THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

XYL - Q3 2017 Xylem Inc Earnings Call

EVENT DATE/TIME: OCTOBER 31, 2017 / 1:00PM GMT

THOMSON REUTERS

CORPORATE PARTICIPANTS

E. Mark Rajkowski *Xylem Inc. - Senior VP & CFO*

Matthew Latino *Xylem Inc. - Director of IR*

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

CONFERENCE CALL PARTICIPANTS

Brian Lee *Goldman Sachs Group Inc., Research Division - VP and Senior Clean Energy Analyst*

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

James Giannakouros *Oppenheimer & Co. Inc., Research Division - Executive Director and Senior Analyst*

John Walsh *Vertical Research Partners, LLC - VP*

Jose Ricardo Garza *G. Research, LLC - Research Analyst*

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

Michael DeLalio *Susquehanna Financial Group, LLLP, Research Division - Equity Research Associate*

Nathan Hardie Jones *Stifel, Nicolaus & Company, Incorporated, Research Division - Analyst*

Robert Scott Graham *BMO Capital Markets Equity Research - Analyst*

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

Scott Reed Davis *Melius Research LLC - Research Analyst*

Walter Scott Liptak *Seaport Global Securities LLC, Research Division - MD & Senior Industrials Analyst*

PRESENTATION

Operator

Welcome to the Xylem Third Quarter 2017 Earnings Conference Call. (Operator Instructions)

I would now like to turn the call over to Matt Latino, Senior Director of Investor Relations. Please go ahead, sir.

Matthew Latino - *Xylem Inc. - Director of IR*

Thank you, Christi. Good morning, everyone, and welcome to Xylem's third quarter 2017 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 third quarter 2017 results and discuss the full year outlook for 2017. Following our prepared remarks, we will address questions related to the information covered on the call. (Operator Instructions)

As a reminder, this call and our webcast are accompanied by a slide presentation available in the Investors section of our website. A replay of today's call will be available until midnight on December 1. Please note, the replay number is (800) 585-8367 and the confirmation code is 41782548.

Additionally, the call will be available for playback via the Investors section of our website under the heading Investor Events.

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 future risks and uncertainties, such as those factors described in Xylem's most recent annual report on Form 10-K and in 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.

Please turn to Slide 3. We have provided you with a summary of our key performance metrics, including 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.

Now please turn to Slide 4, and I will turn the call over to our CEO, Patrick Decker.

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

Thanks, Matt, and good morning, everyone. Thanks for joining us today to discuss our third quarter results. We had a very good quarter, and I'm quite pleased with our team's performance across all of our businesses. Each segment delivered solid revenue growth and robust order growth. We've seen improving conditions in most of our end markets, and we're executing in the marketplace more effectively than ever. We're well on track to deliver on our 2017 commitments, and this broad-based improvement, and the momentum we're building give us even more confidence in our long-term growth targets.

Before I get into our quarterly results, we've had a number of questions about the hurricanes and their impacts. So let me address that issue first.

We were very fortunate in that few of our own colleagues were affected personally in a significant way. From a business perspective, we always position our teams and equipment to ensure we can respond as quickly as possible when disaster strikes. But in this case, it wasn't just our customers who needed help. It was everyone in the path of each storm.

One of the great qualities of Xylem is the passion our colleagues have for helping others in need. It's simply part of our mission as a company. With each hurricane, our employees donated their own money to help with relief efforts. And through our Xylem Watermark program, we redirected significant funding and expanded our employee volunteer initiative to assist these communities at a very difficult time.

The rebuilding efforts are in the early days, and our teams will continue to help. A couple of weeks ago, one team spent several days cleaning out flooded homes and prepping them for reconstruction. And next week, we're sending a group of our colleagues to Puerto Rico to help build water towers in remote areas of the island that still have no access to clean water.

These are just a couple of examples, but they illustrate the purpose-driven culture we're fostering here at Xylem, and I couldn't be prouder of the work they're doing.

So now let me jump into our results. Our top line grew 5% organically in the third quarter. That includes 5% organic growth from our base Xylem businesses and 5% growth from Sensus. Mark will provide the details, but I do want to note that we delivered positive organic growth in each of our end markets and in each of our major geographies.

In addition, we delivered another quarter of robust orders growth, up 6% globally. This again reflects broad-based strength across our businesses, and our healthy bidding pipeline gives us visibility to continue growth in the quarters ahead.

As we've noted previously, treatment orders are a good leading indicator of the longer-term health of the public utility sector, and those were up high-single digits in the quarter. We saw particular strength in North America and Europe.

Speaking of public utilities, we were pleased to see our business in that end market return to growth this quarter, despite a challenging year-over-year comparison with 10% growth last year. There was solid improvement in the U.S. and strong growth in China. This shift in momentum, coupled with our robust orders performance, gives us confidence in the continued health of these markets.

The industrial end market also improved sequentially for the third consecutive quarter. The growth was driven by strong results in our dewatering business, up 9% year-over-year in the quarter. We had notable improvement in the oil and gas sector, which increased approximately 30% overall. This growth was widespread across several geographies. While we're pleased with this turnaround, it's important to keep this in perspective. Oil and gas only constitutes about 2% of our total revenue, though the margin impact is meaningful.

While our teams were working hard and delivering results for our customers, they also continued to execute against our continuous improvement and productivity objectives. In the third quarter, we generated another $40 million in cost savings, a double-digit improvement over the prior year and significant step toward meeting our full year target. Our procurement team has done an outstanding job of delivering savings and building further pipeline opportunities, and we're continuing to gain strong traction with our lean initiatives across the company. Our ongoing commitment to these productivity initiatives will continue to deliver benefits.

Our adjusted EBITDA in the quarter increased 20 basis points to 19.2%, reflecting continued strong operational performance across our businesses as well as the Sensus contribution. We delivered adjusted earnings per share of $0.65 in the quarter, an increase of 20% year-over-year. So given where we are in the year, we've increased the midpoint of our full year earnings guidance by $0.05. Our full year adjusted earnings per share guidance now is $2.39 to $2.41. This reflects our expectations for full year operational performance and an updated assumption for foreign exchange impact.

Before I turn it over to Mark, I want to share a few thoughts on our progress on our strategic priorities. Across the board, execution in the marketplace has been strengthening, reflecting our focus on driving commercial leadership. I was able to see this firsthand over the past several weeks as I attended a major industry conference, and one of our own customer-focused events.

The industry event known as WesTech is the world's largest water quality technical conference and trade show. This year, attracting nearly 25,000 participants. Xylem has a major presence at the show. And over the course of just a few days, we generated nearly 1,000 sales leads and met with hundreds of existing customers.

What those customers are most interested in is the innovation that we're bringing to the market. They want to see how we can solve their problems and add real value to their businesses. The centerpiece of WesTech this year was the introduction of our latest smart Godwin pump. The launch of it alone brought in an audience of 450 people to our booth, which helped to boost dewatering sales leads by more than 250% year-over-year. So a very productive event for connecting with customers.

Then just last week, I opened up the Sensus Reach Conference, which is really more like a user conference, where customers and distributors come together to learn more about the latest R&D developments, share new applications and practices and get technical training on our technologies. We had more than 1,000 participants this year, which was a record number, and the feedback was tremendous. Another very effective way to forge stronger customer partnerships, while at the same time, providing them with an early look at some of our most exciting innovation projects.

One of the many topics discussed at Reach was our progress on a few innovation projects that target the synergies we're driving between Sensus and Xylem technologies. As I said when we announced the Sensus acquisition, their R&D capabilities would accelerate our own innovation and technology initiatives, and they certainly have. We're developing new solutions that extend the systems intelligence technologies within Sensus to other products across the Xylem portfolio. We're now in the early stage of rolling out pilots with select customers, and I look forward to sharing more about those in the months ahead.

We're also making significant progress in accelerating growth in emerging markets. When market conditions turned challenging not long ago, there were a lot of negative voices in the marketplace, but we kept our eye on the long term and remained committed. As a result, we were well positioned to capture early growth as those conditions improved. And that can be seen in the sequential improvement in growth we delivered each quarter this year.

Our third quarter emerging markets revenue increased 8% year-over-year. Our business in China grew 16% in the quarter, driven primarily by strong demand in the public utility sector.

Last month, we held our Board of Directors' meeting in China, where we were able to provide them with an in-depth look at our business there. This was a great chance for them to learn more about the opportunities in China and provide a very visible sign of support for our investments in that country.

India continues to deliver double-digit growth, up 32% this quarter, and its bidding pipeline is growing. And we were very pleased to see our Middle East business return to growth, up nearly 20% for the quarter with double-digit orders growth as well.

Finally, I do want to recognize that today is the 1 year anniversary of our Sensus acquisition. While we work diligently on the integration process, the business has performed well. They've delivered growth in line with our expectations. The team has delivered strong double-digit growth in the smart electric business, further underscoring the value that the energy adjacencies bring to Xylem.

All-in, I'm happy with our progress in this first year, but I will also point out that we are still in the early stages of realizing the full value of this union and look forward to the journey ahead as we lead the industry into the smart infrastructure era.

So overall, I'm very pleased with our performance in the third quarter. We know there continues to be plenty of work ahead in order for us to meet our long-term objectives. But our teams continue to build momentum across our businesses, which has us on track to close out the year strong, meeting our full year commitments and setting us up for a good start to 2018.

With that, I'll turn it over now to Mark for more details on the quarter.

E. Mark Rajkowski - *Xylem Inc. - Senior VP & CFO*

Thanks, Patrick. Let's turn to Slide 5. Overall, revenues were up 33% to $1.2 billion in the third quarter. On a pro forma organic basis, this represents 5% growth with both Sensus and the base Xylem business contributing 5% each.

Foreign exchange increased revenues by $18 million or a little more than 1%. In the base Xylem business, the 5% growth reflects strength across all of our end markets. Notably, it marked a return to growth in public utility, where we delivered 4% growth, despite lapping a challenging prior year growth rate of 10%. The momentum we saw in the second quarter in our industrial markets continued to build during the third quarter, resulting in 4% growth.

We also continue to see strong performance in the commercial and residential end markets, which were up 9% and 5%, respectively. Regionally, the U.S. was up 5% year-over-year with strength across all 4 end markets.

Western Europe performance increased 3% with double-digit growth in commercial and modest growth in public utility.

Emerging markets were up 8%, driven by double-digit growth in each of our key regions of China, India and the Middle East. This growth was partially offset by the lapping of large project deliveries in Asia and Eastern Europe.

Our Sensus business grew revenues 5% and also delivered more than 10% orders growth in the quarter.

Finally, orders for our base Xylem business were also strong, up 6% in the quarter.

Moving to operational performance. We increased our adjusted EBITDA margin by 20 basis points to 19.2% in the quarter. This increase was driven by strong productivity and operating results from our base Xylem business as well as the continued solid performance of Sensus.

Adjusted operating margin was 14.1% in the quarter. Excluding the 70 basis points of purchase accounting amortization for the Sensus acquisition, our adjusted operating margin increased 20 basis points year-over-year in the quarter.

Our teams continued to execute well on our productivity programs, delivering $40 million in cost savings during the quarter. This is an increase of 14% from the prior year.

The acceleration of our cost savings enabled us to more than offset inflation and continue to fund investments for growth.

The strong top line growth and operating performance in our base Xylem business, along with the significant accretion from the Sensus acquisition, enabled us to deliver adjusted earnings per share of $0.65, a 20% increase year-over-year.

Now please turn to Slide 6 and I'll provide additional details on our segment performance.

Beginning with our Water Infrastructure segment. We recorded orders of $558 million, up 5% organically year-over-year. This includes high single-digit growth in treatment and mid-single-digit growth in transport. This performance continues to drive the healthy trajectory that we've seen in these businesses and positions us well for 2018.

We exited the quarter with total backlog for the segment of $622 million, up 10% organically year-over-year. Of this amount, more than $300 million is due to ship in the fourth quarter, an increase of 7% year-over-year on an organic basis. This gives us good confidence in our ability to deliver our outlook of mid-single-digit revenue growth in the fourth quarter.

Water Infrastructure revenue of $520 million represents a 7% increase year-over-year on an organic basis.

Our results in emerging markets led the way again with revenue growth of 16%. We had continued strength in China and India, both growing more than 30% in the quarter, where the markets remain strong, benefiting from government programs and funding.

Our Middle East business rebounded this quarter as well, up more than 35% from the prior year as we saw particularly strong performance from our wastewater transport business.

In the U.S. and Canada, the segment was up 9% and 26%, respectively, primarily due to double-digit growth in our dewatering business. We saw acceleration in the oil and gas and mining markets.

The U.S. grew low-single digits in the public utility end market driven by strength in the wastewater transport business. It's worth noting that this growth comes on top of a very difficult comparison of 25% growth in the prior year. This further reinforces our view on the overall health of the U.S. public utility market.

Western Europe was flat overall as strength from treatment project deliveries in Germany was offset by softness in the U.K. and Italy from lower project spending.

Operating margins for the segment increased 140 basis points to 18.1%, driven by productivity benefits and volume leverage, which more than offset inflation, and favorable project mix and investments.

Please turn to Slide 7. Our Applied Water segment booked orders of $374 million in the quarter, up 9% organically. We exited the quarter with backlog of over $200 million, which is up 18% organically compared with last year. Of this amount, more than $120 million is due to ship in the fourth quarter, up roughly 4% on an organic basis. Our order momentum and backlog provides us with confidence in our ability to accelerate our growth to mid-single digits in the fourth quarter.

Revenue for Applied Water was $354 million, up 2% organically versus the prior year quarter.

In Western Europe, revenue increased 7% with growth across all applications but predominantly within the commercial building sector, where we continue to benefit from our recent investments in energy efficient products and our sales teams.

In the U.S., revenue was up a modest 1%. This reflects growth across all verticals with the exception of industrial water, where we continue to see weakness in irrigation applications due to the wet weather conditions in key agricultural regions of the country.

Emerging markets revenue was down 3%, primarily due to the timing of shipments in Latin America.

Segment operating margins in the quarter increased 30 basis points year-over-year to 15.8%. The increase in adjusted operating margin was due to cost reductions from global procurement and Lean Six Sigma initiatives and from restructuring savings. This was partially offset by cost inflation, unfavorable mix and currency impacts.

Now let's turn to Slide 8 to discuss the performance of our Measurement & Control Solutions segment.

As you know, during the second quarter, we combined our Xylem Analytics, Sensus and Visenti businesses. We have recently renamed this segment, which is now Measurement & Control Solutions. Revenue for this segment was $321 million, up 5% on a pro forma organic basis over the prior year period. This includes 5% pro forma organic growth in both the Sensus business and in the Xylem Analytics business.

For Sensus, revenue in our electric business increased about 60% with growth driven by the deployment of the Alliant project as well as continued strong demand for our new Stratus electric meter. The water business was down about 10% in the quarter. The decline largely reflects the challenging comparison with the prior year period during which the water business grew in the mid-teens as it benefited from restocking of the new iPERL water meter. The business was also impacted by the battery supply issue we discussed last quarter, which pushed out about $4 million of revenue into the fourth quarter. This issue has now been resolved, and we expect the water business to grow double digits in the fourth quarter.

We were also very pleased with the growth in our services business, which grew 47% in the quarter, and the continued momentum in orders, which were up more than 10% with strength across all businesses.

Shifting to our Analytics business. This business delivered 5% growth in the quarter with continued strong performance in environmental monitoring in North America. Orders in Analytics increased by 4% with broad-based growth across most of our geographic markets.

Now moving to segment operating margins. Adjusted operating margin for this segment decreased 80 basis points from 10.5% to 9.7%. The decrease was due to purchase accounting impacts. Excluding this 230 basis point impact, margins for the segment would have been up 150 basis points.

Consistent with the second quarter, we have included an additional slide in the appendix that reflects comparable sales and margin performance on a pro forma basis.

Given the significant impact that amortization from purchase accounting has on this segment's margins, we've presented this analysis on an EBITDA basis.

On a pro forma basis, EBITDA margins in the quarter were down 130 basis points year-over-year to 18.4%. The reduction was primarily driven by increased R&D and commercial investments for new product development and to drive revenue synergies.

Cost reductions more than offset inflation, and sales mix across both the Sensus and Analytic businesses was slightly negative.

Now let's turn to Slide 9 for an overview of cash flows and the company's financial position. We closed the quarter with a cash balance of $283 million. Free cash flow in the quarter increased more than 50% from the prior year to $186 million, and was driven largely by the addition of Sensus. Free cash flow conversion was 170% for the quarter, and this puts us at 101% conversion on a year-to-date basis and on track to deliver greater than 110% free cash flow conversion for the full year.

We invested $42 million in capital expenditures in the third quarter and returned $32 million to our shareholders through dividends. We also repaid $150 million of our short-term debt as we remain committed to maintaining our investment grade credit rating, and working capital improved by 220 basis points year-over-year.

Now please turn to Slide 10 and Patrick will cover the update to our 2017 outlook.

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

Thanks, Mark. We delivered solid results year-to-date and we're on track to deliver on our financial targets for the full year. The changes in our full year guidance reflect our expected full year operational performance as well as updates to our foreign currency assumptions.

At the top line, we now expect to deliver full year revenue of approximately $4.7 billion. On a pro forma basis, we project organic revenue growth of 3% to 4%, which includes organic growth from the base Xylem business of roughly 3% and organic growth of 6% to 7% in our Sensus business.

We continue to anticipate generating $130 million in cost savings for the full year, a 10% year-over-year increase. And as I said previously, we are on pace to meet that target.

Our adjusted operating margin is now forecast to grow about 50 basis points, excluding roughly 60 basis points of margin dilution from Sensus purchase accounting. Here, we've narrowed the range of our previous guidance.

At the bottom line, we now expect to generate adjusted full year earnings per share of $2.39 to $2.41, which excludes integration, restructuring and realignment costs of about $50 million.

We've increased our projection for those costs from our previous forecast of $40 million as we've accelerated certain activities that we now plan to execute in the fourth quarter.

EPS growth is projected to be in the range of 18% to 19%.

Finally, as Mark discussed, we expect to deliver free cash flow conversion of at least 110% this year. This contemplates anticipated capital expenditures of $190 million to $200 million.

Now please turn to Slide 11 and I'll walk you through our end market assumptions.

Please note that our growth estimates on this slide reflect pro forma organic revenue from 2016 for Xylem and include the impact of Sensus. Our growth rate projections for each end market remain unchanged from last quarter, so I'll just review these very quickly.

Public utility constitutes about 47% of our 2016 revenue. For 2017, we continue to expect revenue to grow in the low- to mid-single digit range, with Sensus delivering 6% to 7% growth and the Xylem-based businesses up low single digits.

We continue to expect that full year revenue in our industrial end market will be up low single digits.

And moving to commercial, we project revenue growth to be in the mid-single digit range in 2017.

In residential, we continue to anticipate full year revenue growth in the high single-digit range.

Now please turn to Slide 12 and Mark will walk you through more details on the outlook.

E. Mark Rajkowski - *Xylem Inc. - Senior VP & CFO*

I'll briefly update you on our guidance for the full year and also highlight some of the key planning assumptions for the fourth quarter.

As Patrick mentioned, we're increasing the midpoint of our full year earnings per share guidance range, which is now $2.39 to $2.41. At the midpoint, this reflects a $0.05 increase from our second quarter guidance.

The components of this $0.05 increase include the following: An increase of $0.02 to update our euro FX rate assumption from $1.15 to the October average of $1.17. There is a $0.01 increase for better operational performance in the third quarter. And lastly, another $0.02 related to recent orders momentum and the strong backlog that we have as we enter the fourth quarter.

Now I'll highlight a couple of the key assumptions for the fourth quarter. We're anticipating 5% to 6% pro forma organic revenue growth in the quarter.

As I mentioned, we're assuming the FX euro rate to average $1.17 in Q4. Our adjusted operating margin is expected to be in the range of 15.4% to 15.7% and our adjusted EPS will be in the range of $0.75 to $0.77.

With that, I'll now turn the call back over to Patrick for closing comments.

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

So thanks, Mark. I'm pleased with our performance this past quarter, particularly the momentum that our teams continue to build. Their execution is strong, which is enabling them to capture more growth in our improving end markets.

We're making substantial progress on our strategic priorities. Our focused and disciplined approach has us on track to achieve our near-term objectives, while continuing to advance toward our longer-term business goals and growth targets.

There is still a significant amount of work to do, but we have tremendously committed and capable teams executing this work. Working together, I have great confidence that we will accomplish our objectives, including further value creation for our shareholders.

Now operator, we can open up to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question is coming from the line of Deane Dray with RBC Capital Markets.

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

Maybe I can start with a couple of the big growth numbers this quarter, the China and India numbers up 30%. And for China, could you put this growth in context? We've heard reports of the Chinese amending their 5-year plan regarding water specifically and non-revenue water. Are you beginning to see or are you in discussions where this might be an opportunity for, especially, given your work with Sensus and being able to come with a more integrated strategy towards non-revenue water?

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

Yes. Thanks, Deane. This is Patrick. So I would say we are in the early stages of beginning to do some pilots in those markets, most notably in China. But I would say this order growth and revenue growth that you're seeing, really doesn't reflect any of that. We're in the early stages of that. This is tied back, though, to your comment about a broad government mandate around environmental quality and water quality. And we've seen that momentum really building over the course of the last year or so. And of course, we're also coming off of some easy comps in the second half of last year, but do feel good about the momentum that we're seeing in both of those markets as well as the Middle East.

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

And just given this is the 1 year anniversary for Sensus. And, Patrick, you said in the coming months, you'd hear more about some of these new pilot programs, but I was hoping you could just give us some hints directionally as to where -- what types of applications do these pilots address in terms of watershed monitoring, environmental, maybe non-revenue water? But just directionally, where are these pilot programs focused?

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

Sure, sure. Yes, I'll keep my comments a little bit opaque for competitive reasons as you can appreciate. But certainly, you nailed it in terms of non-revenue water is clearly a big mandate that's beginning to gain momentum around the world. So we've got a few things going on in that area. You're absolutely correct in talking about smarter watershed management. There's a lot that goes into that around water quality, but also kind of advanced analytics before the water hits the treatment plant and some value that we can really drive and add there. So those are a couple of a handful of areas that we're focused on.

Operator

Your next question is from Nathan Jones with Stifel.

Nathan Hardie Jones - *Stifel, Nicolaus & Company, Incorporated, Research Division - Analyst*

Patrick, a couple of times in your prepared comments today, you talked about executing better than ever. I'm wondering if you could give us a little more color on the areas that you feel the execution is improving. What areas you're focused on to continue to drive that forward?

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

Sure. Thanks, Nate. Yes, I'd say a couple, 3 areas that come to mind for me. First is on the commercial side. I -- and we're still in the early innings on this. It's a fragmented market. A lot of competitors out there. I think our teams are more aligned than ever. Now it's always a bit like ducks swimming, I mean, there's a lot of work that goes on behind the scenes here. But I do feel the momentum there in terms of our commercial teams, whether it be the tools we've given them, the incentives that I think also just -- it takes time for people to get familiar with the portfolio. And I think that the ability to generate and share leads, we saw that at WesTech as a good example. The unity there at the booth was outstanding. So that's one area.

The second is in the area of R&D. And I think the investments that we've made over the last few years are beginning to pay off and we're seeing that in the movement of our Vitality Index, but more importantly, some of the share gains that we've had in a couple of our core markets. So those are a couple of areas. I mean, certainly the third would be the whole productivity focus around procurement and lean deployment. While, again, we're still in the early innings there, that's really what's allowed us to fund these other investments we've made on the front end in R&D, while continuing the margin expansion.

E. Mark Rajkowski - *Xylem Inc. - Senior VP & CFO*

And one last point, Patrick, I'd also note is the really good progress the team's making on the Sensus integration work.

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

Absolutely.

Nathan Hardie Jones - *Stifel, Nicolaus & Company, Incorporated, Research Division - Analyst*

Then the second question here. You've got -- in Water Infrastructure and Applied Water, you had 3.2% cost reductions, 4.6% cost reductions. Can you talk about any early read on what kind of numbers we should be expecting for next year? Are you still ramping up cost reductions? Are you starting to plateau on the opportunities there?

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

No. I think that we still have opportunities here, too. We've not plateaued, so we have opportunities here to continue the margin expansion absolutely, and that really is again being driven by the various productivity initiatives. But also bear in mind that we are in the early stages of the simplification work that we talked about and the rollout of global business services and some other tools or programs that continue to further the margin expansion.

E. Mark Rajkowski - *Xylem Inc. - Senior VP & CFO*

Yes. Listen, Nate, as you've heard us talk about in our Investor Day work, I mean, Tony Milando and his team have plans to continue that momentum in Lean Six Sigma and certainly global procurement with new tools and capabilities. And just to reemphasize the last point Patrick made. We're just getting started on our global business services work. So that's all ahead of us.

Nathan Hardie Jones - *Stifel, Nicolaus & Company, Incorporated, Research Division - Analyst*

Maybe I could just rephrase that a little bit. Infrastructure and Applied Water, you put up about 30% incremental margins this quarter. Is that kind of a level we should be expecting you to be able to generate next year?

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

Yes. So we -- I think as we indicated at Investor Day, just to reiterate that, that we historically, we had been generating about 35% plus in incremental margins on a blended basis. This again excluding Sensus. This is the legacy Xylem businesses. And in our long-range targets, we had built in about 30% plus incremental margins. And the only reason for that modest degradation was the mix of business because we do expect to have higher growth in both treatment as well as in the emerging markets. Treatment has a somewhat lower margin in general, but emerging markets, lower margin, not because of emerging markets, but because of the mix of project activity there that would lead to slightly lower incremental margins. So still around that 30% mark.

Operator

Our next question comes from Scott Davis with Melius.

Scott Reed Davis - *Melius Research LLC - Research Analyst*

It's -- the growth rates are pretty interesting. And I don't think following you guys as long as I have, I could remember kind of this much volatility in the growth rates, meaning like treatment up 14%, for example, it just seems like such a big number to me, in general. I mean, can you help us understand how maybe water utilities are acting differently in the marketplace? I mean, is there -- is it kind of getting lumpier over time? And are there things -- weird things going on like budget flushes and stuff that -- or is this just pent-up demand that's just coming off of multiyear recession time period?

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

Yes. Scott, that's a fair question. I think the way I would describe it and characterize it would be that, part of the -- look, we're very pleased with the execution of the teams. I mean, there's an element of share gain in a number of these areas. But having said that, we did have a relatively easy compare, tough second half of last year where we did have the so-called air pockets that were out there. And so we're lapping that now, even having said that you're still seeing pretty robust growth rates here.

So there is some level of just continued fundamental market recovery here in the public utility side. But I think what we're seeing here, in general, is while we don't talk a lot about the industrial piece because we don't have a lot of heavy industry, we're more of the light industrial piece. We've seen some rebound and recovery and strength there. And then I would also say, obviously, now the Sensus business, just given the nature of meter deployments and the AMI deployments, that can be a little lumpy. That will be a little volatile from quarter-to-quarter, shouldn't be volatile from year-to-year, but maybe from quarter-to-quarter.

Scott Reed Davis - *Melius Research LLC - Research Analyst*

Yes, that makes sense. And then I know there's been a lot of M&A speculation. And one of the things, and I'm not going to ask you to comment because you're probably going to say no anyways. But the -- when I -- we can do the math on what you can financially afford maybe in -- and of course, you could issue stock I guess if you really saw something interesting. But do you feel like you've got the people and the systems in place to really manage doing another sizable deal after you've done Sensus and such?

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

Well, thanks, Scott. So I -- as you said, I'm not going to comment on the market rumors and speculation. All I would say there is, we -- I certainly do feel and certainly the board feels that we've got the -- we've got both the financial and the management capacity to do deals of size. But we're only going to do it in a very disciplined manner. We're going to be focusing on good returns on capital. We're only going to focus on assets that are clearly in line with the strategy that we laid out back at Investor Day. But certainly, we've got that capacity, but look, we're going to focus on deploying capital that's really going to create value for shareholders.

Operator

Your next question is from Joe Giordano with Cowen.

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

Similar with Scott's discussion, I'm more interested in when you look across the potential M&A spectrum, like how are you looking as far as new technologies more towards like the Sensus type, communications and analytics versus more traditional like infrastructure that might be a logical fit into the portfolio but has like a different -- it's certainly a different type of investment? So how do you like kind of compare and contrast that when you're weighing decisions?

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

Sure, Joe. So I would just -- I'd go back to what we laid out at -- in our Investor Day back in April. There are 3 areas that we have highlighted. And one is obviously kind of the digitization of the water sector, we call it Systems Intelligence. We talked about industrial water services and we talked about advanced and industrial water treatments. So those are the 3 broad areas that we have prioritized. Now look, it's -- the water sector is a very fragmented industry and we've got a very healthy pipeline of potential targets that are out there that we look at, and we absolutely love the digital space. And there are a number of opportunities that we are continuing to look at there that will fill out some technology gaps that we've got in our offering. So that remains to be a top priority for us. But those are really the 3 areas that we continue to focus on that we laid out back in April.

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

Can you maybe talk about some of the trends you're seeing within industrial treatment specifically as far as maybe some of the burden shifting towards them from a regulatory perspective versus just from a PR perspective, of companies kind of wanting to be that 0 discharge kind of greener footprint. What are you seeing there over the last couple of years?

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

Sure. Yes, yes. So we definitely are seeing trends that are shifting that direction. Part of it is the financial burden that some of the utilities face and they want to offload some of that to the deep pockets. Others in some places is regulatory moves on the part of various governments. It's not been a dramatic shift. I mean -- and I wouldn't suggest that we're like in double-digit land there in terms of that kind of shift, but it's been certainly a strengthening of that demand in that sector. It is still a very, very fragmented industry in that regard. And so that obviously provides some challenges along the way in terms of margins and so forth. But it is certainly healthier now than it's been in the past.

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

And maybe last for me. Can you maybe just give us an update on some of the pilots that, I think you, over the last couple of quarters, you talked about some pilots you had for Sensus, mainly some big stuff potentially in Asia, that you've kind of been going through. So any incremental progress there?

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

Yes, making progress. I'd say, Joe, just for competitive reasons, I'd rather not give too much more information on specifics around the pilots themselves, but feel good about the momentum there. These things are longer-term specification, and we would expect for there to be news there hopefully sometime in 2018.

Operator

Your next question comes from Ryan Connors with Boenning and Scattergood.

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

I wondered, one thing you didn't mention, at least not very prominently, is raw material costs and input costs and that being any sort of a headwind to margin. So I wonder if you can expand on that, what you're seeing on that front and then tying that to a discussion of pricing and price cost management.

E. Mark Rajkowski - *Xylem Inc. - Senior VP & CFO*

Yes, Ryan, let me take that one. The -- we haven't seen a significant ramp in those direct material costs. In fact, it somewhat moderated from the tick up we saw in the second quarter. We're seeing a little bit of it in stainless steel, a little bit of it in copper, but it's really modest. And certainly, what we're looking to do commercially is really make sure that to the extent where we do see a tick-up in those direct material costs that we're making sure that we pass it along to the customers. Certainly, where we can and where we have strong value propositions, and that's work that's ongoing.

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

Okay. That's great...

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

And I would just add, Ryan. Sorry. This is Patrick. I mean I know there's been some other commentary in the space around impact on like brass and copper. Less than 10% of our overall Sensus revenue, not even Xylem, but less than 10% of our overall Sensus revenue is actually exposed to brass and copper. Again, different composites in our materials, et cetera. And again, that's relatively -- I don't want to say it's easy, but it's relatively easy for our procurement teams to mitigate that.

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

Okay. And then the follow-up would be just some more discussion of strategic pricing. It seems that since organic growth is picking up, that should be a good thing for supply and demand balance across the industry. I know pricing has been kind of a headwind the last couple, few years. Is that something we should expect to turn around and we should expect growth to become a contributor to price, say, from next year and beyond? Or what's your view there?

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

Yes. I mean, we certainly would like to believe that the supply-demand equation would be coming into our favor and certainly a focus area for us. And we certainly, as a leader in the marketplace, want to be disciplined in that regard. Whether or not we build that into an outlook, that remains to be seen. We really need to get another quarter or 2 behind our belts here to see real sustained momentum in terms of demand before we build it into an outlook.

Operator

Your next question is from John Walsh with Vertical Research.

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

So just a question around investment spending as we think about next year. Does that -- I know you've talked about what you think your incrementals will drop through, but should that be a headwind or a tailwind as we think about the absolute level of spending or as a percentage of sales?

E. Mark Rajkowski - *Xylem Inc. - Senior VP & CFO*

John, we're -- we still have work to do to really drive some of the commercial synergies that Patrick was talking about earlier in some of these pilot projects. We're going to continue to be innovative and look to continue to invest in R&D to ensure that we have the leading portfolio of solutions for the marketplace and for our customers. So that -- and as we talked about, during Investor Day, that is going to continue to be an area where we'll make continued investments. So that's something that we'd expect to continue to do certainly in 2018 and beyond.

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

And I would -- the other couple of areas I'd offer, John, would be, one, certainly emerging markets as we continue to build out for the future there. That's where a big share of Water Infrastructure investment is occurring and will continue to occur. So we'll continue to support those markets. And then secondly, I would say, not even in terms of just the R&D engineering support, but as we are building out new capabilities to sell some of these new digital value propositions, there will be some investment in sales and marketing there as well. But all manageable within our -- all manageable within the productivity for investment, statements we've made before and will have no impact on our margin expansion goals and aims here.

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

Got you. And then just thinking about the public utility market for Q4 in your full year guidance construct, we're going to come up here against a much easier comparison in the year ago. You have good visibility from your shippable backlog, but will still need some book and ship. Some of your peers have said they've seen slippage. It doesn't appear you've seen that. But can you kind of talk to what are the toggle points to kind of hit the lower end or the higher end of that low- to mid-single digit market for the full year guide?

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

Yes. So right now, we would kind of a -- right down the middle of the fairway would be a mid-single digit growth in fourth quarter for public utility. Obviously, to go above that, would have some modest impact on our full year growth. But you're absolutely asking the right question. At this point in time, does it really matter, what the full year number is, it's more what momentum are we seeing in the fourth quarter, to your point. And we would say that would be mid-single digits.

Operator

Your next question is from Robert Barry with Susquehanna.

Michael DeLalio - *Susquehanna Financial Group, LLLP, Research Division - Equity Research Associate*

This is Mike DeLalio on for Rob. Can you unpack the double-digit order growth at Sensus, what drove that and how fast would you expect those orders to convert?

E. Mark Rajkowski - *Xylem Inc. - Senior VP & CFO*

Sure. Yes, there's -- they've been fairly successful relative to recent project wins. Alliant is one of those. Again, we don't book the entire value of the deal upfront. We do that as commitments and purchase orders are made and issued. And there has been broad strength across all of the end markets, not just electric. We've seen increased activity in gas and in water as well. So it's been fairly broad-based. And this -- these deployments typically, they have a little bit of a ramp, so we saw a little bit of that in Q3. We'll see some more of that in Q4 and into 2018.

Michael DeLalio - *Susquehanna Financial Group, LLLP, Research Division - Equity Research Associate*

Okay. And based on year-to-date orders, it feels like the Sensus segment should be up more than mid-single digits next year, perhaps more than the target 6% to 7%, is that a fair assumption?

E. Mark Rajkowski - *Xylem Inc. - Senior VP & CFO*

Listen, we are definitely seeing some momentum in that business, but we'll give you more details on Sensus and the other parts of our business for 2018 as we go through the next quarter's call.

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

Yes. I would say -- Mike, this is Patrick. I would say that the -- what we have been winning here in terms of projects of late and some others that we have line of sight to were always necessary there for us to be able to support the range of 6% to 8%. And so these things will kind of come and go. And obviously, it's our job to continue to build that funnel and that pipeline, which the teams are doing a great job of doing. But I would say at this point in time, I'd still look at that 6% to 8% as an appropriate kind of guideline.

Operator

Your next question is from Scott Graham of BMO Capital Markets.

Robert Scott Graham - *BMO Capital Markets Equity Research - Analyst*

Good morning, nice quarter. So I have 2 questions that are on previous questions, but maybe a little bit broader. On the cost side, I know that your long-term goal 2020 is a sort of 17%, 18% operating margin. It looks like you are a little -- tracking a little ahead of that. I know that this -- nothing ever straight lines, of course, but would that suggest that maybe some of the saves in the first half of '18 maybe will pull forward? Should we be looking at the 100 basis point per year expansion goal maybe a little bit differently in '18 because you're ahead in '17?

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

No, I wouldn't read too much into it, Scott, in terms of the pace. You're right, it's not going to be linear. A lot of it comes down to the mix of business that we have in any given year, and you'll see some probably higher treatment growth and emerging market growth next year, again, which will have a little bit of a dilutive effect. Not going backwards, just not as heavy incrementals in that area, but then it's our job, obviously, to drive the other parts of the business hard and make up for that. So -- and then we've also got -- we've got some impacts from -- you'll begin to see the benefits of things like global business services come in over the course of probably the latter part of '18 into '19, et cetera. So there is always going to be a blend here, and it's going to be our job obviously to walk you guys through the pieces of that once we get to the end of this year and are giving guidance on '18.

Robert Scott Graham - *BMO Capital Markets Equity Research - Analyst*

Right. Makes sense. The other question was kind of really about pricing. And I think that we all have a tendency, I know certainly I do, to gravitate towards your utility market and you kind of think sort of 0 pricing. But you're in a lot of other markets. And so pricing is pricing wherever you get it. So I guess kind of piggybacking on a prior question, you have good momentum in sort of the other 3 broad markets that you serve here and just sort of wondering if there are pricing opportunities in those markets.

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

No. You're absolutely right, Scott. So the teams in the field are working it hard, ears to the ground, playing the leadership role where we can, hoping others are disciplined where they need to be disciplined on pricing. And so I appreciate your comment. It's far more than the 47% that happens to be in utilities. It's the other 53% that we have opportunities here as well.

E. Mark Rajkowski - *Xylem Inc. - Senior VP & CFO*

And as you can appreciate, as we have our business reviews with our teams, each of them have different competitive positions, market dynamics. But I can assure you that this discussion in terms of making sure that we're getting paid for value and being very aggressive with that is right at the top part of that agenda.

Operator

Your next question is from Brian Lee with Goldman Sachs.

Brian Lee - *Goldman Sachs Group Inc., Research Division - VP and Senior Clean Energy Analyst*

I had a couple of modeling ones. Just maybe first off, on the lag between Applied Water orders growth, you've seen mid-single to high-single digit growth the last few quarters. And then trying to flip to the low-single digit revenue growth that you're putting up. How should we be thinking about those trends converging? And then has there been anything specific to the mix that's been driving what seem to be longer lead times there?

E. Mark Rajkowski - *Xylem Inc. - Senior VP & CFO*

Yes. Let me take that one. I would say that there is a bit of a lag. And as I mentioned in my comments earlier, we are -- because of that strong orders growth, we are going to see an acceleration of revenue growth in AWS next quarter, which into that mid-single digit range, which is very encouraging given recent performance of the business. And some of it's a function of the nature of the projects and some of the wins. They've won some large projects that go beyond 2017 and actually set that business up very well for performance in 2018. So the trajectory has changed. We're seeing some momentum, but not all of that manifests itself in Q3, but we'll see that trend line improve in Q4.

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

And some of those, some of the mix of that order growth as well, Brian, is -- I think people have traditionally thought of the Applied Water business as largely a domestic kind of North America business, but we've got good mix in the emerging markets there. So Middle East is a good example where we got some really good project wins on that business that have longer lead times, not quick turn like they are here in the U.S.

Brian Lee - *Goldman Sachs Group Inc., Research Division - VP and Senior Clean Energy Analyst*

Okay, great. That's helpful. And then just second one on Sensus, I know there were some questions around this earlier. But if we could dive into some of the specifics a bit. Just in terms of smart electric growth, what are you guys thinking about in terms of how much runway there is still left there? Obviously, there has been some good growth here the past couple of quarters, a lot of that due to Alliant, but when does that start to moderate? And then with water, water bouncing back to double-digit growth at 4Q, can you comment on whether those comps into 2018 for water specifically set you up to continue at that level? Or how should we just take that Q4 jump into context as we head into 2018?

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

Sure. So let me -- I'll start with the latter first being water because that's still the lion's share of the business here. And so we would say that double-digit growth comp in Q4 is largely a comp benefit in terms of easier comp. So if you moderate that down, again, we still really feel like we're talking about a 6% to 7% kind of organic growth for Sensus next year. Obviously, we'll model that for you guys when we give guidance, but I wouldn't expect that to be much different.

In terms of electric, I mean, we think there is still a lot of runway in both electric and gas and the lighting piece. So there is a lot of project activity out there. It is competitive. We think we have a terrific offering. There are some other great competitors out there, but we feel good about our offering as well. And we think there are going to be some more big wins there. We need those and we expect to get those to support that top line growth rate. But I certainly wouldn't be expecting it to be growing double digit into perpetuity. So it is going to be impacted by some lumpy projects. But we look at the pipeline and it's a bit of a lava chart, different projects that lay on top of each other and then we have a really, really solid base business that gives us confidence that you really should be thinking about that 6% to 7% growth for next year.

Operator

Your next question comes from Jim Giannakouros of Oppenheimer.

James Giannakouros - *Oppenheimer & Co. Inc., Research Division - Executive Director and Senior Analyst*

Quick follow-up on -- just so I understand the Applied Water orders, the momentum that you're seeing there. And you're citing strength in the Middle East, is that market commentary or is that something that you're doing differently there maybe, established at the local presence or comments that you made on the investments you made in sales? I mean, what's driving that and your confidence that you can kind of sustain growth there in Applied Water into next year?

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

Sure, Jim. So yes, I would say our commentary on the Middle East in general is we did have really robust revenue growth coming off the back of a couple of quarters for the first time in about a year or so of orders growth, and those are now converting. I'd say it's a broader Middle East commentary as opposed to just Applied Water, but it is absolutely the impact of us having made investments there in a greenfield manufacturing location as well as a rental branch. And what that allowed us to do, the first products that we moved into that facility were products to support the Applied Water business and supporting mainly the commercial building market, industrial.

And really, what it did for us was not just help us in the cost position, but really from a lead time perspective. So there are jobs that we're able to bid on now, that the teams either would not have bid on before or would not have won the order because the lead times were too lengthy relative to competition. So that really is what's driving that growth there in the Middle East, and we are certainly seeing a little bit of market recovery there but this really right now is just us taking some share there. And I don't say that in any kind of chest bumping way. I mean, really it's just a matter of now maybe getting more of our fair share of the market based upon better lead times.

Operator

Your next question comes from Jose Garza with Gabelli & Company.

Jose Ricardo Garza - *G. Research, LLC - Research Analyst*

Mark, I guess if you could just kind of comment on -- it looks like the receivables kind of ticked up a little bit. I don't know if there's anything that you kind of want to point out there.

E. Mark Rajkowski - *Xylem Inc. - Senior VP & CFO*

Not really. I mean, it's part of that it's just the timing of revenues. We had a pretty strong performance in the last month and days are roughly in line with where they've been. And we continue to focus on driving down past dues and improving terms.

Jose Ricardo Garza - *G. Research, LLC - Research Analyst*

Okay, fair. And then just on the European public utility side, it's kind of been flattish. I don't know if there's any kind of noticeable change on -- from your customers that you've kind of noticed over the last few months.

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

Not, not really, Jose. I mean, I'd say the -- as we spoke to earlier in the year, we've seen -- I'd say, let's set U.K. aside for a moment, across the rest of Europe, it's still in that low-single digit kind of area, kind of steady-eddie, I think in terms of U.K., we haven't seen the growth there this year that we had historically seen during the typical 5-year AMP cycle. There are couple of reasons for that.

One is just the nature of the spending that the utilities are doing. They're trying to smooth out that spending. So it's less of a bell curve, which impacted them from a cost pressure and inflation standpoint. So there's been some of that. I was over in the U.K. just about a month ago. And so we expect that to still be an attractive opportunity for us. It just probably smooths out a little bit for the next couple of years rather than coming through in lumps. But beyond that, it's still kind of low-single digits in Europe on the public utility side.

Operator

Our final question is coming from Walter Liptak with Seaport Global.

Walter Scott Liptak - *Seaport Global Securities LLC, Research Division - MD & Senior Industrials Analyst*

Good quarter. Wanted to ask about you guys called out the procurement and lean, the benefits that you're going to be getting from that in the future. I wondered if there is any larger buckets of cost savings? Are you done with any kind of special charges related to consolidation of facilities, it's mostly kind of operational excellence going forward?

E. Mark Rajkowski - *Xylem Inc. - Senior VP & CFO*

Walter, this is Mark. We're going to continue to look at opportunities to be more efficient in our manufacturing and supply chain. But as Patrick had commented on earlier from a prior question, there is a substantial effort underway to significantly improve the efficiency and the effectiveness of our back-office operations and we're embarking upon a global business services program that is going to provide us with -- certainly with substantial efficiencies and savings in the coming years, but also will entail some restructuring as we get into that program moving forward.

Walter Scott Liptak - *Seaport Global Securities LLC, Research Division - MD & Senior Industrials Analyst*

Okay, great. And then maybe as the last one and maybe you don't want to do this, but the emerging markets, the opportunities in China, et cetera. Have you quantified the opportunity there?

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

We have. It's always tough to get data in that market that you can rely on and that's not a critical comment. It's just a reality in terms of -- especially given the nature of some of these mandates. So, for example, the whole non-revenue water discussion is a very, very broad complex discussion. Not ever easy to put a definitive dollar amount on. All I would say is, it's big, and it's certainly big enough and attractive enough for us to go after.

But I would say, as we think about kind of where emerging markets overall go over time, if today, we're around 20 some odd percent of our total revenue, that number, in my view, certainly ought to be up north of 30%, maybe closer to 1/3 over time, as we think about just the mix of spending and the investments that we've made. And that really would capture, I think, more than our fair share of the growth rate there.

Operator

Thank you. I'll now turn the call back over to Patrick Decker for any additional or closing remarks.

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

Great. Well, thank you, everybody, for your interest and the questions and your support. So in the meantimes, safe travels. Happy holidays. Happy Halloween. And we'll be in touch with you all, hopefully, in the near term. Thank you.

Operator

Thank you. This does conclude today's Xylem third quarter 2017 earnings conference call. Please disconnect your lines at this time, and have a wonderful day.
