody. Welcome to Xylem's 2017 Xylem Investor Day. For those of us here, thank you for making the trip to Raleigh-Durham. For those joining via webcast, thank you for taking the time and interest in the company.

As I look out today, I see a lot of familiar faces, investors and analysts, but also many newcomers to our story. The turnout today is certainly a testament to the growing interest in our story, especially with the addition of Sensus. I know I speak for our team when I say we're excited to be able to share it with you today.

I'm confident today's presentation will give you a better understanding of our business, an update of our strategy from last Investor Day and a more thorough appreciation of the Sensus business. With that said, let me take a minute to highlight today's agenda. We are going to have a series of speakers, beginning with our President and CEO, Patrick Decker. He will provide you with an update on our business. Following you will hear from Jay Iyengar, our Chief Innovation and Technology Officer; and Tony Milando, our Leader of Continuous Improvement. They will provide a deeper perspective in 2 critical strategic areas. Mark Rajkowski, our Chief Financial Officer, will then provide an update to our 2020 long-term financial objectives. Following his remarks, we'll host the first of 2 Q&A sessions.

In order to keep the program on time, we'll plan to run the first session about 20 minutes. Given that we do have people on the webcast, we're going to ask that you please wait for the microphone to be delivered to you and state your name and affiliation. We'll then take a short break, and the second portion of our presentation will begin with a fireside chat between Patrick and Dave Stanton, President of Suez North America Utilities and a longtime customer of ours.

Following their discussion, we will hear from some of our Sensus leaders, including Randy Bays, President of Sensus; Dale Harber, Executive Vice President of Marketing and International Programs; and Brian Crow, Vice President of Data Analytics and Software Solutions. Then we'll wrap up with some closing comments from Patrick and a second Q&A session.

We'll conclude this session and the webcast portion of today's Investor Day at approximately 12:15, and those in Raleigh-Durham will have an interactive facility tour with demos.

Please take note of the forward-looking statements on Slide 3. We will make some forward-looking statements today, including references to future events or developments that we anticipate will or may occur in the future. I would also draw your attention to some key items for the remainder of the presentations, which relate to our 2017 full year expected results, long-term targets, market growth estimates and financial performance metrics.

With that out of the way, I'll ask everyone to please turn their phones to silent mode and please help me welcome to the podium Xylem's President and Chief Executive Officer, Patrick Decker.

Patrick K. Decker - *Xylem Inc. - CEO, President and Director*

So good morning, everybody, and welcome to Raleigh-Durham. I appreciate you guys taking the time to make the trip down here. We are in the home of our new men's basketball college championships. Having said that, having been here at Sensus a number of times in the Raleigh-Durham area, I've learned a long time ago that don't assume that everybody here is a Tar Heel fan. So there is probably half the people here in Raleigh-Durham that are actually upset right now with victory, but again, nevertheless, thanks for coming down.

Certainly hope that you'll find that this is time well spent as you get to better understand our strategies going forward, but also what Sensus brings to the table for us. Obviously, we've been busy in 2016. And with the acquisition of Sensus and Visenti, that really is why we wanted to invite you here so you can see it firsthand and really understand the power of this combination.

Looking back over the course of the last year, we've clearly created a significant amount of shareholder value. But a key takeaway here for you today is that we are still very much in the early innings of what we see as a long-term run here to creating even more significant value for our shareholders.

We are joined here today by my entire senior leadership team, which are in the back of the room. As we mentioned earlier, I will be giving you an update on our overall strategies. I will then be joined by a number of our leadership team members to walk through key elements of this strategy. We also are being joined and I'm thrilled to have David Stanton here. And many of you who know David, know that he is going to be a terrific set of insights on the water sector and certainly, the power of technology and data and how it can further shape the future of that industry. And last, but by no means least, we are joined here today by our Chairman of the Board, Markos Tambakeras. Markos is sitting in the back of the room here, and he will be -- he will be here through the lunch session. And so I would encourage any of you to reach out to him with any questions, get to know him, and it's terrific to have him here on board.

So with that, why don't we go ahead and get started. So when you look at the strategy that we laid out for investors back in September of 2015, I feel very good about our progress against that journey. Now with any long-term strategy, as you all well know, there are always going to be a series of puts and takes, but I think that we've made good progress on that very powerful investment thesis that we laid out 18 months ago. And I do really believe that our team has begun to deliver on that promise. While certainly, the feature here today is the acquisition of Sensus and Visenti, we've made a lot of good progress in optimizing our core business, whether that be launching exciting new products, whether that be driving productivity for growth initiatives as well as driving ahead of pace margin expansion since September of '15. And again, we completed 4 acquisitions since that last Investor Day, all of which have been in the area of smart water infrastructure. And at the end of the day, those acquisitions that actually even further strengthen our financial profile and our ability to continue to do smart capital deployment and smart M&A over time.

I want to give you a refreshed look at Xylem and who we are now post the addition of Sensus to the portfolio. You'll see here that we are now just past our fifth-year anniversary of having spun out of ITT. There's been a lot that's happened over that 5-year time frame. We are operating in about 80 countries around the world. We now have about 16,000 colleagues as part of our team. Pro forma revenue in 2016 on a combined basis was about $4.5 billion, EBITDA margins of 18.4% and operating margins of just under 14%. And I would also say that what Sensus has also done is has even made more attractive the level of recurring revenue that we have in our portfolio. Historically, it was 40%. Sensus' recurring revenue is far north of that. And so on a blended basis, we give an even more stable focus on our portfolio.

As I mentioned, our senior leadership team is here today in full force, and I look forward to you having a chance to engage with them on the breaks and also on the tours. We really have put together, I think, a very diverse leadership team. They've got a very rich set of experiences from different industries. It's a nice blend of tenure from ITT Xylem, but also adding a number of new faces here over the course of the last 3 years. It really has been this team and our 16,000 colleagues around the world that have really propelled us forward in executing on that long-term strategy that we laid out. Our focus right now is very much on continuing to build an even deeper bench across the organization focusing really on sustainable enterprise over time.

So our vision as a team, because it takes more than one person, is that we will become the distinctive market leader in the water sector. And what does that mean? How does it manifest itself? First of all, we will have and continue to build industry-leading product and technology portfolios that are really focusing in on bringing leading-edge technology and value-added solutions to our customers. With the move to smart infrastructure, Xylem will be the company that leads that transition of the water industry to smart infrastructure. But I want to be clear, and I get this question on a regular basis, commitment to electric and gas. We are fully committed to the electric and gas utility businesses that we brought with -- from Sensus. That actually is going to be a great adjacency for us as we help cities around the world build smart infrastructure to support the needs that I'll talk about here in a moment. This vision requires that we really build a sustainable high-performance culture, one that is focused on speed, decisiveness, but also constantly learning and constantly improving. It also requires us to act more like one company rather than the collection of businesses that spun out of ITT 5 years ago. And that's a big theme of ours as a leadership team.

To be recognized as the thought leader matters because we expect to be the go-to source as we are shaping the thoughts of the water sector, but also more broadly, smart infrastructure, and that we are the ones that lead that charge. And we cannot do it alone.

Embedded in that vision for the company is making sure that we build an enterprise that is sustainable for the long run. I have no desire to have come to Xylem, build something really special and really impressive, only to see it was not sustainable over time. I want my legacy and our team's legacy to be that we really build a sustainable, successful market-leading enterprise.

So I've laid out here some key elements of how do we go about doing that. It starts first with our people. There is a huge correlation that you all probably know between employee engagement over time and the safety performance of an organization. Because safety is where management puts their money where their mouths are, and our time where our mouths are. 3 years ago, when I came on board, we staked a claim that safety was going to be one of our top operating imperatives, and I'm very pleased with the performance that we've had over that time frame.

We've also put some big objectives out there in terms of behaving like better corporate citizens in terms of our own environmental footprint. So we laid out objectives that we were going to reduce our water consumption, our greenhouse gas emissions as well as our waste generation. And I'm pleased to say that we reduced our greenhouse gas emissions this past year by 15% and we reduced our water consumption by 11%. So we're on good path here to move forward. Collaboration is key in the water sector. No one company can go it alone. And so the investments of time and money that we put behind thought leadership and getting involved in things like the bipartisan council on infrastructure, whether it be the business roundtable, whether it be the Value of Water Coalition, we've put a lot of time and effort into helping build those enterprises so we can help shape the thoughts of the industry.

And lastly, you get nowhere without employee engagement. And we've got a tremendously powerful program called Watermark that is really unique to our company and has gone a great long way in engaging our employees to realize there is something bigger here than necessarily just to making the number in the quarter, but how you really focus on building something strong that lasts for a lifetime.

Very brief update on segment structure. We've got 3 segments. You will notice in our press release today that we did announce that we will be combining our Xylem Analytics business along with Visenti into Sensus that will be putting together like-minded businesses that are focusing in on bringing advance sensing technology to help fuel the industry's move to smart infrastructure. There is a lot of commonalities between those businesses and certainly, Randy will talk more about that later this morning.

Otherwise, our Water Infrastructure business is really predominantly focused on wastewater, while our Applied Water business is focused predominantly on clean water distribution in the commercial building and industrial space.

So while -- you will hear people talk about air pockets in the industry and there will be bumps in the road in terms of end market demand, the bottom line is when you think back to this slide that I showed you at Investor Day 1.5 years ago, little has changed in terms of the large macro trends that are shaping the world's view on infrastructure. First the policy environment is increasingly focused on water and smart infrastructure, which includes electric and gas utilities. The World Economic Forum has ranked water as one of the top 10 global crises for the last 3 years running. It's estimated over the next several decades that 2.5 billion or more people are going to be migrating to the major cities around the world. 70% of new infrastructure to be built will be built in emerging markets. But this is not limited to any one locale. Flint, Michigan, is a stark reminder of what happens when water infrastructure is neglected. And so these issues and challenges are spread around the world, and we are the company that has the technology and the wherewithal to really help lead these prominent solutions.

You may also recall from our last Investor Day, we talked about 3 major themes that drive the need for technology in the water sector, and this also applies across broader electric and gas utility infrastructure. We refer to it as our PQR framework. So productivity is really about the efficient management of water and wastewater across the network. Water management is inherently inefficient from an energy standpoint. Few people realize that one of the biggest contributors to greenhouse gas emissions around the world is actually water management. And the technologies already exist today to abate those emissions by up to half at a negative or neutral cost. They simply need to be adopted and put in place. Water quality speaks for itself. Resilience is really about how do we help our broad set of customers, not just what utilities, but all of our customers build more robust and resilient infrastructure to withstand the impacts of extreme weather events and climate change. And that certainly is fueling larger investments and spend, especially along coastal seaboards.

Now I want to shift gears and take you back to, you may recall, the road map for value creation that I laid out back at the last Investor Day. And there were 5 elements of that. And I'm not going to spend much time on this slide, you will be able to take it away with you. But this is a brief scorecard on how we performed against those commitments that we laid out. And you will notice that we are openly acknowledging that the one that is yellow is arguably one of the most important, and that's growth. So I'm going to spend the next 5 to 10 minutes talking about what I personally and what we as a team are doing to focus on accelerating that profitable growth here in the immediate and medium term. But before I go there, very pleased with what we've done in continuous improvement, margin expansion, productivity for growth, investments we made for growth. Tony Milando is going to cover that in more depth here in a moment. We've done a lot obviously in the M&A area. We've been very busy. We've deployed $1.8 billion of capital over the past year in M&A. And probably even better news is not just the attractiveness of the assets that we've acquired and the synergies there, but as Mark will walk through later, what they do to also refueling our cash arsenal over the next few years to continue to do really smart big capital deployment, I think is a movement forward from where we were in September of '15. And then lastly, I think we've done a pretty good job of returning capital to shareholders. We've increased our dividend here most recently. We'll continue to grow that in line with our EPS growth over time.

So let me shift gears now to arguably one of the most important topics of the day, and that is growth. You will recall that I laid out 4 pillars to accelerating profitable growth 1.5 year ago. It was what we're doing to drive commercial leadership, emerging markets, the role of M&A and the role of innovation and technology.

On the commercial leadership element, there are a few things that I want to spend a couple of minutes on here. The first 2 are organizational moves. And these organizational moves are very much with the view towards the tip of the spear being driving faster top line growth.

The first was what I mentioned earlier, and that's the combination of Sensus Analytics and Visenti. And Randy Bays and Colin Sabol are going to be working together to make sure that we rapidly put together an optimized business unit there that really leverages the strength of both, and there are tremendous strengths. You will see those on the tour. You will hear Randy talk about those later this morning. But we think this is going to be a really powerful offering to our customers, and it's something through voice of customer they have been asking us to accelerate because of the power they see in the combination there.

The second is, those of you that are familiar with the story know that over the last few years, we have integrated the commercial teams in Europe, in our emerging markets, and the idea there is to put sales teams under common leadership, organize them around what we call industry verticals, otherwise simply known as common customer sets, and give them access to the full portfolio of products and solutions that are relevant to that customer. Two, making it easier for customers to do business with us. So they have one point of contact to go to as opposed to a dozen. And we've seen in Europe and emerging markets a real benefit in terms of top line growth from organizing in that fashion. North America is where we are now doing that effective in Q2. It's our largest geography. And this will now take our Transport, Treatment, Dewatering businesses along with our Applied Water businesses, and have those under common commercial leadership and that's going to be led by Ken Napolitano, along with leading the Applied Water business globally.

Lastly, you're going to hear from Randy talk about how that -- the customer is at the center of everything as it relates to Sensus. And that's been a real demarcation point for the Sensus team. The same is happening here within the historical Xylem businesses. We have been slow to react very much like other industry players. We have created distractions over the years of our salespeople, and we did not even have baseline metrics that would measure the voice of customer, like Net Promoter Score, or be able to gauge the morale of our sales teams through things like sales force barometer. So these are tools that we've rolled out this past year. We have baseline set, and the whole idea here is to make it easier to really get the voice of our customers and our sales teams, and where do we need to be focusing to make it easier for them to get more time in selling rather than administrative work.

I want to shift next to emerging markets. I am always fascinated about emerging markets. The short attention span that many investors oftentimes have around emerging markets, and it kind of comes and goes every couple of 3 years. We're taking a long view on emerging markets, okay? I said earlier, 70% of new infrastructure is being built and going to be built over the next few decades in emerging markets. So we need to be there. We are focused on these countries. You'll recall 1.5 years ago, that I'd said when I first joined Xylem, it was not as if we didn't have a good presence in emerging markets, but we were in dozens of them and we weren't focused on the ones in my view that really mattered the most. And so we had talked about at that time, China and Middle East were our top 2 priorities. I would say, what's changed here now is India has certainly entered the fold for us for reasons that I'll mention here in a moment.

In China, water is a top policy mandate of the central government, and we continued over the course of the last year to see money flowing into that sector. 2/3 of our revenue in China is tied to Water Infrastructure. And our overall order growth rate in 2016, which was great momentum for this year, was up 19%. So we are seeing a full-on recovery in China based upon this top policy mandate for the government. And we've continued to increase our localization of product and offerings there and we've expanded our supply chain there over the last year.

Middle East, no doubt disappointing right now. It's obviously being impacted by prolonged decline in oil prices and the revenues associated with that for governments. But we are still bulls to the long run on the Middle East based on the obvious, the lack of access to water, water scarcity is a huge issue there. We opened our greenfield manufacturing and R&D facility there just recently and feel good about the progress we've got in front of us.

India, this is really all about supporting Prime Minister Modi's efforts around smart cities as well as the Ganges and other river cleanup efforts. We've won $80 million in big projects there over the course of the last 18 months. The lion's share of that is still in front of us. So the $55 million belies the size of the business and the opportunity there. And we are using those projects to build out our local sales, supply chain and R&D capability to really make this sustainable over the long run, because India certainly is a very bright spot for us for years to come.

Jay is going to really hit this hard in her section around what we're doing to invest in innovation technology with a view not towards innovation for the sake of innovation, but innovation that customers are going to pay for. So I just want to leave you with a couple of points here. First is, that we are clearly evolving Xylem from a traditional industrial company into more of a technology company serving the industrial market. You can see that by way of the size of the investment that we are making in R&D relative to what we have committed to 1.5 year ago. But also, I would point out that we are very much focusing on building an open innovation ecosystem. There are so many players that are out there in the water sector that need to be able to collaborate with someone that has size and scale. And we expect to be one of those companies that people can partner with and really kind of fail fast, learn quickly and bring new technologies to market, and a proof point of that is Visenti, which you will hear more about this morning, which very much is down this path.

So on the M&A side. Since Investor Day, we've done 4 deals, all of which were in the smart infrastructure space. Clearly, the acquisition of Sensus, bringing them to the portfolio with Visenti is a game changer for us. And I want to be clear here that as important as M&A is for us going forward, we are laser-focused on integrating successfully Sensus and Visenti, make sure we realize the full value of those opportunities. Sensus is going to serve as a really strong platform for attractive bolt-on acquisitions, both by way of the valuation we got it for, but more importantly by their technical capabilities and their channels to market. But at the same time, we are not limited to focusing on smart infrastructure. As I said at our last Investor Day, we are also looking at industrial water treatment, we're looking at industrial services, and we would not rule out acquisitions in those space. But we will maintain the same disciplined approach towards M&A that we demonstrated since I have been here over the last 3 years.

Now the prioritization of smart infrastructure is what really led to bringing Sensus and Visenti into the portfolio. This truly is a game changer for us. It's a game changer for the industry. I'll let you be the judge of that after you sit through this morning and you see the technologies. But I am very, very excited about the opportunity here. And this is a great example of where, you've heard me say before, M&A can serve as a very effective proxy for R&D in an industry where IP is so fragmented. And so there are times that you need to go out and acquire that, and certainly, this move forward here advances significantly the work we were otherwise focusing on building out our own remote monitoring and control capability of the wastewater and outdoor water space. We've now leapfrogged that by bringing Sensus and Visenti into the portfolio.

A byproduct of that was one of the attractive things about Sensus as well was their heavy focus on public utilities, which is a very attractive continued growth industry and will be for years to come. Prior to the acquisition, about 1/3 of the Xylem revenue was in public utilities, water utilities. Virtually all of Sensus' revenue is tied to public utility. And so we're changing our profile now to where roughly half of our revenue will be in the attractive public utility space.

A second effect of this is geographic exposure. We now with Sensus have a better balance in my view, a larger exposure to the attractive U.S. economy, and for reasons that Mark will explain later, it also helps us with our overall cash profile in terms of domestic cash versus overseas cash. So there were a number of other positives that come from this that I think are going to serve to help create faster market growth exposure than we have in the past.

So this is a slide that we all get very excited about. And I'm not going to belabor it here, or perhaps I will a little bit. There are really 3 big areas that we have identified through our work during the diligence phase prior to the acquisition that really I think are the big money slides here. So first of all, Sensus has more than 20 large multiyear long-term deals that they've been pursuing at various stages of development. And these are long lead times. They are across water, gas and electric, but there are several of them that are with water utilities that are currently Xylem customers with who we have very strong relationships. And so there's nothing but positive that comes out of that kind of combination between the 2 companies. There is never any guarantees in life. It's a big pipeline, about $3.5 billion worth of deal revenue that was spent over a decade, and we are very confident that we are going to be successful on at least some of those deals going forward here.

The wastewater and outdoor water space. This is an area where despite Sensus' exposure to the water sector, it didn't really have a presence in the wastewater and outdoor water space. That's where Xylem is strongest in terms of our recognition with customers. Secondly, we did voice of customer work, and I want to give 2 testimonials to the power of this. One is a very large customer that we have in common in Florida. And their comment was, if we were -- we already have an investment in the FlexNet communication platform of Sensus that you'll hear more about here this morning. If only we were able to connect our instrumentation that's out testing water quality in lakes, reservoirs, rivers, dams, streams, we could reduce our labor costs and truck rolls by being able to draw that data remotely. That's one opportunity. Two, another large customer in California. Again, we already have an investment in FlexNet and telecommunication and the data analytics platform. We’ve wanted to actually extend that across our wastewater network so we can pull data off the wastewater network, but we would have had to get 2 companies to work together in the past to deal with that, we don't have time for that. So now we've got a player that can come in and hopefully advance that on a rapid basis. Now I will say, we are taking a rapid prototype approach similar to what Sensus historically has done. These have lead times. This doesn’t turn to revenue in a quarter or 2. There is real hardcore technical engineering work that has to happen and the specs are written to a customer level. And so it will take some time, but you do see here on the bottom of the slide, where we see things ramping over time in terms of our revenue synergy ranges.

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The third area is just get on with it, lead sharing. So for example, in Europe, Xylem as you all know, have very strong distribution channels across Europe. Sensus has strong channels, but there are opportunities for us to share leads or cross-sell meters as well as pumps and others to our own channel partners that are there. The same exists here in North America, and again, Randy will talk a little bit more about that later in the morning.

As a result of all of that, I'm happy to say, when we announced the deal, I had said that I would be disappointed if we did not have at least $100 million of revenue synergies by the third year. And what we're saying here today is that we would expect that to be at least $50 million to $75 million more than what we had originally laid out at the time we announced the deal.

A lot of words on this slide. But the point of this slide is to say, we do believe that we've got some very unique elements of our business model and our capabilities that allow us to win in the marketplace and maintain market leadership. I could have put this slide up 18 months ago at Investor Day, and it would have looked largely the same, except for the fact that adding Sensus and Xylem to the portfolio has only strengthened what this business model can be as a real differentiator for us to win. I would say one of the most powerful things is how sticky our collective relationships are with big customers, and across the board, they oftentimes see us as an extension of their own organization. And they are focused on long-term high-quality, high-value relationships with companies they trust. And as you hear Randy talk later this morning about the demarcation when he joined in Sensus around quality issues and other areas, that has only further deepened that trust with customers and these utilities.

So here's the money slide. And Mark is going to go through this in more depth later this morning. So originally, we had called for 3% to 5% organic growth, we've taken that up by a point. Mark will explain the dynamics here as to what's going on behind that 1 point increase on both the bottom end and the top end of the range. We're also adding a further 100 basis points to both the bottom and the top end of our margin expansion expectations. And we're also now saying that because of increased productivity, better growth and, again, continued focus on cost synergies and other Lean Six Sigma expansion, we expect now for our core EPS growth, this is before deployment of capital, core EPS growth to go from 8% to 12% now to the mid-teens. We think this is a very compelling investment proposition, and we're very confident about the ability to deliver on this. And of course, as we said last time, EPS growth will only be further accelerated by smart capital deployment in what we believe to be the high teens from an EPS growth perspective.

So wrapping up my section here. You may recall this slide. It's the same powerful investment thesis that we laid out at our last Investor Day. I would say it's only gotten stronger. It's gotten stronger because we do have, I believe, a more favorable end market exposure in this new portfolio. We are clearly making strides that you will see, adding significant strides in innovation, not just through M&A, but organically that Jay will take you through. Very healthy runway for further margin expansion. And so as I opened, I would leave you with the fact that at the end of the day, while we've generated a lot of value in the past year, we are still very much in the early innings on this story. And hopefully, you'll be compelled and excited after what you hear later this morning.

So with that, I now am going to introduce Jay Iyengar. Jay has been with us now for about 1.5 years. She has been a terrific addition to the team. When she first got here, she joined right before our last Investor Day. And she has been very, very busy with our teams internally with the acquisitions, to really focus in on how do we enable strategy and growth through innovation technology, not innovation or technology for the sake of innovation and technology, and how that turns into organic growth.

So with that, Jay, welcome to the stage.

Jayanthi Iyengar - *Xylem Inc. - Chief Innovation & Technology Officer and SVP*

Thank you, Patrick.

(technical difficulty)

elements of both aerospace and automotive. Exciting times at Xylem. We are on a great journey. A lot of opportunity for us to really drive organic growth through innovation. So let's get started. So we have a long history of innovation. Innovation is really not new to Xylem, right? Many of our businesses were built on transformative technologies, built on the foundation of technology itself. And what we're doing now is elevate

(technical difficulty)

Starting with the top left. It always starts with the customer, right? Due to our intimacy with the customer and the fact that we're working very closely with them, we understand -- we have insights into some of the challenges that they face. And we are targeting our technologies to address some of those challenges they are talking about.

As you know, this is a conservative industry for a very good reason. So in the best way and the most effective way to deploy technology is to do early partnerships. Patrick talked about that earlier, Sensus is very, very good at doing this. And given the trust that the customers have, they are engaging with us very early on in some of these co-developments, really to create proof points to prove out technologies so that it can have a much broader impact and that we can deploy it much further.

So second is, as I mentioned, we're changing the way we are focusing on disruptive technology and new business models. This approach includes allocating the amount of investments, not just the money, money and also resources. Creating a framework where the teams have the flexibility to go prove some things out, which is a bit risky because we are not exactly sure of the outcome, but still we are actually very focused on doing those because of the high growth potential that comes from there.

Third is, the best way to speed this up is to have an open innovation model. We have a eco -- what we call the ecosystem of partners that I'll share in a moment. We are leveraging their strengths, we don't have to do everything ourselves, leveraging their strengths, we just need to know when to connect the dots and really speed up the way we bring innovation into the market.

And last but not least, it's all about how we optimize R&D spent in all areas, starting with a one-company mind-set, looking at the right product portfolio. Global engineering -- leveraging the global engineering capabilities and consolidating as appropriate. So in the next few minutes, I'm going to go through some details on each one of these steps in our innovation roadmap.

So let's just talk about what matters most to our customers, and hopefully when David Stanton comes up on stage, he will elaborate some of these things. But -- so let's -- public utility is our largest customer base, the #1 thing that they worry about is really they cannot afford to have any equipment failure. The failure has got an enormous public safety potential. So that's going to be a #1 on their minds. Slightly for -- right behind that is really the operational efficiency. If you look at a energy consumption of a treatment plant, it's about 30% of their annual revenue goes towards paying the energy bills. On top of it, maintaining and repairing an aged infrastructure is very, very high on in terms of where the revenue get spent as well. Just to give you a feel for it, in the U.S. alone, let's just take the clean water distribution side of the infrastructure. In the U.S. alone, somewhere between 25% to 30%, depending on where you are, of the water that leaves the treatment plant is unaccounted for. Somewhere along the way it gets lost. A term called nonrevenue water is a term that's used constantly from the utilities to look at, are they really getting the revenue of the water that they're sending out from their treatment plants? Even on the wastewater distribution side, the concern over any kind of spills, environmental hazards associated with spills as well as any -- managing the sewer overflow, maintaining that is going to be a really important aspect of what the public utilities are concerned about.

Switching over to the industrial side of it. Uptime, meaning guarantee operations where their plants are running all the time is the #1 priority for the industrial customers, followed by energy efficiency. As you know, our industrial customer base varies from mining to oil and gas, it's a much larger industrial customer base. In many of these industries, water itself is a part of the operations. From that perspective, managing the water cycle within the industry itself, things like 0 liquid discharge becomes an important part of their focus and recycle reuse is a technology that they will be using to maintain that. We're also seeing that there is a trend here where the industrial customers are more and more willing to outsource a part of their water management operations to capable third parties like Xylem. So Patrick talked about industrial water services, we see that, that happening more and more and we see that as a next growth area for us as well.

Quickly touching on the commercial side of it. It is all about energy efficiency, really maintaining -- also maintenance costs. It's not just about the efficiency of the pump, equipment itself, also the smart energy management of buildings. You see a lot of green buildings initiatives going on globally. What does this all mean, right? This is very compelling case that says that a smart infrastructure is very vital to solving all these customer challenges. And at Xylem, we are in a great position, and we have the technologies to address the smart infrastructure needs of our customers.

Let me just give you one specific example here. So the picture on the left, it's kind of hard to believe, it's kind of shocking. This is actually the photograph of a infrastructure in the U.S. As you can clearly see, it's pretty devastating in terms of leaks and breaks. What's also complex is given the vast infrastructure we have, many of our customers don't even know where their assets are. So when there is a small leak, when there is even a major leak, till it gets to be really bad and comes to the surface, they have a hard time pinpointing the leaks, and during that time, obviously, the repair costs and what it takes to repair is going to be pretty devastating in terms of their cost structure.

The chart in the middle is a schematic of a smart infrastructure. So what you see are -- network of course the clean water distribution network, there are sensors deployed along the way. You have smart equipment deployed. There is actually a communication protocol where -- two-way communication where the smart devices talk to -- connect to a cloud architecture, and really be able to provide a broader view of, a broader visualization of what's going on in the smart distribution network. Basically having this type of architecture will definitely support the utilities to be more proactive, maintain their uptime and be able to pinpoint leaks and be able to address issues much more proactively and really maintain the network running for a longer time.

So if you look at that architecture, at Xylem, we have products and technologies to support all aspects of the architecture. If you look at what Sensus technologies we -- are available, Visenti, and even -- even the Sensus -- Xylem analytics sensing technologies, if you put it all together, we are able to support this in a big way. And we are doing that. So it's not just the clean water distribution network, even if you look at a smart wastewater distribution network or even expand this concept into smart cities, smart utilities, you're talking about gas, electric, lighting, et cetera, so we are able to support all of those technologies by having all of those initiatives by having a technology in our portfolio.

So let's just talk about what are we doing differently, how are we driving organic growth, right? We look at it 2 ways. One is, the top one I call, it is a strengthening the core. It's really about having a strong product portfolio, having a strong new product development portfolio. Since the last Investor Day, we've launched 40 new products. Our product pipeline is very strong. If you look at the products we've launched, the focus had been energy efficiency in most of the products. And about over half of them have embedded intelligence in them. So we see much more deployment of embedded intelligence across the industry.

Second thing is -- Patrick talked about emerging market focus. Few of these products were specifically targeted for emerging markets. I'm happy to say that they were actually designed in the region for the region. And we are significantly expanding the emerging market development capabilities in addition to the manufacturing capabilities as well.

So a few of these products were in what I -- what we call the breakthrough product, and I will give you some examples in a moment. So the core strength. I know we are enhancing the strength of our core business. What's new here is the second part. We are looking at -- we are investing in advanced technology and disruptive innovation in a very deliberate way. Allocating percent of R&D investments, both resources and -- both money, and actually, resources as well, we have a dedicated team focused on executing on the core advanced technology projects. The -- we have a framework on what are the ideas, how do we get the ideas into the funnel and how the team executes. This is new for '16 and gaining a lot of momentum in the company.

So as I mentioned before, think of this as an incubator inside the company; think of it as the incubation model inside the company. As I mentioned before, this is bold because some of these projects, we don't know the outcome until we actually run through it. And the flip side of it, it's got a tremendous potential of what it can deliver once it's successful.

Just to give you some examples of projects that the teams are running: 3-D printing of a pump housing, an advanced electric motor that really reduces the footprint by 50%, a sensor that can sense multiple parameters in the water. So quite exciting projects. And I can tell you, it's been a significant motivator for our engineering team. It's really bringing out the innovation spirit in the organization, another proof point that we are becoming a technology-savvy company.

So let me share a few of the products, a couple of the products, just to give you a feel for product examples. So the one on the left is the Flygt Concertor. This is the world's first intelligent wastewater pump. As you can see in the picture, there's a brain -- it's got a brain. The picture says it must be true. So all joking aside, it is an intelligent system where there's a controller and a software that's embedded inside the pump that does pretty advanced things. Actually, it can sense its environment. It knows the temperature around it. It can sense clog conditions. It can dynamically adjust its own performance depending on what it's seeing. And it also, on a regular basis, communicates with the pump station operators so that -- it takes care of its house and communicates back to the pump station operator.

The tremendous benefits of -- on a very simplistic basis is really the total cost of ownership. So the energy efficiency, it's about 70% more efficient than a conventional pump system. And as far as operational efficiency, just to give you a feel for it, since it's a smart pump, it's got software in it, it's possible -- we have software to tune the pump characteristics. So by doing that, it's about 80% reduction in the hardware assets by -- for the customers so that they're able to dynamically adjust the pump performance with the software.

A lot of excitement. In fact, last week, we were at DC Water, one of the public utilities in the Washington, D.C. area. They procured their first pump, and we were there. In fact, Patrick was there actually launching this product, and we'll be working with them collaboratively to show the value proposition for them as well.

On the right side is the Sensus ally, and the clean water side is the residential water meter. It's the first -- world's first water meter with integrated 3-state valve. What that means is on, off and trickle flow so it's got, obviously, intelligence built into it. It communicates two-way with the network. So for those -- if there's a leak in the system or if they sense a leak, they can shut it off remotely. The utility is able to shut the meter off really to avoid further damage -- further leakage. The second part of it is they can turn it on for new customers that come on board, they're able to remotely turn the meter on. And third, for those customers who don't pay their bills, they can lower the flow to a really painfully low level to keep that going that as well.

In addition to it, the pump has temperature sensors and pressure sensors so that the utilities can really manage and monitor the whole network, whether it's any kind or types of fluctuations or any type of freeze warnings. So it does really elevate the game of the information that the meter provides to the utilities toward a better management of their network.

So where do we take this? Where do we go from here, right? If you think about moving up at the technology curve, it's about digital solutions, taking an intelligent product, moving it up the technology curve to provide digital solutions. We refer to this as systems intelligence. You hear us talk about the term systems intelligence in the company. It is -- it's all -- think of this as an industrial IoT, Internet of Things, industrial IoT. So this is a technology -- progression technology curve. At the foundation of it all are the core products. I mentioned -- talked about some of the core intelligence products. If you go up from there, it is about devices that help connect that product to the network. Obviously, the communications protocol -- FlexNet is a proprietary protocol that Sensus -- that we own; that, I'm sure, Randy will talk more about that later. And connecting it to the cloud, we see an increased adoption of cloud with the utilities. As I mentioned to you, the technology progression is coming into the water industry, and we see adoption of cloud. And then it's all about data analytics. It is really about providing an insight -- an actionable insight from looking at the data analytics, whether it's better monitoring I know predictive analytics, better diagnostics. So that's where the value resides. That's where we'll be monetizing data.

Once the structure's in place, it's always easy to connect enterprise information, whether it's weather information or any other type of GIS, geographical information system, connected to it to further enhance the value. And I can tell you, it's not that complicated to take a device and hook it up to the cloud. What is really challenging is to create scale. So do this in a scale -- in a high-scale manner is really the challenge here. And this is where Sensus technology provides the building blocks, helps us build scale as we expand the systems intelligence application to wastewater, outdoor water or dewatering, any of the other applications. That's where we are leveraging scale from Sensus.

So moving on to the next element of my road map, which is about partnerships. So this is all about creating speed. How do we actually go faster in innovation? This is one of the important tenets that we are looking -- well, that we are pursuing. We are very deliberate about the types of partnerships and who we are partnering with. The graph shows kind of the landscape of our partnership. A couple of things I want you to focus on is it is global. So the partnerships are very global. So you're talking about -- if you look at the partners, it is Asia, Europe and the U.S. And this partnership enables us to do some cutting-edge technology. Working with MIT or Stanford, we can do some cutting-edge technology. We also have access with thought leaders, people that are progressive and thought leaders in the space. And Patrick talked about our own thought leadership paper that we published. And clearly, the graph here, young professionals, the young students who can fill our talent pipeline. So it's got multidimensional benefits to this.

Just to give you an example, one specific thing, we're working with MIT on next-generation phosphate sensors. Phosphate sensors is an important elements of algal blooms in the natural water. Having phosphate sensors at a low cost would definitely help treatment plants to kind of optimize their treatment operations as well.

So early in the game, early success. We have a good example of the success. So this is Visenti. Visenti is a company that we partnered with a long time ago. We cultivated that partnership. It's an offshoot from MIT. Singapore PUB -- in Singapore, Singapore PUB has been very active in collaborating with Visenti. So with that Singapore PUB and MIT partnership and now you know Visenti is a part of our core technology, so very excited about this. Elements of this are new. It's causing a lot of excitement in the company, and there's more to come on this.

So last but not certainly least, we are focusing on optimizing R&D for our enhanced ROI, focusing both on product development of our new products as well as sustaining. On the new product side, it's looking at the portfolio and looking at how do we concentrate our efforts on our projects that are high value. We had a pretty long list of projects, and we've cut that down about 20%, and we have increased our 5-year revenue potential by 20% as well. It's really focused on concentration on what matters.

Second is, obviously, the rigor around product development process itself. We have deployed a standard product development process, enhancing the discipline around it, bringing in timely help as needed on a metrics-based way. We are looking at a new product development.

On the -- if you think about product life cycle management, right, we have a lot of mature products in the field. And we've kind of launched the enterprise-wide, company-wide program where we're using -- reexamining the value of this customer -- value of these products from a customer perspective. Using voice of the customer to update or make minor modifications to further create margin expansion opportunities with mature products that are in the field.

Third is about productivity of R&D. It's really about creating a one-company mind-set and collaborating across the company on R&D development. So I'll give you a little bit more color on that.

So we are moving to a center for excellence model where appropriate. Given the complexity of our distributed R&D sites, we've got some focal points in a few key areas with resources and accountability. The COEs will have full ownership of driving standard technology platforms. The biggest benefit of this model is it's easier to build capability and scale up as needed, and productivity benefits are also enormous. Basically awarding redundancy when the teams are working together.

So one example is systems intelligence center for excellence. This SICOE is being led by Dave Ayers right here in Raleigh. He develops common technology platforms for connected solutions across Xylem, building on proven elements of technology from Sensus. In other words, we have centralized the elements of technology curve that I discussed previously, starting with connectivity products, gateways, network communication, cloud management et cetera. So this is also the best way for us to scale up, drive consistency as we expand our systems intelligence offerings in applications such as wastewater, outdoor water, dewatering, et cetera. So it's also the most efficient, productive way for us to spend our R&D dollars.

Another proof point is on the emerging markets side of it. We are expanding our footprint in India for R&D, and these teams are responsible for global engineering and product localization. We are today in a city called Vadodara. We've been there for -- it's not new. We've been there since 2008. The focus of that team has been mainly on the mechanical engineering disciplines. And now that -- knowing that we need to build capability in electronics and software and data analytics and there's more demand that's coming, so we are strengthening capabilities there and actually opening up a sister campus in Bangalore. It's planned for Q2 of '17.

So let's just talk about the results here in a word. So on the -- the bar graph on the left is about R&D investments. In our previous Investor Day, we had announced 4% of R&D -- 4% R&D investment as a percent of revenue in the previous Investor Day, and we are getting close to that now in 2016. So we are further increasing our commitment to R&D to target around 5% by 2020, which is a healthy amount, and we believe this is the best ROI we have in the business.

Results. Vitality Index. 5-year Vitality Index has gone up year-over-year. The number in '16 there includes Sensus. But even if you strip that out, the rest of the businesses have increased by 100 basis points from '15 to '16. And we are setting up a new target. We had 25% before; now it's 30% new target for what we want to achieve in terms of Vitality Index. It's pretty exciting, a pretty bold target and associated with really good investments as well.

So hopefully, you can walk away with a good feel for our journey here in innovation technology. Our transformation into becoming a technology-savvy company, our approach, what we're doing differently for innovation technology. As you tour the facility this afternoon, you will see and hopefully share the excitement we have around technology and around overall innovation in general.

So with that, I'd like to welcome Tony Milando to give you a perspective on continuous improvement.

Anthony V. Milando - *Xylem Inc. - SVP for Continuous Improvement and Business Transformation*

Thanks, Jay. Okay. Now for the sexy stuff. My name is Tony Milando. Welcome to the headquarters for Sensus, and welcome to Investor Day and spending a little bit of your day with us. I have the pleasure of talking about the Continuous Improvement program and giving you a bit of an update from the last time we spoke in September of 2015.

And I hope when you leave today, you'll walk away with a few key messages: Number one is, we're slightly ahead of our plan as we laid out in 2015. In fact, we have executed on or are executing on everything we talked about during that investor conference: that our Continuous Improvement effort is really gaining momentum. We're seeing the tools being used outside of the plant, outside of official Kaizen, so we really feel like the culture is starting to shift; that while procurement and Lean Six Sigma, which have carried the margin expansion day so far, we are really starting to see some initial positive momentum behind some of our transformational projects. And we've laid a lot of the plans and are more confident about those plans to commit to what you'll see is a higher target for 2020 on the business simplification side. And then last but not least, hopefully, you'll see from some of the things we still have yet to go that we still believe we're in the early innings of this transformation.

So those of you that were with us in 2015, you will recognize the left side of this chart. We talked about our commitment and our 3-pronged strategy around procurement, Lean Six Sigma and business simplification. Think about procurement and Lean Six Sigma as that year-over-year product engine for us, where business simplification really guides the big transformative projects for the company. And the key takeaway here is that we raised the expectations on both sides, on all 3 areas, and we've done that because we've seen better-than-anticipated results in our procurement maturity. We've seen lean projects happening outside of the 4 walls earlier than anticipated, and we really put a lot more meat around the bone and granularity to our business simplification programs. And all of that's allowed us to raise our confidence level about we think we can deliver over the next 4 years.

Now what's important about this and worth noting is that this excludes the synergy that we get between combining Sensus and Xylem where we have committed to at least $50 million in net savings. And I'll talk to that a little bit later.

So let's talk a little bit about the progress that we've made. I won't talk about each one of the elements here, but I will hit on a couple of highlights. Based on our centralization of procurement, we were able to launch standard payment terms across the industry, across our supply base. And that's allowed us to raise our days payable outstanding from the mid-40s to about the mid-50s. So about 10 days. And you can think of every day being worth of that $6 million of free cash flow. So well over $50 million of free cash flow just through payment terms over the last 2 years. We bought and put in place an e-procurement system in early 2016, and this has given us tremendous visibility to our supply base. And we're now able to consolidate spend around the world and different parts of the region that's allowed us to put out for bid this year of about $350 million or spend. This is in 2016.

From a lean perspective, we've trained our top 300 leaders in the company -- we started this late in 2015, this represents about a top 3% of the legacy Xylem employee base -- on how to lead lean initiatives within their businesses or departments. And so this was making our leaders appropriately dangerous when I came to lean and really sniff out lean around the company. And we did this in-site 20 leaders at a time. They led the program. They participated in the value stream mapping, and they actually identified over $20 million of productivity on those training sessions alone that have either been executed or are being executed. We launched what we call a living lean WebEx. So this is a monthly WebEx where we have -- it's invited all of our people managers. And so we can get roughly 200 to 300 people on the call once a month, really evangelizing best

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practice around lean and how we can learn from each other. Patrick Decker is on the call. The senior leadership team is on the call. We open it up for Q&A. It's a very interactive session and really drives employee engagement around changing the culture around lean.

We talked about -- in 2015 about really addressing our footprint, and we have a commitment out there to reduce our footprint by 10%. So we've been able to execute on about 10% of the rooftops, which is about 40 rooftops, mostly branch consolidation, sales office consolidation. There's been a manufacturing facility that's been closed as well, but it represents about 400,000 square feet. We think we have upside here to another 0.5 million to 1 million square feet going over the next 4 years.

And then last but not least, we talked about how we take complexity out of our G&A. And one of the ways we're going to do that is really employ shared services in a much bigger way. And so we launched a European shared service center in Poland just outside of Krakow back in September that's processing basic financial transactions at this point. And we'll talk more about that because that becomes a much bigger project for us going forward. So the culture is clearly changing, but we have a lot more to go. We have a lot more upside.

So let's shift gears and talk about what's next. From a procurement perspective, as I mentioned, we have much better visibility now, and our procurement organization is much more mature. And so in addition to the $350 million we put out for bid through request for quotes, RFQs, last year, we have a similar amount on the market is as we speak today, and we've already identified over $300 million that we're going to put out for bid in 2018. We feel like we can continue to do this over the next 3 to 4 years.

But we're also building capability, and so we've add should costs into our weaponry. And this is not new in the purchasing field, but it's clearly new for Xylem. And this is where we take commodity benchmarks alongside of manufacturing simulations. And we're able to simulate what a part should cost us based on the commodity makeup and the manufacturing process. And this gives our procurement folks an incredible advantage when they sit and negotiate with suppliers and actually work with the suppliers to eliminate that cost. This happens to be a real-life part out of Morton Grove facility, a cover plate, where you can see, there's a 23% gap between what the part should cost, we believe, and what we're actually paying. Now we won't get all of that, but we'll get a meaningful component of that.

So you can see we're really starting to up our game relative to the maturity in our procurement organization. And as you put that into context of our overall journey, you can see what we set ourselves. This year, when we save over $100 million of material savings, that will be the third consecutive year that we put ourselves in the upper quartile of procurement in terms of benchmarks in the industry. And so we really feel like that firmly places us in a high-performing organization. But what's more important is that we have a couple of other bullets still left to go. And number one is around indirect spend. So we've spent a fair amount of money investing in our indirect spend organization, adding some tools there as well. And you'll hear more about that on future earnings calls, but we feel like there's upside on the -- really untapped part of our business.

And then one of the items I mentioned in 2015 was this value-optimized design. And we're partnered with Jay from a technology standpoint and running a program now that really has a long cycle, but we're making -- we're building the pipeline as we speak. And this is looking at our mature portfolio through 3 different lenses: through the voice of the customer; from a design perspective, alongside competitive teardowns; and also from a supplier perspective. And through these 3 lenses, we're able to rightsize the product and make sure that we're getting paid for the value that product delivers or rightsize the product to adjust the value.

Long-cycle program. We're building a pipeline now. It'll start to read money here a little bit in 2017, but more so in 2018 and beyond. So we're building that pipeline and the road map to take this margin expansion story even further.

Now let's shift gears and talk about the second part of that stool, the second leg of the stool: our lean game. We'll continue to invest in our teachers or CI professionals or dedicated black belts and green belts. And you can see the investments we made from 2015 to 2016. We have 71 dedicated black belts in the company. This is pre Sensus. We're going to continue to make that investment. We look at this as a student-to-teacher ratio where we look at about 150 employees to every dedicated black belt or green belt or a dedicated CI individual. And they're going to help us evangelize, teach, train and drive projects throughout the company. We'll continue to use Kaizen as our method of choice to build that muscle inside the company about problem solving. We had a goal this year. We didn't know where to peg ourselves. We blew the goal away and delivered nearly 1,200 Kaizens and point Kaizens in 2016. We'll continue to up that until we feel comfortable that we built that muscle. I'll talk about an element in a minute where we're going to make sure that the muscle sticks.

But one of the other areas -- one of the other things we're doing is we're opening the aperture around where lean takes shape; not just in the factories but outside of the 4 walls. And on the right here is a nice example of how we're doing that. This happens to be where we were losing sales in what we call our motor attach rates. So in Morton Grove, we sell pumps with motors that we procure, and we couldn't get visibility in enough time to have the motors in stock when we needed them. So our customers would buy the pump and attach their own motors from their own inventory. And through bring our 3 motor vendors in house and look -- and using some standard lean tools through Kaizen for a week, we were able to reduce the order to acknowledgement lead time by 60%. And in the first 2 months of launching, we've increased our revenue on that product by $120,000. So really, an elegant way of applying lean beyond just the typical sell layouts and value stream mappings in the plan. So clearly, we're trying to drive and build that foundational mind-set and components for our lean program. How that fits into our overall journey is what you see now. And right now, we feel like we're squarely still in that developing range. Some of our businesses are well down the path. Other ones, frankly, are just getting started. But what's -- what I want you to take away from this chart is this notion called organizational baseline under the institutional phase.

We piloted this last year with 3 facilities. And we're going to go ahead and baseline every part of our organization, manufacturing-wise as well as nonmanufacturing-wise. And this really, across 15 attributes in lean maturity, measures where an organization sits. And so if you're 1, we want you to get to a 2. If you're a 2, we want you to get to a 3. And by doing this, we'll be able to know where every part of our organization is and how we're going to measure success. And with each successive level comes an associated benefit for productivity and an opportunity to expand margin for our business.

The third leg of the stool is around business simplification. And again, we talked about this. For those of you who were there in September of '15, you would have recognized the 3 buckets that we're looking at. Simplification. From a logistic standpoint, this is all about footprint consolidation. And I talked about where we've come from, what we've progressed on over the last 2 years and what the opportunity is that lies ahead of us still. From a commercial simplification, this is the work that was started in Europe about simplifying our organization. You heard Patrick talk about that, about simplifying sales operations, service operations through training and recognition. And we're seeing benefit in our European operation. On top of that, now we can add the consolidation that we just talked about on the North American commercial organization, where we not only know that that's going to help elevate and grow our top line, but we also feel like there's opportunity in the back office and sales operations and supply chain to drive more margin expansion from that -- those projects.

And the G&A rightsizing is all around driving higher sale -- shared services. And I'm going to talk about that in just a second. So you can see, through these programs and putting more meat around the bone, we feel more confident about raising the goal here by 20% versus what we told you in 2015.

So let's talk about a couple of different areas of business simplification. Number one is global business services. So today, our back-office functions, and what we consider back-office functions are IT, finance, HR, procurement, order management, really run across a 100 different instances of ERP systems. And this is really a holdover from the spin-off from ITT. And you can imagine the complexity that those systems drive, the transaction complexity, the nonvalue-added work that our employees go through to drive processes just to close the books every month. Incredible amount of complexity. And so what we're going to do is take those processes off of those legacy systems and put them on one common platform that will drive some cost efficiency from that perspective. We're going to centralize where this work is done so that we're going to get good at it, and we'll be -- we'll increase the cycle time, the compliance and the quality of processing those transactions. And then we'll employ a more new technology called robotic process automation, which allows you to manipulate transactions through an application against rule-based transactions that have taken place.

Think about an accounts payable clerk that's trying to process and redeploy an e-mail to another associate. We can do that through robotic process automation. Simple applications that allow us to optimize and take the nonvalue-added work out. So we're really excited about this. This is a huge change management project for us. And so we've put together a project management office. We've brought in an expert that's done this before to run this and run GBS as a service -- internal service provider for the company. And we've established a steering committee that Mark and I chair once a month. So we're really excited about this. We think it's a really simplify our back office and drive that margin expansion that we're excited about.

From a working capital perspective, we know that every good company has a great hygiene here, and we've made some really good progress over the last couple of years. You can see the gray bar is the Xylem-only progress that we've made. But it was really around the basic blocking and tackling. It's focusing on some of the key elements of working capital. We've done some training. We've added it to our annual incentive plan. But going forward, we're going to really leverage the discipline that we get with the Sensus merger.

You can see where they operate at nearly half of our rate in terms of percent of sales. And we'll always keep in front of us that benchmark aspirational goal that we want to get to. Our long-term goal here is about 18% of sales. We've also added a center -- a working capital center of excellence, and we brought in experts around sales and operations planning from Newell Rubbermaid Group. We've brought in order-to-cash experts from Danaher, and they'll create the center of excellence for working capital and allow us to make the progress we know we can make in this part of our simplification effort.

The last portion I'll touch on is around our cost synergies. And these are the synergies we get from bringing Sensus and Xylem together. And as we mentioned, we're excited about being able to achieve well over $50 million of savings as a run rate in 2019. But I think what's important here, given some of my experience and having been through a couple of these before, most recently in Stanley Black & Decker, we're comfortable and very aligned in terms of the process that we followed here. So we really focused on capturing the value right away. And so we have a very well-laid-out road map on where the savings are coming from. We focused on not disrupting the business. So we had 0 customer attrition through the process. We focused on day 1 and day 100 execution, and we found very little issue with either one of those go-lives. And then last but not least, we focused on the people and making sure that we overcommunicated about what was happening. And so this is obviously an area that we're excited about, bringing some synergies and speed-to-cycle time to the company. And we feel pretty good about where we are, and we're tracking to plan.

So I'll just wrap by saying, hopefully, you see that our strategy we laid out 2 years ago is well on track. Continue to expect progress here. Sensus adds not only scale from a procurement perspective, but also real capability that we can leverage in various parts of our organization. We're also bringing scale and capability to procurement into Lean Six Sigma, and we think this is really going to allow us future valuation adders for inorganic growth going forward. And then last but not least, it's really about building that culture of Continuous Improvement. And we look to making improvement not just within the operations side, but with everyone, every day.

So with that, I want to thank you for your time, and I want to turn it over to Mark Rajkowski, our CFO.

Mark Rajkowski - *Xylem Inc. - CFO and SVP*

Patrick, I got your glasses here so -- thanks, Tony. Good morning, everybody. Welcome. It's great being with you here today. It's been about 1 year; in fact, about 1 year to the day when I joined Xylem. And so in addition to this being Investor Day, it's also my anniversary. So I want to thank you for celebrating that with me today. Good to see a number of familiar faces out there, folks that I've met over the past year working with Xylem, and also a few faces from my past life as CFO of MeadWestvaco. So I know I haven't met all of you, and I do look forward to catching up with the folks that I haven't met over the course of the day today and, if not today, the months to come.

Before I joined the company, there were a number of things that I was really excited about with respect to Xylem. And the first was that Patrick and the management team had a very clear and focused strategy. There was no question they knew where they wanted to take this company. They knew where they wanted to play, and they knew how they were going to win. And that's not always the case. And that's really essential and the starting foundation for creating shareholder value.

Secondly, it was clear to me that there were significant opportunities for value creation, both on the growth side, organic, strong brands, great market positions, as well as the opportunity to create value through meaningful capital deployment. And last but not least, and you got a good dose of that from Tony, I saw substantial opportunity in creating value through further operational improvements. And lastly, given my past experience over the last 35-plus years both on the financial and the operational side, I saw this as a really good fit for me to help contribute to this team and help them unlock that value. So with that, I can tell you it's been one heck of a busy first year, but the good news is we're just getting started.

I think we've got an exciting story. I think we've got a compelling investment thesis. It's certainly based off of the consistent and strong execution that this management team has delivered over the last several years. And to that point and with the exception of organic revenue growth that Patrick addressed early on due to some of the industrial headwinds, we have gotten ahead of each of the key financial metrics that we set out in our September 2015 Investor Day, and we're also well positioned to continue to deliver on our commitments in the years ahead.

Having had the opportunity now to work with Randy and the team for the last 5 months, I can tell you, the acquisition of Sensus is truly transformational. I think, as you spend the rest of the day here, you, too, will come away really seeing the power that Sensus brings to accelerate Xylem's revenue, margin and cash flow profile. As Patrick highlighted earlier, and this is worth repeating, we are increasing our long-term targets for each of our key financial metrics. We also expect to generate over $3 billion in operating cash flow through 2020. Our strong cash flow, combined with our larger scale and leverage capacity, will enable us to deploy an additional $1.8 billion of capital through 2020. This represents a 50% increase over what we had committed to back in September of 2005.

So I'm going to quickly hit the highlights of what's changed since our 2015 Investor Day targets, and then we'll go deeper into each of these areas. We're updating our 2020 outlook for revenue growth, operating margins, cash flow and capital deployment, all of which are improved with the higher productivity savings that Tony addressed as well as the addition of Sensus and significant related synergies.

So let me begin with our revenue targets. At our 2015 Investor Day, we assumed overall organic revenue growth of 3% to 5% through 2020, and we assumed 3% to 4% for the 2016 through 2018 period. With organic revenue growth of only 1% in 2016 and slower expected recovery in the industrial markets as well as some of the commodity-dependent countries, we've lowered our base Xylem growth rate to 2% or 3% through 2018. This will have an impact of reducing our overall organic growth rate in the base Xylem business by 1 point to 2% to 4% through 2020. Having said that, we do expect growth prospects in these industrial markets and the commodity-dependent emerging market countries to begin to accelerate in 2018. And so we expect our overall base Xylem revenue growth for 2019 to 2020 to return to 3% to 5% level. On the positive side, the underlying smart meter markets served by Sensus is growing at a faster rate than Xylem's business. And with our expectation of growth of 6% to 7% through 2020, Sensus will add a full point of growth to Xylem's overall organic growth rate.

We also have good confidence in delivering at least $150 million of revenue synergies with Sensus. That, too, will add an additional full point of revenue growth to the combined company's increase in our overall organic growth rate to 4% to 6% through 2020.

So let me spend a minute looking at our end market growth rates. In addition to Sensus improving our overall growth profile by 2 percentage points, it also shifts our revenue exposure to our fastest-growing and our least volatile industry vertical: the public utility sector. With substantially all of Sensus' revenues in the public utility markets, pro forma sales from that vertical now represent almost 50% of our consolidated revenues. We expect this market to grow at an overall rate of 6% to 8%, reflecting the faster growth of smart meter segments as well as the benefits of revenues, synergies and continued share gains.

In the industrial market, the significant sales decline we saw in 2016 in the oil and gas and mining segments had a dramatic impact on industrial growth last year. We expect the slow recovery in these segments to mute industrial markets growth through 2018. But beyond 2018, we do expect a strong snapback as we see commodities recovery as well as some of the benefits of a long-awaited build-up in infrastructure to return to our -- to return our growth rate to 3% to 5%. We expect commercial building services to remain a stable market for us, growing at 2% to 4% over the period with a low single-digit growth rate in the U.S. through 2017, accelerating modestly thereafter. Our outlook for European commercial building services is for low to mid-single-digit growth.

So now looking at our growth targets by geography. There are a couple of points that I'd like to highlight here. The first is the acquisition of Sensus has meaningfully shifted our revenue base to the U.S., which now represents almost 50% of our sales on a pro forma basis. And as a reminder, with almost 70% of the faster-growing Sensus revenues in the U.S., our revenue growth outlook for that market has increased substantially to 4% to 6% through 2020. Patrick alluded to this earlier. The geographic shift in our revenue base has a very positive impact for our U.S.-based cash flows, which will make it easier to fund our dividend, fund M&A, debt service as well as share repurchases. We continue to expect emerging markets to provide outsized growth opportunities compared to the other geographies. We have and will continue to invest in local R&D capability, sales capabilities and manufacturing to further strengthen our position in these markets. Over the period, we expect to benefit from growing infrastructure investments in India and a modest but ongoing recovery in China to be a tailwind. We do expect continued weakness in the Middle East through at least 2018.

In addition to our solid revenue growth profile, we have substantial opportunities to further expand our operating margins above what we laid out in the 2015 Investor Day. We now expect to increase our operating margins by an additional 100 basis points to a range of 17% to 18%. We'll achieve this through the greater savings from our expanded productivity programs that Tony took you through just a minute ago as well as from the significant benefits we expect from the addition of Sensus.

So if we just look at our base Xylem business, our current outlook for 2020 reflects a 60 basis point improvement over what we said back in 2015, and that's prior to the impact of the 2016 acquisitions. Base Xylem margin profile will benefit from higher productivity sales as well as lower R&D investments required to build out systems intelligence and data analytics capabilities that we acquired with the acquisition of Sensus. This improvement will be partially offset by margin drag from the lower growth rate that we expect to see through 2018 as well as higher expected rates of inflation that we do expect to see through 2020.

As many of you recall, we closed several acquisitions in 2016, certainly Sensus and Visenti being on that list. And this reduced our operating margins by 60 basis points, and that was largely due to the noncash impact of purchase accounting amortization. But clearly -- oops, could you go back one? I was a little quick on the trigger finger there. But clearly, the Sensus revenue cost synergies have the greatest impact on expanding our operating margins. And with over $150 million of revenue synergies and the net cost synergies that we're going to deliver over the next several years, this will provide us with 150 basis points of margin expansion. The last point on this slide is, is you'll see that the operating margins of the base Sensus business are slightly dilutive to Xylem's overall margins. But keep in mind that those margins include 200 basis points of noncash amortization related to purchase accounting. So without that, that margin profile was actually 150 basis points higher, and we'll talk about that in a little bit as we get into EBIDTA.

Okay. At our last Investor Day, we had targeted $3.5 billion of capacity for capital deployment, representing a combination of cash, cash flow, cash on the balance sheet plus leverage. We deployed $1.8 billion in 2016 largely in the connection -- in connection with the acquisition of Sensus, which, as you will see today, no doubt, will be a source of significant value creation for Xylem. Well, that's good news for the shareholders. Even better news is the fact that we'll quickly be rebuilding this capacity back up to $3.5 billion by 2020. We'll do this with higher operating cash flows from the expanded productivity programs; the synergy benefits, both on the revenue and the cost side from Sensus; as well as from new leverage capacity created by our greater EBITDA scale. I'll cover our capital deployment strategy in a minute. But clearly, we have substantial opportunity to accelerate value creation.

So let me take a minute to walk you through our financial framework. It all starts at the top line. We expect to deliver 4% to 6% organic revenue growth over the period, largely fueled by Sensus. The combination of over $600 million of productivity savings and the Sensus-related revenue and cost synergies will drive 400 to 500 basis points of margin expansion. All of that will result in the generation of over $3 billion of operating cash flow, which will also include significant improvements in our working capital performance, as Tony mentioned. We expect to deliver 110% free cash flow conversion. As I mentioned, we will have $3.5 billion of available capacity for capital deployment for smart M&A as well as returning value to shareholders. You can be sure that we will remain disciplined and value focused in making our capital deployment decisions.

We also continued to strengthen our balance sheet, and we expect to reduce our leverage by the end of this year back to our target level of between 2.5x and 3x EBIDTA. We believe it's strategically important for us to maintain our current investment-grade credit ratings to provide the flexibility to enable both efficient as well as opportunistic capital deployment.

So I'm going to spend a minute on our capital deployment strategy. Pretty straightforward. Hasn't really changed from 2015 Investor Day. First, we're going to prioritize investing in our core business, funding high-returning growth investments in new product development in our emerging markets and, importantly, in enabling the Sensus revenue synergies. These are clearly our highest value-creating opportunities. Second, we'll continue returning value to shareholders through a consistent and increasing dividend that we will grow in line with earnings. As Patrick said, for 2017, that represented a 16% increase year-over-year. With our remaining capital capacity, we'll continue to fund value-creating acquisitions. And while we remain very, very focused in terms of executing our integration plans around Sensus, and there's a lot of work to do there, it's important to understand that we do have a very robust pipeline of attractive targets. And those targets have been further broadened as well as strengthened with the addition of Sensus. Share repurchase remains our lowest priority for capital deployment. We will use this to manage share dilution as well as for deploying excess cash on the balance sheet.

So this slide lays out the key criteria that we use in assessing and evaluating potential acquisitions, and it also shows how the Sensus acquisition measures up. Sensus acquisition, by far and away, the largest and most impactful deal this company has ever done. We're able to purchase Sensus at an attractive price, and we were also able to structure the transition in a very efficient fashion, both leveraging our non-U. S. cash position as well as obtaining low-cost financing. We're extremely pleased with the addition of Sensus to the Xylem family. And clearly, as you look at this transaction, it checks all of the boxes in terms of our key M&A screens. It is worth noting that in assessing targets, we do not include revenue synergies in that analysis. So that $150 million to $175 million of revenue synergies provides upside to the return on invested capital and IRR metrics for this deal. We'll continue to follow the same disciplined blueprint in future M&A, particularly our focus on return on invested capital being meaningfully above weighted average cost of capital. Not easy to do, particularly at some of the valuations. So you got to be very disciplined, but that is essential for creating shareholder value.

As Patrick mentioned earlier, effective the second quarter of this year, we are going to be combining our Analytics business which currently resides in our Water Infrastructure segment with Sensus and Visenti. This combination will certainly accelerate the value creation that we see through our revenue synergies. And I know this is of interest to all of you out there. We will be providing restated financial information on the new segment basis to you in advance of our second quarter earnings call. And importantly, we will continue to maintain the transparency and the visibility around Sensus performance. It's important for us to be tracking that as well as you to understand how we're performing against the acquisition criteria when we did the deal.

Before closing out with a summary of our 2020 long-term growth targets, let me just reaffirm our 2017 guidance. It's not changing. This remains the same, okay. So with that, let's move on to the long-term targets. We expect to deliver improved financial performance across each of our key metrics compared to our 2015 Investor Day. I've already covered targets for revenues, operating margins, cash flow and capital deployment. But I'd like to highlight a couple other metrics that are important. One I mentioned earlier is EBITDA. With a significant impact to our operating margins related to the amortization of Sensus purchase accounting, EBITDA becomes an increasingly important metric for our investors to understand the underlying profile of our cash flows as well as our margins. Compared to our prior target, our current outlook reflects an improvement in EBITDA of 150 basis points. So we expect to deliver EBITDA of between 21.5% and 22.5% by 2020. Also on our EPS, mid-teens EPS growth target, this assumes no capital deployment. This assumes that we get cash, and we let it build on the balance sheet. Now that's a fairly conservative assumption. And if you look at scenarios where we are deploying capital, both for M&A or share repurchases, that EPS growth through 2020 would be at the high teens plus.

So in closing, over the next 4 years, the execution of our plan will certainly deliver more attractive financial returns, financial performance. But importantly, we are also shaping a company that's going to be more efficient, more agile, more competitively and technologically competitive, more relevant to our customers. And we think as you look at all of that, this represents a significantly more compelling investment thesis than what we laid out back in 2015.

So with that, I think it's time for Q&A.

Matt Latino

So in order to best facilitate the Q&A session, I just ask you to simply raise your hand, and I'll do my best to identify you and point you out to the mic handlers. And then just state your name and affiliation before, so we have it on record there. First question?

QUESTIONS AND ANSWERS

Ryan Michael Connors - *Boenning and Scattergood, Inc., Research Division - MD and Senior Analyst of Water and Environment*

So it's Ryan Connors from Boenning and Scattergood. This question really is for Patrick as well as for Jay a little bit, Jay's Slide #33 about the technology curve. And it seems that there are tens of thousands of public utility customers, even the large customers number well into the hundreds. And yet it seems like those that are truly embracing the higher end of that technology curve are much more anecdotal. You're going to have United here and SUEZ, which is certainly one. Jay mentioned DC Water, well known for that. So my question is what's the road map to broadening the adoption of that type of system? Because it certainly contrasts with your experience, Jay, on automotive and aerospace where innovation is sort of a job 1 for everybody. So what's the road map there? And how important is that to realizing the vision of that becoming material?

Patrick K. Decker - *Xylem Inc. - CEO, President and Director*

Okay. So my mic -- so this is Patrick for those on the webcast. And certainly Jay, you can chime in here afterwards. First, I want to say you're seeing Mark and I do a Q&A. We don't dress up like this for earnings call Q&A, so never. It's fair to say. It's a great question, Ryan. I think the way we look at it, I do think it's important for investors to understand that this is opportunity in front of us. There's a reason why the water utility sector is -- has been historically risk-averse and slow to adopt, and it is because of the fear of failure in certain operations and applications. From our experience, the smaller to medium-size utilities, even larger ones, though, they do react and respond to reference cases when they see other thought leaders as water utilities make certain moves. So whether that be SUEZ, whether that be DC Water, Singapore PUB, Thames Water in the U.K., they do have an impact on shaping people's comfort level with making those moves, but only once they've had a proven business case. And that's why the approach that we are taking is to really leverage the combined Sensus-Xylem capability to do more rapid prototype with large-scale utilities and even other industrial customers, build a reference case, prove it out, fail fast and learn quickly. And then we expect to then begin to see that conversion and adoption going forward. Because I don't want to speak for David. I've got questions of that effect later as to are utilities willing to pay up for these higher order solutions and to what extent do total cost of ownership business cases matter as we go forward. We see early changes of behavior in that space, and I think it only accelerates over time. But your point is well taken. This is not something that happens in a quarter or even a year or 2, but we do see a movement afoot in the space more broadly defined.

Clifford F. Ransom - *Ransom Research, Inc. - Founder and President*

This is Cliff Ransom. I don't know whether to ask Tony this. I'm a big fan of your operational excellence program. But it strikes me that an 18% working capital goal is still way off a, what I would call, a world-class benchmark. I know it used to be a lot higher. Am I missing something inherent in the business? Or why shouldn't there be a lot more leverage there?

Patrick K. Decker - *Xylem Inc. - CEO, President and Director*

I'll certainly speak, first, for 15 seconds, and then I'll hand it over to Tony to comment. I agree with you, Cliff, and I think that certainly we're going to be going after an even more aggressive improvement goal in that area. It does come down to relative order of priorities and in focusing the organization on growth, on margin expansion, at the same time, focusing working capital as much as a clean bill of health. Because as you well know, you tend to have poor working capital performance because you have disruption in the supply chain, and that's typically associated with bad customer experience. And so we're not going to put a limit on what that ratio could be. Certainly more of a best in class will be down around the mid-teens, in that area. And certainly, with Sensus' profile, they're even already well beyond that. So I think there is upside there. But we felt right now, for sake of putting a long-term target out there for investors to kind of model in value, that was an appropriate place for us to pause. You want to comment, Tony?

Anthony V. Milando - *Xylem Inc. - SVP for Continuous Improvement and Business Transformation*

The only thing I'd say is we do feel like there is more entitlement to the payable side of things. I think some of it is due to the channels that we participate in and the entitlement from how quick that we can get paid from some of our customers, but there's a lot of cleanup that we can do relative to being better in terms of performing our contracts with our customers and making sure we have better hygiene there. But probably the larger element for us and the piece that takes the longest is turning on the inventory where we have a lot of SKUs, a lot of complexity. And that's a longer row to hoe in terms of how we put better hygiene in our product development process to do more platforming, do more part reuse. And that really allows us to shorten lead times to take in the inventory. But that's probably the biggest single area.

Clifford F. Ransom - *Ransom Research, Inc. - Founder and President*

And then the other question is in your opening comments, Patrick, you talked a lot about employee engagement. But then I think it only came up one more time in anybody's presentations. Maybe it will happen after the break. How do you measure that? What are your metrics? And will you give us a feel for a correlation between that and all these other metrics?

Patrick K. Decker - *Xylem Inc. - CEO, President and Director*

Sure. Yes. So employee engagement is a very, very big deal for us. And I think that -- I think I can speak for most CEOs, especially in the industrial space these days. I don't think that we've been in as prolonged of a low, no-growth environment, and that weighs on organizations in terms of employee morale. And you can only get people to run faster so often. And so to me, we haven't seen across the industry a big spike in turnover because quite frankly there aren't a lot of other places for people to go necessarily right now. But as soon as things fall, that's what I keep my mind on is how do we really make Xylem that place that people say, "I want to work there because they are serving a higher purpose. It's a place that I can grow my career. It's an inclusive environment where my views are heard and they matter." And it's a way to really also help blend newer talent coming into the organization in the entry level. So we are -- we do surveys. We'll be having employee engagement survey that will be rolling out here over the next few months. We've not done one for the last few years. Now Sensus has done one every year. We did one since then. And quite frankly, with all of the changes that we had going on within Xylem the last couple of years, I specifically made the call, Cliff, that the time was not right until we at least have gotten through another major move in the portfolio. And this is perfect timing now for us to get that level of engagement. We've done that across our top 300 leaders. We did an intense 1-month exercise to get their raw, anonymous feedback on what was working and what was not working. So it's going to be retention turnover metrics. It's going to be engagement scores along various lines coming out of the survey. And quite frankly, at the end of the day, the one that matters most to me, Cliff, is the sales force barometer baseline that we got, where our sales people tell us on a regular basis what percentage still that we are helping them sell more and win more versus getting in their way. And that's going to be an important baseline for us to be measuring against as well.

Deane M. Dray - *RBC Capital Markets, LLC, Research Division - Analyst*

It's Deane Dray from RBC. I just thought one of the most important slides within Jay's presentations was the graphic on the smart water infrastructure. And I don't want to preempt some of the later presentation with David Stanton. But just maybe, Patrick, if you could expand on a couple of key points on this because I do think this is the most exciting opportunity for Xylem, and you've made that clear today. The first is I saw that you've got pressure and temperature is just kind of sitting out there, and there's so much more you have the capability of monitoring, both from an analytic standpoint with precision, but also to connect it remotely through FlexNet and have real time update. So maybe just expand on integrating of the analytics there beyond just pressure and temperature. And then at the top of that slide, it said Asset Management, and that's on the feedwater side. So it's not just the network of pipes, but it's the feedwater, the quality of the water. And I know that's something that David Stanton is likely to address as well. But just the integration beyond the pipe networks of water and wastewater, but the feedwater quality as well.

Patrick K. Decker - *Xylem Inc. - CEO, President and Director*

Yes. Well, that's a perfect question, Deane. And just administratively, we do have more time baked in for a second Q&A. So we want to make sure that after you've all heard what we think is a pretty exciting opportunity here with Sensus, Visenti and Xylem, we'll be able to answer those even in more depth in that section. But what I would say is there is absolutely far more to come, Deane, in terms of -- the way we're viewing this is we did a ton of voice of customer work as part of our diligence to really understand what are the real pain points, not just within the utilities themselves, but other uses of water that they are prepared to pay up for because there's a real business use case that's there. Taking Ryan's comment earlier and the fact that now some of these customers can be slow to adopt, but the reality is you got to start somewhere. And we do believe that with bringing Visenti and Sensus into the fold, our ability to connect the installed base of devices that we already have out there, whether it be in outdoor water analytics, whether it be wastewater networks, there's a tremendous value proposition that's there. One of the things that I will tee up for David to speak about is the broader move of real thought leaders around smart watershed management, the downstream effects of upstream problems in the water supply. And that's a whole new body of work that only a few utility operators are beginning to think about, but there's clearly something there. And we're in the early stages of working through what role we could play given the FlexNet investment and our thought leadership around treatment, wastewater networks, outdoor water, et cetera. Asset Management, you're absolutely right, extending the lives of investments that have already been made. But also in new greenfield, how do you design that in a way that is even smarter and more capital effective over time? So there's more we can talk about in maybe the second Q&A this morning. And then, Scott?

Scott Reed Davis - *Barclays PLC, Research Division - MD and Head of Global Industrials Equity Research*

It's Scott Davis. Just a couple of clarifying points. The new higher targets that you've set, is that also going to be set for compensation targets by the board for you guys and then your teams?

Patrick K. Decker - *Xylem Inc. - CEO, President and Director*

Yes.

Scott Reed Davis - *Barclays PLC, Research Division - MD and Head of Global Industrials Equity Research*

Okay. That's simple enough. And R&D, I mean, you've been seemingly getting a pretty good bang for your buck of just spending 2.6% of revenues, and you picked up some good technology with these 2 nice acquisitions you've made. But what's the magic number in 5%? And how do you get there fast enough to feel like you're getting money's worth? And I guess the context I think about is other companies have done that have taken like 7 years, 8 years to get there. It's not something you can ramp up, just go hire people and get effective use out of immediately. But maybe some color on that, please.

Patrick K. Decker - *Xylem Inc. - CEO, President and Director*

Sure. Going back to your first question, I mean, the short answer is yes. But certainly, we have long-term targets that are approved by the board. Just for those that are new maybe to the story, our annual incentive plan, which is our top leadership team and top few hundred is 1/3 focused on organic revenue, 1/3 focused on earnings and margin, 1/3 focused on working capital. And then of course, our long-term incentive plan is based upon a 3-year average on ROIC targets as well as 50% based on relative TSR compared to the S&P 500 less industrial. So just for the record, to put that out there, we're very much aligned around these targets. And certainly in the break, you can certainly reach out to Markos. He will verify to you that we go through and do a look-back and check-in to where are the incentive targets we're setting for this year. How do they play out relative to what we said at the time that we had? We get them approved year-by-year. And so the board does a great job governing that. On the R&D side, the -- effectively what we're saying here is when you look at the level of spending that Sensus has today, it's about 10% of their total revenue, which is much more like a software and technology company. Now that is even ahead of their peers and our peers in the industry. But it really is there to support a very robust new product pipeline, lots of which is already coming to fruition, but still a very healthy pipeline that's rolling out this year, next and the following. I would suggest that, everything else equal, because there has been some catch-up being played by Randy and the team since he's been here, everything else equal, that would probably moderate and modulate down a bit. But then along comes Xylem. And so what we talked about last Investor Day was we would be adding 100 basis points to that base of 2.6% to 3%, we get up to 4%. What we're saying now is Sensus will play that role for us in being that center of excellence. Lastly, certainly, we will modulate that based upon the health of the pipeline, how we're doing in any given year from a growth and earning perspective. So there's nothing magical about the 5%, other than it's a good healthy metric, and it's not much higher than what our pro forma blend is right now in terms of rate of spend.

Robert Barry - *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

It's Rob Barry at Susquehanna. Two questions. One on industrial. We've seen end markets start to inflect. We were chatting a little about this earlier, but you don't seem to be factoring that necessarily into the outlook. So is that just conservatism? Or just given the diversity of your industrial, should we just naturally expect kind of healthy lag from some of the short-cycle metrics?

Mark Rajkowski - *Xylem Inc. - CFO and SVP*

Yes. This is Mark Rajkowski. I think we see more of a lag. We're not really seeing that inflection point at this point in time. We do think -- and as I remarked in my comments, we do see that starting to occur in late -- later in 2018. We are on a bit of a lag. We do think there will be some benefits from infrastructure buildup at some point in time. But again, I think it's later in 2018. So that we'll call it a 2-year gap where that recovery is a little bit slower. We think, at least from our perspective, that is a pretty down-the-middle view of what the reality is.

Patrick K. Decker - *Xylem Inc. - CEO, President and Director*

We hope we're wrong. We hope it comes faster, but we just didn't feel it was prudent to build that at least to the '17, '18 time frame of guidance.

Robert Barry - *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

Fair enough. The second question was actually just on gross margin and what the outlook is there. I think at the last event, it was 42% to 43%. And I'm curious if that's changing at all. And in particular, if you could talk about pricing. I mean, given the vitality is going up so much, are you getting paid for all of the innovation? Or are you choosing to kind of use price to gain share? How are you thinking about pricing?

Mark Rajkowski - *Xylem Inc. - CFO and SVP*

Yes. Good questions. In terms of gross margins, we continue to expect to see a strong gross margin profile in that low 40s percent range. The -- in terms of pricing, I think this is one of the opportunities that Patrick certainly was getting at as we think about commercial excellence and what we're doing with our sales teams to really get out there and make sure they know exactly the value that we're bringing to our customers, what their pain points are, what is the total cost of ownership. So we're focused more on pricing on a value basis. We are not looking to go out and price for share. We'll -- we need to be competitive in the marketplace, but we really want to go out there and price for value. In our model, we have assumed, really, neutral impact on pricing. So it's a fairly conservative view. We think there's upside there, but we got to go out in the marketplace and deliver that.

Patrick K. Decker - *Xylem Inc. - CEO, President and Director*

Yes. So we probably will have another Q&A that's actually longer after the Sensus session this morning. But we probably have time for maybe 2 more questions, and then we're going to break.

Joseph Craig Giordano - *Cowen and Company, LLC, Research Division - MD and Senior Analyst*

Joe Giordano from Cowen. Two on -- I guess the most common pushback I tend to get about recent developments here. So when you talk about the overlap with Sensus and the leverage that brings to your public utility customers, a lot of people are a bit -- concerned is probably not the right word, but they question. You're talking to 2 very different people at the same place. So how silo-ed are the utilities themselves? And are they like overlapping people that you're talking to? Are they almost like 2 separate companies under the same house?

Patrick K. Decker - *Xylem Inc. - CEO, President and Director*

Yes. So really -- thanks for the question, Joe. This is Patrick. It really goes customer by customer. I would say the larger the utility, the more likely it's going to be silo-ed. And the smaller to medium-size utilities just aren't that big to be silo-ed, so it's easier to get to that common decision point. But what I would say is, again, we talk about this being a journey, especially in terms of leveraging FlexNet, the telecommunications capabilities to devices that are out there that Xylem has sold in. Part of the reason that does have a lead time that we talked about was what Sensus, and quite frankly, Visenti as well are bringing to us is they had historically sold into the C-suite of the enterprise. It's a major investment from an IT standpoint, from a capital outlay. So they're talking to the CEOs or C-suite. It's not that Xylem has not done that in the past, but it's been less common for us to be able to get that access, other than maybe me or other senior executives showing up to a customer meeting. So we think that combination together is going to open a number of doors for us to have a different kind of conversation than what we might have had historically and cut across the silos.

Joseph Craig Giordano - *Cowen and Company, LLC, Research Division - MD and Senior Analyst*

That's very interesting. And then last one on the revenue guide, pushing it 100 basis points. Given where you were last year and where you are, where the guidance is this year, did you feel pressure to bump that a little bit? And I kind of get the sense that people -- if the ability was shown to grow 3%, people would be extremely pleased with that. So now moving to 4% to 6%, I assume that's probably you're going to get the most pushback from people generally. What kind was the thought process there and having not shown that kind of growth over the last couple of years?

Mark Rajkowski - *Xylem Inc. - CFO and SVP*

Yes. Listen, good question. And we really deconstructed all that. So as you look at the base Xylem growth rate, we actually did take that down a point. And again, it's for all the reasons that we've discussed around the industrial markets, some of the pressures on the emerging market countries that are impacted by commodities. So while that's down a point, we think that's a realistic view. Remember, we had a big -- we took a big hit this past year, particularly in oil and gas, mining and also in the Middle East. We think that growth rate makes sense. What's really getting us to 4% to 6% is the benefits from Sensus, both the point that Sensus adds in the base business because they're playing in the smart meter segment that is just faster growing and secondly, as we talked about, over $150 million of revenue synergies, which adds another point. So the growth, that increase from 4% to 6% is really fueled by the addition of Sensus.

Patrick K. Decker - *Xylem Inc. - CEO, President and Director*

And I would just maybe augment this, Joe, and then we'll move to break here. So no pressure there at all, Joe, to go up or feel the need to go up. I mean, at the end of the day, this is about delivering on our commitments. So anything we're putting out here is a commitment that we're going after. And so you look at that core Xylem growth that we took down by a point, even relative to what we did this past year, if you look back over the last 2 years, we were in a prolonged steep decline in a rather small part of our business, which is now only 5% of our total revenue, that being oil and gas and mining. But it was off the magnitude of a full point of organic growth 2 years in a row. So if you add those back, you actually get us back closer to this range where one doesn't have to believe or hope a lot to be able to see a change in trajectory, and the comps get easier here in the second half of the year. So a lot of work to do, but we feel confident with the targets we put out here.

Joseph Craig Giordano - *Cowen and Company, LLC, Research Division - MD and Senior Analyst*

So not incrementally more aggressive in your view?

Patrick K. Decker - *Xylem Inc. - CEO, President and Director*

No, no.

Matt Latino

All right. So will that, we'll take about a 10-minute break and reconvene here about 11:15.

(Break)

PRESENTATION

Matt Latino

Thanks, everybody. So with part 2 of the presentation, starting now, we'll have Dave Stanton, who's the President of North America utilities for SUEZ for a fireside chat with Patrick.

Patrick K. Decker - *Xylem Inc. - CEO, President and Director*

Great. So I am really thrilled to have David here. I think it's probably not entirely common at an Investor Day you would actually have either a customer or somebody with really broad-based utility experience here to answer a number of questions. David has committed to me that he's going to be very open, candid along the way.

Now we have, just for sake of time management, we're not going to be able to open it up on the floor for questions. But we did canvass a number of people beforehand. And hopefully, we'll get the questions at the right level that will help inform you a bit more around the water utility industry but also how David and other executives think about technology, pain points, et cetera.

So real quick for those of you that don't know David. David, he currently serves as President of SUEZ in their North America utility operations and federal services, where he oversees the operations and management of regulated water and wastewater businesses across the nation. David has over 25 years of experience in the water industry, both in the United States as well as abroad globally. Prior to SUEZ, David served as CEO and member of the board of APTwater, a company focused on water reuse. David grew APTwater from its inception through organic sales, service and acquisition of new technology, and he built an innovative platform and market strategy. Prior to APTwater, he served as COO and interim CFO of SouthWest Water, where he led the company through a turnaround, ending in a sale to a private equity company. David launched his water career in 1990 with a startup company, which was acquired by Wheelabrator Technologies. And then as the industry consolidated, our paths crossed. He moved to Tyco International, where we worked together for a few years. And there, he advanced through a number of positions of increasing responsibility before being appointed Executive Vice President of EarthTech's international asset management division. David holds a B.S. in Electrical Engineering from Cornell University and has had continuing education in the University of Virginia Darden School and in Six Sigma process improvement methodologies.

So with that, I want to give a warm welcome to David here today.

David Stanton - *SUEZ Water Resources Inc. - President of Utility Business*

Thank you.

QUESTIONS AND ANSWERS

Patrick K. Decker - *Xylem Inc. - CEO, President and Director*

So top of mind, David, I'm really just going to tee up some questions here, and you go where you wish to go. No doubt on the minds of probably everybody in here, it's one of the first question I always get, is your view on where we are in the U.S. municipal water recovery. Kind of what inning are we in? There's been some commentary on air pockets and possible delays on the muni front driven by changes in administration, uncertainty, et cetera. What are you seeing at this point?

David Stanton - *SUEZ Water Resources Inc. - President of Utility Business*

Well, we're sort of, of the view that we're in kind of a long-term, positive up cycle in the entire public utility market, whether it's the investor-owned utility side, which I would say is on a very nice ramp right now, or on the municipal side. The drivers are the drivers that you identified. Largely, there are delays sometimes on the municipal side based on political cycles and these types of things. But the general trend and availability of capital and the need has shifted, not only just from like a regulatory need, but more of an incentive, and a lot of cases, from the government to actually get about it and start fixing the problems and most of the regulation that affects the water sector is state by state. It's not the federal regulation that gets so much attention. And there's an increasing number of states putting in infrastructure incentives to invest in water and wastewater infrastructure to the point where it's driving for us the directions of our growth and where capital is going.

Patrick K. Decker - *Xylem Inc. - CEO, President and Director*

I think it was acknowledged by Ryan Connor earlier that you and a few other utilities are clearly more progressive than others. And I know you're very humble, but that's the fact. Could you talk a bit about the adoption of new technologies and the need for innovation in the water sector? And then beyond that, maybe address from your perspective, without putting you on the spot, Ryan's question earlier, around what does it take for other utilities to adopt things more quickly? What are they looking for as the proof point?

David Stanton - *SUEZ Water Resources Inc. - President of Utility Business*

So when we look at the overall utility market, we sort of divide things -- and it's North America I'm speaking about generally. And it's a little different as we go around the world. But in North America, we sort of divide the utilities into kind of A, B and C camp. A is the thought-leading innovative utility, the early adopters, the ones that will drive where the industry is going. And we've already talked about a couple of them, DC Water, SUEZ, American Water. The -- out West, you've got East Bay MUD, Orange County. You've got a variety of large utilities. And the A group is where all the innovation happens. All the way on the other end, you have the C group, which is municipality-run utilities that are bankrupt, under duress, have pension problems. Their balance sheets don't work. Their systems are far out of compliance. They have no access to capital easily or strong rates to support their utility needs. The big group is in the middle, and they're Bs. And Bs are sort of 2 categories. The Bs that are looking to the As because they want to move in that direction and the Bs that are headed to C. You know what I mean? So the whole idea about adoption, in my opinion, is working with the thought leaders and then identifying the Bs that really want to move up to As and kind of save some of them from dropping to Cs. But what gets all the press are those Cs, and they are a problem. We do tackle that problem at SUEZ with the C, but it's a different challenge. And so a lot of the time you hear that, boy, it's just an impossible market. You're not talking about the As and kind of B pluses. You're talking about the B minuses and the C utilities. So I think segregating the market and identifying the addressable market in some fashion that divides it up as opposed to looking at it like a lump is really clever. And then when you do that, in our experience, you still have a giant market. You really haven't compromised the opportunity because nobody has a significant market share in anything that we do in the water segment.

Patrick K. Decker - *Xylem Inc. - CEO, President and Director*

So when you heard myself and Jay talk a little bit about pain points that a utility faces, I guess either feel -- corroborate that, maybe augment from your perspective. I mean, a day in the life of a utility operator, what are the biggest pain points? And what role do you see technology playing? And are you willing to pay up for it?

David Stanton - *SUEZ Water Resources Inc. - President of Utility Business*

Yes. That's a good question. So I'm going to kind of start -- I'll start kind of at the top. We heard a little bit in the strategy this morning about the role of efficiency as a core tenet of what the industry needs, and I think we actually undersell that as an industry. And the opportunity to drive efficiency in the utility environment is extraordinary, and the opportunity to use data to drive that value proposition is really where the industry is headed. And why it's so important is because we have an infrastructure requirement that far exceeds our ability to finance it through rates, okay. Now there's a municipality utility or an investor-owned utility can't just raise rates enough to fix all our pipes and all our infrastructure problems because of the political pressure and the fact that it's not just reasonable to jack up somebody's rates in 1 year 100% or something like that. So we have this rate constraint, which is our biggest constraint for solving our infrastructure problem. And so the opportunity that we are trying to leverage and trying to get the entire industry to work towards, not just SUEZ and other utilities, is by driving efficiency, we create opportunity to invest under the same rates, okay, disproportionately. And so the efficiency story isn't natural for utility markets because we're generally cost recovery on the cost side, whether you're municipal or investor owned. We recover our cost in rates. You just add up your cost, put in rates, and it comes back to you. You make your money, either on investment and then investor-owned side through capital investment. On the municipal side, it's through issuing bonds, and they pay investment fees and that sort of thing. So driving that efficiency is really, really core to the future of sustainable utility management. And what we've discovered, and we launched this across SUEZ-wide, but in North America, we got really serious about it 4 years ago, really impacting kind of the smart utility concept in all the core categories of utility management. And we're going to talk more about the Sensus value stream, which is largely meter to cash, But we also launched it in asset and workforce management. We also launched it in capital creation, where we have to build new assets and new utility. And then we also did it in sort of SCADA production management, sort of this -- sort of the mechanics of how you pump and treat water. So in all those areas, we just made a strategic decision to do it all at once. We weren't going to do one area at a time or one big waterfall project. So we started tackling these activities all together. And as a result, when we started, we have sort of a governing metric, which drives this efficiency idea, which was we started our cost of operating expense as a percent of revenue, so sort of the inverse of gross margin, OpEx over revenue was somewhere around 52%. And here we are, a little less than 5 years later, we're down to below 42% in this -- in the North American SUEZ footprint. And if you look at the American Water and Aqua, they launched a similar program at similar times. And you can see their published data with very similar results. So what that's done is it's given us 10% under rates to increase our investment. So we've more than doubled our capital investment in that same period of time, and our rates have only gone up 3% or 4% as a result. So that dynamic is what we're trying to create across the industry right now, and it is driven by data-driven decision-making. That efficiency comes from the data that we're getting from these processes.

Patrick K. Decker - *Xylem Inc. - CEO, President and Director*

Could you -- to that point, I know the term big data is thrown around a lot, and God knows there's tons of data that can come off the network. But when you think about the problem that you're trying to solve, big data being turned into actionable information, where do you see that being most helpful to you in the utility space? There's a lot of data we could give you, but really what matters most in your mind?

David Stanton - *SUEZ Water Resources Inc. - President of Utility Business*

Sure. It's interesting. When we launched all these activities, we did sequence them in ways that we thought were logical. And one mistake we made, which it was that we actually didn't automate our work order processes first. And what we found was as we're bringing data to life, like in the meter-to-cash process, anything you do with data analytics in the utility, that generates an opportunity to improve the utility, turns into a work order because that's how we get work done. Everything becomes a work order. So what was happening to us we adopted Sensus. We started rolling this out. We started really focusing on the metering side first as the first opportunity, and we started generating work orders faster than we could process them through our largely paper process. And if we were to process them, we would quadruple the amount of paper all of a sudden we were generating. So we've rapidly had to catch up with integrating sort of an automated workflow with our digital output. But that's really -- the key is being able to look at the data, analyze it in a way that's useful for operations, create a work order, get that work done and then get that resulting data back into the legacy -- the asset management tool or the information record quickly and accurately.

Patrick K. Decker - *Xylem Inc. - CEO, President and Director*

So there's a lot of things that can complicate change management. And whenever you put this out in front of the organization, obviously these are big, bold changes that you laid out. We're not going to do it in sequence. We're going to do it one time. You talk about the impact of workload in the immediate term. What other elements do you -- kind of the degree of difficulty of you even changing inside your organization to deal with the inflow of this information of data.

David Stanton - *SUEZ Water Resources Inc. - President of Utility Business*

Well, I mean, we can focus -- on the meter-to-cash side, we looked at really upgrading and improving our meter fleet, changing our -- everything into full AMI, okay, collecting that data, analyzing it, feeding it through our billing tool. And the Sensus FlexNet is the core, in the middle of that process workflow. And what we quickly have found is that just -- I mean, a very simple thing like being able to analyze data and make decisions on it is not a core competency of most utility workers. I mean, a lot of our utility workers have learned their skill as a trade, and they come up through apprentice-like program over years and years to learn what to do. They learned it from the guy that did it before them or the -- and always the guy. Now it's sometimes the gal. We have some women working their way through operations. And so yes, so that's been a big change. Now we are -- as we create digital solutions and the algorithms that are attached to them start to make some of the decisions, first of all, we're capturing some of the institutional knowledge of those workers in the process, and we're also making it much easier to train a younger worker to be able to adopt and manage that. And this workforce evolution, to be quite frank, would be the constraint if we had to roll this all out in a year. But the fact is even that we're aggressive and we're rolling out as fast as we can, it's kind of a 5- to 7-year rollout to hit all the distant reaches of our utility networks. And so we have time. So we're trying to do this workforce redevelopment program. And we're working with our vendors. I mean, we find vendors like Xylem and Sensus that are largely manufacturing and equipment thinking companies, and now we don't want their pump. We want the smart pump, and it's all about the data that comes out of that pump. So it doesn't matter if the pump works. We assume that's the deal. The data has got to work. And so getting that cultural change actually extends out to our vendor groups as well and to bring to life the data that we want.

Patrick K. Decker - *Xylem Inc. - CEO, President and Director*

I always -- people who know me know that I have a tremendously healthy respect for our competitors. And so you have a lot of choices out there every day, and we've got some great competitors across the industry, whether it be in the pump side, whether it be in the metering side, the technology. But you've been a long-time customer and advocate of Sensus, and I know also you deal with a number of our competitors. In your perspective, what differentiates Sensus from the competition? And when it comes to the FlexNet technology, which I realize for some of in the room, they don't know what that is yet, Randy will talk about that in a moment, what was the big selling proposition in your mind?

David Stanton - *SUEZ Water Resources Inc. - President of Utility Business*

Sure. So we largely looked at sort of 2 core decisions. One was how are we going to communicate with our sort of Internet of Things. These devices meters, we have 650,000 of them that are scattered all over, and we need to get all that data back in on a regular basis. And we don't want to do it differently at every utility, okay. We already had installed Itron systems, Aclara systems, Neptune systems. So we went out and did kind of a thorough review and study on the -- what we thought was the best system, and we ended up selecting Sensus. And a couple of things that sort of led that. I mean, there are a lot of small things, but a few big things. One is you need 2-way communication. If you can imagine, even if it's a pump or a smart sensor or a meter, that now has software on it that's doing smart things for you. That software needs to be upgraded. It needs to be patched. It needs to be secured from Chinese hackers. So you have to have a way to communicate 2 way with that. And surprisingly, most -- not all systems communicate 2 way. And surprisingly even more, some states don't allow 2-way communication with meters because they think it gives us the ability to manipulate the meter. And so we actually had to go state by state and get approval to have 2-way communications with our meter. So there's a lot of work to get that decision in. It wasn't just a procurement decision. We actually had to go get regulatory policy change in order to adopt Sensus systemwide. And so that was one big piece of it was the 2-way communication. The other is the license frequency. It's extremely important. And I would say the -- but sort of the competition killer for us was Aclara probably has those 2 features pretty close to Sensus. I don't mean to offend the Sensus guys. But I mean, they have more or less have something in that category. But the robustness of the communications was such that if you have hills, buildings, larger terrain, it was an order of magnitude fewer fixed collectors for Sensus than it was for Aclara. So a geography where we might have 200,000 meters might take 40 or 60 Aclara collectors, and it took 10 to 20 Sensus collectors. And that has a massive impact on our maintenance cost, the number of towers we have to locate, the number of sites and the maintenance and all these types of things. So that was a big part of it. The second piece which I'm just as excited about is when we started this process, we knew we wanted an analytical platform for all the big data coming from our customers. And we actually -- this is now 3-plus years ago, we actually went out and did a beauty pageant with 8 companies that had product. And they all came in, Oracle, I mean, everybody came in and tried to sell us on the solution. And there the solution was basically something they had done for power. And then they said, "What do you want for water, we can do it," okay, and so -- but it's going to cost you millions of dollars. You know what I mean? So we decided at the time to make no decision on an analytical platform for big data because we didn't think there was anything out there that was adequate for the water industry, so we chose to make no decision. And we basically made some modifications to our SCADA system to receive the data in the interim, so we could play around with it. But we gave a lot of feedback to everybody. And the Sensus analytics platform we felt, 2 years later, had really come full circle and really identified the right mix of needs for the water. Now, we're implementing that Sensus analytics platform, which is really going to be a valuable contribution to the whole puzzle.

Patrick K. Decker - *Xylem Inc. - CEO, President and Director*

When you think about synergies across different parts of the water network, because commonly as a utility, you're managing not just the clean water network, the wastewater network, you got outdoor water. What do you see with the investment in FlexNet? What do you as some of the synergies that are there in terms of connecting devices? You've talked about a little bit about that already. But what do you see as some of the bigger pain points in the network?

David Stanton - *SUEZ Water Resources Inc. - President of Utility Business*

Well, the most exciting picture we have in all of SUEZ North America is this picture of our FlexNet read zone around New York City. So we have all the utility, starting at Bayonne, going all the way up above Rockland, almost to West Point. We have half of Westchester County, and then we run all the wastewater of Nassau County. So we have this big horseshoe right around Manhattan, and that horseshoe now is saturated with FlexNet, okay. It's the most densely populated nonurban area. I mean, it's technically an urban suburb, I guess, of New York City. And we also have a unique aspect that we run all the watersheds in North Jersey, which most utilities don't. And so we actually manage them either alone or in partnership with North Jersey municipal water authority. We own half of their watershed as well. So we have kind of this unique opportunity to bring data to life in an interesting way in that area. And I don't know exactly where this is going to take us, to be quite frank, but I think it's going to be sort of revolutionary. It's going to evolve. But in the end, we're going to look back on it and say, "Wow, this is huge." And I'll give you a couple quick examples. One is sort of in network, where we have dozens of sensors now. We think that, and we're working with Xylem on this, is that if we can saturate our network with sensoring thousands of sensors, that, that same data and up into a good analytics platform is going to tell us a lot more about water quality and water quality management throughout the region. And if we kind of go on the other side of our plants upstream, the rivers, reservoirs, creeks and streams, quite frankly, there's a couple of USG water gauges on them that were installed 30 years ago. And the flows on those streams are largely regulated by a Supreme Court case ruling in the 1950s that says how much passing flow and these types of things have to be there. And no -- everyone is afraid to challenge the math because it came out of a Supreme Court case on the Delaware River. So we're thinking if we sensor upstream and we start building the environmental data and how to do it right that we will learn and develop entirely new ways of increasing yield and management of the entire watershed region, and ultimately, the long-term sustainability of it.

Patrick K. Decker - *Xylem Inc. - CEO, President and Director*

Well, again, I think for 2/3 of the people in the room here who live in the New York Metro area, they didn't realize you're the guy to call.

David Stanton - *SUEZ Water Resources Inc. - President of Utility Business*

Yes. I have a few business cards. And if you call me too much, I'm installing one of those valve shutting-off meters at your house from Sensus.

Patrick K. Decker - *Xylem Inc. - CEO, President and Director*

So -- well, hopefully -- again, it's been terrific to have you here, David. Hopefully, it's been insightful for the folks and the audience here and online. We're early stage in the partnership here on the whole broader watershed management. There's more to come on that. And I think it really -- that is the forefront of thought leadership, so I want to applaud you for taking a role in that. So thank you very much.

David Stanton - *SUEZ Water Resources Inc. - President of Utility Business*

Thank you. Happy to be here.

PRESENTATION

Matt Latino

Okay. So with that, we're just going to set up the stage here quick, and then we'll pivot into the Sensus portion of the presentation.

And that will start with Randy Bays, our President of Sensus.

D. Randall Bays - *Sensus USA Inc. - President*

Okay. Thanks, Matt.

Okay, well, thank you very much. We appreciate you being here. And, David, thank you. I think we just took an order for maybe 10,000 ally meters there, so it's great news. We'll accept that.

Really excited to be here. Just a little bit about myself. I have been with Sensus 3.5 years. My experience goes back 20 years. I am also kind of celebrating an anniversary, 20 years of kind of managing companies. I started back in April 1997, so I've been around a while. And prior to that, many engineering and operational roles with at several companies, including 10 years at General Electric. And so it's been great for me. I have enjoyed being at Sensus. I have to say that I'm really excited about this combination with Xylem. In fact, I think I can speak to the whole Sensus team when I say we're excited to be here. Think about where we've been over the last few years this getting -- this kind of a decision made and landing with a company like Xylem. This has been extremely positive for the company. And I also think we're going to be a formidable force in the market as we go forward. We’re very excited about it.

Okay, key messages today. I'll just hit these things very quickly. I've got a lot of charts, so I apologize, I'm going to go very quickly and first off is solving customer challenges with a comprehensive portfolio of technology -- sensors and technology to resolve end to end customer solutions. And what we're really talking about there is starting all the way at one end where it's a water meter or sensor or something and going all the way through to Analytics. David referenced that. It's very important to have the data. And so we're working across that whole spectrum. It's very important. There's a lot of things that tie together there.

Secondly, accelerating growth potential in several areas. We have a couple of areas we're extremely excited about and certainly North America. We're continuing to innovate and bring products to the market. So we're super excited about that. And we're not just talking products, we're talking software as well. And then the other thing is large international deals. We're extremely excited about what's happening in the international market. We've got some great opportunity. We're currently pursuing 20-plus deals. The value of those deals, as Patrick mentioned, is $3.5 billion.

Now, I have to

(technical difficulty)

over 15 years, so I've just got to mention that, but we're very excited.

Now the other point I'll make is, on those large international deals we have about 9 of those we're in pilot on. So we've actually stood up FlexNet, doing some things for our customers. We also have a differentiated business model. It's first driven by technology; second, it's driven by customer-first mind-set. We're really focused on -- in serving our customers well. We're very focused on it. We continue to work on it. We call it customer first. And then the last thing is quality. And I have to say, generally speaking with -- about the industry a little bit, there is always a few quality issues. So we've taken that head on and we've driven quality leveraging Six Sigma tools. And then lastly is just the revenue synergy that we're going to enjoy with the close cooperation with Xylem as we move forward.

From a business perspective, talking about 2016 EBITDA -- I'm sorry, sales $891 million in 2016, EBITDA 20.3%. We've also performed very well over the last year -- 3 years. We've met all of our commitments to our owners over the last 3 years. So we're a very strong team when it comes to planning the business and executing the business. We believe strongly on those principles. Forecasting 6% to 7% revenue growth between 2017 and 2020. We feel that's achievable and we're excited about that.

Key customers. We love our customers, we find the business to be very sticky, they're typically very loyal and the relationships really last for many, many years and hopefully, David, we can -- down the road, 20 years, we'll still be having these relationships, I'll be pretty old at that point. But I am just saying that we're excited about these long-term relationships. And we know how important it is to you that you get the kind of service that you need. So -- and we have you right there at the top of the list by the way. So when we deal with utilities, we are dealing at the highest level in these utilities. I made a trip out to Portland to visit PGE and SaaS power just a couple of weeks ago and my meetings are with the CEOs of these companies. We'll also work throughout the organization, but we're meeting with the highest level in these organizations. We're meeting with key decision makers. Very, very important. It's also very important to have those lower level relationships too, but we want you to understand that we're working at a very high level.

Just talking about revenue. You can see 65% of our revenue is in water and about 15% in gas, 9% in electric. And I was glad to hear Patrick reaffirm our commitment to the gas and electric space. It's very important to us. And I would say that our technology in those markets is just as awesome as what we have in the water space. And we have a very strong product road map. Dale has done a great job. He will be speaking here in a minute about strong product road map that we're executing against, and we feel very good about that.

When it comes to international business, about 68% of our business is in the U.S. However, we are starting to get tons of traction internationally. 2 deals we won over the last few years have been the DECC deal and Thames Water deal in the U.K. Each of those deals were worth about $300 million apiece over that 15-year time horizon.

And I have to say, I joined the company about the time we won the DECC deal. And one of my biggest concerns was coming in and how can we execute a deal of this magnitude. It just feels so big, it's complicated, it's across the pond. And the team has done a flawless job on both of these deals and the execution of these projects. I was over at Thames a couple of months back, and they are very complementary. And their question is, what's next? Where do we go? What's the next level? And so I'm very excited about that. We are also very excited about the continued growth and recurring revenue in software and data analytics and really our services model as well.

Now our technology is really front and center. We love technology in this company. We've had a big appetite for technology. Over the last 3.5 years, we spent about 10% in R&D. And, again, we've got that tied to road map. It's not just -- we're not just throwing things up. We have a plan and we're executing. 600 software and hardware engineers and technical staff. We have several R&D facilities. You happen to be in the largest one that we have in the company, we're very proud of this. I think you're really going to enjoy the tour of the facilities later. There's been a lot of really great progress and -- made here over the last few years. But we're not only innovating on our own, we're also doing acquisitions to add to the capability of the company.

So let's take Wedeco. Brian Crow joined us April 1, 2014 and it's been 3 years. Sorry, Brian, I didn't get a cake for you, I forgot about that. But we have really went into data analytics in a big way. Brian was working primarily in the electric space and his team, we immediately wrapped resources around the team and he released the first water product, I believe, in September of 2015. And today we've captured more than 200 customers with that water analytics platform. And the good thing about water analytics and any of these analytics platform is they go this way, they're typically 5-year kind of deals, but they also go up too. As you develop more advanced analytics, you can add to that. So it's really been fantastic.

Secondly, Sentec. Sentec is probably one of the premier IoT companies in the space today. They are based in Cambridge. There are about 40 people and 12 PhDs. And this is why we kind of look at technology and we feel like we can do really anything. We can integrate with anything as we go forward. Very good company. We had the opportunity to acquire them, and they've been front and center on several of our new product initiatives in gas, and electric and also on water. So very good company, based in Cambridge. They're mostly Cambridge graduates. There's 1 Oxford graduate there, but -- and he takes a lot of heat, but it's a very, very capable -- it's not really what I call a think tank, it's a bunch of smart guys that work very hard every day. They're getting stuff done. They're moving developments along. And if we have a problem -- quality problem even, pick up the phone, hey, we have this thing come up, what do you think? And it's always great. They have a great perspective and have been a really big help to us.

Visenti, very quickly. I think one of the presents that Patrick gave us shortly after the acquisition of Sensus into Xylem was, Patrick sat down with us and said we're acquiring Visenti, and we were kind of like, kind of floored by that, because we had pursued Visenti in early 2014. And it was kind of, thank you, Patrick, it was a very nice gift, we appreciate it. But it's a great company. Visenti brings a acoustic methodology for leak detection and detecting nonrevenue water. And we have a kind of a different approach. And when you bring them together, they're really -- you really get 1 plus 1 equals 3. We're very excited to have them on the team. They're actually arriving tonight. We're spending the next couple of days. This will be our second skull session with them, just to talk about the growth and the opportunities and how we're going go and pursue the market. But one thing is very important, we see a nice play in the North American market with their technology and our technology, but the international deals that we talked about, the 20-plus, there's also some really good opportunity there, because a lot of these large international AMI deals they're looking at nonrevenue water as a big driver for their business case. And so we're going to bring that together and package it. So we think 6 or 7 of those deals are going to be helped by having Visenti on the team.

Just to give you a little -- just try to make this a little more realistic for you and kind of bring it down a little bit. I'm sure you're familiar with some of these things, you can see gas, water, electric, IoT. But we're just trying to make this easy to kind of understand. Here is a gas meter; here is the iPERL, water meter, ally water meter and Smart Gateway, and so on. But basically we have a device here typically metrology or sensor and then on top of that we have radio communications, we call it SmartPoint. This allows us to communicate back to the base station, so the data is flowing like this. The amount of information we get goes from just every 15 minutes or it could be every hour, every 4 hours, it depends. And this layer, we have a network management software, which kind of operates FlexNet and then you go up to the next level, which is applications and analytics. And at this layer, we have 633 customers that are Software-as-a-Service customer. So we manage the software, our software, in one of our 3 data centers in North America. And it's a real positive for us because it's easier for us to manage in our own data center, and secondly, we get paid for it, so we like that. So this is just to give you a feel. And again, 400 million messages per day traveling across our networks around the world. And Brian likes to always reference Twitter, because I think Twitter is nearly 500 million messages per day, we're 400 million messages.

Now going to the next level, extremely exciting. We have Visenti coming into play. We have the transport and the pumps. We have Xylem analytics, water analytics. We have a whole bunch of technology now that we're going to put our arms around and get that communications technology fitted to those things and then guess what? We're going to ride up to the top to David's point just a minute ago and get the actionable insights out of the data.

If you think about the amount of data that's coming through these utilities, it's terabytes of data. And how do you look at 100,000 meters every day? What you need is the exception reporting. For example, iPERL is one of the most accurate meters in the industry. It measures extremely low flow rates. So we can actually -- using data analytics, we can tell customers if they have leaks in their homes. We have the capability to do that. So if you ever get a placard on your door and it says you might have a leak, it's probably an iPERL.

Going on. This is powering the city. We like to put this chart out but, again, it just gives you the -- a feel of the range of products that we have. But not everything we have is a meter, we have Smart Gateway, we have all kinds of DA solutions, we have base stations. It's a very, very broad range of products.

But I want to spend a minute on FlexNet, and I think David did a great job already kind of presenting this for me. But first private, purpose built, it's licensed spectrum. So it means no one else can enter that spectrum. A lot of our competition operate on open spectrum, same spectrum, where there's baby monitors, garage door operators and lot of other things. So we are in licensed spectrum, and that's a big advantage for us just for the reliability and the resiliency of the network. It's dedicated and secure.

The other thing is, and David touched on this as well, is really the idea that you -- we have less infrastructure, our technology because we're licensed spectrum, we can operate in higher power and we have less infrastructure. So it's easier to maintain in the cases of tornadoes, hurricanes, ice storms, those kinds of things. It's easier to maintain because there's less of those base stations out in the field.

The other thing about our technology with FlexNet, it's easy and expandable. So if you're a electric utility and you decide that you want to have lightning, it's easily done. We're full duplex, we can communicate in both directions at the same time and so it's just very, very capable, it's kind of future proof, if you will.

Lastly, deployment services. I just have to say a couple of things here. So we have a consulting team that are very knowledgeable in utility consulting. We have a team that helps with deployment of projects. We have a team that will do training and we have a team -- just a -- we could help in just any utility situation. We have a lot of experience. There's a lot of times where we lean forward beyond what our technology is doing in the utility and help utilities solve their problems, and I think that's customer first.

Next is just leveraging our core strengths to win. Technology, certainly, at the top of our list, continuing to spend that 10% of revenue, driving a very strong product road map. Passionate and energized management team. We are a company that has run a couple of surveys. We used the Great Place to Work survey over the last couple of years. We've seen dramatic improvement. But there is no rocket science to engaging employees, it's just about engaging employees, if you will. And we've been very excited here about we have seen. But most of the people in this company believe strongly that the work that we're doing is very, very important when it comes to conserving natural resources or it's improving utility operation, they believe the work is important. Customer first is a priority for us. We want to continue to serve better than anyone in the industry and keep that trusted partner kind of mind-set with our customers. Then lastly is just the diversity of everything you bring together, great technology, great people, customer first, working in water, gas, electric and lighting.

Growth. We believe strongly in growth. We have a great story around growth. First off, it's just investing in new products and software for the North American market, in our core markets, just continue to invest. Secondly, we've talked about the international deals, $3.5 billion that we're pursuing. Again, we have done 9 pilots. That's going very well. Also capturing the synergies with Xylem, whether it's just the cross-promotion and cross-selling, it's going very, very well. I happen to sit in with the North American team frequently, and I have to say that the teams are working seamlessly in North America. So it's very good. And then bringing technology to wastewater and outdoor water, something we're going to do very, very quickly.

Scaling. Visenti is also a priority and using their technology to support our wins in the international market.

Quality is my last chart, and I see my shop clock has run out here, so -- but I just want to say a couple of things about this. This has really been a big differentiator for us. Again the industry quality has not been great. I've been through 6 Six -- 3 Six Sigma implementations, and we've started with Six Sigma with Mike McGann. He'll be on giving -- leading a tour here a little later on. But Mike is also trained at GE. And we have a couple of hundred green belts that are in training or have been trained, we have 15 black belts and we have 3 master black belts, and this is not just fluffy stuff, this is real stuff. It's a part of the fabric of the company today. And those black belts, once they complete the program, we typically move them up into a better job, and it's been very beneficial for us. It has really increased our capabilities. Six Sigma system tests, you'll see that as we tour, just testing across the full spectrum end-to-end. You can't put a product in the field today that doesn't work, and it really takes beta testing, it takes good system testing. These are complex products.

Return material analysis. 4 years ago, nothing was coming back to the company. They were doing no return material analysis. We now analyze everything, and we've taken all those learnings from those return materials and driven it into our new products and driven it into our existing products to make sure the quality is good. And we've seen that. The data supports that. It has really helped us tremendously to reduce our warranty costs. It has improved customer satisfaction. It has been very, very big for us.

Quality control. In the factories, we're doing a very good job there. We've got a lot of data to support the progress we've made there. It's intense focus. Software-as-a-Service Analytics is just another thing that we're actually, I would call this more of a health of the system kind of thing. We're actually -- we have millions of things that we can look at from our SaaS models, millions of devices that have been deployed, meters and so on. So we can actually look at that. We are actually doing some predictive analytics. We haven't marketed this as a product to sell, but it is very, very interesting and what the capability and Brian's team have done around Data Analytics. So I do see and hope there's a product down the road there for that.

So again, just key takeaways. Technology, very key to us. We're excited about it. We're innovating. We've got a strong road map. One point I didn't mention is, a lot of our customers are combo utilities. They are not just water or electric. They may do water, gas, electric, lighting. So having the combined capability, very important. Early stages of growth, very exciting in North America. There's still big opportunity there. Existing customers that we've deployed with will come back and buy more of our products, whether software or for example the ally meter, the remote shut-off ally meter. They will continue to use our technology. Differentiated business model around technology, customer first and quality and lastly, is the significant revenue synergies to be realized with Xylem.

So that's it. Thank you. Sorry, that was kind of quick. But thank you very much. Appreciate the opportunity. And I'll introduce Dale Harbor.

Dale Harber - *Sensus USA Inc. - EVP of Global Marketing and International Programs*

Thanks, Randy. I appreciate it very much. So I don't know if this speaks to my judgment or perhaps Randy's judgment, but this is now the third company that I worked for Randy at. I spent the last 3.5 years here at Sensus. It's been an interesting kind of 3.5 years, and it's really been great. Early in my career, I spent also at General Electric and, interestingly enough, ITT Aerospace and then several private equity portfolio companies. So with that, I hope to walk you through a little bit of what we're doing in the sales and marketing space within Sensus.

So first off, again, kind of key messages in the sales and marketing space. I'll talk to you a little bit about the markets that we serve. But suffice it to say, we have heard about water, gas and electric as kind of the core markets that we serve. We're excited about the long-term trends that we see in that space, but more exciting is some of the adjacent space, like intelligent lighting control and some of the Data Analytics that go into those markets that are driving kind of our accelerated growth. As Randy talked about, we believe we have the industry-leading product portfolio in the space. We've done a fairly significant 3-year investment in product portfolio that we, again, believe is industry leading. And then, again, I think it's been talked a lot about, but try to bring home a little bit more what the Xylem acquisition does for us at Sensus. How it drives some of our international growth. How we leverage that. And then also how it helps us here in North America.

So there was a kind of early market pioneer that talked about there is no such thing as a growth industry, only companies that are organized and operated to create and capitalize on growth opportunities. And for us, these drivers create essentially market opportunities or growth opportunities for Sensus. So just a couple of examples kind of in each space. In the compliance and regulation, the DECC deal that Randy talked about, that's a Department of Energy -- Department of Climate Control in the U.K. They mandated 2020 smart meter adoption. So that compliance for the U.K. market has driven smart meter adoption.

Similarly, in the gas market, there is a PHMSA requirement, that's the Pipeline Hazardous Material and Safety Association require that gas pipelines every mile have a monitoring device so they can test for pipeline integrity for cathodic protection. What we've been able to do is automate that process and create an operational efficiency using FlexNet where they can get that data not only annually, but they can now get it monthly or weekly if they so choose.

Aging infrastructure. Jay talked about nonrevenue water. So for us, nonrevenue water is a very tangible marketing tool. She said something to the effect of 30% kind of nonrevenue water. I think World Bank says the cost to water utilities is about $14 billion annually for nonrevenue water. So we can help drive value and helping those utilities capture that lost revenue associated with aging infrastructure and water leaks, we can certainly benefit our business.

Housing starts and urbanization is kind of obvious, but technology-driven adoption, again, you've had several examples of that today. But that helps us to not only taking technology that we pioneer in the electric market, but bringing it to the water market. I'll talk about a case later where we have a customer that does about 450,000, what we call, remote connect or disconnect of a water meter -- excuse me, of an electric meter annually. So if you think about truck roll and they're doing 450,000 remote connects or disconnects of that meter, whether it's a move-in or move-out or a nonpay or whatever the situation is, if we can bring that technology to the water space with our ally product, think about the value that we're bringing to the water utilities of having the capability of do that.

So as a proxy, I'll talk a little bit about the metering market. Globally, it's about a $12 billion market. About 50% kind of that $12 billion is electric, 30% water, 20% gas and the associated kind of growth rates forecasted over the next 3 years. So it's an extremely large, attractive market in all 3 segments. What's interesting globally is, less than 25% of the 3 billion meters installed are smart, and for purposes of this, we talk about a smart meter being a meter that has communication capability, whether it's embedded in the meter or attached to the meter, it has capability to communicate the data that it's measuring. So you can see, globally, electric leads the adoption, but water and gas are very low in terms of adoption of smart technologies. What's interesting if you contrast that and I'll show you the North American market, it's about $2 billion market. Again, similarly, about 50% electric, 30% water, 20% gas, a little bit lower CAGR, which again is part of what's driving our strategy to go toward international markets with our product. But the adoption rate is much higher. So the North American utilities have certainly seen the value of adopting technology and moving towards smart infrastructure for operational benefits. So again, electric tends to lead the adoption rate, but water and gas somewhat quickly behind. So still a huge market, if you think about globally, 75% of the market has an upsell opportunity to a smart technology. Here in North America, still about 40%, but also what we're seeing is about - in that 60% that have adopted smart technology, we're starting to see a refresh cycle. So we're starting to see some of the early adopters of that technology start coming back for more advanced systems, more capability in their AMI structure.

A little bit about our go-to-market strategy. As Randy talked about, we have a very high-touch customer engagement. We have about 300 sales associates globally. We use a combination of, what I would call, a key account strategy focused on large deals, particularly in the AMI space, and then we have regional coverage, both in North America and internationally, and that regional coverage allows us to get to the high number of utilities that David has talked about in terms of the number of utilities that exist in North America. So we do about 70% of our revenue through distribution, and we have typically exclusive distributor agreements. So they're selling Sensus and they're selling Sensus products only into that market. At the bottom of the chart, there’s a little bit about a typical AMI sales cycle. So you can see and it's been talked a little bit about, these tend to be on a large AMI deal fairly protracted sales cycles. Could be as much us 2 years on the front end of engagement, understanding pain points, potentially doing pilots. More and more, we see more and more pilots being done with some of the larger AMI deployments. Customer then go to RFP, go to a down select, go to a contract and then go to deployment. I think the interesting thing about the deployment, typically these are 15- to 20-year contracts, but a significant portion of the revenue is in the hardware that's deployed in the first 5 years and then the last 10 to 15 years of the contract, typically we get into a subscription-type software services and that's where we're trying to upsell analytics, that's what we're trying to add-on additional solutions underneath the FlexNet umbrella.

I talked about high touch. Here is just an example of some -- one of the things that we've done at Sensus to improve our customer engagement and our high touch aspect. This is something we call our Reach Conference. It's -- last year, we had about 1,000 attendees at this conference, that's more than double from 2013. We have what we call sessions. These are typically 45 to an hour session, where we do some kind of training, where we do some kind of training, where we do some kind of product education, where we do some kind of product road map to give our customers a view of what's coming, what can they expect from us as we go forward. So we're really excited about what that does for us. The other thing we've done in the customer engagement piece is something called a Sensus Partner Alliance Network. So we -- all customers of Sensus are able to participate in the Sensus Partner Alliance, and we have monthly calls with the groups. And we understand from them kind of engagement, what's happening in the marketplace, what lead times are going, what operational issues may be. But we communicate with them very regularly, and we typically do that via subcommittee. So it would be water, gas, software, analytics. We have 7 different subcommittees that we use to engage with our customers.

Next, 2 case studies that I think are very exciting and really drive home the value of Sensus. The first is Thames Water. I think Thames has been mentioned a couple of times. But one of the largest water utilities -- no, nothing disparaging, David, okay. One of the largest water utilities in the U.K., certainly I think in Europe. They had 3 operational challenges that they were trying to address: meter accuracy, meter read capability and nonrevenue water. We signed a contract with them in March of 2015. As Randy says it was a 15-year contract, $300 million kind of the initial contract value. We're in the middle of that deployment now. We've sold about 400,000 meters and it's going extremely successful in the deployment at Thames. I think one of the interesting data points, and I know Brian is going to talk about Data Analytics, Randy indicated he visited a couple of weeks ago at Thames. They indicated in the first 100,000 meters that they installed under FlexNet, they got more data from those 100,000 meters in 1 day than they had the previous year from their entire 3 million population. So essentially that's an hour read for a day -- 24 hours versus the data that they were getting out of their entire population getting a read once a year.

The other case study is a Philadelphia-based combo account. Randy talked a little bit about combination accounts. This happens to be PECO. They have 1.8 million electric, 0.5 million gas customers. Again, it was probably a very traditional AMI deployment in that they deployed AMI in order to generate operational cost savings associated with the labor to read the meters. What they've gained from it is, they've installed -- they do about 450,000 remote connects, disconnects a year. Again, huge operational savings. And then in terms of outage management, they get tremendous value from being able to pinpoint outages, being able to save labor costs associated with restoration of service, and the timeliness of that service drives a high customer satisfaction.

Again, 3 key takeaways. What I would say is, I believe Sensus is organized and prepared to drive success in the markets that we serve. We have made a significant investment in our product portfolio to drive growth and we're excited about that. And then lastly, if you remember the market charts, $12 billion globally and only $2 million (sic) [$2 billion] in North America. So 80% of the market that we serve is outside North America. The Xylem global footprint and the Xylem brand will accelerate the growth that we had started in the international space, and we're really excited about how that comes together for us.

So with that, I will introduce Brian Crow. Brian is going to talk about Data Analytics.

Brian Crow

Thanks, Dale. Before I hand it back over to Patrick to wrap up, let me give you a little bit of a glimpse of what we get really excited about, where our passion lies, a glimpse of the future. While I was putting this together, I thought that I would basically just come up here on stage, shout analytics, drop the mic and walk off. Then they told me that we have this lapel mic and it will be kind of messy to pull it out of my shirt and drop it off, it wouldn't be quite the same experience.

So let me jump into and give you a little bit about my background. I started my career as an engineer in electric utility. And so lot of the problems that we are solving today are problems that I dealt with at the utility 25 years ago. I realized firsthand as a young professional the amount of data that was coming in from out of the field was greater than any amount of data that we'd ever have before, but also knew that it would transform the way that we approach solving problems and the way that we engineer for the future. Data is coming off of every item, everywhere, every second. Increased labor costs, [aborting] truck rolls, higher energy costs, reducing waste, an uncertain regulatory environment. These are all issues that our industry has to tackle. And at Sensus and Xylem, we'll give you a little bit of an idea on how we're helping the utilities to tackle these issues. First, we're looking to drive growth inside of our utilities by combining the data analytic applications alongside the analytics -- alongside the data that's coming in from the field in order to provide insight and move these utilities from being very reaction -- reactive to very forward-thinking, looking ahead of what's going on. We do this by balancing building products that span different departments inside of the utility, from engineering and operations to marketing, finance and customer service. As David mentioned in his speech up here earlier, he realized that there is work orders that are tied to this data that's coming out of there. We've got field force. The more areas inside of the utility that we can build applications to solve problems, the greater the products that we are developing in the field and the value that drives for those. So it makes us as a company stickier the more analytic applications that we can drive inside of the utility.

Randy probably mentioned in passing and context, very much like the hot sauce commercial, and you know, we put that stuff on everything, all throughout there, we can put analytics on pretty much everything. If you want to put analytics on wastewater pumps, absolutely, let's go for it. If we want to combine wastewater pumps, storm water pumps, metering from the freshwater system, hydrology coming in from the geographic network, absolutely, let's go do it. Analytics can solve problem. If for nothing else, it will help to benchmark the mad scientist inside the organizations that have great ideas and they just need some data to help back it up.

Our applications alongside the products that Xylem deploys in the field alongside the communications technology are best-in-class. We pair that up with a unique data management platform, and we're able to store, capture and analyze more data than has ever happened in the utility industry. Our strategy is to build a moat around all of this data that's coming in from the field because all too often that data is handed off to another system who's able to extract the value from that. I can't tell you how many times I go into a utility and executives talking about a problem that someone found. Where'd the data come from, it came from SAP, it came from Oracle, it came from IBM, it came from some other application. And that's not true. The data came from the field sensors, the data came from the pumps, the data came from the meters, right? If we can say the data came from the Xylem analytics network, the data came from the Xylem package, the data came from the Xylem mad scientist, then we've just increased our stickiness as a customer. We're building ourselves as that strategic, value-added, trusted partner for the utility and that's our ultimate goal. We do this through designing, building and deploying analytic solutions that are very purpose built to solve specific problems at the utilities. As David mentioned, most utilities, right? They don't want to buy a toolbox. That's what the original vendors that were coming to David to talk about the different analytic applications. They basically were providing a toolbox and were going to develop something on the fly. Utilities like to buy something that they know exactly what they're getting. And we do this by building these purpose-built solutions, while at the same time we're keeping our eye on internal analytic applications that will provide us the next generation of revenue-generating products. It's these products that will be our future go-to-market in growth areas.

What we find is that the operators in the utility industry, believe it or not, they're still very, very thirsty for just basic information and reporting. They are looking towards the day, though, where they have a system that is not so much rearview mirror looking, but it is conveying to them not what happened yesterday, but what is happening in real time right now and, more valuable, predicting what will happen down the road.

Completing this chain of events in the field, from data to action to analysis and back to action, that's the ultimate goal. We want to complete the full life cycle of what the value the data can bring from us. We do this by building credibility with our customers and delivering these specific applications that satisfy their thirst for the basic need of information. I can't tell you how many times we go into a utility and as opposed to trying to say, let's not boil the ocean, let's focus on 2 items, 2 top problems and solve those problems like nobody else can, we build so much trust and credibility that we can continue to move horizontally inside of that utility. That's when we become the trusted adviser that they're looking for to help them save money, operate more efficiently or predict to solve problems faster.

When I'm working with our sales teams, a number of the things that I typically will convey to them is, almost all utilities have their 3 pillars, like Patrick talked about earlier, our 4 pillars of who we are as a company. Almost every utility has a combination of their 3 pillars of who they are as a utility, right? They're either focus on customer service, they are focused on financial excellence or they're focused on operational excellence. We build analytic applications that will meet somewhere on these -- one of these 3 pillars, and when we do that, we're able to become their trusted adviser. We're able to show them that we can deliver the applications that they're looking for. And if we align our applications up under one of those 3 areas, we're always typically successful in the sales cycle side of the utility.

Now let me share with you just a couple of examples of some of the applications that we've delivered to the field. One of the applications actually became -- came out of our internal analytics applications that Randy mentioned in one of his previous slides. We have an internal analytic applications where we're not only trying to sell product out in the field, but we're internally analyzing data from inside of Sensus to make ourselves better from an engineering perspective, from operations perspective, from a design perspective. But in one of those very specific cases, we were analyzing some field data for electric meters coming out from one of our customers and we start to see anomalies happening in the data. We sent our Data Analytics team to the field to see what was going on and work with that utility because we actually thought we had a growing issue around the electric meters themselves because what the data was bringing off. What we found is 100% of the meters that were on the list that we thought were suspect were actually throwing off data from the electric grid that was telling the utility that the transformer upline that serves that electric utility was about -- that served that electric meter was about to fail. So for me that was the utopia of kind of the data science and the analytics. Where we want to get to is that point in time where we're driving down the path, we think we're going after 1 problem and all of a sudden there is a curve on the road and we're solving a completely different problem that we can turn into a revenue-generating application.

But on the simple side, we deliver a lot of just visualizations. You will see this on the tour today. A lot of just simple visualizations that give the utility that basic need for data as it exists today. I've always said the data as it's coming in from out of the field is telling a story, but it's coming at us so fast, the utilities don't know how to understand that story. They don't understand how to read that story, right? We've got to build visualization tools that help the utility to understand the story that the data is telling as it comes in from out of the field. So one of the dashboards we'll show you on the tour today is very simple 6-block, unbilled commodity dashboard. And all this does, it just simplifies the rolling up of all of the meter data at that particular utility and aggregating it at different points that has happened on a day-by-day basis. And believe it or not, utilities have not had access of their daily sales in forever, pretty much for the history of utilities. They don't typically know how much they send down line from their stations. They pass through a meter that they will bill for at some point in the future, 30 days, 45 days, whatever the bill cycle may be, they don't have that data on a daily basis. And so just that one dashboard changes the way that our utilities are able to forecast, plan, change their environment based on what they're seeing on a very, very granular basis and this is very powerful for the utility.

So with that, I'm going to hand it back over to Patrick for Q&A. Thank you all for your time, coming today and look forward to meeting you on the tour.

Patrick K. Decker - *Xylem Inc. - CEO, President and Director*

So I guess I'm the last thing between you and lunch, and hopefully for those of you who're able to join the tour, I just wanted to, again, thank you all for taking the time to join us here in Raleigh-Durham. And for those of you that are on the WebEx, hopefully for those of you who traveled here, it was a good use of your time, hopefully highly educational around not just Sensus and the other acquisitions we done, but how we really think that we can use this to truly transform the industry. I know it's been a bit overwhelming probably to some extent and that was probably by design so that we could really kind of share with you what we're excited about. I think as you walk around the tour today, you'll get even more of a visualization of how this actually works in the field.

I'd just reinforce that we are in the early stages here of both realizing the value of this combination. But secondly, in the early stages of the value creation for Xylem. I'm excited by the confidence that those of you that own the stock have had over the last few years and certainly, the past year and you've got our commitment as a leadership team to continue that journey and fight like hell to make sure that we outperform the market. As I said at the opening, I think our investment thesis, while it remains unchanged, has only been strengthened by the capabilities we've built over the last year and also the smart deployment of capital that we did to truly transform ourselves into more of a technology company. So look forward to, again, follow up with you all. For those of you that listen on the WebEx, we always welcome people to come here and visit our office in Raleigh-Durham. And for those of you that are here, more than happy to schedule follow-ups for you as well. So have a great day everybody. And we look forward to the tour.

Matt Latino

We have Randy, and is Mark -- we're going to do about 15 minutes of Q&A here on the second portion of the presentation, then we'll move right to a lunch that we have set up in the conference room next door followed by the investor tours around the facility. You have a number on the back of your badge, which will indicate which group you'll be in for that. I'll start with John here.

QUESTIONS AND ANSWERS

John Walsh - *Vertical Research Partners, LLC - VP*

John Walsh with Vertical Research. I guess a question for Patrick. We were talking about this a little bit during the break. But I was just wondering, obviously, early innings, but if you can help baseline us on how much of the portfolio today is either software or embedded software. And then really where you feel that entitlement is 5, 10 years down the line when you think about the portfolio holistically.

Patrick K. Decker - *Xylem Inc. - CEO, President and Director*

Yes. So I would say -- as I said -- first of all, we're in the early stages I think of really exploring understanding what the true revenue synergy potential is here. I've gotten the question before as to what portion of the historical Xylem business was so-called smart technology. And I think that there was some myth that was there that pumps can't have embedded intelligence in them. And I think we truly are educating the industry that they absolutely can and do. And so I do think that when you look across our traditional kind of rotary equipment business, our pump offerings for the most part all have the capability to have embedded intelligence in them, it's not limited to the Flygt Concertor pump that we showcased this morning or at WEFTEC. But it really comes back to where it's most relevant in addressing pain points for customers. And that really is largely around energy efficiency when you're thinking about rotary equipment and the pump. I think in terms of other applications, we certainly believe that when you think about our installed base of rotary equipment within Xylem, there is clearly, as you heard Brian say, slapping a sensor on there and getting data off that is not necessarily the challenge. It's turning that into actionable information that somebody is going to act upon, pay us for or it's going to inform a buying decision. And that's one where I'd be hesitant to through a number out and say it's going to be X percent of our total revenue. The Software-as-a-Service model today is under 10% for the Sensus piece. That just I find incredibly exciting. I mean, if what you've heard from David here today from an operating standpoint and Brian from his own experiences in utility doesn't get you excited about what the possibility is here, then probably nothing will. I think it really just comes down to it's as a matter of time and it's a matter of really building up the value prop and selling that broadly across the industry.

Deane M. Dray - *RBC Capital Markets, LLC, Research Division - Analyst*

I want to touch on M&A and the funnel. And one of the messages today is the spectrum of opportunities that Xylem has, and 2 that you landed are on both ends of the spectrum with a Sensus $1.7 billion and then you got Visenti which you have just as such as excitement about, and this was a rounding error compared to that, but the technology out there and the addition of Visenti is very meaningful. So what does the funnel look like? Are there more Visentis out there? Because you don't have to wait, given the current balance sheet, to go after these bolt-on technologies. And then how much of the funnel overlap? When I met Randy in New Orleans, it was surprising how much that you all were like mind in terms of what are the potential acquisitions.

Patrick K. Decker - *Xylem Inc. - CEO, President and Director*

Well, I'll start first and then certainly Randy can chime in here on the pipeline. To your point, Deane, what I find really exciting about this move with Sensus is, it really was a validation for us of the move into smart infrastructure that there really is value to be created there. And when we looked at the pipeline that Sensus was already cultivating and compared that to our own, there was a fair degree of overlap in terms of bolt-on opportunities, various ranges and sizes, but that really were getting at how do you leverage this telecommunications platform, the data analytics around that to solve other pain points for customers, not just limited to the water industry. And so we talk about things like asset management, we think about other forms of managing nonrevenue water, you heard David talk about mobile workforce management as a big pain point. There's a number of areas that we've gotten our pipeline that we think we're going to be able to do here that are not big dollar outlays. It really comes down to just making sure that we are laser focused, again, on getting the integration done successfully of Sensus, I feel very good about it. We're in the early days here. But letting that -- you recall the value mapping road map that we laid out 1.5 years ago. That's really informing that pipeline. But it's healthy, it's robust. And then I would say, again, it's not limited just to smart infrastructure. We've got the industrial treatment and industrial services opportunities there as well. Randy, you want to comment?

D. Randall Bays - *Sensus USA Inc. - President*

No. I mean, just we're working closely together with the Xylem team. We've got our list together. There's activity there. And I think it's super exciting. And so I don't know if I can say any more than that. Mark is right here, he might smack me, but I can just tell you, I feel really good about working with the team. We kind of come together very quickly and figured out how to -- actually it has brought resource to us to help us get things done in this regard. And so it's going to be exciting, I think.

Unidentified Analyst

So when you think about the added layers of intelligence that are going to be taken with Sensus, leveraged to the portfolio, added to the product categories. We've seen this intelligence come forward not in this space before, but the question becomes what kind of margin can you actually get on the core products as you layer that through. Obviously, you seem to think that you can capture that margin beyond just other applications like SaaS and leveraging in those ways. So maybe a discussion on how you think about that on a forward basis. And what about the products you think is going to allow that extra price point on a per sale basis?

Patrick K. Decker - *Xylem Inc. - CEO, President and Director*

Yes, I'll start first and then these guys can jump in. I think, look, we are very cognizant and focused on not just giving away systems intelligence and data analytics as some kind of a commodity that ends up through driving margin erosion of some sort. And I think a good example of this is, when you think about the work that we were doing in Xylem before the Sensus addition to the portfolio, we were building out organically our own remote monitoring and control capability. But we were doing it in 12 different ways, in 12 different locations around the world, with 12 different teams working on it, all good stuff. It was people doing on their own local need. What we're able to do now and we were selling value add when we had that capability because it made it easier to sell our -- for example, our Flygt Concertor pump. The value-add there is to have that connected to a broader network of data collection. And so these things will help push through higher margin, higher value-added products from our base equipment portfolio. But also when -- as we studied the Sensus deals here, Thames Water, DECC, those happen to be 2 international. These guys are selling North American deals every day that they attract very attractive margin profiles on these businesses because of the value-add that's embedded in there. It's tough to compare pricing per se because each deal is somewhat different and unique. You want to comment, Randy ?

D. Randall Bays - *Sensus USA Inc. - President*

I'd say in terms of we are a technology powerhouse. We're very innovative with the technology. We -- one of the first things we do as we're developing products is we go out and we patent the technology. You saw the hundreds of patents that we have. And so we try to protect ourselves. And we believe that these products will get a high margin. A lot of our project -- our products do very well in the marketplace. But I would say the other thing is we have a very rigid stage-gate process, where if the business case is not there to go do something, we just don't do it just because it's cool or interesting. We do stuff that's going to make us money. And -- so I think the combination of just protecting the IP and doing a good job with business cases will lead us down to very profitable new products.

Clifford F. Ransom - *Ransom Research, Inc. - Founder and President*

Cliff Ransom. Randy, you're by background with GE and some of your colleagues from GE a Six Sigma guy. What happens when you fully integrate lean thinking with the Six Sigma tool? What's going to happen in your Sensus operation?

D. Randall Bays - *Sensus USA Inc. - President*

Well, that's an interesting question. The kind of -- just to back up just for a second, it's been kind of interesting working with Tony. Because Tony has been on this lean march and he has done a fabulous job and doing a great job. And then we've been on more of the Six Sigma march. And I've also been on the other side and he has been on the other side. But I can tell you that once we get together, there is tremendous power in lean. There is a lot we can do. We have lean some of our lines out. We have done some work there. But we've had over the last few years really more of a focus around quality. And so that's an another hit we're going to get down the road, that's going to be another step up down the road as we start to bring it all together. I'll tell you openly we have not -- I mean, we've done cost reduction, we've taken cost out but true lean implementations, we've barely scratched the surface, so there's a lot of opportunity for the Sensus side.

Patrick K. Decker - *Xylem Inc. - CEO, President and Director*

Well, I would just augment that, Cliff, with the fact likewise, when you look at our products, what -- we've historically not had significant quality issues within the historical Xylem businesses. It's not really been a top-level focus in terms of knowing cost to quality across the board. And so the programs that Randy and Mike McGann -- you guys will meet Mike on the tour, very impressive leader in this space. There is equally an opportunity for us to really apply that Six Sigma approach especially on the quality end for Xylem.

Clifford F. Ransom - *Ransom Research, Inc. - Founder and President*

Want a quick follow-up, if I may. Tony, when I started getting brainwashed about IoT, it wasn't that it made the business more efficient, it wasn't even that you could create SaaS models, it was that you wound up with better products because you feed back all that data until you have product and service offerings that are competitive barriers to entry. Now I haven't heard a lot about that today, am I on base or off base?

Patrick K. Decker - *Xylem Inc. - CEO, President and Director*

Cliff, you're totally on base in that, we are -- you'll recall back to my vision for the company. They are those CEOs and leaders that would look at it and say we want to be that company, that technology company of the future that's focused on Software-as-a-Service and Data Analytics. And what I specifically said was that we were going to have a leading portfolio of products and technologies, because to me, to your point, it's the domain expertise around the equipment that you're able to optimize that really becomes a value-add, but too, it is the barrier to entry. And I think even some of the competitors within the metering space are dealing with that challenge, and if they don't have the product to offer, they have to partner with other companies in that space. Nothing wrong with that model but certainly if your heritage is around the equipment and the technology, that truly can be a barrier.

John Quealy - *Canaccord Genuity Limited, Research Division - MD and Analyst*

John Quealy, Canaccord Genuity. Two questions. First, big picture, philosophical, technical. So for the Xylem portfolio as we bring more intelligence to the end point, how do you decide what's an ASIC-based intelligence, so more of a commoditized intelligence? What's more of a more value-add field programmable, so if you can talk about that first. And then secondly, in my view, Sensus has a great combo utility, perhaps the best market share in combo utilities. If I was going to put my (inaudible) hat on, I'd call that smart cities, but you didn't. So talk about what's holding back use cases around smart cities. And how you folks will think about it. So just 2 big picture.

D. Randall Bays - *Sensus USA Inc. - President*

Well, it's a good question. I would say a couple of things. Some of this has been about distributed intelligence and things like that as part of that is really driven by technology. Our FlexNet technology is really -- it's not necessary to do the distributed intelligence to make the system perform pretty well. And I think a lot of that might be market spend, just one point. The other thing about smart cities, and we talk about this a lot internally. We always look at the business case, does this really make sense. We -- if you listen to all the marketing hype out there and I hope I'm not going off the reservation here. But putting a sensor on everything is probably, even though Brian would love to do that because he'd like the data, may not be the best use of the technology. We always think about how do we help the utility, how do we make the utility perform better. We talk about the Internet of Things for utilities. We could certainly work in parking meters. We can certainly work in parking garage. We can do all that stuff very easily. But the business case is not really core to us right now. We are focused on really utilities. However, our lighting module, the vantage point is kind of a step into that. But we really feel that really fits into the utility space more. But everything that can be done out there in the Internet of Things, we can do. it's just a question of does it make sense, let's not do it just because it's fun, let's do it because it makes us money.

Patrick K. Decker - *Xylem Inc. - CEO, President and Director*

And I think just to augment that, when you think about a smart city, there's a lot going in a smart city because we don't really have many of them. So you really have to go where the profit pulls are. Who are the users of this water or the people that are complying with regulation and where are they prepared to pay to address the pain point. Industrial campuses is an area that we're going to be exploring where -- these are people that you can sell a business case model to them. And so where we can penetrate that by putting up some FlexNet base stations, there's a real opportunity that these are all lead times that we're looking at that will go out certainly more than in the next few years.

D. Randall Bays - *Sensus USA Inc. - President*

Great point. We believe campuses around the country not only -- I mean from a safety standpoint, there's some things we can do that would really bring -- to improve the safety on campuses, and we've been working on this including smart lighting. There's some really great business cases out there. They have money. So it's a great point, Patrick.

Unidentified Analyst

I feel like in the last couple of years maybe we talked a bit more about this opportunity in industrial to maybe leverage the wastewater portfolio there and maybe as the burden shifted away a bit from the municipalities a bit more upstream. We haven't talked about that much today. Is that -- by design is that less -- is that more of a timing push out? Or is that less of an opportunity? And then last question on the portfolio as you go forward, it says behind you, Xylem let's solve water, you also talked about your dedication to gas and electric. And I wonder how far -- like what do you see your core as now? And how comfortable do you feel going a bit outside of what you'd have said maybe 2 years ago?

Patrick K. Decker - *Xylem Inc. - CEO, President and Director*

Sure. Let me take the second one first. I would say, as I mentioned in my comments, I and we are completely committed to the electric and gas and even lighting opportunity that we talked a bit earlier. Certainly, Markos, our chair, is here, these are conversations we've had with our board, and I was very clear to the board and they were very aligned around the fact that I'm not going to be, and I know this is Deane's favorite phrase for me, I'm not going to be dogmatic on all things water. And so that means that we would always consider acquisitions that brought in a nonwater piece to it. Having said that and we are going to be investing in those businesses. I mean we would not rule them out for smart M&A bolt-ons, those kind of things. And the reason we're adding the R&D money that we talked about, this goes back to the question of maybe why 5%, was the first question I got from customers in the electric and gas space was, it's great Patrick that you're verbally reaffirming your commitment. But we have ongoing technical development needs in that space. We want to see you put your money where your mouth is. And so we will be investing in that part of the business. But we're not going to lose our identity as a water company because there's a lot of power in that and that really also is the lifeblood of the company. On the treatment -- on the industrial treatment piece, that remains an attractive opportunity for us. Our business today is about 80% in the municipal treatment space and only 20% in industrial. Industrial is growing rapidly, albeit always -- also is our muni exposure. The team there has done a terrific job over the last year to 1.5 years in improving the margins in that business, getting it well above the cost of capital and really create value. And I think we're getting close there that if the right opportunities came along to augment that portfolio, we would certainly take a look at it. No commitments there, not signaling anything. But certainly, we see the opportunity as attractive today if not even more attractive than it was a year and a half ago.

Matt Latino

Okay. So with that, we'll move to lunch and then we'll have the tours. Apologies for the overrun in time, but hopefully you felt it worthwhile.
