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# EDITED TRANSCRIPT

XYL - Q4 2016 Xylem Inc Earnings Call

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## PRESENTATION

**Operator**

Welcome to the Xylem fourth-quarter and full-year 2016 earnings conference call.

(Operator Instructions)

I would now like to turn the call over to Phil De Sousa, Vice President of Investor Relations. You may begin, sir.

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**Phil De Sousa** - *Xylem Inc - VP of IR*

Thank you, and good morning, everyone, and welcome to Xylem's fourth-quarter 2016 earnings conference call. With me today are Chief Executive Officer, Patrick Decker, and Chief Financial Officer, Mark Rajkowski.

They will provide their perspective on Xylem's fourth quarter and full year 2016 results, and discuss the full-year outlook for 2017. Following their prepared remarks, we will address questions related to the information covered on the call. In order to have enough time to address everyone on the call today, I'll ask that you please keep to one question and allow -- and a follow-up, and then return to the queue.

We anticipate that today's call will last approximately one hour. As reminder, this call and our webcast are accompanied by a slide presentation available in the Investor section of our website at www.xyleminc.com.

A replay of today's call will be available until midnight, March 7. Please note the replay number is 800-585-8367, and the confirmation code is 41770453. Additionally, the call will be available for playback via the Investor section of our website under the heading, presentations. Please turn to slide 2.

We will make some forward-looking statements on today's call, including references to future events or developments that we anticipate will or may occur in the future. These statements are subject to risks and uncertainties, such as those factors described in Xylem's most recent annual report on Form 10-K, and subsequent reports filed with the SEC. Please note that the Company undertakes no obligation to update any forward-looking statements publicly to reflect subsequent events or circumstances, and actual events or results could differ materially from those anticipated.

With that said, please turn to slide 3, for a few key notes regarding today's presentation. First, I would like to highlight that we have provided you with a summary of some of our key performance metrics we reported earlier this morning in our release. This includes both GAAP and non-GAAP metrics.

For purposes of today's call, all references will be on an adjusted basis, unless otherwise indicated, and non-GAAP financials have been reconciled for you, and are included in the appendix section of the presentation. Additionally, please that note references to 2016 metrics include the financial impact attributable to previously closed acquisitions, and have been adjusted to exclude non-recurring transaction and acquistion-related costs. Now please turn to slide 4, and I will turn the call to our CEO, Patrick Decker.

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**Patrick Decker** - *Xylem Inc - CEO*

Thanks, Phil, and good morning, everyone. We appreciate you joining us to discuss our fourth quarter and full-year performance.

2016 was a transformative year for Xylem, as we delivered strong financial results. We made significant progress on each of our five strategic priorities, delivering organic growth in a very challenging and mixed market. At the same time, we accelerated capital deployment to change the mix of our portfolio and end market exposure, in order to grow faster and deliver greater value to our shareholders.

Specifically, we deployed nearly $2 billion last year for acquisitions that collectively are reshaping the growth and profitability profile of Xylem. The additions of Sensus and Visenti immediately expanded our portfolio of systems intelligence offerings, a key plank of our strategic agenda, and extended Xylem into higher growth sectors, such as smart metrology. And as the data scientists from Visenti and Sensus are now collaborating with Xylem's commercial teams who bring deep customer knowledge and insights from a wide variety of water sectors, a host of possibilities are opening up to develop value-add solutions that address our customer's pain points.

In addition to our inorganic expansion, we made excellent progress on our ongoing productivity initiatives to improve operational efficiency and reduce our cost structure. These efforts delivered more than $130 million in cost savings, surpassing our full-year goal, and underpinning 130 basis points of operating margin expansion. Importantly, with these changes, we are better positioned to deliver increased growth and profitability over time.

Throughout the year, our team stayed focused and delivered against our long-term objectives. [I'm pleased with] what we accomplished, but even more excited about what the future holds, as we continue to extend our reach and leadership in the global water industry.

Now let's turn to our results. Looking at the top line, we closed out the full year with 3% growth overall, and 1% organic growth. This was driven primarily by a robust public utility end market, and a relatively stable commercial business.

That said, there's no question that we were disappointed with our fourth quarter revenue. While we knew we'd have a tougher year-over-year comparison, we did not foresee public utility organic revenue growth coming in flat globally, which had been up double-digits in the previous three quarters. The shortfall primarily occurred in Europe, where we anticipated a historical level of year-end customer spend-out that did not materialize.

In the US, we continued to see a weak industrial market, primarily due to ongoing weakness in oil and gas, and lower demand in the light industrial sector. Clearly, we had a challenging fourth quarter, and some of those headwinds will likely continue in the near-term.

On a positive note, we delivered a 2% organic increase in orders globally during the fourth quarter, which included 3% growth in our water infrastructure segment. It is also worth noting that our treatment project funnel continues to grow, up double-digits to $2.5 billion from this time last year. This is another indicator of expected continued long-term growth in the water utilities sector.

Mark will get into the specifics of our segment performance, but I did want to highlight that Sensus delivered $132 million in revenue in the final two months of the year, which brought their full calendar year organic growth to 10% on a pro forma basis. The addition of the Sensus business clearly improves Xylem's overall growth profile, and as we have identified significant revenue synergy opportunities, that picture is getting even brighter.

As I've already mentioned, we generated 130 basis points of operating margin expansion excluding the impact of acquisitions, which is well ahead of pace to meet the long-term financial targets we announced at Investor Day. We closed out the year with a strong fourth quarter, 220 basis points of margin expansion driven by productivity actions and cost savings initiatives. This strong performance enabled us to continue to invest in strategic initiatives to drive future growth, while still delivering on our financial commitments.

At the bottom line, we delivered earnings per-share of $2.03 for the full-year, a 10% increase over the prior year. This performance reflects our continuing trajectory of improving financial returns, and demonstrates our ability to deliver solid earnings growth in a still challenging global industrial environment.

In the fourth quarter, we delivered earnings per share of $0.66, also a 10% improvement over the prior-year period. For the full-year, we generated $386 million in free cash flow, resulting in a 120% conversion rate, again well ahead of our original commitment for the year.

Looking back at 2016, we faced a mixed economic environment across our end markets and regionally. However, there was, and continues to be consistency in key fundamentals and underlying trends that impact our business in very positive ways, now and in future years.

First, a steady increase in spending on water infrastructure across nearly all geographies; a growing understanding of the operational and cost benefits of systems intelligence solutions in the water sector, as well as in the electric and gas industries; recognition of the power of big data to optimize business operations. And finally, increased demand for solutions that address both the mitigation of, and adaptation to the impacts of climate-related issues such as extreme weather events.

With our recent acquisitions, now more than ever, Xylem is uniquely positioned to be the partner of choice in capturing the opportunities that will result in these trends. That is why I am so confident about our ability to drive sustained profitable growth, and create greater value for shareholders and our other key stakeholders.

Our alignment on five strategic priorities brings focus to our efforts to capitalize on these macro trends and drive growth. We made measurable progress against each of them last year, and we expect that to continue, if not accelerate in the year ahead.

Let me quickly address a few of them. Enhancing our commercial leadership is core to fueling our top line growth. We made a number of changes this year to further strengthen our one Xylem approach to serving customers. That is, making it easier for them to do business with us, and ensuring that we provide quick and easy access to our full portfolio of solutions.

Regarding Sensus, we're in the early stages of bringing our teams together to collaborate. As I've mentioned before, we are being very deliberate in our integration work to ensure that we do not disrupt the existing businesses. We are, however, cross-educating key teams on our respective portfolios, and enabling lead-sharing through salesforce.com and other tools.

We intend to fully leverage Xylem's leverage position in the wastewater, outdoor, and applied water sectors to introduce Sensus solutions. And conversely, we are leveraging Sensus' leading position in the clean water space to offer additional Xylem technologies. As we previously announced, we expect this combination to realize substantial revenue synergies over the next few years, worth at least $100 million.

And our teams are now working on those initiatives. I'll have more to say about those opportunities at our upcoming Investor Day in April.

Shifting now to our second strategic priority, driving growth in emerging markets. Our performance last year was mixed across our emerging market territories, with 1% growth for the year. But we began to build more momentum, as we moved through the fourth quarter, closing out the year with a 6% increase over the prior-year period.

One standout was India, [which] generated high double-digit growth in the quarter and the full-year. While still a relatively smaller business, the opportunities for growth in India was very attractive, with strong government support for water infrastructure projects, and broader Smart City initiatives.

China returned to growth in the fourth quarter, as demand for infrastructure projects continued to build. A positive leading indicator for this business is the double-digit growth in orders that the team delivered for the full-year. This sets us up for attractive growth in 2017 and beyond.

We arguably made the most significant progress this year on our third strategic priority, strengthening innovation and technology. The acquisitions of both Sensus and Visenti, are strong demonstrations of M&A serving as a proxy for R&D. The addition of these businesses enabled a step-change in our systems intelligence and smart infrastructure capabilities.

Last month, we established a new Xylem Center of Excellence at Sensus' research center in Raleigh-Durham. There we will develop new integrated solutions, that further differentiate our offerings, and provide value that our customers are seeking, and are willing to pay for.

We're also expanding our India technology center, with a new campus in Bangalore that will focus on supporting our systems intelligence-related work, as well as support our expanding product localization work in India and other emerging markets. I expect our expanded capabilities to accelerate our R&D progress, which will be a significant driver of value creation over time.

Building a culture of continuous improvement is another area, where we continue to deliver strong results. We've been on the self-help journey for some time now, but there is more opportunity than ever to derive greater value out of our productivity and business simplification initiatives. And as we noted before, these efforts underpin our productivity for growth mindset, as we redirect some of these savings to strategic growth initiatives.

With each acquisition, we gain new perspectives on how to improve our operational efficiency, and in addition to realizing synergies through global procurement and footprint rationalization. We intend to update you on our productivity plans and expected cost synergy capture related to the Sensus integration at our Investor Day in April. But for now, I will say that we're already ahead of our plan to achieve 300 to 400 basis points of margin expansion by 2020 in our base business, and continue to expect to realize at least $50 million in net cost synergies, related to the Sensus integration.

As we build on this progress, we are well-positioned to accelerate our growth and value creation in 2017. We expect to generate full-year revenue growth of 20% to 22%, including the contribution from acquisitions completed in 2016. On a pro forma basis, organic revenue is expected to grow 2% to 4%.

Our productivity initiatives will help to drive up to 130 basis points in EBITDA margin expansion. We expect to deliver 2017 EPS growth of 12% to 20%, excluding the impact of foreign exchange translation. And we are aiming for another year of strong free cash flow conversion, coming in at more than 110%.

We increased our dividend to shareholders by 10% last year. Consistent with our commitment to return capital to shareholders, in line with earnings and cash flow growth, today we announced that we will further increase our dividend by 16% in 2017. Now I'll turn it over to Mark for more details on our results.

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**Mark Rajkowski** - *Xylem Inc - CFO*

Thanks, Patrick. Since you've already covered the highlights of the full-year results included on slide 5, let's turn to slide 6, where I'll discuss our fourth quarter results. Overall, revenues were up 10% in the quarter. Acquisitions contributed 14% growth, which was partially offset by an organic revenue decline of 2%. Additionally, foreign exchange headwinds reduced the top line by 2%.

From an organic perspective, commercial was the only vertical market to generate growth this quarter, up 1%. The public utility market was flat versus the prior-year period, after growing 12% over the last three quarters. This deceleration primarily reflects a tougher prior-year comparison in the US, as well as weaker than expected revenue in certain European countries.

Industrial markets were down 3% overall, with deeper than expected declines in our light industrial business. Rounding out our performance, revenues declined 3% in both the residential and agricultural end markets.

Regionally, the US market drove most of the organic decline for the quarter, down 7%, and Western Europe was down a modest 1%. And as Patrick mentioned, our emerging market revenue was a bright spot, rebounding from a tough third quarter with 6% overall growth.

Before moving to our margin results, I'll address the Sensus revenue performance in the quarter. Revenue for November and December was $132 million. It was short of our expectations, primarily driven by a delay in the shipment of scheduled orders to a customer in Saudi Arabia, due to Letters of Credit not being released. In January, we have begun shipping these orders, as letters of credit are now being processed.

Despite weaker than expected revenue in the quarter, our teams did an exceptional job driving productivity, [which led] to 60 basis points of margin expansion to 15.3%. Excluding the 160 basis points of dilution from acquisitions, which is largely from the amortization of intangible assets from the Sensus acquisition, our operating margin expanded 220 basis points. Given the market challenges we faced during the quarter, I'm pleased with our team's performance in delivering earnings per share of $0.66, an increase of 10% year-over-year.

Please turn to slide 7, and I'll provide additional details on our reporting segments. Before addressing revenues and earnings performance, I'll begin with our fourth quarter order activity, and backlog position as of year-end.

Water infrastructure recorded orders of $572 million in the quarter, up 3% organically year-over-year. This growth was primarily driven by treatment orders, which were up 30%. While this is excellent progress, and a sharp change in trajectory from the last several quarters, it is important to understand that the majority of these projects require longer lead times, and will not ship until 2018 or later.

We exited the quarter with total backlog of $528 million, down approximately 2% organically year-over-year. Of this amount, $210 million is due to ship in the first quarter of 2017, down approximately 8% on an organic basis, which will be a drag on revenue growth in the first quarter.

Water infrastructure revenue of $612 million represents a 2% year-over-year decline on an organic basis. Acquisitions added $7 million to the top line, while foreign exchange was a $14 million headwind.

In the US, this segment declined [6%] overall. The significant challenges that have impacted our dewatering business this year, including double-digit declines in the oil and gas market, continue to mute growth in the quarter. Our public utility business partially offset this decline with 3% growth in the quarter, despite lapping a 13% increase in last year's fourth quarter.

Western Europe decreased 2% overall, primarily driven by unexpected weakness as municipalities in a couple of countries slowed their level of spend in the quarter. This was partially offset by solid performance in the UK, where our team's drove 6% growth, [as] we continue to benefit from the expansion of the public utility investment cycle.

Emerging market results were mixed, but up 1% overall. The 10% growth in Asia was primarily driven by the timing of revenues on large projects in India and Laos. This was largely offset by ongoing weakness in the Middle East, where the level of government spend for infrastructure continued to be constrained, resulting in a 10% decline year-over-year.

Operating margin for this segment decreased 80 basis points to 18.3%, as productivity initiatives drove 420 basis points of margin expansion. This strong margin performance allowed us to more than offset inflation of 180 basis points, lower volumes and unfavorable mix, which was largely driven by the declines in our higher-margin dewatering business. Acquisitions were a 70 basis point drag on margins in the quarter.

Turning to the full-year, segment revenue of $2.2 billion grew 2% on an organic basis. Acquisitions added $32 million to the top line, while foreign exchange was a $55 million headwind.

Organically, growth in our treatment and wastewater transport businesses reflect a stable public utility market, where we have been gaining share. This was partially offset by headwinds in the industrial sector, particularly in our dewatering business, and to a lesser extent our analytics business.

Operating margin increased 100 basis points year-over-year to 15.2%. Benefits from our productivity programs and cost reductions, as well as a modest price realization more than offset inflation, and funded investments during the year. Acquisitions diluted overall performance by 50 basis points.

Please turn to slide 8. Applied water both quarters of $348 million in the quarter, which was flat organically over the prior year period. Our book-to-bill ratio was 0.99 in the quarter, which is in line with our historical performance.

Overall, we exited the quarter with backlog of $163 million, down 3%% organically compared to last year. Of this amount, approximately $100 million is due to ship in the first quarter of 2017, down about 1% on an organic basis. Revenue was $351 million, down 2% organically versus the prior-year quarter.

In the US, segment revenue was down 9% year-over-year in the quarter. This was primarily driven by the segment's industrial vertical, which declined 16%. The decline reflects continued weakness in oil and gas, and in the general industrials markets. Delays in projects drove 3% lower year-over-year revenues in the US commercial building sector.

In Europe, revenue increased 2%, with particularly strong growth in the UK, where our investment in both new products and sales capabilities continues to drive solid industrial performance. Finally, emerging markets revenue grew 15%, reflecting a strong return to growth from a stabilizing commercial building market in China, and recent strength in Latin America from industrial project deliveries. This growth more than offset declines of 11% in the Middle East.

Segment operating margin in the quarter increased 230 basis points to 15.7% year-over-year. Strong productivity drove a 540 basis point margin improvement. This result more than offset 140 basis points of cost inflation, lower volumes, and 60 basis points of strategic growth investments.

On a full-year basis, the segment recorded revenue of $1.4 billion, down 1% organically year-over-year. Revenue declined 5% in the US, primarily driven by lower demand for light industrial applications. These declines were largely offset by growth in Europe, and the emerging markets.

Operating margin increased 70 basis points year-over-year to 14.6%. The outstanding execution from the team on the productivity side enabled the funding of our localization investment in the Middle East, and also more than offset the impact of volume declines and inflation.

Now let's turn to slide 9. We closed the quarter with a cash balance of approximately $300 million. As we mentioned in our third quarter earnings call, we utilized approximately $400 million of European cash to close the Sensus acquisition.

To complete these transactions, we also issued a combination of short- and long-term debt of $1.3 billion. We remain committed to maintaining our investment-grade credit rating, which will require that we focus our capital deployment primarily on debt repayment over the next 12-plus months.

During the fourth quarter, we invested $34 million in capital expenditures, and also returned $28 million to our shareholders through dividends. Free cash flow in the quarter was approximately $200 million, a 21% increase from the prior year. Free cash flow conversion was 214% in the quarter, compared to 145% conversion last year.

This improvement was driven by better working capital performance, as well as higher non-cash amortization from Sensus. While working capital increased overall, the improvement as a percent of revenue primarily reflects the addition of Sensus during the fourth quarter. From a working capital efficiency standpoint, Sensus positively impacts our profile, as they have a very efficient model, where working capital as a percentage of revenue is approximately 10%. This is reflected in the 310 basis point improvement year-over-year in working capital, as a percentage of revenue on a pro forma basis.

In looking at the base Xylem business, we improved working capital as a percentage of sales by 70 basis points, excluding FX translation and acquisitions. Please turn to slide 10, and Patrick will cover the update to our 2017 outlook.

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**Patrick Decker** - *Xylem Inc - CEO*

Thanks Mark. As I said earlier, we are well-positioned heading into 2017 to continue to make significant progress on our long-term financial targets. Transformative changes we made at Xylem over this past year have shifted our portfolio towards advanced technologies and repositioned our future growth and earnings profile. As we move through 2017, we expect our 2016 acquisitions to help accelerate our revenue growth.

On a pro forma basis, we anticipate organic growth of 2% to 4%. This includes organic growth from the base Xylem businesses of 1% to 3%, and Sensus organic growth of 6% to 7%. We expect generally stable conditions across the majority of our portfolio, albeit mixed geographically.

I will cover our in-market outlook for 2017 in a few minutes. As we drive our continuous improvement work deeper into the organization, we expect our lean and global procurement initiatives to generate incremental gross savings of approximately $80 million. Our adjusted operating margin is expected to grow in the range of 20 to 60 basis points, excluding roughly 60 basis points of margin dilution from acquisitions. This dilution is largely driven by purchase price accounting impacts, relating to non-cash intangible amortization.

We anticipate generating earnings per share of $2.20 to $2.35, which excludes integration restructuring and realignment costs of about $30 million. This projection also includes $0.08 of negative foreign currency translation impact. Excluding foreign exchange impact, EPS growth is expected to be in the range of 12% to 20%.

Finally, the Sensus acquisition adds a tremendous cash-generating business to our portfolio. As we maintain our disciplined approach to capital deployment, and continue to improve our working capital, I expect us to deliver free cash flow conversion of at least 110% this year. This also contemplates expected capital expenditures in the range of $190 million to $200 million, which is in line with historical spend of the combined businesses.

Please turn to slide 11, and I'll walk you through our end market assumptions for 2017. Now please note that our commentary and growth estimates on this slide, reflect organic revenue for our base Xylem businesses. Public utility was 36% of total 2016 revenues. Following a year during which we delivered 8% growth in this end market, we are expecting 2017 organic growth to moderate, but still grow low to mid single-digits.

In the US, which represents approximately one-quarter of our public utility base, we will have a tough comparison given the exceptional 17% growth we delivered in 2016. As a result, we believe growth in this region will be in the low to mid single-digit range.

In emerging markets, we expect large project activities to drive mid to high single-digit growth, particularly in China and India. And in Europe, we anticipate low single-digit growth, largely driven by strength in the UK.

Our industrial end market represents 44% of total 2016 revenue. In 2017, we expect full-year organic revenue to be flat to up low single-digits. We believe that soft market conditions in general industrial that occurred in the US during 2016, will carry into at least the first half of 2017, with modest growth returning over the second half.

We continue to assume that the oil and gas markets will be down modestly year-over-year, despite some pockets of uptick in activity. We expect emerging market performance to be mixed, with some strength in China and Latin America, offset by continued weakness in the Middle East.

Moving to commercial, here we consistently saw low single-digit growth throughout 2016. We expect this level of growth to continue into 2017. Market data and input from our customers and channel partners suggest a low growth environment in the US, where we have a leading market position, and more than half of our total commercial exposure

Beyond the US, the global outlook is mixed. We believe Europe will be closer to flat, with lower construction activity, and funding uncertainty in certain countries. Also our business in Europe faces a tough prior-year comparison of 10% growth. China appears to be stabilizing, and we expect our business there to grow in 2017, after a weak performance last year.

In residential, we also project full-year revenue to be flat to up low single-digits. In the US, we expect a flattish environment, given the competitive landscape and replacement nature of the sector we serve.

The European market looks to be modestly stronger as residential building permits increase. Now please turn to slide 12, and Mark will walk you through more details on the outlook.

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**Mark Rajkowski** - *Xylem Inc - CFO*

This slide provides the bridge from our full-year 2016 results, to our 2017 annual guidance for revenue and EPS, using the mid-point of our guidance range. From our $3.8 billion revenue base, we're adding 2% of organic growth from the base Xylem business. Sensus adds approximately 21% of incremental revenue growth, bringing total expected revenues to approximately $4.6 billion or 23% year-over-year growth.

Foreign exchange headwinds of 2% reduce our 2017 full-year revenue guidance to a mid-point of approximately $4.5 billion. In terms of EPS, we expect our core business to add $0.13, which reflects organic revenue growth, carryover restructuring savings, and the benefits of our productivity programs partially offset by inflation, investments, and a weaker mix of revenue.

Sensus is expected to add an incremental $0.20 of EPS. Note that we now expect the Sensus contribution to be higher than our previous guidance range of $0.10 to $0.12. This results in operational EPS performance of $2.36, up 16% year-over-year on a currency neutral basis. Based on our full-year foreign currency assumptions which are summarized on slide 14, we expect $0.08 of currency headwinds to reduce our overall 2017 EPS guidance mid-point to $2.28 per share.

Please turn to slide 13. This slide reflects our 2017 outlook for our Sensus business. This year, we expect Sensus to deliver pro forma organic revenue growth of 6% to 7%, versus 10% growth in 2016.

Last year, the business had a very strong year, in growing both the water and electric utility sectors, significantly benefiting from a number of new product launches. This year, we expect revenue growth to be driven by mid single-digit growth in water, a double-digit increase in the electric utility sector, and another year of double-digit growth in software-as-a-service. We expect revenue in the gas utility sector to be flattish.

EBITDA margin is forecast to be approximately 19.5% for the full-year, down 80 basis points from the prior year.

Benefits from volume growth and net cost synergies will be offset by growth investments. These investments will provide for the expansion of R&D capacity and the commercial capabilities that will be critical to enabling the substantial revenue synergies we expect to generate over time, as well as growing the base Sensus business.

I'd also point out that approximately 50% of the $15 million of net cost synergies from the Sensus acquisition are reflected in the base Xylem 2017 financial performance. The year-over-year operating margin decline also reflects 220 basis points of incremental depreciation and amortization from purchase accounting.

Please turn to slide 14. As the team has done in prior years, we're providing the seasonal profile of our business, as well as highlights of our 2017 planning assumptions. For the first quarter, we expect continued weakness in the global industrial markets, coupled with a tough prior-year public utility compare. We anticipate this will result in an organic revenue decline in the range of 1% to 2% for the base Xylem business.

Acquisitions are expected to add approximately $230 million to $240 million of revenue, with the vast majority contributed by Sensus, which we expect to grow organically at 6% to 7% in the first quarter. In addition, foreign exchange translation unfavorably impacts revenue approximately $20 million.

As for our first quarter segment operating margin, we expect margins to be down 70 to 110 basis points, including a 30 basis point reduction due to the non-cash amortization of Sensus intangible assets. The year-over-year operational decline is primarily attributable to lower volumes, and a weaker mix of higher margin revenue that we saw in the first quarter of last year, from very strong repair and maintenance revenues in the US public utility market, and from lower dewatering revenues in 2017.

At the corporate line, we expect a quarterly run rate of approximately $12 million to $13 million per quarter. Interest and other expense is anticipated to be approximately $80 million, up nearly $30 million year-over-year, primarily reflecting the impact of incremental debt issued in connection with the Sensus acquisition.

Our full-year operating tax rate of 22% also reflects the mix impact of adding Sensus for the full-year. And our share count assumption reflects a modest year-over-year increase. Please note that the 2017 outlook excludes approximately $30 million for anticipated integration, restructuring and realignment costs.

Finally, please note the summary of our FX assumptions on this slide, which includes our euro guidance assumption at [1.04]. We believe this transparency is helpful, given the recent volatility in currency rates. With that now, I'll turn the call back over to Patrick for closing comments.

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**Patrick Decker** - *Xylem Inc - CEO*

Thanks, Mark. So overall, I am pleased with our team strong execution in a still challenging global market. Looking ahead, we expect our acquired businesses to be catalysts for accelerating our revenue, profitability, and earnings growth. That, coupled with our ongoing commitment to continuous improvement and business simplification efforts, positions us well for outperformance in 2017.

Now, operator, we can open it up to questions.

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## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions)

Deane Dray with RBC.

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**Patrick Decker** - *Xylem Inc - CEO*

Good morning.

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**Mark Rajkowski** - *Xylem Inc - CFO*

Deane?

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**Patrick Decker** - *Xylem Inc - CEO*

Operator, we can't hear the question.

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**Operator**

Mr. Dray, go ahead.

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**Deane Dray** - *RBC Capital Markets - Analyst*

Hey, can you hear me now?

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**Patrick Decker** - *Xylem Inc - CEO*

Yes. Good morning. (multiple speakers -- laughter)

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**Deane Dray** - *RBC Capital Markets - Analyst*

Okay, sorry about that. Hey, if we could start with the tone of the US municipal market by geography, and start with the US. So obviously tough comps, but do you still feel we're in a multi-year spending cycle by the utilities that started last year, and what's your visibility there? And then related is this -- all the intrigue about where and how the Trump infrastructure spending may find its way into the water infrastructure markets.

I saw this week, a preliminary listing of state's wish list of shovel-ready projects, and about 10% of them were specifically geared towards water treatment plants. So let's just start on the US side, spending cycle, visibility, and maybe some comments about Trump?

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**Mark Rajkowski** - *Xylem Inc - CFO*

Sure, absolutely. Thanks, Deane. So yes, talking first on US water utility sector, we do very much believe that we continue to be in the midst of a multi-year bull run there, Deane. And I think the -- what you're seeing here, in terms of the softness in Q4, was really driven by Europe, not so much the US.

Our guide in Q1 really has been driven by the tough comp that we have versus the first quarter last year, where we had exceptionally strong growth we had, that was really driven by as you will recall, an unseasonably warm weather in Q1. So we had a lot of pull-ins from Q2 to Q1. So that's just strictly a tough comp, that we're seeing in the US piece.

In terms of visibility that we've got, as we alluded to in our comments, the big pipeline funnel continues to grow double-digits, in the treatment business which is a leading indicator for the health of the water utility sector. And so, again, my confidence is very strong there, that we will see strength over the course of this year, as well as future years.

In terms of the Trump policies, I would say -- let me take the opportunity to touch on a few different policy agenda items that are out there, and leading first with infrastructure spend. We certainly believe that it could be a significant catalyst, in terms of spending in the water sector. Obviously, questions remain on timing, as well as the funding.

We also think that there has been a little bit of uncertainty in terms of projects that are already shovel-ready, as to whether the funding was going to happen at a local level, at a state level, or a federal level. And that's led to a little bit of softness here in the short-term. But all indications that we get from other E&C companies that have reported as well, is they too, are speaking fairly bullish about infrastructure spend here in the US. And you're seeing it in their bidding pipeline.

The second area would be around tax reform. I know that there are a number of investors that probably assume that we may not benefit that much from any lower US tax rates. But actually, our efficient tax rate is really driven by our European supply chain and tax efficient structure there. Especially with the Sensus acquisition, we've got a sizable US tax base here, and we would certainly benefit from any lowering of rates in the US.

And then third is, discussions around any impact on cross-border tax, given that we import a fair amount our products here in the US. The reality is, if you look at water infrastructure, while we are a net importer of products there, the reality is most, if not all of our competitors are also global players that import as well.

And then, for our applied water business, and our Sensus business, most of those businesses are US. And they are actually supplied out of our factories for the most part here in the US. And so, we really don't think that's going to have any meaningful impact on us. So I thought I'd take the opportunity, Deane, to go beyond just the one item from the Trump administration, to cover maybe three or four areas.

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**Deane Dray** - *RBC Capital Markets - Analyst*

Terrific. And then, hopefully, Phil won't count that as, one of my questions. (laughter) Just to round out the thought on the European municipal market, sounds like there were pockets of weakness, but it wasn't in the UK. Were these election-related at all?

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**Mark Rajkowski** - *Xylem Inc - CFO*

Yes. So the UK was up high single-digits in the quarter, and we would expect them to continue to grow at similar rates here in 2017, as we're really hitting the sweet spot of the [amp] cycle in the UK. The softness there in the quarter, and what we're seeing in Q1 is really some slow down in -- we normally see a spend-out of muni budgets there in a couple of key markets, that we didn't see in the fourth quarter. And we're simply still being cautious about that in Q1. And to your point Deane, everything we've seen here, does lead us to believe that it's specifically related to France and Spain, and that's certainly is related to some uncertainty around the upcoming election.

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**Patrick Decker** - *Xylem Inc - CEO*

But we view that as temporary.

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**Deane Dray** - *RBC Capital Markets - Analyst*

Yes, and just last question for me, I'd be remiss if I didn't call out the free cash flow conversion. And it wasn't too long ago, when Xylem had set cash conversion as a priority, and it was -- you were in and around 90%, so if we can get to 100[%]. Well, you've blown past that. So Mark, just give us a sense on sustainability. You have set 110% for conversion goal for this year. What would have been the key changes within working capital, and also the Sensus contribution?

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**Mark Rajkowski** - *Xylem Inc - CFO*

Yes, sure Deane. And it's really combination of a couple of factors, and you hit on both of them, first, being working capital.

We have made continued progress in the base Xylem business, and saw improvement from a year-over-year in terms of working capital as a percentage of sales of 70 basis points, particularly in the areas of days payable, which improved by almost [6] days, continued progress in our receivables, which were up over [2] days. We lost a little bit of ground in inventories, and that was largely a function of the slow down in sales in the fourth quarter. But really good progress, and we expect to continue to push that in 2017.

And then, the other point that you alluded to is Sensus, and they have a very efficient model. Their working capital as a percentage of sales is around 10%, and they generate a lot of cash. And that is a -- just a structural and sustainable change in terms of the amount of cash conversion that they'll deliver as part of the combined Company.

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THOMSON REUTERS

**Deane Dray** - *RBC Capital Markets - Analyst*

Yes. Great job on cash, and we like that dividend increase. Thank you.

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**Mark Rajkowski** - *Xylem Inc - CFO*

Thanks, Deane.

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**Operator**

John Walsh with Vertical Research.

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**John Walsh** - *Vertical Research Partners - Analyst*

Hi, good morning

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**Patrick Decker** - *Xylem Inc - CEO*

Good morning, John.

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**John Walsh** - *Vertical Research Partners - Analyst*

Thanks. So thinking about the [$0.20] now for Sensus, do you have any guidance on how that phases in, either quarterly, or H1 versus H2?

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**Mark Rajkowski** - *Xylem Inc - CFO*

It's pretty stable. We might see a modest tick up, as we execute the net cost synergies, but it's relatively stable as -- I think we pointed out on one of the slides, what the revenue profile looks like from quarter to quarter. So we [wouldn't] expect too much variability there.

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**John Walsh** - *Vertical Research Partners - Analyst*

Okay. And then, thinking about your industrial framework for 2017, and maybe parsing out some of the lighter commercial versus the heavy industrial. We are hearing about kind of an acceleration in those markets. And just wondering, if maybe the reason for your outlook is, that it might be tied a little more towards CapEx, and maybe MRO spending in that vertical. But any thoughts on how that business typically recovers, when we start to see improved industrial activity? Is it a two quarter lag, how do you guys think about that?

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**Patrick Decker** - *Xylem Inc - CEO*

Yes, so this is Patrick. So I would split it into really two pieces of the industrial sector. In the light industrial sector, that actually is more of a replacement business for us, and so we tend to be selling more into OpEx budgets. And so, historically, that business has grown in the low single-digits, kind of tied to GDP.

That's why we were kind of caught off guard a bit in the fourth quarter, with unexpected -- some slow down there in the US. And we do expect that to recover, but I think we're trying to be -- we're trying to be modest and conservative, certainly here in the first half of the year, as to expectations. So we're obviously curious to see how Q1 and Q2 play out here, and we would expect some normal recovery there.

The other piece of the industrial exposure for us, albeit less, is clearly in the energy sector, more the heavy industrial piece. We're less exposed there, but the reason you hear us calling that out, is simply because of the fact that impacts our dewatering business for the most part, which is a high-margin business.

It's hard for us to gauge whether we're being conservative on our guide here, but we've seen the softness now for a number of quarters, and we simply think it's prudent to continue to build that into our outlook, at least in the first half of the year. So we're hopeful as others are, that there will be a market recovery over the course of the year, but we're certainly not banking on that in our guidance range.

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**Deane Dray** - *RBC Capital Markets - Analyst*

Great. Thanks for taking my question.

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**Patrick Decker** - *Xylem Inc - CEO*

Sure.

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**Mark Rajkowski** - *Xylem Inc - CFO*

Thank you.

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**Operator**

Nathan Jones with Stifel Nicolaus.

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**Nathan Jones** - *Stifel Nicolaus - Analyst*

Good morning, everyone.

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**Patrick Decker** - *Xylem Inc - CEO*

Good morning, Nathan.

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**Nathan Jones** - *Stifel Nicolaus - Analyst*

Patrick, I'm hoping you could help us bridge the gap between the down 1% to 2% first quarter, and up 2% at the mid-count -- mid-point, sorry, for the full-year?

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**Patrick Decker** - *Xylem Inc - CEO*

Sure.

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**Nathan Jones** - *Stifel Nicolaus - Analyst*

Given that orders have been roughly flat here, down in the fourth quarter. How do you -- how does that pick up come along? I see you've got easier comps as the year goes along, but we have seen slowing organic growth, as we have gone through the year. If you can help us bridge from 1Q to the full-year?

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**Patrick Decker** - *Xylem Inc - CEO*

Yes. No problem at all Nathan. So first, I would say -- just to restate some of the things we have said here. First quarter really is driven predominantly by a tough comp versus last year, because again, we had unseasonably warm weather. We had a really strong Q1 last year as you'll recall. And so, that's being predominantly driven by a tough comp there.

As well as the impact in Q1 of the slowdown in orders that we saw in Q2 and Q3 of last year, which are now working -- that's working its way through our funnel. And that will work its way out in the first half of this year. But then we did actually see an uptick in infrastructure orders, both Q3 and Q4.

Now some of those have some longer lead times, which by definition would ship out in the second half of the year, in early 2018, but we expect to see the benefit of that uptick in orders that we talked about here in the fourth quarter for water infrastructure, [up] 3%.

And then I would say, we also -- as you point out, we do have an easier comp in the second half year-over-year, because of some of the slowdown in organic growth that we saw in Q3 and Q4. In terms of how it splits quarter by quarter, think of it roughly as down 1% to 2% in Q1, basically flat, flattish in Q2, up 1% to 2% in Q3, and up a little bit more than that in Q4, as I'm talking about the base legacy Xylem business. That excludes the impact, of course, of Sensus.

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**Nathan Jones** - *Stifel Nicolaus - Analyst*

Yes. And then, I'd like to follow up a bit more on the heavy industrial side here. The [rig count] bottomed in, in the middle of last year. We've seen that improve. There's lot of folks out there talking about seeing improvement in the mining industry.

Is there some problem with channel inventory, or do you lag recovery, more than maybe, I guess, I was thinking in that business? I'm just a little bit surprised that you're not seeing, or forecasting better revenue growth in those two parts of the business?

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**Patrick Decker** - *Xylem Inc - CEO*

Sure, yes. We do have -- we do lag to a small extent, recoveries in rig counts. And that typically from our experience would be at least a couple quarter [timing] that we would see there. And that 's just the nature of our customer base. And to some extent, our indirect channel, in terms of nervousness that they would have around opening up the cupboards, in terms of buying more rental fleet, et cetera.

Part of this also is, some overhang in terms of them having adequate rental fleet to meet their demand, as we sit here today. But that certainly, that pressure will certainly return to them, as the market recovers. And we are seeing pockets of uptick in activity, and we're encouraged by that. But we just again, right now think it's prudent for us to not be building in an assumed recovery in that business, until we have a quarter or two, of actually having seen it in our results.

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**Nathan Jones** - *Stifel Nicolaus - Analyst*

If I could slip one more in on the public utility segment. You guys have clearly been outperforming the market there, so clearly, been gaining share. Can you talk about the two or three main areas, or main things that you think are driving those share gains, and how sustainable they are?

**Patrick Decker** - *Xylem Inc - CEO*

Sure. Yes, I mean, we're obviously, we don't take it for granted, so we're always looking over our shoulders. So we're always paranoid obviously around how we stay ahead of the market in these areas. But I would say first of all, we've got arguably one of the strongest channels to market in the US, both in terms of geographical coverage. But also our -- the strength of our channel partners there, as well as our direct sales team. And I think about the service component that we're able to offer relative to some of our competitors offerings.

Clearly, when you've got a rising tide of an end market like we have in public utility, whoever has the lead market share position is typically going to grow disproportionate to the rest of the market. We are certainly benefiting from that. But I would say, at the end of the day, it really comes down to the quality of our product offering, coupled with the service.

And so, we've had some recent product launches, our new [Concertor] launch which is being extremely well-received by the marketplace, as well as some of additional service offerings that we have built on that. And I would say lastly, although it's always hard to hang your hat on this, but we put a lot of effort in our sales team in leveraging our salesforce.com investment which has really helped in terms of lead generation, and substantially increasing our funnel, and pipeline of bidding opportunities. So there's a number of things, Nathan, that go into this. I wouldn't point to any one or two things, but those would be the top three or four.

**Nathan Jones** - *Stifel Nicolaus - Analyst*

That's helpful color. Thanks very much.

**Patrick Decker** - *Xylem Inc - CEO*

Okay. Thank you.

**Operator**

Joe Giordano with Cowen and Company.

**Joseph Giordano** - *Cowen and Company - Analyst*

Hey, guys. How are you doing?

**Patrick Decker** - *Xylem Inc - CEO*

Hey, Joe. Good morning.

**Joseph Giordano** - *Cowen and Company - Analyst*

So starting with Sensus, so and I know your initial accretion guide was very preliminary, but what kind of changed, the big bucket that changed to get from [10%] to [12%] to [20%]? And can you talk a little bit more about the clean water applications that Sensus can pull core Xylem into? I think it's -- people kind of understand core business pulling Sensus in, but can you talk about the other side of that a little bit?

**Mark Rajkowski** - *Xylem Inc - CFO*

Yes, Joe, let me -- I'll -- this is Mark. Let me touch on the Sensus accretion question, primarily two areas. One, as we locked down on our valuation and purchase accounting, the amount of amortization related to intangible assets was not as high as we originally expected. So that is -- that's about $0.06. And we also did a better job in terms of how we went out, and financed the transaction, that was a couple of cents. And they're continuing to perform strongly, and have a lot of momentum. So those are the primary reasons.

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**Patrick Decker** - *Xylem Inc - CEO*

Yes Joe, and on the synergies from a revenue standpoint, I would step back first of all, and re-summarize where we think the big ticket areas of opportunity are. First, there is there is a funnel of a number of large multi-year contracts that Sensus was already pursuing before this partnership, with utilities that we already have a good relationship with, that we can help there from a Xylem perspective. Or that on a combined basis now, the strength of our offering will help us succeed in some of those bids.

Secondly, is in the area of the wastewater side, where we're able to leverage their metrology in terms of their [FlexNet] system, as well as their data analytics and data science capabilities to provide offerings to a number of customers that we already have in common in the water utility space, but also to be able to go after new customers with a test and improvement offer.

Now there's lead times involved in doing the engineering and technical work around that, so that's why we don't expect to see meaningful revenue synergies in 2017, and we don't have any of that baked into our guidance, although we are certainly going to [drive] like hell to deliver some. The bottom line is, we don't have that into our, in our guidance.

And the third area is, to your point, when we look at the opportunities to now leverage Sensus' capabilities in the clean water network side, we get other parts of our applied water business, as well as our dewatering, and outdoor analytics space, where we believe we're going to be able to leverage their data analytics, and data science and software as a service capability, to be able to connect our own devices, whether it be in the industrial space, whether it be in commercial buildings.

But again, those are longer lead times. We'll have a lot more to say about the nature of those opportunities and the size, in Investor Day in April. And then lastly, now we haven't even talked about Visenti yet, and we'll hold that until Investor Day, because I think people will get very excited about what capabilities they bring to the party here as well.

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**Joseph Giordano** - *Cowen and Company - Analyst*

Okay, that's great color. And fair to say, that the Sensus accretion, almost none of that is from a change in the operational expectations, it is all accounting-related? So that's good to see. As you guys have spent this much money, and clearly, your focus is on these higher technology type aspects, when I look at your total portfolio, and you sit back, are there areas now, that maybe don't need to be part of Xylem, that you're not -- you don't see spending incremental dollars on, that maybe you can look to divest?

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**Patrick Decker** - *Xylem Inc - CEO*

Yes, I, certainly on the divestiture front, I wouldn't ever rule out anything long-term. But I would, I'd say today, as we sit here, I wouldn't expect anything of significant size and scale. Our -- looking at our portfolio, and just doing good disciplined portfolio management, whether it be where we allocate capital, but also which ones we won't even be a part of, is something we look at on a regular basis. And again, if there was anything there, meaning we would certainly share that at Investor Day. But we don't envision anything of significant size and scale, as we sit here today.

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**Joseph Giordano** - *Cowen and Company - Analyst*

Okay. Thanks, guys.

**Patrick Decker** - *Xylem Inc - CEO*

Okay. Thank you.

**Operator**

[Mitch Bomadero] with Robert Baird.

**Mike Halloran** - *Robert W. Baird & Company, Inc. - Analyst*

Hey guys, can you hear me?

**Patrick Decker** - *Xylem Inc - CEO*

Good morning.

**Mike Halloran** - *Robert W. Baird & Company, Inc. - Analyst*

Hey, guys. This is Mike Halloran. Sorry about that. I must have got our lines mixed up.

**Patrick Decker** - *Xylem Inc - CEO*

Yes.

**Mike Halloran** - *Robert W. Baird & Company, Inc. - Analyst*

So first question, the share count creep here, is this just a reflection of focus on debt paydown, and less of a focus on buying back stock? Or is there something else going on?

**Patrick Decker** - *Xylem Inc - CEO*

No, you --

**Mark Rajkowski** - *Xylem Inc - CFO*

Nailed it. (multiple speakers)

**Mike Halloran** - *Robert W. Baird & Company, Inc. - Analyst*

And then --

**Mark Rajkowski** - *Xylem Inc - CFO*

Just focused on getting our debt down to where we need to get it.

**Mike Halloran** - *Robert W. Baird & Company, Inc. - Analyst*

So a second question then, and I'll keep mine to two. When you look backwards at the last time we had an infrastructure build go through, if I remember correctly, there were delays going into the build, as people decided to wait and see what kind of funding, they could get externally, as opposed to funding things with their current stream.

How do you think that dynamic plays out this time? Are you seeing any signs of project softness, or anything that would reflect a similar dynamic to the last cycle?

**Patrick Decker** - *Xylem Inc - CEO*

Mike, I'm in your camp on this, based on the very reasons you laid out. We've not seen it widespread, but we have seen it in pockets, where there are projects that are in the hopper, that we have seen some slowness in terms of -- and we believe it is, because of people looking to see, well, does it need to be funded locally within our own budgets? Or is there going to be state or federal funding that comes forward?

What's encouraging about that is, the fact that we are seeing, and you're probably seeing and hearing from other E&Cs in the space that they're seeing up ticks in their quoting activity. And so, the work is absolutely out there. And we do believe that we have hit a little bit of a softness here for a couple of quarters. And the question is, when do those things come forward? And so, that's certainly my perspective. Now Phil has been here around for long time, and he can certainly give his perspective specifically, on what we've seen historically within the Xylem businesses.

**Phil De Sousa** - *Xylem Inc - VP of IR*

Yes, Mike, I was just going to -- thinking back to that year. And the only thing I would highlight is back then, that created a bit of uncertainty that the market really wasn't ready for, and how to think about it going forward. So that probably went on for a few quarters before it started to shake loose. I think, this time around, yes, certainly there's a little bit of air pocket here, but not likely to last beyond the first quarter or two, here in 2017.

So I mean, we're obviously watching it pretty closely. But that's the general feel by our teams, and they're obviously really close to their customers, because we predominately go direct. So feeling a little bit more confident about the life of which that air pocket might last this time around.

**Mike Halloran** - *Robert W. Baird & Company, Inc. - Analyst*

Great. Thanks guys.

**Patrick Decker** - *Xylem Inc - CEO*

Thanks, Mike.

**Operator**

Ryan Cassil, with Seaport Global Securities.

**Jacob Schowalter** - *Seaport Global Securities - Analyst*

Hey, good morning. This is [Jacob Schowalter] on for Ryan.

**Patrick Decker** - *Xylem Inc - CEO*

Good morning.

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**Jacob Schowalter** - *Seaport Global Securities - Analyst*

Good morning. In commercial, where's the strength that you guys are seeing coming from? Is it more so, institutional in government buildings, or is it coming from elsewhere?

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**Patrick Decker** - *Xylem Inc - CEO*

Yes, it's predominately coming from institutional areas. So again, we throw that in, in terms of hospitals, universities, kind of government spend in that space, so that's the first piece as it relates to the US.

I would say the other piece that we're seeing is, a pretty strong rebound at this point in time, was within a few of the emerging markets, most notably China bouncing back. China has been on its back here, in terms of our commercial building exposure through 2016. And we really saw that turn in the fourth quarter, and we that expect that to continue through 2017. And we're seeing a tremendous growth in India from the whole Smart Cities focus as well.

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**Jacob Schowalter** - *Seaport Global Securities - Analyst*

All right. And then, in India, I know guys got a couple few larger orders back in early 2016. Did you see any follow-on activity coming through, in regards to larger orders for India?

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**Patrick Decker** - *Xylem Inc - CEO*

Yes, I'd say two things, one, we do see a very rich pipeline and funnel there right now, and are actively bidding on projects of similar size. And so, hopefully we'll bag some of that this year. In fact, that would not help this year. That would be a 2018 kind of benefit, but we've got very good line of sight to our outlook for 2017, given these are our large projects.

I would say that, with the focus of Prime Minister Modi on both infrastructure and Smart Cities, we see that run continuing for quite some time. Having said that, what we are also doing right now is, especially as we have ramped up our manufacturing capabilities there, as well as our R&D and technical center, we're trying to help our teams their focus as much on building the day-to-day recurring business base there, and all the aftermarket service that comes with it, to make sure that once we get through the next few years of large projects, that we've got a really established, a really attractive established base business there that recurs.

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**Jacob Schowalter** - *Seaport Global Securities - Analyst*

All right. Thank you guys for answering my question.

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**Patrick Decker** - *Xylem Inc - CEO*

Sure. Thank you.

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**Operator**

Robert Barry with Susquehanna.

**Robert Barry** - *Susquehanna Financial Group / SIG - Analyst*

Hey, guys. Good morning.

**Patrick Decker** - *Xylem Inc - CEO*

Hey, good morning.

**Robert Barry** - *Susquehanna Financial Group / SIG - Analyst*

I just wanted to actually clarify the answer to an earlier question about the revenue growth progression. I think you indicated, down low, single in the first quarter, kind of flattish and up low single in the third quarter. That kind of implies flattish through the first nine months, so which I think implies for 4Q -- (multiple speakers)

**Mark Rajkowski** - *Xylem Inc - CFO*

Yes, to clarify, (multiple speakers) Yes, to clarify, Robert, so really what it is -- (multiple speakers)

**Robert Barry** - *Susquehanna Financial Group / SIG - Analyst*

going to be back-end-weighted?

**Mark Rajkowski** - *Xylem Inc - CFO*

Yes, so let me walk you through it again. So it would be down 1% to 2% in Q1. And it would be flat -- it would be flattish to up low single-digits in Q2. And then, it would be up somewhere in the low single-digits, kind of 2% to 4% in Q3 and Q4.

**Robert Barry** - *Susquehanna Financial Group / SIG - Analyst*

In each of Q3 and Q4?

**Mark Rajkowski** - *Xylem Inc - CFO*

That's correct. And that's really being driven by easier compares, and the uptick in orders here, the last couple quarters, infrastructure.

**Robert Barry** - *Susquehanna Financial Group / SIG - Analyst*

Got you, okay. And then, what's your visibility and confidence that we get there? I know a lot of the business is pretty short cycle.

**Patrick Decker** - *Xylem Inc - CEO*

Yes, I'm quite confident on our ability to get there. I think, obviously, we have visibility to Q1. We got good visibility into Q2, given the project mix that we've got, and what we see happening in backlog.

And we'll begin to benefit to some extent from the order uptick in water infrastructure in Q3 and Q4. And then, as you look at Q3 and Q4 of 2017, a combination of easier compares, as well as just an overall history around the dewatering business, and some of the opportunities we see there, as we lap those tougher compares. So we think there's quite high confidence in our ability to get to these numbers [for the full year].

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**Robert Barry** - *Susquehanna Financial Group / SIG - Analyst*

Got you. And then maybe just finally, a question on the investment spending and the lock, is investment spending on a year-over-year basis, is that a headwind or a tailwind? And what is the thought on flexing it as needed, to keep margin goals on track, as that's been the approach in the past? Thank you.

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**Mark Rajkowski** - *Xylem Inc - CFO*

Sure. Robert, I'll take that one. We've got a very good line of sight to the planned strategic investments. And as we have done over the course of the last few years that I've been here, we will throttle those as responsibly as we need to be, depending on upon where the top line is coming in, and so we've got good line of sight and discipline around that.

At the same time, I would say, there's still a lot of self-help margin expansion opportunity here. And so, we do think there's tremendous opportunity, both the productivity from procurement, as well as Lean Six Sigma, as well as trying to overdrive the cost synergies associated with the Sensus partnership here together.

So I think, the combination of margin expansion opportunities, just by good old fashion operating discipline that we're continuing to drive, coupled with line-of-sight to throttle our investments appropriately, gives us confidence that we'll deliver on this margin expansion.

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**Robert Barry** - *Susquehanna Financial Group / SIG - Analyst*

Great. Thank you.

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**Patrick Decker** - *Xylem Inc - CEO*

Okay. Thank you.

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**Operator**

I will now turn the floor back over to Patrick Decker for any additional or closing remarks.

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**Patrick Decker** - *Xylem Inc - CEO*

Sure. So again, I mean, thanks everybody for joining, thanks for your continued interest and commitment. Safe travel in the meantime, but between now and then, we got a -- we want to remind you, we've got an exciting Investor Day coming up here on April 4. In just beginning of Q2, so it will be April 4.

It's going to be located at our Sensus location, just outside of Raleigh-Durham, North Carolina, in Morrisville, North Carolina, it's about 5 miles from the Raleigh-Durham airport. And you'll be welcome to join both presentations, as well as a tour of our Innovation center, and the Sensus headquarters there. So in the meantime, safe travels, and we'll see you soon. Thanks.

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**Operator**

Thank you. This does conclude today's Xylem fourth quarter 2016 earnings conference call. Please disconnect your lines at this time, and have a wonderful day.

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