Xylem (XYL) at the Post-Evoqua Reckoning

The Waterline

A high-quality operating business stapled to a mediocre capital-allocation record.

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The Tale of Two Companies

The Operator

- Trades like a compounder.
- Generates an exceptional 25-35% Return on Invested Capital (ROIC) excluding goodwill.
- Driven by robust pricing power, 50% incremental margins, and the successful execution of 80/20 operational cleanup under Matt Pine.



The Capital Allocator

- Earns like a commodity industrial.
- When accounting for the massive goodwill footprint from serial acquisitions, ROIC collapses to 8.5-9.2%.
- Barely clearing the company's estimated 8-10% WACC.

Synthesis: At ~$125 per share (16x TTM adjusted EBITDA), the market is pricing these two conflicting realities as if they are the same thing. This ~25-point ROIC gap is the entire investment debate.

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Segment Anatomy: Deconstructing the $9B Revenue Engine

Water Infrastructure (WI)

Revenue: ~$2.64B (29%)

Margin: 26-27% EBITDA

Moat: Spec-sheet driven, rate-base utility funded.

Verdict: The Legacy High-Quality Asset

Measurement & Control (M&CS)

Revenue: ~$2.09B (23%)

Margin: ~20% EBITDA

Moat: 15-20 year FlexNet RF-mesh network lock-in.

Verdict: The Oligopoly Crown Jewel

Water Solutions (WSS)

Revenue: ~$2.46B (27%)

Margin: ~23.9% EBITDA

Moat: 41% recurring services, industrial exposure (ex-Evoqua).

Verdict: The Best Earnings Stream (carrying the goodwill anchor)

Applied Water (AW)

Revenue: ~$1.85B (20%)

Margin: ~20% EBITDA

Moat: Weak. Competes on price Pentair/Grundfos.

Verdict: The Cyclical Price-Taker

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Industry Dynamics & The Moat

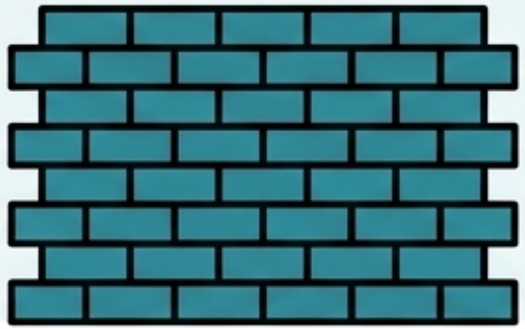
Moat Strength Spectrum



Wide Moat

M&CS AMI Smart Meters

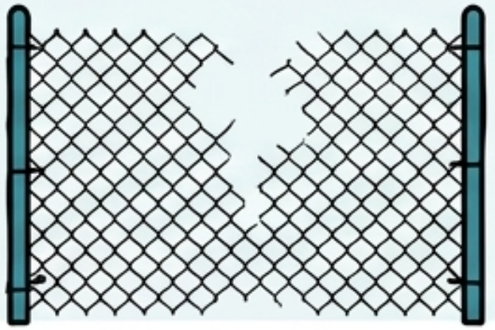
- Proprietary 900 MHz FlexNet network commands 53.3% NA traffic share. Creates 15-20-year utility switching costs.



Moderate Moat

WI Utility Pumps & WSS Services

- Flygt/Wedeco hold deep regulatory specification lock-ins at utilities.
- Evoqua's fleet density provides local service advantages.



Non-Existent Moat

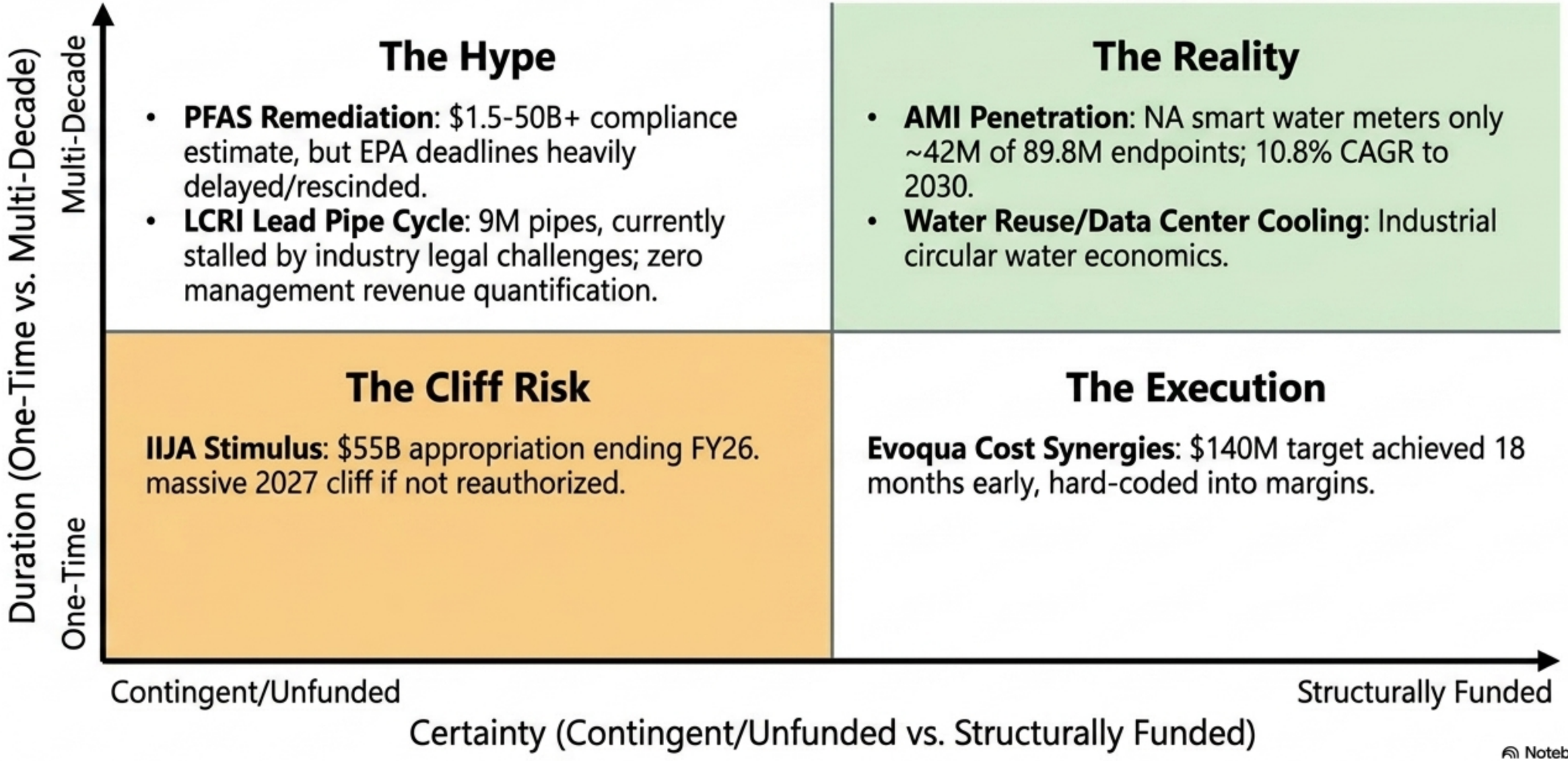
AW Commodity Pumps

- Competes in a fragmented commercial/residential market against Wilo, Franklin Electric, and Asian imports. High foreign low-cost labor exposure.

Takeaway: Xylem's moat fails at the consolidated financial level. Strategic oligopolies in M&CS and WI are diluted by generic cyclical exposure in Applied Water.

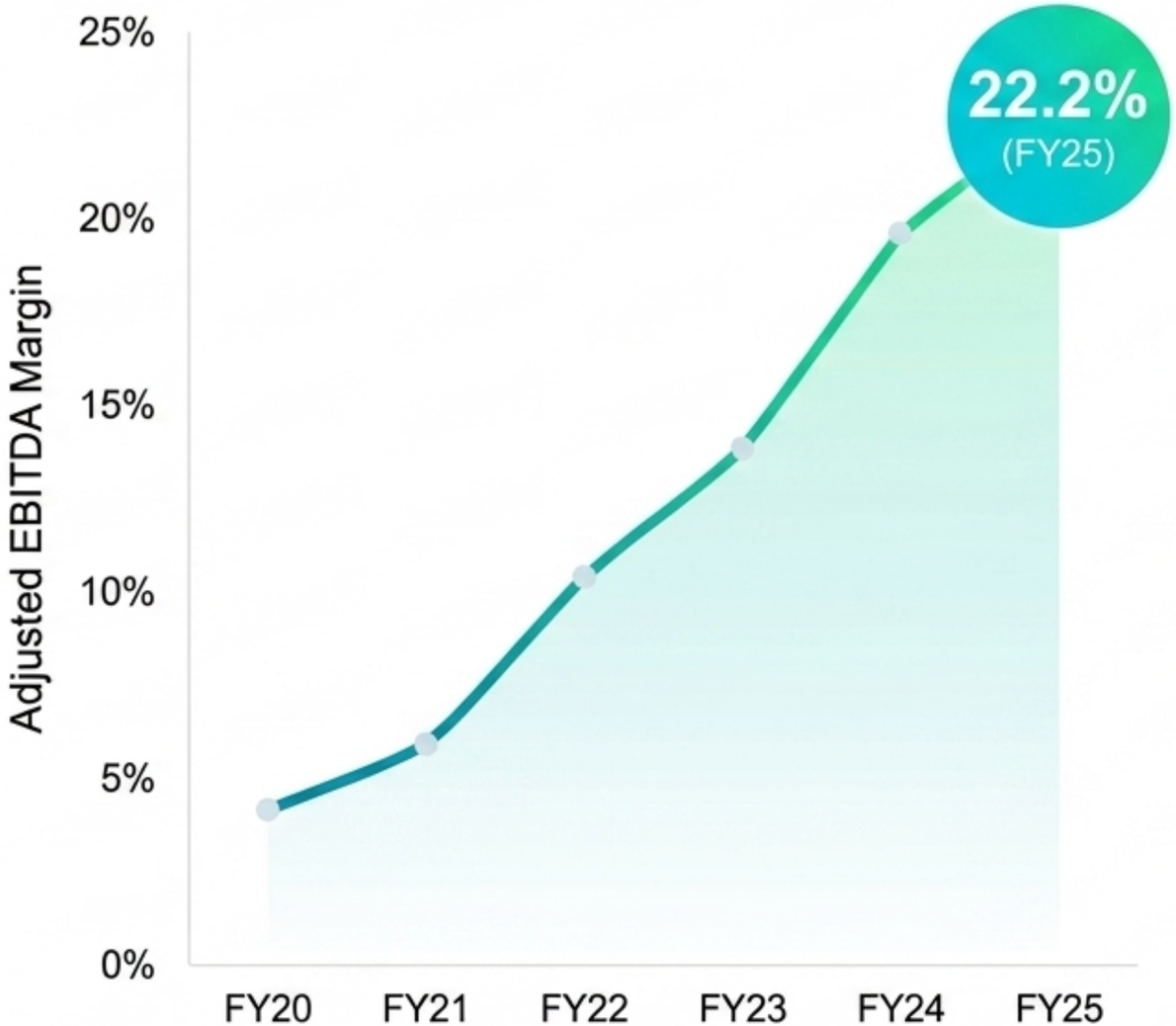
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The Growth Driver Reality Filter



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The Operating Engine (Above the Waterline)



Pricing Power

Durable and persistent. Successfully mitigated **~$160M** in net tariff exposure via pricing and supply chain shifts without **volume collapse**.

Self-Help Execution

The 2024-2025 margin expansion is overwhelmingly internally driven. **Pulled forward $140M** in Evoqua **synergies** by 18 months.

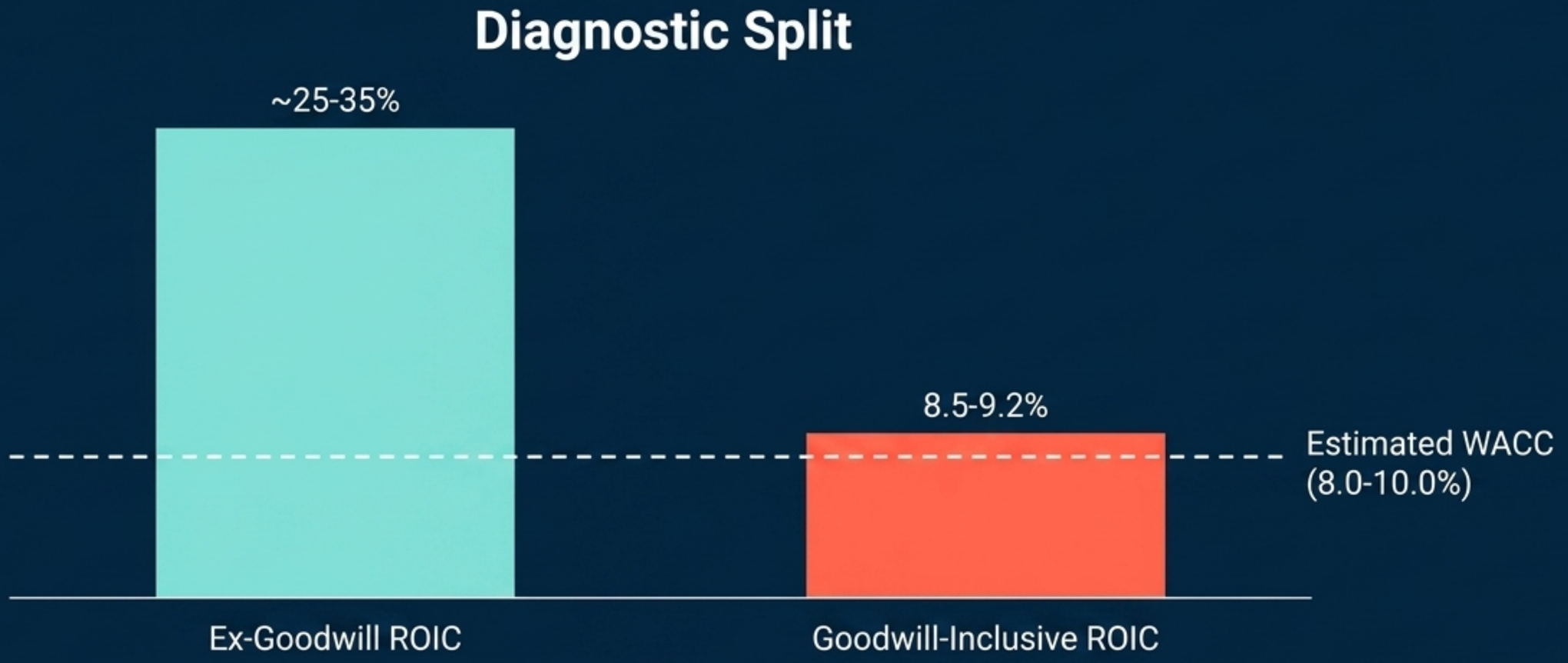
Exceptional Incrementals

Running a **spect**acular **~50% incremental EBIT margin on organic** revenue growth.

The underlying assets operate with **exceptional capital efficiency (tangible capital ROIC sits at ~31%).**

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The Capital Anchor (Below the Waterline)

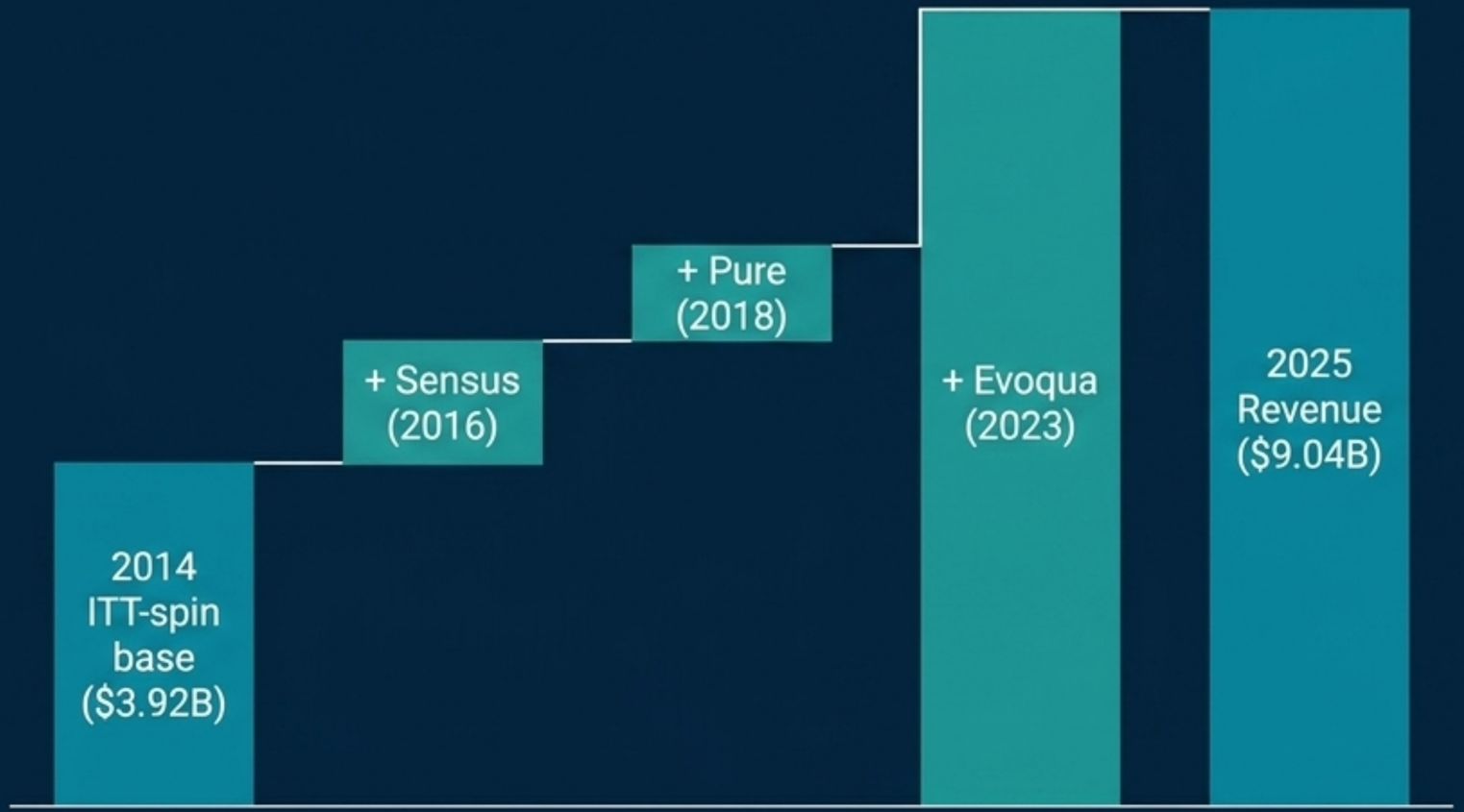


The Indictment: The ~25 percentage-point gap between operating returns and consolidated returns is the diagnostic signature of a company that built scale by ta **paying full price**. Between 2015 and 2025, Xylem deployed ~$10B in M&A enterprise value to achieve a $1.4B step-up in EBITDA—yielding only ~14% before baseline organic growth.

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Buying to $9B: A Decade of Capital Deployment

The Growth Reality: Over the past decade, Xylem's reported revenue compounded at ~9.5%. However, organic growth averaged only ~3%. The bulk of top-line expansion was purchased.

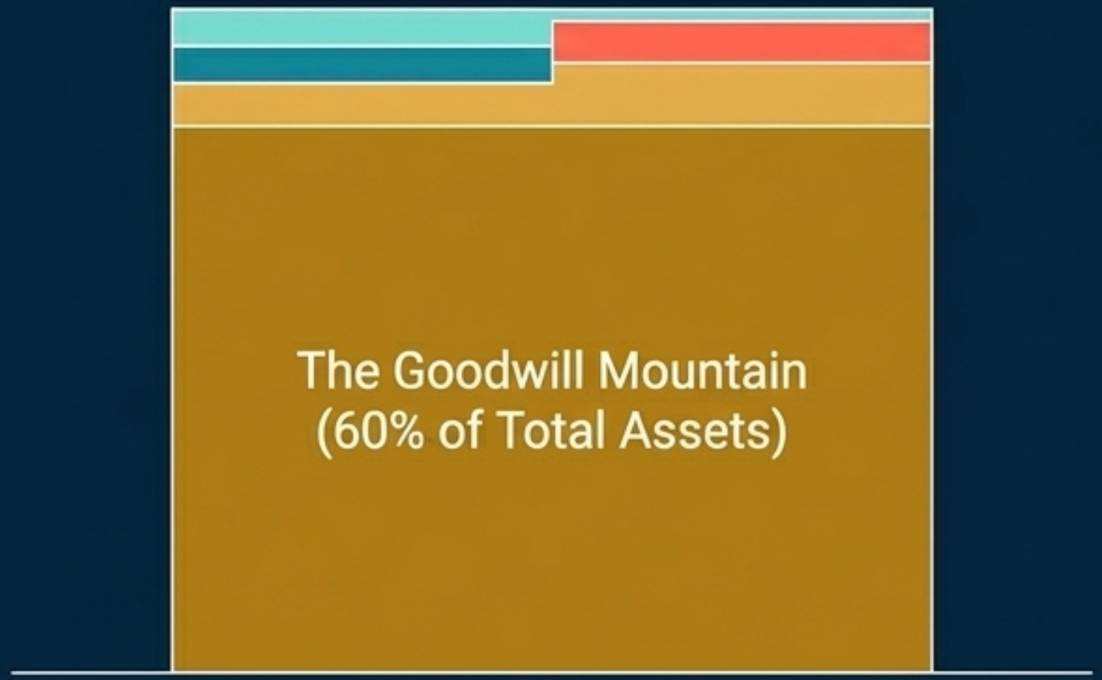


The Dilution Toll: Between 2022 and 2024, diluted share count swelled from 180.2M to 242.6M. Xylem permanently expanded its share count by ~33% to fund to ind the Evoqua purchase alone, diluting the per-share value of its legacy operating brilliance.

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The Evoqua Math: Paying 25x for Quality

[High Asset Quality] + [25x Pre-Synergy Premium] = [Multi-Year ROIC Drag]



- **The Deal**: Paid a 29% control premium on top of an already stretched multiple, totaling ~$7.5B Enterprise Value. Implied multiple: 25.2x pre-synergy EBITDA.
- **The Asset Shift**: Successfully added vital industrial exposure and pushed WSS services revenue to 41%, filling a critical strategic gap.
- **The Consequence**: In 2025, the full-goodwill ROIC on the deal is an estimated 4.5%. Against an 8% WACC, this $7.5B deployment will not earn its cost of capital on an inclusive basis until 2029-2030.

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The Peer Reality Check

Company	EBIT Margin	ROIC	FCF Margin	EV/EBITDA
Xylem	**14.6%**	8.5%	9.7%	**16.0x**
Peer Median	20.5%	~14%	~15%	15.5x
Badger	22.0%	~22%	~20%	19.9x
Veralto	23.2%	~26%	18.4%	17.9x
Pentair	23.3%	15.4%	17.9%	14.4x
Roper	29.0%	6.1%	~33%	14.3x

Context: Xylem sits second-to-last among its peer group in Return on Invested Capital, trailing significantly on EBIT and FCF margins.

Takeaway: Despite structurally worse returns and cash generation than Badger, Veralto, or Pentair, Xylem trades at a slight premium to the peer median EV/EBITDA multiple. The turnaround is entirely priced in.

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The Pine Turnaround Playbook

CEO Matt Pine's First 24 Months

80/20 Simplification

Brutal SKU and customer rationalization. Accepted a ~2% deliberate revenue drag in 2026 to permanently elevate margin quality.

Early Synergy Capture

$140M Evoqua cost targets finalized 18 months ahead of schedule.

Divesting to Focus

Oct 2025 sale of Sensus International (European AMI) to Aurelius PE—unwinding legacy M&A spread.

Returning Capital

Feb 2026 authorization of a $1.5B share repurchase program (largest in company history).

Takeaway: Pine's actions read purely as operational cleanup, de-leveraging (net debt ~0x), and capital discipline. No transformational deals—yet.

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Near-Term Headwinds & Yellow Flags

M&CS Backlog Burnout





Backlog has burned from **$2B** peak to **$1.4B**. Q4 saw major project slippage. The core question for 2026: **What is the true organic growth rate ex-backlog?**

China Collapse



-70%

-30%

Q4 2025 saw China orders **plummet -70%** and **sales -30%** due to intense local price competition. Expected to drag heavily through H1 2026.

Poor Cash Conversion





2025 FCF/Adjusted Net Income cash conversion was a weak **0.73x**, driven by a $333M working capital build. Must normalize to preserve the FCF narrative.

Quality of Earnings Gap



Gap between GAAP and Adjusted EPS is widening (+30-35%), driven by $220M/year in PPA intangible amortization—a real economic cost ignored by adjusted metrics.

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The Governance Warning: Incentivizing the Wrong Behavior



The Change: In 2025, the Board explicitly removed ROIC from forward Long-Term Incentive (LTI) design. Management is now judged purely on adjusted EBITDA margin, organic revenue, cumulative adjusted EPS, and relative TSR.

The Structural Risk: Xylem carries ~60% goodwill on its balance sheet. Stripping capital efficiency (ROIC) from the compensation matrix pays management for revenue and EPS growth regardless of the cost of capital used to acquire it.

The Threat: With a de-levered balance sheet (0.9x leverage) and $2-3B in M&A dry powder, the compensation structure actively rewards another value-neutral mega-acquisition.

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The Debate vs. The Reality (What is Priced In?)

The Bull Case

- Pine turnaround is real (23.2% Q4 margin).
- AMI and reuse provide multi-decade secular tails.
- Balance sheet is pristine.
- Evidence needed: Org growth 5%+ through 2026; WSS margin holds >23%.

The Bear Case

- Evoqua goodwill guarantees 5+ years of unearned WACC.
- M&CS backlog is masking structural deceleration.
- LTI misalignment threatens $2-3B dry powder.
- Evidence needed: M&CS ex-backlog turns negative; Inclusive ROIC stalls below 9%.



Priced for Decline **Priced for Perfection**

Valuation Reality: At ~$125/share ($31.8B EV), a reverse-DCF requires a 4.5-5% 10-year organic revenue CAGR to justify the current price. The market is pricing management's mid-single-digit algorithm as already met, granting zero excess credit for upside.

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The Single Most Important Question

Matt Pine
+ $3B Dry Powder

Path A: The Quiet Compounder

Resists temptation. Uses capital for $1.5B buyback, 80/20 rationalization, and niche bolt-ons.

Result: Goodwill ROIC gradually clears WACC; Xylem earns its multiple.

Path B: The Serial Acquirer

Chases growth to satisfy EPS-driven LTI targets by acquiring another Evoqua-style platform at 20x+ EBITDA.

Result: Turnaround is capitalized into a new goodwill mountain. The value-destruction cycle repeats.

Every analytical tension in this stock collapses into this single variable. Operations are fixed; the capital allocator is on trial.

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