CSG SYSTEMS INTERNATIONAL INC
Form 10-Q
May 09, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2012

OR

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

For the transition period from to

Commission file number 0-27512

CSG SYSTEMS INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

Delaware	**47-0783182**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

9555 Maroon Circle

Englewood, Colorado 80112

(Address of principal executive offices, including zip code)

(303) 200-2000

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES x NO ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES x NO ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer , accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES ¨ NO x

Shares of common stock outstanding at May 3, 2011: 33,978,977

CSG SYSTEMS INTERNATIONAL, INC.

FORM 10-Q for the Quarter Ended March 31, 2012

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CSG SYSTEMS INTERNATIONAL, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS UNAUDITED

(in thousands, except share amounts)

	March 31, 2012	December 31, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$ 178,408	$ 146,733
Short-term investments	10,147	12,097
Total cash, cash equivalents and short-term investments	188,555	158,830
Trade accounts receivable:		
Billed, net of allowance of $2,925 and $2,421	170,909	179,804
Unbilled and other	27,791	30,981
Deferred income taxes	18,654	19,982
Income taxes receivable	1,324	4,139
Other current assets	17,400	16,224
Total current assets	424,633	409,960
Property and equipment, net of depreciation of $120,117 and $116,125	37,292	41,154
Software, net of amortization of $59,565 and $56,521	28,183	29,966
Goodwill	222,124	220,013
Client contracts, net of amortization of $166,174 and $159,225	94,359	98,403
Deferred income taxes	1,681	1,008
Other assets	13,951	14,393
Total assets	$ 822,223	$ 814,897
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current maturities of long-term debt	$ 20,500	$ 27,000
Client deposits	31,768	30,523
Trade accounts payable	28,512	27,198
Accrued employee compensation	31,188	42,005
Income taxes payable	14,137	2,334
Deferred revenue	52,329	44,824
Other current liabilities	18,286	23,501
Total current liabilities	196,720	197,385
Non-current liabilities:		
Long-term debt, net of unamortized original issue discount of $29,053 and $30,256	283,447	282,744
Deferred revenue	8,486	8,631
Income taxes payable	4,226	4,114
Deferred income taxes	24,534	28,188
Other non-current liabilities	19,618	19,121
Total non-current liabilities	340,311	342,798
Total liabilities	537,031	540,183

Stockholders' equity:		
Preferred stock, par value $.01 per share; 10,000,000 shares authorized; zero shares issued and outstanding		
Common stock, par value $.01 per share; 100,000,000 shares authorized; 34,127,496 and 33,822,232 shares outstanding	652	645
Additional paid-in capital	450,100	449,376
Treasury stock, at cost, 31,034,308 and 30,551,519 shares	(720,083)	(714,893)
Accumulated other comprehensive income (loss):		
Unrealized gain on short-term investments, net of tax	1	1
Unrecognized pension plan losses and prior service costs, net of tax	(1,803)	(1,794)
Unrecognized loss on change in fair value of interest rate swaps, net of tax	(769)	(618)
Cumulative foreign currency translation adjustments	1,293	(1,998)
Accumulated earnings	555,801	543,995
Total stockholders' equity	285,192	274,714
Total liabilities and stockholders' equity	$ 822,223	$ 814,897

The accompanying notes are an integral part of these condensed consolidated financial statements.

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CSG SYSTEMS INTERNATIONAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME UNAUDITED

(in thousands, except per share amounts)

	Quarter Ended March 31, 2012	Quarter Ended March 31, 2011
Revenues:		
Processing and related services	$ 136,314	$ 131,378
Software, maintenance and services	48,693	51,714
Total revenues	185,007	183,092
Cost of revenues (exclusive of depreciation, shown separately below):		
Processing and related services	61,960	61,259
Software, maintenance and services	28,009	29,505
Total cost of revenues	89,969	90,764
Other operating expenses:		
Research and development	27,922	28,638
Selling, general and administrative	31,625	33,339
Depreciation	5,837	6,247
Restructuring charges	702	
Total operating expenses	156,055	158,988
Operating income	28,952	24,104
Other income (expense):		
Interest expense	(4,152)	(4,341)
Amortization of original issue discount	(1,203)	(1,449)
Interest and investment income, net	220	234
Other, net	(205)	(303)
Total other	(5,340)	(5,859)
Income before income taxes	23,612	18,245
Income tax provision	(11,806)	(6,751)
Net income	$ 11,806	$ 11,494
Weighted-average shares outstanding - Basic:		
Common stock	32,392	32,610
Participating restricted stock	66	327
Total	32,458	32,937
Weighted-average shares outstanding - Diluted:		
Common stock	32,561	32,852
Participating restricted stock	66	327

Total		32,627		33,179
Earnings per common share:				
Basic	$	0.36	$	0.35
Diluted	$	0.36	$	0.35

The accompanying notes are an integral part of these condensed consolidated financial statements.

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CSG SYSTEMS INTERNATIONAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME UNAUDITED

(in thousands)

		Quarter Ended	
		March 31, 2012	**March 31, 2011**
Net income		$ 11,806	$ 11,494
Other comprehensive income, net of tax:			
Unrealized pension plan gains and prior service costs		(9)	4
Cash flow hedges:			
Unrealized loss on change in fair value of interest rate swap contracts, net of $93 tax	(153)		
Less: Reclassification adjustment for losses included in net income, net of $(2) tax	(2)	(151)	
Foreign currency translation adjustments		3,291	5,908
Other comprehesive income, net of tax		3,131	5,912
Total comprehensive income		$ 14,937	$ 17,406

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CSG SYSTEMS INTERNATIONAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS UNAUDITED

(in thousands)

	Quarter Ended March 31, 2012	Quarter Ended March 31, 2011
Cash flows from operating activities:		
Net income	$ 11,806	$ 11,494
Adjustments to reconcile net income to net cash provided by (used in) operating activities-		
Depreciation	5,837	6,247
Amortization	10,302	10,146
Amortization of original issue discount	1,203	1,449
Gain on short-term investments and other	(8)	(13)
Deferred income taxes	(3,111)	7,904
Excess tax benefit of stock-based compensation awards	(286)	(814)
Stock-based employee compensation	3,147	3,274
Changes in operating assets and liabilities:		
Trade accounts and other receivables, net	13,252	4,085
Other current and non-current assets	(1,152)	(3,229)
Income taxes payable/receivable	14,614	(3,443)
Trade accounts payable and accrued liabilities	(14,045)	(24,301)
Deferred revenue	6,630	(14,688)
Net cash provided by (used in) operating activities	48,189	(1,889)
Cash flows from investing activities:		
Purchases of property and equipment	(2,318)	(4,250)
Purchases of short-term investments	(10,142)	(12,680)
Proceeds from sale/maturity of short-term investments	12,100	15,000
Acquisition of and investments in client contracts	(1,693)	(2,383)
Net cash used in investing activities	(2,053)	(4,313)
Cash flows from financing activities:		
Proceeds from issuance of common stock	556	335
Repurchase of common stock	(8,078)	(4,027)
Payments on acquired equipment financing	(417)	(427)
Payments on long-term debt	(7,000)	(37,500)
Payments of deferred financing costs		(205)
Excess tax benefit of stock-based compensation awards	286	814
Net cash used in financing activities	(14,653)	(41,010)
Effect of exchange rate fluctuations on cash	192	1,339
Net increase (decrease) in cash and cash equivalents	31,675	(45,873)
Cash and cash equivalents, beginning of period	146,733	197,858
Cash and cash equivalents, end of period	$ 178,408	$ 151,985

Supplemental disclosures of cash flow information:		
Net cash paid during the period for-		
Interest	$ 4,473	$ 4,581
Income taxes	242	2,453

The accompanying notes are an integral part of these condensed consolidated financial statements.

CSG SYSTEMS INTERNATIONAL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. GENERAL

We have prepared the accompanying unaudited condensed consolidated financial statements as of March 31, 2012 and December 31, 2011, and for the first quarters ended March 31, 2012 and 2011, in accordance with accounting principles generally accepted in the United States of America (U.S.) (GAAP) for interim financial information, and pursuant to the instructions to Form 10-Q and the rules and regulations of the Securities and Exchange Commission (the SEC). Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of our management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation of our financial position and operating results have been included. The unaudited Condensed Consolidated Financial Statements (the Financial Statements) should be read in conjunction with the Consolidated Financial Statements and notes thereto, together with Management s Discussion and Analysis of Financial Condition and Results of Operations, contained in our Annual Report on Form 10-K for the year ended December 31, 2011, filed with the SEC. The results of operations for the first quarter ended March 31, 2012 are not necessarily indicative of the expected results for the entire year ending December 31, 2012.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates in Preparation of Financial Statements. The preparation of the accompanying Financial Statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Postage. We pass through to our clients the cost of postage that is incurred on behalf of those clients, and typically require an advance payment on expected postage costs. These advance payments are included in client deposits in the accompanying Condensed Consolidated Balance Sheets (the Balance Sheet or Balance Sheets) and are classified as current liabilities regardless of the contract period. We net the cost of postage against the postage reimbursements for those clients where we require advance deposits, and include the net amount in processing and related services revenues. The cost of postage that has been shown net of the postage reimbursements from our clients for the first quarters of 2012 and 2011 were $67.4 million and $67.8 million, respectively.

Cash and Cash Equivalents. We consider all highly liquid investments with original maturities of three months or less at the date of the purchase to be cash equivalents. As of March 31, 2012, our cash equivalents consist primarily of institutional money market funds, commercial paper and time deposits held at major banks.

As of March 31, 2012, we had $4.8 million of restricted cash that serves to collateralize outstanding letters of credit. This restricted cash is included in Cash and cash equivalents in our Balance Sheet.

Short-term Investments and Other Financial Instruments. Our financial instruments as of March 31, 2012 include cash and cash equivalents, short-term investments, accounts receivable, accounts payable, interest rate swap contracts, and debt. Because of their short maturities, the carrying amounts of cash equivalents, accounts receivable, and accounts payable approximate their fair value.

Certain of our short-term investments and cash equivalents are considered available-for-sale and are reported at fair value in our Balance Sheets, with unrealized gains and losses, net of the related income tax effect, excluded from earnings and reported in a separate component of stockholders equity. Realized and unrealized gains and losses were not material in any period presented.

All short-term investments held by us as of March 31, 2012 and December 31, 2011 have contractual maturities of less than one year from the time of acquisition. Our short-term investments at March 31, 2012 and December 31, 2011, consisted entirely of commercial paper. Proceeds from the sale/maturity of short-term investments for the first quarters of 2012 and 2011 were $12.1 million and $15.0 million, respectively.

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The following table represents the fair value hierarchy based upon three levels of inputs, of which Levels 1 and 2 are considered observable and Level 3 is unobservable, for financial assets and liabilities measured at fair value on a recurring basis (in thousands):

	March 31, 2012			December 31, 2011		
	Level 1	Level 2	Total	Level 1	Level 2	Total
Assets:						
Money market funds (1)	$ 96,545	$	$ 96,545	$ 77,174	$	$ 77,174
Commercial paper (2)		20,435	20,435		16,895	16,895
Total	$ 96,545	$ 20,435	$ 116,980	$ 77,174	$ 16,895	$ 94,069
Liabilities:						
Interest rate swap contracts (3)	$	$ 1,249	$ 1,249	$	$ 1,005	$ 1,005
Total	$	$ 1,249	$ 1,249	$	$ 1,005	$ 1,005

(1) As of March 31, 2012 and December 31, 2011, all of the money market funds were classified on our Balance Sheet in cash equivalents.

(2) As of March 31, 2012 and December 31, 2011, of the total commercial paper, $10.3 million and $4.8 million, respectively, were classified on our Balance Sheet in cash equivalents, and $10.1 and $12.1 million, respectively, were classified on our Balance Sheet in short-term investments.

(3) As of March 31, 2012 and December 31, 2011, the fair value of the interest rate swap contracts were classified on our Balance Sheet in other non-current liabilities.

Valuation inputs used to measure the fair values of our money market funds were derived from quoted market prices. The fair values of all other financial instruments are based upon pricing provided by third-party pricing services. These prices were derived from observable market inputs.

We have chosen not to measure our debt at fair value, with changes recognized in earnings each reporting period. As of March 31, 2012, the estimated fair value of our Credit Agreement debt of $183 million (carrying value including current maturities) was approximately $192 million, and was estimated using a discounted cash flow methodology. As of March 31, 2012, the estimated fair value of our $150 million (par value) convertible debt, based upon quoted market prices or recent sales activity, was approximately $146 million.

3. STOCKHOLDERS EQUITY AND EQUITY COMPENSATION PLANS

Stock Repurchase Program. We currently have a stock repurchase program, approved by our Board of Directors, authorizing us to repurchase our common stock from time-to-time as market and business conditions warrant (the Stock Repurchase Program). During the first quarter of 2012, we repurchased 0.3 million shares of our common stock under the Stock Repurchase Program for $5.2 million (weighted-average price of $15.84 per share). We did not repurchase any shares under our Stock Repurchase Program during the first quarter of 2011. As of March 31, 2012, the total remaining number of shares available for repurchase under the Stock Repurchase Program totaled 3.1 million shares.

Stock Repurchases for Tax Withholdings. In addition to the above mentioned stock repurchases, during the first quarters of 2012 and 2011, we repurchased from our employees and then cancelled 0.2 million shares of common stock for $2.9 million and 0.2 million shares of common stock for $4.0 million, respectively, in connection with minimum tax withholding requirements resulting from the vesting of restricted common stock under our stock incentive plans.

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Stock-Based Awards. A summary of our unvested restricted common stock activity during the first quarter of 2012 is as follows:

	Quarter Ended March 31, 2012	
	Shares	Weighted-Average Grant Date Fair Value
Unvested awards, beginning	1,620,394	$ 17.87
Awards granted	985,691	16.40
Awards forfeited/cancelled	(33,000)	17.79
Awards vested	(535,322)	16.49
Unvested awards, ending	2,037,763	$ 17.51

Included in the awards granted during the first quarter of 2012, are performance-based awards for 150,313 restricted common stock shares issued to members of executive management, which vest in equal installments over three years upon meeting either pre-established financial performance objectives or pre-established stock price objectives. The performance-based awards become fully vested upon a change in control, as defined, and the subsequent involuntary termination of employment.

All other restricted common stock shares granted during the first quarter of 2012 are time-based awards, which vest annually over four years with no restrictions other than the passage of time. Certain shares of the restricted common stock become fully vested upon a change in control, as defined, and the subsequent involuntary termination of employment.

We recorded stock-based compensation expense for the first quarters of 2012 and 2011 of $3.1 million and $3.3 million, respectively.

4. EARNINGS PER COMMON SHARE

Basic and diluted earnings per common share (EPS) amounts are presented on the face of the accompanying Condensed Consolidated Statements of Income (the Income Statement or Income Statements). The amounts attributed to both common stock and participating restricted common stock used as the numerators in both the basic and diluted EPS calculations are as follows (in thousands):

	Quarter Ended March 31,	
	2012	2011
Net Income attributed to:		
Common stock	$ 11,782	$ 11,380
Participating restricted common stock	24	114
Total	$ 11,806	$ 11,494

The weighted-average shares outstanding used in the basic and diluted EPS denominators related to common stock and participating restricted common stock are as follows (in thousands):

	Quarter Ended March 31,	
	2012	2011
Weighted-average shares outstanding Basic:		
Common stock	32,392	32,610
Participating restricted common stock	66	327

Total	32,458	32,937
Weighted-average shares outstanding Diluted:		
Common stock	32,561	32,852
Participating restricted common stock	66	327
Total	33,627	33,179

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The reconciliation of the basic and diluted EPS denominators related to the common shares is included in the following table (in thousands):

	Quarter Ended March 31,	
	2012	2011
Basic weighted-average common shares	32,392	32,610
Dilutive effect of common stock options	15	21
Dilutive effect of non-participating restricted common stock	154	221
Dilutive effect of 2010 Convertible Notes		
Diluted weighted-average common shares	32,561	32,852

Potentially dilutive common shares related to stock options and non-participating unvested shares of restricted common stock of 0.5 million and zero, respectively, for the first quarters of 2012 and 2011, were excluded from the computation of diluted EPS related to common shares as their effect was antidilutive.

The 2010 Convertible Notes have a dilutive effect only in those quarterly periods in which our average stock price exceeds the current effective conversion price of $24.45 per share.

5. DEBT

Our long-term debt, as of March 31, 2012 and December 31, 2011, was as follows (in thousands):

	March 31, 2012	December 31, 2011
Credit Agreement:		
Term loan, mandatory principal payments during term, with remaining principal balance due December 2015, interest at adjusted LIBOR plus 3.75% (combined rate of 4.23% at March 31, 2012 and 4.30% at December 31, 2011)	$ 183,000	$ 190,000
$100 million revolving loan facility, due December 2015, interest at adjusted LIBOR plus applicable margin		
Convertible Debt Securities:		
2010 Convertible Notes senior subordinated convertible notes; due March 1, 2017; cash interest at 3.0%; net of unamortized original issue discount (OID) of $29,053 and $30,256, respectively	120,947	119,744
	303,947	309,744
Current portion of long-term debt, net	(20,500)	(27,000)
Total long-term debt, net	$ 283,447	$ 282,744

Credit Agreement. During the first quarter of 2012, we made a $7.0 million mandatory repayment on our Term Loan as a result of defined excess cash flows. This payment satisfied the $5.0 million mandatory repayment for the first quarter of 2012 and $2.0 million of the $5.0 million mandatory repayment for the second quarter of 2012. In addition, in April 2012, we made a prepayment of $5.0 million on our Term Loan.

As of March 31, 2012, we were in compliance with the financial ratios and other covenants related to the Credit Agreement. As of March 31, 2012, we had no borrowings outstanding on our revolving loan facility and had the entire $100 million available to us.

2010 Convertible Notes. As of March 31, 2012, and as it relates to our 2010 Convertible Notes, none of the contingent conversion features have been achieved, and thus, the 2010 Convertible Notes are not convertible by the holders.

Upon conversion of the 2010 Convertible Notes, we will settle our conversion obligation as follows: (i) we will pay cash for 100% of the par value of the 2010 Convertible Notes that are converted; and (ii) to the extent the value of our conversion obligation exceeds the par value, we will satisfy the remaining conversion obligation in our common stock, cash or any combination of our common stock and cash. As of March 31, 2012, the value of our conversion obligation did not exceed the par value of the 2010 Convertible Notes.

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6. DERIVATIVES

Interest Rate Swap Contracts. We are party to interest rate swap contracts with the objective of managing our exposure to fluctuations in interest rate movements, thereby eliminating the variability of cash flows on certain portions of the interest payments related to the Term Loan component of our Credit Agreement.

A summary of our interest rate swap contracts as of March 31, 2012 is as follows (dollars in thousands):

	Beginning of Term	End of Term	Weighted-Average Notional Amount Over Term	Fixed Rate
2012 Swap	March 13, 2012	March 13, 2013	78,000	1.085%
2013 Swap	March 13, 2013	March 13, 2014	51,000	2.181%

We have designated our interest rate swap contracts as cash flow hedges. Swaps designated as cash flow hedges involve the receipt of variable-rate amounts from a counterparty over the lives of the contracts in exchange for us making fixed-rate payments to the counterparty over the lives of the contracts without exchange of the underlying notional amount.

As of March 31, 2012, the fair value of the interest rate swap contracts, reflected in other non-current liabilities in our Balance Sheet, was $1.2 million, with the loss, net of tax, reflected as a reduction in other comprehensive income.

Changes in the fair value of these interest rate swap contracts, designated as hedging instruments of the variability of cash flows associated with floating-rate, long-term debt obligations, are reported in accumulated other comprehensive income (AOCI) in the stockholders equity section of our Balance Sheet. These amounts subsequently are reclassified into interest expense as a yield adjustment of the hedged debt obligation in the same period in which the related interest on the floating-rate debt obligations affects earnings. The amount of gains/losses reclassified from AOCI to income/loss (effective portions) for the first quarter of 2012 were not material. The estimated net losses on the interest rate swap contracts that will be reclassified into earnings within the next twelve months are not expected to be material. Our interest rate swap contracts qualify as effective relationships, and as a result, hedge ineffectiveness was not material during the first quarter of 2012.

We are exposed to credit-related losses in the event of non-performance by the counterparty to the interest rate swap contracts. The counterparty to the interest rate swap contracts is a major institution with investment grade credit ratings. We evaluated the counterparty credit risk before entering into the interest rate swap contracts and will continue to closely monitor the financial markets and the risk that the counterparty will default on its obligations. This credit risk is generally limited to the unrealized gains in such contracts, should the counterparty fail to perform as contracted.

We do not use derivative financial instruments for speculative purposes.

7. LONG-LIVED ASSETS

Goodwill. The changes in the carrying amount of goodwill for the three months ended March 31, 2012, were as follows (in thousands):

January 1, 2012 balance	$ 220,013
Adjustments related to prior acquisitions	(14)
Effects of changes in foreign currency exchange rates	2,125
March 31, 2012 balance	$ 222,124

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Other Intangible Assets. Our intangible assets subject to ongoing amortization consist primarily of client contracts and software. As of March 31, 2012 and December 31, 2011, the carrying values of these assets were as follows (in thousands):

March 31, 2012			December 31, 2011		
Gross Carrying Amount	Accumulated Amortization	Net Amount	Gross Carrying Amount	Accumulated Amortization	Net Amount
$ 260,533	$ (166,174)	$ 94,359	$ 257,628	$ (159,225)	

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iso4217:EUR

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

FORM 10-K

(Mark One)

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2018
or
¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to
Commission file number: 1-35229

Xylem Inc.

(Exact name of registrant as specified in its charter)

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

1 International Drive, Rye Brook, NY 10573
(address of principal executive offices and zip code)
(914) 323-5700
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
Common Stock, par value $0.01 per share	New York Stock Exchange
2.250% Senior Notes due 2023	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 4 Securities Act. Yes þ No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 o Section 15(d) of the Act. Yes ¨ No þ

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months such shorter period that the registrant was required to file such reports), and (2) has been su such filing requirements for the past 90 days. Yes þ No ¨

Indicate by check mark whether the registrant has submitted electronically, if any, every Inte Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this during the preceding 12 months (or for such shorter period that the registrant was required to and post such files). Yes þ No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S contained herein, and will not be contained, to the best of registrant's knowledge, in definitive information statements incorporated by reference in Part III of this Form 10-K or any amendr this Form 10-K. þ

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer non-accelerated filer, a smaller reporting company, or an emerging growth company. See de of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging gr company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer þ Accelerated Filer ¨ Non-Accelerated Filer ¨ Smaller company ¨ Emerging growth company ¨

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 o
Act). Yes ¨ No þ

The aggregate market value of the common stock of the registrant held by non-affiliates of th
registrant as of June 30, 2018 was approximately $12.0 billion. As of February 15, 2019, the
179,552,698 outstanding shares of the registrant's common stock, par value $0.01 per share

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement for its 2019 Annual Meeting of Shareow
be held in May 2019, are incorporated by reference into Part II and Part III of this Report.

Xylem Inc.
ANNUAL REPORT ON FORM 10-K
For the fiscal year ended December 31, 2018
Table of Contents

*Included pursuant to Instruction 3 of Item 401(b) of Regulation S-K.

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PART I

The following discussion should be read in conjunction with the consolidate financial statements, including the notes, included elsewhere in this Annual on Form 10-K (this "Report"). Except as otherwise indicated or unless the c otherwise requires, “Xylem,” “we,” “us,” “our” and “the Company” refer to Xy subsidiaries. References in the consolidated financial statements to "ITT" o "former parent" refer to ITT Corporation (now ITT LLC) and its consolidated subsidiaries (other than Xylem Inc.) as of the applicable periods.

Forward-Looking Statements

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

Factors that could cause results to differ materially from those anticipated ir overall economic and business conditions, political and other risks associate our international operations, including military actions, economic sanctions c barriers including tariffs and embargoes that could affect customer markets, non-compliance with laws, including foreign corrupt practice laws, export an import laws and competition laws; potential for unexpected cancellations or of customer orders in our reported backlog; our exposure to fluctuations in f currency exchange rates; competition and pricing pressures in the markets serve; the strength of housing and related markets; weather conditions; abil retain and attract talent and key members of management; our relationship and the performance of our channel partners; our ability to successfully ider complete and integrate acquisitions; our ability to borrow or to refinance our existing indebtedness and availability of liquidity sufficient to meet our need changes in the value of goodwill or intangible assets; risks relating to produc defects, product liability and recalls; claims or investigations by government regulatory bodies; security breaches or other disruptions of our information technology systems; litigation and contingent liabilities; and other factors se under “Item 1A. Risk Factors” and in subsequent filings we make with the S and Exchange Commission (“SEC”).

All forward-looking statements made herein are based on information curren
available to the Company as of the date of this Report. The Company unde
no obligation to publicly update or revise any forward-looking statements, w
as a result of new information, future events or otherwise, except as require
law.

ITEM 1. BUSINESS

Business Overview

Xylem, with 2018 revenue of $5.2 billion and approximately 17,000 employe
leading global water technology company. We design, manufacture and ser
highly engineered products and solutions ranging across a wide variety of c
applications primarily in the water sector, but also in electric and gas. Our b
portfolio of products, services and solutions addresses customer needs acr
water cycle, from the delivery, measurement and use of drinking water to th
collection, test and treatment of wastewater to the return of water to the environment.

We have differentiated market positions in core application areas including
transport, treatment, test, smart metering, smart infrastructure analytics, dig
solutions, condition assessment and leak detection, building services and in
processing. Setting us apart is a unique set of global assets that include:

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- Fortress brands with leading positions, some of which have been in use for than 100 years
- Far-reaching global distribution networks consisting of direct sales forces ar independent channel partners that collectively serve a diverse customer bas approximately 150 countries
- A substantial installed base that provides for steady recurring revenue
- A strong financial position and cash generation profile that enables us to fur strategic organic and inorganic growth initiatives, and consistently return ca shareholders

Key pillars of our long-term strategy include: (1) accelerate profitable growth increase profitability by driving continuous improvement initiatives; (3) leade and talent development; (4) focus on execution and accountability; and (5) c social value in everything we do.

Company History and Certain Relationships

On October 31, 2011 (the "Distribution Date"), ITT Corporation ("ITT") comp the Spin-off (the “Spin-off”) of Xylem, formerly ITT’s water equipment and se businesses. The Spin-off was completed pursuant to a Distribution Agreeme dated as of October 25, 2011 (the “Distribution Agreement”), among ITT (no LLC), Exelis Inc., acquired by Harris Inc. on May 29, 2015 (“Exelis”), and Xy

Our Industry

Our planet faces serious water challenges. Less than 1% of the total water available on earth is fresh water, and these supplies are under threat due to such as the draining of aquifers, increased pollution and the effects of clima change. Demand for fresh water is rising rapidly due to population growth, industrial expansion, and increased agricultural development, with consump estimated to double every 20 years. By 2025, more than 30% of the world’s population is expected to live in areas without adequate water supply. Even developed countries with sufficient clean water supply, existing water supply infrastructure is aging and inadequately funded. In the United States, deteri pipe systems, theft or inaccurate meters result in approximately one out of e six gallons of water being lost between the treatment plant and the end cust This problem of "non-revenue" water is a major financial challenge of many globally, especially in developing markets where non-revenue water can rep 15% to 60% or more of net water produced. These and other challenges cre opportunities for growth in the global water industry. We estimate the total addressable market size to be approximately $550 billion.

We compete in areas that are pivotal to improving water productivity, water and resilience. Water productivity refers to the more efficient delivery and us clean water. Water quality refers to the efficient and effective management wastewater. Resilience refers to the management of water-related risks and resilience of water infrastructure. Our customers often face all three of these challenges, ranging from inefficient and aging water distribution networks (w require improvements in “water productivity”); energy-intensive or unreliable wastewater management systems (which require improvements in “water qu or exposure to natural disasters such as floods or droughts (which require improvements in “resilience”). Additionally, through the acquisition of Sensu also provide solutions to enhance communications and efficiency, improve s and conserve resources to customers in the water, electric, gas, and lighting

sectors. Delivering value in these areas creates significant opportunity for th
Company. We estimate our total served market size to be approximately $5
billion.

The Global Water Industry Value Chain

The water industry value chain includes Equipment and Services companie
Xylem, which address the unique challenges and demands of a diverse cus
base. This customer base includes water and wastewater utilities that suppl
treat clean water or transport and treat wastewater or storm water through a
infrastructure network, and engineering, procurement and construction or (E
firms, which work with utilities to design and build water and wastewater
infrastructure networks, as depicted below. Utilities and EPC customers req
products, solutions, services, technology and application expertise from the
Equipment and Services providers to address trends such as rising pollution
stricter regulations, increasing operational costs and the increased outsourc
process knowledge. In addition to utilities and EPC customers, Equipment a
Service providers also provide distinct technologies to a wide array of entitie
including farms, mines, power plants, industrial facilities and residential and
commercial customers seeking to address similar trends.

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Water Industry Supply Chain

Business Strategy

Our strategy is to enhance shareholder value by providing distinctive solutio our customers' most important water productivity, quality and resilience cha enabling us to grow revenue, organically and through strategic acquisitions, streamline our cost structure. Key elements of our strategy are summarized

- **Accelerate Profitable Growth.** To accelerate growth, we continue to focus several priorities:
- ***Emerging Markets*** - We seek to accelerate our growth in priority emerging markets through increased focus on product localization and channel devel
- ***Innovation & Technology*** - We seek to enhance our innovation efforts wit increased focus on smart, digitally enabled technologies and innovation tha significantly improve customers' productivity, quality and resilience.
- ***Commercial Leadership*** - We are strengthening our capabilities by simplif commercial processes and supporting information technology systems.
- ***Mergers and Acquisitions*** - We continue to evaluate and, where appropria act upon attractive acquisition candidates to accelerate our growth, includin adjacent markets.
- **Drive Continuous Improvement.** We seek to embed continuous improven into our culture and simplify our organization to make the Company more ag more profitable and create room to reinvest in growth. To accomplish this, w continue to strengthen our lean six sigma and global procurement capabiliti while also continuing to optimize our cost structure through business simplif which aims to eliminate structural, process and product complexity.
- **Leadership and Talent Development.** We seek to continue to invest in att developing and retaining world-class talent with an increased focus on lead and talent development programs. We will continue to align individual perfo with the objectives of the Company and its shareholders.
- **Focus on Execution and Accountability.** We seek to ensure the impact o strategic focus areas by holding our people accountable and streamlining o performance management and goal deployment systems.
- **Create social value in everything we do.** We seek to have a positive impa communities through the combination of corporate social responsibility and employee, customer, and stakeholder engagement.

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Business Segments, Distribution and Competitive Landscape

We have three reportable business segments that are aligned around the cr market applications they provide: Water Infrastructure, Applied Water, and Measurement & Control Solutions. See Note 21, "Segment and Geographic our consolidated financial statements for financial information about segmer geographic areas.

The table and descriptions below provide an overview of our business segm

	Market Applications	2018 Revenue (in millions)	% Revenue	Major Products	Primar
Water Infrastructure	Transport	$1,779	82 %	• Water and wastewater pumps • Filtration, disinfection and biological treatment equipment • Mobile dewatering equipment	• Fly • Go • Le • Sa • We
	Treatment	397	18 %		
		$2,176	100 %		
Applied Water	Industrial Water	$706	46 %	• Pumps • Valves • Heat exchangers • Controls • Dispensing equipment systems	• A Pump • Be Goss • Flo • Go Wate Tech • Jab • Lo • Sta Xc
	Commercial Building Services	596	39 %		
	Residential Building Services	232	15 %		
		$1,534	100 %		
Measurement & Control Solutions	Water	$692	46 %	• Smart meters • Networked communication devices • Data analytics • Test equipment • Controls • Sensor devices • Software & managed services	• Em • Pur • Se • Sm • Val • Vis • W • YS
	Test	344	23 %		
	Gas	195	13 %		
	Electric	143	10 %		
	Software as a Service/Other	123	8 %		
		$1,497	100 %		

• Critical infrastructure services

Water Infrastructure

Our Water Infrastructure segment supports the process that collects water f source, treats it and distributes it to users, and then treats and returns the wastewater responsibly to the environment through two closely linked applic *Transport and Treatment*. The *Transport* application also includes sales and of specialty dewatering pumps and related equipment and services, which p the safe removal or draining of groundwater and surface water from riverbed construction sites or other industrial sites and bypass pumping for the repair aging utility infrastructure, as well as emergency water transport and remov during severe weather events.

The customer base consists of two primary end markets: utility and industria utility market includes public, private and public-private entities that support wastewater and storm water networks. The industrial market includes custo who require similar water and wastewater infrastructure networks to suppor various industrial operations.

Water Infrastructure provides the majority of its sales through direct channe remaining sales through indirect channels and service capabilities. Both util industrial facility customers increasingly require our teams' global but locally proficient expertise to use our equipment in their specific applications. Seve trends are increasing demand for this application expertise: (i) the increase the type and amount of contaminants

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found in the water supply, (ii) increasing environmental regulations, (iii) the n
increase system efficiencies to optimize energy and other operational costs
the retirement of a largely aging water industry workforce that has not been
systematically replaced at utilities and other end-user customers, and (v) th
build-out of water infrastructure in the emerging markets. We estimate our s
market size in this sector to be approximately $17 billion.
Given the highly fragmented nature of the water industry, the Water Infrastru
segment competes with a large number of businesses. We differentiate ours
in the market by focusing on product and service performance, quality and
reliability, innovation, speed to market with new or disruptive technologies,
application expertise, brand reputation, energy efficiency, product life-cycle
timeliness of delivery, proximity of service centers, effectiveness of our distr
channels and price. In the sale or rental of products and provision of service
benefit from our large installed base, which requires maintenance, repair an
replacement parts due to the critical application and nature of the products a
conditions under which they operate. Timeliness of delivery, quality and the
proximity of service centers are important customer considerations when se
a provider for after-market products and services as well as equipment renta
geographic regions where we are locally positioned to provide a quick respo
customers have historically relied on us, rather than our competitors, for
after-market products relating to our highly engineered and customized solu
Our key competitors within the Water Infrastructure segment include KSB In
Sulzer Ltd., Evoqua Water Technologies, United Rentals, Danaher Corpora
and Grundfos.

Applied Water

Applied Water encompasses the uses of water and serves a diverse set of e
markets including: residential, commercial and industrial. Residential consu
represent the end users in the residential market, while owners and manage
properties such as apartment buildings, retail stores, institutional buildings,
restaurants, schools, hospitals and hotels are examples of end users in the
commercial market. The industrial market includes OEMs, exploration and
production firms, and developers and managers of industrial facilities, such
electrical power generators, chemical manufacturers, machine shops, clothi
manufacturers, beverage dispensing and food processing firms and car was
In the Applied Water segment, end markets vary widely and, as a result,
specialized distribution partners are often preferred. As such, the Applied W
segment provides the majority of its sales through strong indirect channels w
remaining sales going through our global direct sales channels. We have
long-standing relationships with many of the leading independent distributor
markets we serve and we provide incentives to distributors, such as special
loyalty and training programs.
We estimate our served market size in this sector to be approximately $19 b
Population growth, urbanization and regulatory requirements are macro gro
drivers of these markets, driving the need for housing, food, community serv
and retail goods within growing city centers.

Competition in the Applied Water segment focuses on brand equity, applica
expertise, product delivery and performance and energy efficiency, quality a
price. We compete by offering a wide variety of innovative and high-quality
products, coupled with world-class application expertise. We believe our

distribution through well-established channels and our reputation for quality
significantly enhance our market position. Our ability to deliver innovative pr
offerings has enabled us to compete effectively, to cultivate and maintain cu
relationships and to serve and expand into many niche and new markets. O
competitors within the Applied Water segment include Grundfos, Wilo SE, F
plc and Franklin Electric Co., Inc.

Measurement & Control Solutions

Measurement & Control Solutions develops advanced technology solutions
enable intelligent use and conservation of critical water and energy resourc
segment delivers communications, smart metering, measurement and contr
technologies and critical infrastructure technologies that allow customers to
effectively use their distribution networks for the delivery, monitoring and co
critical resources such as water, electricity and natural gas. We also provide
analytical instrumentation used to measure water quality, flow and level in c
water, wastewater, surface water and coastal environments. Additionally, w
software and services including cloud-based analytics, remote monitoring a
management, leak detection, condition assessment, asset management an
pressure monitoring solutions. We also offer smart lighting solutions that im
efficiency and public safety efforts across communities.

At the heart of our leading technologies is automation, data management ar
decision support. Communications networks automate and optimize meter r
monitor flow rates and detect and enable rapid response to

changing and unsafe conditions. In short, they provide insight into operation enable our customers to manage the entire scope of their operations remote through their networks. At the center of our offering is the FlexNet communi network, which provides a common communications platform and infrastruc essential services. This two-way communication technology remotely conne wide variety of smart points in a given network with protocols, frequently on licensed spectrum in the U.S., that enable reliable, resilient and secure transmissions. These technologies allow our customers to remotely and continuously monitor infrastructure, prioritize and manage maintenance and data to optimize all aspects of their networks. Our advanced infrastructure a complement these offerings with intelligent solutions that help utility decision-makers manage their networks more effectively in real time.

The majority of our sales in the U.S. is conducted through strong, long-stan relationships with leading distributors and dedicated channel partners for wa gas and electric markets. Internationally, direct sales are often made in mar without established distribution channels; however, some distribution chann used in more developed markets. A more direct sales approach, with key ac management, is employed for large utilities and government programs.

We estimate our served market size in this sector to be approximately $21 b Macro growth drivers include increasing regulation, aging infrastructure and worldwide movement towards smart grid implementation. Water scarcity an conservation, as well as the need to prevent revenue loss (via inaccurate m readings, leaks or theft) are among the drivers of smart meter and leak dete technologies.

Our Sensus-branded meters are well positioned in the smart metering secto fastest growing sector of the global meter industry. We set ourselves apart i industry by focusing on our communication network, innovation, new produc development and service offerings that deliver tangible savings of non-rever water through improved meter accuracy, reduced theft and identification of l Pure Technologies' equipment and services are also well positioned in the l detection sector which is attracting considerable attention as aging infrastru and increased regulatory scrutiny exert pressure on operating budgets. Our competitors within the Measurement & Control Solutions segment include It Badger Meter, Landis+Gyr, Neptune (Roper), Elster (Honeywell), Mueller W Products, Danaher Corporation, Hach and Teledyne.

Geographic Profile

The table below illustrates the annual revenue and percentage of revenue b geographic area for each of the three years ended December 31.

	Revenue					
(in millions)	**2018**		2017		2016	
	$ Amount	**% of Total**	$ Amount	% of Total	$ Amount	% of Total
United States	**$2,424**	**47%**	$2,161	46%	$1,574	42%
Europe	**1,449**	**28%**	1,335	28%	1,195	31%
Asia Pacific	**660**	**13%**	611	13%	518	14%
Other	**674**	**12%**	600	13%	484	13%
Total	**$5,207**		$4,707		$3,771	

In addition to the traditional markets of the United States and western Europ opportunities in emerging markets within Asia Pacific, eastern Europe, Latin America and other countries are growing. Revenue derived from emerging r comprised approximately 20% of our revenue in each of the last three years

Supply and Seasonality

We have a global manufacturing footprint, with production facilities in Europ North America, Latin America, and Asia. Our inventory management and distribution practices seek to minimize inventory holding periods by striving delivery of the inventory and manufacturing as close as possible to the sale distribution of products to our customers. All of our businesses require vario parts and raw materials, of which the availability and prices may fluctuate. F and raw materials commonly used in our products include motors, fabricate castings, bearings, seals, batteries, PCBs and electronic components as we steel, brass, nickel, copper, aluminum and plastics. While we may recover s cost increases through operational improvements, we are still exposed to so pricing risk, including increased pricing risk due to duty and tariff assessmen the United States on foreign imports. We attempt to control costs through fixed-priced contracts with suppliers and various other programs, such as o global procurement initiative.

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Our business relies on third-party suppliers, contract manufacturing and cor
markets to secure raw materials, parts and components used in our product
typically acquire materials and components through a combination of blanke
scheduled purchase orders to support our materials requirements. For man
products we have existing alternate sources of supply, or such sources may
readily available.

We may experience price volatility or supply constraints for materials that ar
available from multiple sources. From time to time, we acquire certain inven
anticipation of supply constraints or enter into longer-term pricing commitme
with suppliers to improve the priority, price and availability of supply. There
been no raw material shortages in the past several years that have had a
significant adverse impact on our business as a whole.

Our business segments experience a modest level of seasonality in their bu
This seasonality is dependent on factors such as capital spending of custon
well as weather conditions, including heavy flooding, droughts and fluctuatio
temperatures, all of which can positively or negatively impact portions of our
business.

Customers

Our business is not dependent on any single customer or a few customers t
of which would have a material adverse effect on our Company. No individu
customer accounted for more than 10% of our consolidated 2018, 2017 or 2
revenue.

Backlog

Backlog includes orders on hand as well as contractual customer agreemen
the end of the period. Delivery schedules vary from customer to customer b
on their requirements. Annual or multi-year contracts are subject to resched
and cancellation by customers due to the long-term nature of the contracts.
such, beginning total backlog, plus orders, minus revenues, will not equal en
total backlog due to contract adjustments, foreign currency fluctuations, and
factors. Typically, large projects require longer lead production cycles and
deployment schedules and delays can occur from time to time. Total backlo
$1,689 million at December 31, 2018 and $1,513 million at December 31, 20
We anticipate that approximately 65% of the backlog at December 31, 2018
recognized as revenue during 2019.

Research and Development

Research and development ("R&D") is a key foundation of our growth strate
we focus on the design and development of products and application know-
that anticipate customer needs and emerging trends. Our engineers are inv
new product development as well as improvement of existing products to in
customer value. Our businesses invest substantial resources into R&D. We
anticipate we will continue to develop and invest in our R&D capabilities to p
a steady flow of innovative, high-quality and reliable products and integrated
solutions to further strengthen our position in the markets we serve. In addit
investments made in software development, which were capitalized, we incu
$189 million, $181 million, and $110 million as a result of R&D investment
spending in 2018, 2017 and 2016, respectively.

We have R&D and product development capabilities around the world. R&D
activities are initially conducted in our technology centers, located in conjunc
with some of our major manufacturing facilities to ensure an efficient and ro
development process. We have several global technical centers and local

development teams around the world where we are supporting global needs
accelerating the customization of our products and solutions to address loca
needs. In some cases, our R&D activities are conducted at our piloting and
facilities and at strategic customer sites. These piloting and testing facilities
us to serve our strategic markets globally. As part of expanding our bandwid
to increase our access to technology, we have built innovation eco-system
partnerships with academic institutions, start-up accelerators and venture ca
organizations.

Capitalized Software

We capitalize software developed for sale to external customers, which is in
within "Other intangible assets, net" on our Consolidated Balance Sheets. A
December 31, 2018 and 2017 we had net capitalized software for sale to ex
customers of $128 million and $89 million, respectively.

Intellectual Property

We generally seek patent protection for those inventions and improvements
we believe will improve our competitive position. We believe that our patent
applications are important for maintaining the competitive differentiation of o
products and improving our return on research and development investmen
While we own, control or license a significant number of patents, trade secr
proprietary information, trademarks, trade names,

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copyrights and other intellectual property rights which, in the aggregate, are
material importance to our business, management believes that our busines
whole, as well as each of our core business segments, is not materially dep
on any one intellectual property right or related group of such rights.
Patents, patent applications and license agreements expire or terminate ove
by operation of law, in accordance with their terms or otherwise. As the port
our patents, patent applications and license agreements has evolved over ti
do not expect the expiration of any specific patent to have a material advers
on our financial position or results of operations.

Environmental Matters and Regulation

Our global operations are subject to various laws and regulations governing
environment, including the discharge of pollutants and the management and
disposal of hazardous substances. While environmental laws and regulation
subject to change, such changes can be difficult to predict reliably and the t
potential changes is uncertain. Management does not believe, based on cur
circumstances, that compliance costs pursuant to such regulations will have
material adverse effect on our financial position or results of operations. How
the effect of future legislative or regulatory changes could be material to our
financial condition or results of operations.
We continue to be dedicated to environmental and sustainability programs t
minimize the use of natural resources, and reduce the utilization and genera
hazardous materials from our processes and to remediate identified environ
concerns. As to the latter, we are currently engaged in site investigations an
remediation activities to address environmental cleanup from past operation
current and former manufacturing facilities. We do not anticipate these liabi
will have a material adverse effect on our consolidated financial position or r
of operations. At December 31, 2018, we had estimated and accrued $4 m
related to environmental matters.

Environmental Sustainability

At Xylem, sustainability is at the very center of who we are and what we do.
leading global water technology company, we address one of the world's mo
urgent sustainability challenges on a daily basis - responsible stewardship o
shared water resources. Technology is playing an increasingly important rol
helping the world solve water issues. We have a long history of innovation,
today, we are focusing more than ever on the powerful capabilities of smart
technology, integrated management and big data. These solutions will allow
transport, treat, test and use water smarter and more sustainably than in the
and enable our customers to realize greater water and energy efficiencies. C
to global water and environmental challenges informs how we think about
sustainability and drives us to become a more sustainable company.

Our approach to climate-related issues is informed by Xylem's Climate Cha
Policy, which defines our climate change approach across product developm
operations, employees and external engagement. For example, in the past t
years, we have completed several acquisitions to build out our Measuremen
Control Solutions portfolio around systems intelligence, bringing best-in-clas
advanced metering infrastructure, advanced data analytics and software
development capabilities to our portfolio. These technologies have enhance
ability to help customers facing water scarcity, storm water overflows and ot
climate-related issues. We are also focused on increasing our capabilities in

areas of advanced industrial water treatment and industrial water services. W
committed to sustainability through our own operations as well, as we are re
our environmental footprint by decreasing our water intensity, greenhouse g
emissions and waste sent to landfills.

Employees

As of December 31, 2018, Xylem had approximately 17,000 employees wor
We have approximately 5,900 employees in the United States, of whom
approximately 16% are represented by labor unions. In certain foreign coun
our employees are represented by work councils. We believe that our facili
in favorable labor markets with ready access to adequate numbers of worke
believe our relations with our employees are good.

Available Information

We are required to file annual, quarterly and current reports, proxy statemen
other information with the SEC. Our annual reports on Form 10-K, quarterly
reports on Form 10-Q, current reports on Form 8-K, proxy statements and
amendments to those reports are available free of charge on our website
www.xylem.com as soon as reasonably practicable after such reports are
electronically filed with or furnished to the SEC. The information on our web
not, and shall not be deemed to be, a part hereof or incorporated into this or
our other filings with the SEC.

In addition, the public may read or copy any materials filed with the SEC, fre
charge, at *www.sec.gov.*

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ITEM 1A. RISK FACTORS

In evaluating our business, each of the following risks should be carefully considered, along with all of the other information in this Report and in our o filings with the SEC. Should any of these risks and uncertainties develop int actual events, our business, financial condition or results of operations coul materially and adversely affected. The risks and uncertainties described bel those that we have identified as material but are not the only risks and uncertainties we face and therefore may not be exhaustive. We operate in a continually changing business, economic and geopolitical environment and result new risk factors may emerge from time to time. We can neither predic certainty these new risk factors nor assess the extent to which any new fact combination of factors, may adversely impact our business or results of ope

Risks Related to Operational and External Factors

Failure to compete successfully in our markets and disruptive technol could adversely affect our business.

We offer our products and services in competitive markets. We believe the principal points of competition in our markets are product and service perfor quality and reliability, innovation, speed to market with new or disruptive technologies, application expertise, brand reputation, energy efficiency, proc cycle cost, timeliness of delivery, proximity of service centers, effectiveness distribution channels and price. Maintaining and improving our competitive p will require successful management of these factors, including continued investment by us in manufacturing, technology and innovation, research and development, engineering, marketing, customer service and support, and ou distribution networks. Our future growth rate depends upon a number of fac including our ability to (i) identify emerging technological trends in our target end-markets, (ii) develop and maintain competitive products, services and business models and defend our market share against an ever-expanding n of competitors including many new and non-traditional competitors, (iii) enha our products and services offerings by adding innovative features or disrupt technologies that differentiate them from those of our competitors and preve commoditization, (iv) develop, manufacture and bring compelling new produ services to market quickly and cost-effectively, and (v) attract, develop and individuals with the requisite technical expertise and understanding of custo needs to develop new technologies and introduce new products and service We may not be successful in maintaining our competitive position. Our com or third parties from outside of our industry may develop disruptive technolo products and services that are superior to ours, may develop more efficient effective methods of providing products and services or may adapt more qu than we do to new or disruptive technologies or evolving customer requirem The failure of our technologies, products or services to maintain and gain m acceptance due to more attractive offerings could significantly reduce our re or market share and adversely affect our competitive standing and prospect Pricing pressures also could cause us to adjust the prices of certain product stay competitive, which could adversely affect our market share and financia performance. Failure to continue competing successfully or to win large con could adversely affect our business, financial condition or results of operatio

Our results of operations and financial condition may be adversely aff by global economic and financial market conditions.

We compete around the world in various geographic and product markets. I
47%, 25% and 20% of our total revenue was from customers located in the
States, western Europe and emerging markets, respectively. We expect rev
from these markets to be significant for the foreseeable future. Important fac
impacting our businesses include the overall strength of these economies a
customers' confidence in both local and global macro-economic conditions;
industrial and private sector spending, federal, state, local and municipal
governmental fiscal and trade policies; the strength of the residential and
commercial real estate markets; interest rates; availability of commercial fin
for our customers and end-users; the availability of funding for our public se
customers; and unemployment rates. A slowdown or prolonged downturn in
markets could have a material adverse effect on our business, financial con
and results of operations.

Economic and other risks associated with international sales and oper could adversely affect our business.

In 2018, 53% of our total revenue was from customers outside the United St
with 20% of total revenue generated in emerging markets. We expect our sa
from international operations and export sales to continue to be a significant
portion of our revenue. We have placed a particular emphasis on increasing
growth and presence in emerging markets. Many of our manufacturing oper
employees and suppliers are located

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outside of the United States. Both our international operations and sales are subject, in varying degrees, to risks inherent in doing business outside the U States. These risks include the following:

- changes in trade protection measures, including embargoes, tariffs and othe barriers, and import and export regulations and licensing requirements;
- instability and uncertainties arising from the global geopolitical environment as economic nationalism, populism, protectionism and anti-global sentimen
- changes in tax laws and potential negative consequences from the interpret application and enforcement by governmental tax authorities of tax laws an policies;
- unanticipated changes in other laws and regulations or in how such provisio interpreted or administered;
- potential disruptions in our global supply chain;
- possibility of unfavorable circumstances arising from host country laws or regulations, including those related to infrastructure and data transmission, and privacy;
- currency exchange rate fluctuations and restrictions on currency repatriatio
- disruption of operations from labor and political disturbances;
- regional safety and security considerations;
- increased costs and risks in developing, staffing and simultaneously manag number of global operations as a result of distance as well as language and cultural differences; and
- outbreak or escalation of insurrection, armed conflict, terrorism or war.

Changes in the geopolitical or economic environments in the countries in wh operate could have a material adverse effect on our financial condition, resu operations or cash flows. For example, changes in U.S. policy regarding international trade, including import and export regulation and international t agreements, could also negatively impact our business. In 2018, the U.S. im tariffs on certain goods imported from China and certain other countries, wh resulted in retaliatory tariffs by China and other countries. Additional tariffs i by the U.S. on a broader range of imports, or further retaliatory trade measu taken by China or other countries in response, could result in an increase in chain costs that we may not be able to offset or may otherwise adversely im our financial condition and results of operations.

Additionally, we continue to monitor Brexit and its potential impacts on our r of operations and financial condition. Volatility in foreign currencies is expec continue as the United Kingdom executes its exit from the European Union. United Kingdom's membership in the European Union terminates without an agreement (referred to as a “hard Brexit”), there could be increased costs fr re-imposition of tariffs on trade between the United Kingdom and European increased transportation costs, shipping delays because of the need for cus inspections and procedures and shortages of certain goods. The United Kin will also need to negotiate its own tax and trade treaties with countries all ov world, which could take years to complete. In the case of a “hard Brexit”, ou exposure to disruptions to our supply chain, increased costs, the imposition tariffs and currency devaluation in the United Kingdom could result in a mat impact to our consolidated revenue, earnings and cash flow.

Further, any payment of distributions, loans or advances to us by our foreig
subsidiaries could be subject to restrictions on, or taxation of, dividends on
repatriation of earnings under applicable local law, monetary transfer restric
and foreign currency exchange regulations in the jurisdictions in which our
subsidiaries operate. In addition to the general risks that we face outside the
United States, our operations in emerging markets could involve additional
uncertainties for us, including risks that governments may impose withholdi
other taxes on remittances and other payments to us, or the amount of any
taxes may increase; governments may seek to nationalize our assets; or
governments may impose or increase investment barriers or other restrictio
affecting our business. In addition, emerging markets pose other uncertainti
including the difficulty of enforcing agreements, challenges collecting receiv
protection of our intellectual property and other assets, pressure on the pric
our products and services, higher business conduct risks, ability to hire and
qualified talent and risks of political instability. We cannot predict the impact
events might have on our business, financial condition and results of operat

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Our business could be adversely affected by cyber threats or other interruptions in information technology, communications networks an operations.

Our business operations rely on information technology and communication networks, including those operated by third parties, to process, transmit and our electronic information or our customers' electronic information, and man support a variety of business processes or activities. Regardless of protecti measures, essentially all systems are susceptible to disruption due to cyber attacks including denial-of-service, computer viruses and security breaches risk, equipment or system failure, vandalism, natural disasters, power outag shutdown, telecommunication or utility failure and other events. In addition, have designed products and services that connect to and are part of the "In Things." While we attempt to provide adequate security measures to safegu products from cyber threats, the potential for an attack remains. A successfu attack may result in inappropriate access to our or our customers' informatio inability for our products and services to function properly.

We, and some of our third party vendors, have experienced cybersecurity a in the past and may experience them in the future, likely with more frequenc involving a broader range of devices. To date, none have resulted in any ma adverse impact to our business or operations. We have adopted measures designed to mitigate potential risks associated with information technology disruptions and cybersecurity threats, however, given the unpredictability of timing, nature and scope of such disruptions, we could potentially be subjec production downtimes, operational delays, other detrimental impacts on our operations or ability to provide products and services to our customers, the compromise of confidential or otherwise protected information, destruction o corruption of data, security breaches, other manipulation or improper use of systems or networks, financial losses from remedial actions, loss of busines liability to others, regulatory enforcement actions, and/or damage to our reputation. We also have or operate through a concentration of operations certain sites, such as production and shared services centers, where busine interruptions could cause material damage and costs. Transport of goods fr suppliers and to customers could also be hampered for the reasons stated a Disruption to any of the information technology and communications networ which we rely, or an attack on our IoT products and services, could interfere our operations, disrupt service to our customers, interrupt production and shipments, damage customer relationships and negatively impact our reput any of which could have a material adverse effect on our competitive positio results of operations, cash flows or financial condition.

Although we continue to assess these risks, implement controls and perform business continuity and disaster recovery planning, we cannot be sure that interruptions with material adverse effects will not occur.

A material disruption to any of our facilities or operations, or that of th parties upon which we rely, may adversely affect our business.

If our facilities or operations, or that of third parties upon which we rely in ou supply chain and critical business operations, were to be disrupted as a res significant equipment or system failure, natural disaster, power, water or communications outage, fire, explosion, critical supply failure, terrorism, cyber-based attack, political disruption, labor dispute, work stoppage or slov adverse weather conditions or other reason, our financial performance coul adversely affected. Interruptions could cause an inability to meet customer demand, increase our costs, reduce our sales, and impact our business pro and activities. We also have or operate through a concentration of operatior certain sites, such as production and shared services centers, where busine interruptions could cause material damage and costs. Any interruption in ca may be lengthy and have lasting effects, require a significant amount of management and other employees' time and focus, and require us to make substantial expenditures to remedy the situation, which could negatively affe profitability and financial condition. Any recovery under our insurance policie not offset the lost sales or increased costs that may be experienced during t disruption of operations, which could adversely affect our business, financia condition and results of operations.

We may not achieve some or all of the expected benefits of our restruc and transformation plans and our restructuring may adversely affect o business.

In recent fiscal years, we have initiated restructuring, realignment and transformation plans in an effort to optimize our cost structure and improve o operational efficiency and effectiveness. In 2017, we undertook steps to adv multi-year effort to transform many of our support functions and related technologies, including Finance, Human Resources and Procurement. We r be able to obtain the cost savings and benefits that were initially anticipated connection with our restructuring and transformation plans. Implementing pl restructuring

activities could be delayed resulting in delayed realization of the operational
financial benefits from such actions. Additionally, as a result of these plans,
may experience a loss of continuity, loss of accumulated knowledge or ineff
during transitional periods. Transformation, realignment and restructuring ca
require a significant amount of management and other employees' time and
which may divert attention from operating and growing our business.

The successful implementation and execution of our restructuring, realignm
transformation actions are critical to achieving our expected cost savings as
effectively competing in the marketplace and positioning us for future growt
Factors that may impede a successful implementation include the retention
employees, the impact of regulatory matters including tax, matters involving
third party service providers selected to assist us including their compliance
the Company's internal controls over financial reporting, and adverse econo
market conditions. If our restructuring actions are not executed successfully
could have a material adverse effect on our competitive position, business,
financial condition and results of operations.

Our strategy includes acquisitions, and we may not be able to execute acquisitions of suitable candidates or integrate acquisitions successf

As part of our growth strategy, we plan to pursue the acquisition of other
companies, assets, technologies and product lines that either complement o
expand our existing business. We may not be able to identify suitable candi
negotiate appropriate acquisition terms, obtain financing that may be neede
consummate acquisitions, complete proposed acquisitions, successfully inte
acquired businesses into our existing operations or expand into new market
addition, we cannot make assurances that any acquisition, once integrated,
perform as planned, be accretive to earnings, or prove to be beneficial to ou
operations or cash flow.

Acquisitions involve a number of risks and present financial, managerial and
operational challenges, including: diversion of management attention from e
businesses and operations; integration of technology, operations personnel
financial and other systems; potentially insufficient cybersecurity controls or
insufficient internal controls over financial or compliance activities or financi
reporting at an acquired entity that could impact us on a combined basis; th
to realize expected synergies; the possibility that we become exposed to
substantial undisclosed liabilities or new material risks associated with the a
businesses; and the loss of key employees of the acquired businesses. Fail
successfully execute our acquisition strategy could adversely affect our com
position, business, financial condition or results of operations.

Failure to comply with laws, regulations and policies, including but no limited to the U.S. Foreign Corrupt Practices Act or other applicable anti-corruption legislation and data privacy and security laws, could re fines, criminal penalties and an adverse effect on our business.

We are subject to regulation under a wide variety of U.S. federal and state a
non-U.S. laws, regulations and policies, including laws related to anti-corrup
trade regulations, including export and import compliance, anti-trust and mo
laundering, due to our global operations. The U.S. Foreign Corrupt Practice
(the "FCPA"), the U.K. Bribery Act of 2010 and similar anti-bribery laws in o
jurisdictions generally prohibit companies and their intermediaries from mak
improper payments to government officials or other persons for the purpose

obtaining or retaining business. Our policies mandate compliance with these anti-bribery laws. We operate in many parts of the world that are recognized as having governmental and commercial corruption and in certain circumstances, strict compliance with anti-bribery laws may conflict with local customs and practices. We cannot assure you that our internal control policies and procedures will always protect us from improper conduct of our employees or business partners. In the event that we believe or have reason to believe that our employees or business partners have or may have violated applicable laws, regulations or policies, including anti-corruption laws, we may be required to investigate or have outside counsel investigate the relevant facts and circumstances, which can be expensive and require significant time and attention from senior management. Any such violation could result in substantial fines, sanctions, civil and/or criminal penalties, and curtailment of operations in certain jurisdictions, and might materially and adversely affect our business, results of operations or financial condition. In addition, actual or alleged violations could damage our reputation and ability to do business.

Additionally, to conduct our operations, we regularly move data across national borders, and consequently we are subject to a variety of continuously evolving and developing laws and regulations in the United States and abroad regarding privacy, data protection and data security. The scope of the laws that may be applicable to us is often uncertain and may be conflicting, particularly with respect to foreign laws. For example, the European Union's General Data Protection Regulation ("GDPR"), which became effective in May 2018, greatly increases the jurisdictional reach of European Union law and adds a broad array of requirements for handling personal data, including the public disclosure of significant data breaches. Other countries, such as China, have enacted or are enacting data localization laws that require data to stay within their borders. these evolving compliance and operational requirements impose significant of compliance that are likely to increase over time. Any such violation could in substantial fines, sanctions or civil penalties, damage to our reputation ar materially and adversely affect our business, results of operations or financi condition.

Our business could be adversely affected by significant movements in foreign currency exchange rates.

We conduct approximately 53% of our business in various locations outside United States. We are exposed to fluctuations in foreign currency transactio exchange rates, particularly with respect to the Euro, Swedish Krona, Polish Canadian Dollar, British Pound and Australian Dollar. Any significant chang value of currencies of the countries in which we do business relative to the v the U.S. Dollar or Euro could affect our ability to sell products competitively control our cost structure, which could have a material adverse effect on ou business, financial condition and results of operations. Additionally, we are s to foreign exchange translation risk due to changes in the value of foreign currencies in relation to our reporting currency, the U.S. dollar. The translati is primarily concentrated in the exchange rate between the U.S. Dollar and t Euro, Chinese Yuan, British Pound, Canadian Dollar, Swedish Krona and Australian Dollar. As the U.S. Dollar fluctuates against other currencies in w transact business, revenue and income can be impacted. For instance, our revenue increased by 0.5% due to favorable foreign currency impacts. Strengthening of the U.S. Dollar relative to the Euro and the currencies of th countries in which we do business, could materially and adversely affect ou growth in future periods. Refer to Item 7A "Quantitative and Qualitative Disc about Market Risk" for additional information on foreign exchange risk.

Failure to retain our existing senior management, engineering, techno sales and other key personnel or the inability to attract and retain new qualified personnel could negatively impact our ability to operate or gr business.

Our success will continue to depend to a significant extent on our ability to r attract a significant number of employees in senior management, engineerin technology, sales and other key personnel. The ability to attract or retain employees will depend on our ability to offer competitive compensation, ben training and development and an attractive culture. We will need to continue develop a roster of qualified talent to support business growth and replace departing employees. Effective succession planning is also important to our long-term success. Failure to ensure effective transfer of knowledge and sm transitions involving key employees could hinder our strategic planning and execution. A failure to retain or attract highly skilled personnel could advers affect our operating results or ability to operate or grow our business.

Product defects and unanticipated use or inadequate disclosure with r to our products could adversely affect our business, reputation and fin statements.

Manufacturing or design defects in (including in products or components tha source from third parties), unanticipated use of, or inadequate disclosure of relating to the use of our products could create product safety, regulatory or environmental risks, including personal injury, death or property damage. Th events could lead to recalls or safety alerts relating to our products, result in

removal of a product from the market and result in product liability claims be
brought against us. Although we have liability insurance, we cannot be certa
this insurance coverage will continue to be available to us at a reasonable c
will be adequate to cover any product liability claims. Manufacturing, design
software or service defects or inadequacies may also result in contractual
damages or credits being issued, which could impact our profitability. Recal
removals and product liability and quality claims can result in significant cos
well as negative publicity and damage to our reputation that could reduce de
for our products and have a material adverse effect on our business, financi
condition and results of operations.

Our financial results can be difficult to predict.

Our business is impacted by a substantial amount of short cycle, and book-
business, which we have limited insight into, particularly for the business tha
transact through our distributors. We are also impacted by large projects, w
timing can change based upon customer requirements due to a number of f
affecting the project beyond our knowledge or control, such as funding, read
of the project and regulatory approvals. Accordingly, our financial results for
given period can be difficult to predict.

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Changes in our effective tax rates and tax expenses may adversely aff financial results.

We sell our products in approximately 150 countries and 53% of our revenu generated outside the United States in 2018. Given the global nature of our business, a number of factors may increase our effective tax rates and tax expense, including:

- the geographic mix of jurisdictions in which profits are earned and taxed;
- the statutory tax rates and tax laws in the jurisdictions in which we conduct business;
- the resolution of tax issues arising from tax examinations by various tax authorities; and
- the valuation of our deferred tax assets and liabilities.

Xylem is regularly examined by various tax authorities throughout the world the resolutions of these examinations do not typically have a significant imp our effective tax rates and tax expenses but they could. Additionally, in Dec 2017, the United States enacted tax reform legislation ("Tax Act"). The legis implements many new U.S. domestic and international tax provisions. Many aspects of the Tax Act remain unclear, and although additional clarifying gu is expected to be issued (by the Internal Revenue Service ("IRS"), the U.S. Department or via a technical correction law change), it may not be clarified some time. In addition, many U.S. states have not yet updated their laws to into account the new federal legislation. As a result, there may be further im of the new law on our results of operations and financial condition. It is poss that the Tax Act, or interpretations under it, could change and could have ar adverse effect on us, and such effect could be material.

Our business could be adversely affected by inflation, tariffs and othe manufacturing and operating cost increases.

Our operating costs are subject to fluctuations, particularly due to changes i prices for commodities, parts, raw materials, energy and related utilities, fre and cost of labor which may be driven by prevailing price levels, exchange r changes in trade protection measures including tariffs, and other economic In order to remain competitive, we may not be able to recuperate all or a po these higher costs from our customers through product price increases. Fur a declining price environment, our operating margins may contract because account for inventory using the first-in, first- out method. Actions we take to mitigate volatility in manufacturing and operating costs may not be successf as a result, our business, financial condition and results of operation could b materially and adversely affected.

Our business could be adversely affected by the availability of parts a materials or the inability of suppliers to meet delivery requirements.

Our business relies on third-party suppliers, contract manufacturing and cor markets to secure raw materials, parts and components used in our product we expect that reliance to increase. Parts and raw materials commonly used products include motors, fabricated parts, castings, bearings, seals, batterie PCBs and electronic components, as well as steel, brass, nickel, copper, alu and plastics. We are exposed to the availability of these materials, which ma subject to curtailment or change due to, among other things, interruptions in production by suppliers, labor disputes, the impaired financial condition of a particular supplier, suppliers' allocations to other purchasers, changes in tra protection measures including tariffs, exchange rates and prevailing price le

ability to meet regulatory requirements, weather emergencies or acts of war
terrorism. Any delay in our suppliers' abilities to provide us with necessary r
could impair our ability to deliver products to our customers and, accordingly
have a material adverse effect on our business, financial condition or results
operations.

Our indebtedness may affect our business and may restrict our operat flexibility.

As of December 31, 2018, our total outstanding indebtedness was $2,308 m
as described under "Liquidity and Capital Resources." Our indebtedness co

- increase our vulnerability to general adverse economic and industry conditi
- limit our ability to obtain additional financing or borrow additional funds;
- create uncertainty and complexity in managing debt that uses LIBOR as a reference rate, including as a result of the planned transition away from LIB the Secured Overnight Financing Rate ("SOFR");
- limit our ability to pay future dividends;
- limit our flexibility in planning for, or reacting to, changes in our business an industry in which we operate;
- require that a substantial portion of our cash flow from operations be used f payment of interest on our

indebtedness instead of funding working capital, capital expenditures, acqui
or other general corporate purposes; and

- increase the amount of interest expense that we must pay because some o borrowings are at variable interest rates, which, as interest rates increase, v result in higher interest expense.

In addition, there can be no assurance that future borrowings or equity finar will be available to us on favorable terms or at all for the payment or refinan our indebtedness. If we incur additional debt or raise equity through the issu preferred stock, the terms of the debt or preferred stock issued may give the holders rights, preferences and privileges senior to those of holders of our c stock, particularly in the event of liquidation. The terms of the debt may also impose additional and more stringent restrictions on our operations than we currently have.

Our ability to make scheduled principal payments of, to pay interest on, or to refinance our indebtedness and to satisfy our other debt obligations will dep our future operating performance, which may be affected by factors beyond control. If we are unable to service our indebtedness, our business, financia condition and results of operations would be materially adversely affected.

We may be negatively impacted by legal and regulatory proceedings.

We are subject to various laws, ordinances, regulations and other requireme government authorities in foreign countries and in the United States, any vio of which could potentially create substantial liability for us and damage our reputation. Changes in laws, ordinances, regulations or other government p the nature, timing, and effect of which are uncertain, may significantly increa expenses and liabilities.

From time to time we are involved in legal and regulatory proceedings that a incidental to the operation of our businesses (or the business operations of previously owned entities). These proceedings may seek remedies relating environmental matters, tax, intellectual property, acquisitions or divestitures product liability and personal injury claims, privacy, employment, labor and p matters, government contract issues and commercial or contractual dispute continuing transition to connected or digital technologies and solutions has increased our exposure to intellectual property litigation and we expect that will continue to increase as we execute on our innovation and technology pr

It is not possible to predict with certainty the outcome of claims, investigatio regulatory proceedings and lawsuits, and we could in the future incur judgm fines or penalties or enter into settlements and claims that could have an ad effect on our business, results of operations and financial condition in any particular period. Additionally, we may be required to change or cease oper at one or more facilities if a regulatory agency determines that we have faile comply with laws, regulations or orders applicable to our business.

The global and diverse nature of our operations, coupled with the increase i regulation and enforcement in many regions of the globe, means that legal a compliance risks will continue to exist and additional legal and regulatory proceedings and other contingencies, the outcome of which cannot be pred with certainty, will arise from time to time. In addition, subsequent developm legal and regulatory proceedings may affect our assessments and estimate

loss contingencies recorded as a reserve and require us to make payments
excess of our reserves, which could have an adverse effect on our results o
operations and financial condition.

***Weather conditions and climate changes may adversely affect, or caus
volatility in, our financial results.***

Weather conditions, including heavy flooding, droughts and fluctuations in
temperatures or weather patterns, including as a result of climate change, c
positively or negatively impact portions of our business. Within the dewateri
space, pumps provided through our Godwin and Flygt brands are used to re
excess or unwanted water. Heavy flooding due to weather conditions drives
increased demand for these applications. On the other hand, drought condit
drive higher demand for pumps used in agricultural and turf irrigation applica
such as those provided by our Goulds Water Technology and Lowara branc
Fluctuations to warmer and cooler temperatures result in varying levels of d
for products used in residential and commercial applications where homes a
buildings are heated and cooled with HVAC units such as those provided by
B&G brand. The unpredictable nature of weather conditions and climate cha
may result in volatility for certain portions of our business, as well as the ope
of certain of our customers and suppliers.

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If we do not or cannot adequately protect our intellectual property, if th parties infringe our intellectual property rights, or if third parties claim we are infringing or misappropriating their intellectual property rights, may suffer competitive injury, expend significant resources enforcing rights or defending against such claims, or be prevented from selling products or services.

We own numerous patents, trademarks, copyrights, trade secrets and other intellectual property and licenses to intellectual property owned by others, w the aggregate are important to our business. The intellectual property rights we obtain, however, may not provide us with a significant competitive advar because they may not be sufficiently broad or may be challenged, invalidate circumvented, independently developed, or designed-around, particularly in countries where intellectual property rights laws are not highly developed, protected or enforced. Our failure to obtain or maintain intellectual property that convey competitive advantage, adequately protect our intellectual prope detect or prevent circumvention or unauthorized use of such property and th of enforcing our intellectual property rights could adversely impact our busin financial condition and results of operations.

From time to time, we receive notices from third parties alleging intellectual property infringement or misappropriation. Any dispute or litigation regarding intellectual property could be costly and time-consuming due to the complex the uncertainty of intellectual property litigation. Our intellectual property por may not be useful in asserting a counterclaim, or negotiating a license, in re to a claim of infringement or misappropriation. In addition, as a result of suc claims of infringement or misappropriation, we could lose our rights to critica technology, be unable to license critical technology or sell critical products a services, be required to pay substantial damages or license fees with respe the infringed rights or be required to redesign our products at substantial co of which could adversely impact our competitive position, financial condition results of operations. Even if we successfully defend against claims of infrin or misappropriation, we may incur significant costs and diversion of manage attention and resources, which could adversely affect our business, financia condition and results of operations.

A significant portion of our products and offerings in our Measuremen Control Solutions segment are affected by the availability and regulati radio spectrum and could be affected by interference with the radio sp that we use.

A significant portion of the offering in our Measurement & Control Solutions segment use radio spectrum, which is subject to government regulation. To extent we introduce new products designed for use in the United States or a country into a new market, such products may require significant modificatio redesign in order to meet frequency requirements and other regulatory specifications. In some countries, limitations on frequency availability or the making necessary modifications may preclude us from selling our products countries. The regulations that govern our use of the radio spectrum may ch and the changes may require us to modify our products or seek new partne either directly or due to interference caused by new consumer products allo under the regulations. The inability to modify our products to meet such requirements, the possible delays in completing such modifications, and the such modifications all could have a material adverse effect on our business,

financial condition, and results of operations. In addition, suitable partners f
co-development may not be able to be secured by us.

In the United States, our products are primarily designed to use licensed sp
in the 900MHz range. If the Federal Communications Commission ("FCC")
renew our existing spectrum licenses, our business could be adversely affe
addition, there may be insufficient available frequencies in some markets to
or develop our planned operations at a commercially feasible price or at all.

Outside of the United States, certain of our products require the use of radio
frequency and are subject to regulations. In some jurisdictions, radio station
licenses may be granted for a fixed term and must be periodically renewed.
advanced and smart metering systems offering transmits to (and receives
information from, if applicable) handheld, mobile, or fixed network reading d
in licensed bands made available to us through strategic partnerships and a
reliant to some extent on the licensed spectrum continuing to be available th
our partners or our customers. We may be unable to find partners or custom
that have access to sufficient frequencies in some markets to sustain or dev
our planned operations or to find partners or customers that have access to
sufficient frequencies in the relevant markets at a commercially feasible pric
all.

***We may incur impairment charges for our goodwill and other indefinite
intangible assets which would negatively impact our operating results***

We have a significant amount of goodwill and purchased intangible assets o
balance sheet as a result of acquisitions we have completed. As of Decemb
2018, the net carrying value of our goodwill and other indefinite-lived intang
assets totaled approximately $3 billion. The carrying value of goodwill repre
the fair

value of an acquired business in excess of identifiable assets and liabilities the acquisition date. The carrying value of indefinite-lived intangible assets represents the fair value of trademarks, trade names and FCC licenses as c acquisition date. We do not amortize goodwill and indefinite-lived intangible that we expect to contribute indefinitely to our cash flows, but instead we ev these assets for impairment at least annually, or more frequently if interim indicators suggest that a potential impairment could exist. A goodwill impair charge will be recognized if the fair value of a reporting unit is less than its c amount. Significant negative industry or economic trends, disruptions to our business, inability to effectively integrate acquired businesses, unexpected significant changes or planned changes in use of the assets, failure of the F renew licenses, divestitures and market capitalization declines may impair c goodwill and other indefinite-lived intangible assets. Any charges relating to impairments could adversely affect our results of operations and financial condition.

We cannot make assurances that we will pay dividends on our commo stock or continue to repurchase our common stock under Board appr share repurchase plans, and likewise our indebtedness could limit our to pay dividends or make share repurchases.

The timing, declaration, amount and payment of future dividends to our shareholders fall within the discretion of our Board of Directors and will depe many factors, including our financial condition, results of operations and cap requirements, as well as applicable law, regulatory constraints, industry prac and other business considerations that our Board of Directors considers rele There can be no assurance that we will pay a dividend in the future or contir pay dividends.

Further, the timing and amount of the repurchase of our common stock und Board approved share repurchase plans has similar dependencies as the p of dividends and accordingly, there can be no assurances that we will repur our common stock.

Additionally, if we cannot generate sufficient cash flow from operations to m debt payment obligations, then our ability to pay dividends, if so determined Board of Directors, or make share repurchases will be impaired and we may required to attempt to restructure or refinance our debt, raise additional cap take other actions such as selling assets, reducing or delaying capital expenditures, reducing our dividend or delaying or curtailing share repurcha There can be no assurance, however, that any such actions could be effect satisfactory terms, if at all, or would be permitted by the terms of our debt or other credit and contractual arrangements.

Developments in environmental laws and regulations could impact our financial condition or results of operations.

Our operations, product and service offerings are subject to and affected by federal, state, local and foreign environmental laws and regulations. In addit could be affected by future environmental laws or regulations, including, for example, those imposed in response to climate change concerns. Complian current and future environmental laws and regulations currently requires and expected to continue to require operating and capital expenditures.

Environmental laws and regulations may authorize substantial fines and crin sanctions as well as facility shutdowns to address violations, and may requi installation of costly pollution control equipment or operational changes to lir

emissions or discharges. We also incur, and expect to continue to incur, cos
comply with current environmental laws and regulations.
Developments such as the adoption of new environmental laws and regulat
stricter enforcement of existing laws and regulations, violations by us of suc
and regulations, discovery of previously unknown or more extensive contam
litigation involving environmental impacts, our inability to recover costs asso
with any such developments, or financial insolvency of other responsible pa
could in the future have a material adverse effect on our financial condition
results of operations.

The level of returns on postretirement benefit plan assets, changes in interest rates and other factors could affect our earnings and cash flo future periods.

Certain members of our current and retired employee population are covere
pension and other employee-related defined benefit plans (collectively,
postretirement benefit plans). We may experience significant fluctuations in
related to our postretirement benefit plans as a result of macro-economic fa
such as interest rates, that are beyond our control. The cost of our postretir
plans is incurred over long periods of time and involves factors and uncertai
during those periods which can be volatile and unpredictable, including rate
return on postretirement benefit plan assets, discount rates used to calculat
liabilities and expenses and rates of future compensation increases. Manag
develops each assumption using relevant plan and Company experience ar
expectations in conjunction with market-related data. Our liquidity, financial
(including shareholders'

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equity) and results of operations could be materially affected by significant c
in key economic indicators, actuarial experience, financial market volatility, f
legislation and other governmental regulatory actions.

We make contributions to fund our postretirement benefit plans when consid
necessary or advantageous to do so. The macro-economic factors discusse
above, including the return on postretirement benefit plan assets and the mi
funding requirements established by local government funding or taxing aut
or established by other agreement, may influence future funding requiremen
significant decline in the fair value of our plan assets, or other adverse chan
our overall pension and other employee-related benefit plans, could require
make significant funding contributions and affect cash flows in future period

The market price of our common stock may fluctuate significantly.

We cannot predict the prices at which our common stock may trade. The ma
price of our common stock may fluctuate widely, depending on many factors
of which may be beyond our control, including:

- actual or anticipated fluctuations in our operating results due to factors relat our business;
- success or failure of our business strategy;
- our quarterly or annual earnings, or those of other companies in our industr
- our ability to obtain financing as needed;
- stock repurchases or dividends;
- acquisitions and divestitures;
- announcements by us or our competitors of significant new busines awards;
- announcements by us or our competitors of significant acquisitions or dives
- changes in accounting standards, policies, guidance, interpretations or prin
- changes in earnings estimates by securities analysts or our ability to meet t estimates;
- our ability to execute transformation, restructuring and realignment actions;
- the operating and stock price performance of other comparable companies;
- natural or environmental disasters that investors believe may affect us;
- overall market fluctuations;
- fluctuations in foreign currency impacts;
- fluctuations in the budgets of federal, state and local governmental entities a the world;
- results from any material litigation, governmental or regulatory body investig or tax examination;
- changes in laws and regulations affecting our business;
- impact of trade protection measures including tariffs; and
- general economic conditions and other external factors.

Stock markets in general have experienced volatility that has often been un
to the operating performance of a particular company. These broad market
fluctuations could adversely affect the trading price of our common stock.

Anti-takeover provisions in our organizational documents and Indiana could delay or prevent a change in control.

Certain provisions of our fourth amended and restated articles of incorporat
our amended and restated by-laws may delay or prevent a merger or acquis
part or all of our business operations. For example, our articles of incorpora
and our by-laws, among other things, require advance notice for shareholde
proposals and nominations. In addition, our articles of incorporation authoriz

Board of Directors to issue one or more series of preferred stock. These pro
may also discourage acquisition proposals of our business operations or de
prevent a change in control, which could harm our stock price. Indiana law a
imposes some restrictions on mergers and other business combinations bet
any holder of 10% or more of our outstanding common stock and us.

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In connection with our Spin-off, ITT (now ITT LLC) and Exelis, acquired Harris Inc., will indemnify us for certain liabilities and we will indemnif (now ITT LLC) or Exelis for certain liabilities. If we are required to inde ITT (now ITT LLC) or Exelis, we may need to divert cash to meet those obligations and our financial results could be negatively impacted. In t case of ITT's or Exelis' indemnity, there can be no assurance that thos indemnities will be sufficient to insure us against the full amount of su liabilities, or as to ITT's or Exelis' ability to satisfy its indemnification obligations in the future.

Pursuant to the Distribution Agreement and certain other agreements with IT (now ITT LLC) and Exelis, ITT (now ITT LLC) and Exelis agreed to indemnif from certain liabilities, and we agreed to indemnify ITT (now ITT LLC) and E for certain liabilities. Indemnities that we may be required to provide ITT (no LLC) and Exelis may be significant and could negatively impact our busines parties could also seek to hold us responsible for any of the liabilities that IT ITT LLC) or Exelis has agreed to retain. Further, there can be no assurance the indemnities from ITT (now ITT LLC) and Exelis will be sufficient to prote against the full amount of such liabilities, or that ITT (now ITT LLC) and Exe be able to fully satisfy their indemnification obligations. Moreover, even if we ultimately were to succeed in recovering from ITT (now ITT LLC) and Exelis amounts for which we are held liable, we may be temporarily required to be these losses ourselves. Each of these risks could negatively affect our busi results of operations and financial condition.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

None.

ITEM 2. PROPERTIES

We have approximately 385 locations in more than 52 countries. These pro
total approximately 12.3 million square feet, of which more than 345 locatio
approximately 6.6 million square feet, are leased. We consider the offices, p
warehouses and other properties that we own or lease to be in good conditi
generally suitable for the purposes for which they are used. The following ta
shows our significant locations by segment:

Location	State or Country	Principal Business Activity	Approx. Square Feet
		Water Infrastructure	
Emmaboda	Sweden	Administration and Manufacturing	1,197,000
Stockholm	Sweden	Administration and Research & Development	182,000
Bridgeport	NJ	Administration and Manufacturing	136,000
Shenyang	China	Manufacturing	125,000
Yellow Springs	OH	Administration and Manufacturing	112,000
Quenington	UK	Manufacturing	86,000
		Applied Water	
Morton Grove	IL	Administration and Manufacturing	530,000
Montecchio	Italy	Administration and Manufacturing	379,000
Nanjing	China	Manufacturing	363,000
Auburn	NY	Manufacturing	273,000
Stockerau	Austria	Administration	233,000
Lubbock	TX	Manufacturing	229,000
Strzelin	Poland	Manufacturing	185,000
Cheektowaga	NY	Manufacturing	147,000
		Measurement & Control Solutions	
Ludwigshafen	Germany	Manufacturing	318,000
Texarkana	AR	Manufacturing	254,000
Uniontown	PA	Manufacturing	240,000
DuBois	PA	Manufacturing	197,000
Durham	NC	Administration and Research & Development	154,000
DuBois	PA	Manufacturing	137,000
		Regional Selling Locations	
Dubai	United Arab Emirates	Manufacturing	144,000
Nottinghamshire	United Kingdom	Sales Office	139,000
Nanterre	France	Sales Office	139,000
Langenhagen	Germany	Sales Office	134,000
		Corporate Headquarters	
Rye Brook	NY	Administration	67,000

ITEM 3. LEGAL PROCEEDINGS

From time to time we are involved in legal and regulatory proceedings that a
incidental to the operation of our businesses (or the business operations of
previously owned entities). These proceedings may seek remedies relating
environmental matters, tax, intellectual property matters, acquisitions or
divestitures, product liability and personal injury claims, privacy, employmen
and pension matters, government contract issues and commercial or contra
disputes. See Note 19, "Commitments and Contingencies", of the consolida
financial statements included in Item 8 of Part II of this 10-K for information
regarding certain legal and regulatory proceedings we are involved in.

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ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

EXECUTIVE OFFICERS OF THE REGISTRANT

The following information is provided regarding the executive officers of Xyl
of January 31, 2019:

NAME	AGE	CURRENT TITLE	OTHER BUSINESS EXPERIENCE DURIN YEARS
Patrick K. Decker	54	President and Chief Executive Officer (2014)	• President and Chief Executive Harsco Corp. (diversified, world industrial company) (2012)
E. Mark Rajkowski	60	Senior VP and Chief Financial Officer (2016)	• Senior VP and Chief Financial MeadWestvaco Corp. (worldwid packaging company) (2004)
Tomas Brannemo	47	Senior VP and President, Transport and Treatment (2017)	• Senior VP and President, Tran (2014) • VP, Transport (2013)
David Flinton	48	Senior VP and President, Dewatering (2015)	• VP, Engineering and Marketin Applied Water Systems (2013)
Pak Steven Leung	62	Senior VP and President, Emerging Markets (2015)	• VP, Global Sales, Valves and C Pentair Plc (diversified, worldwi industrial manufacturing compa (2013)
Kenneth Napolitano	56	Senior VP and President, Applied Water Systems and Americas Commercial Team (2017)	• Senior VP and President, Appl Water Systems (2012)
Colin R. Sabol	51	Senior VP and President, Measurement & Control Solutions (2017)	• Senior VP and President, Anal and Treatment (2015) • Senior VP and President, Dew (2013)
Paul A. Stellato	44	VP, Controller and Chief Accounting Officer (2017)	• VP, Financial Planning and An (2014) • Director, Financial Planning ar Analysis (2011)

Kairus Tarapore	57	Senior VP and Chief Human Resources Officer (2015)	• Senior VP and Chief Administr Officer, Babcock & Wilcox Comp (energy and environmental technologies and services) (201
Claudia S. Toussaint	55	Senior VP, General Counsel and Corporate Secretary (2014)	• Senior VP, General Counsel a Secretary, Barnes Group Inc. (international industrial and aero manufacturing) (2012)

Note: Date in parentheses indicates the year in which the position was assu

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BOARD OF DIRECTORS

The following information is provided regarding the Board of Directors of Xy
of January 31, 2019:

NAME	TITLE
Markos I. Tambakeras	Chairman, Xylem Inc., Former Chairman, President Chief Executive Officer, Kennametal, Inc.
Curtis J. Crawford, Ph.D.	President and Chief Executive Officer, XCEO, Inc.
Jeanne Beliveau-Dunn	Former Vice President and General Manager, Cisco Systems, Inc.
Patrick K. Decker	President and Chief Executive Officer, Xylem Inc.
Robert F. Friel	Chairman, President and Chief Executive Officer, PerkinElmer, Inc.
Victoria D. Harker	Chief Financial Officer, TEGNA, Inc.
Sten E. Jakobsson	Former President and Chief Executive Officer, ABB
Steven R. Loranger	Former Chairman, President and Chief Executive Of ITT Corporation
Surya N. Mohapatra, Ph.D.	Former Chairman, President and Chief Executive Of Quest Diagnostics Incorporated
Jerome A. Peribere	Former President and Chief Executive Officer, Seale Corporation

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PART II

ITEM 5. MARKET FOR THE REGISTRANT’S COMMON EQUITY, RE STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Price and Dividends

Our common stock trades publicly on the New York Stock Exchange under trading symbol “XYL”. As of January 31, 2019, there were 10,898 holders of r of our common stock.

Dividends are declared and paid on the common stock at the discretion of o Board of Directors and depend on our profitability, financial condition, capita needs, future prospects and other factors deemed relevant by our Board. Therefore, there can be no assurance as to what level of dividends, if any, v paid in the future. In the first quarter of 2019, we declared a dividend of $0.2 share to be paid on March 14, 2019 for shareholders of record on February 2019.

There were no unregistered offerings of our common stock during 2018.

Fourth Quarter 2018 Share Repurchase Activity

The following table summarizes our purchases of our common stock for the ended December 31, 2018:

(in millions, except per share amounts)

Period	Total Number of Shares Purchased	Average Price Paid per Share (a)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (b)	Approximate Dollar Shares That May Ye Purchased Under th Programs (b)
10/1/18 - 10/31/18	—	—	—	$363
11/1/18 - 11/30/18	—	—	—	$363
12/1/18 - 12/31/18	—	—	—	$363

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

(b) On August 24, 2015, our Board of Directors authorized the repurchase of up to $500 milli shares with no expiration date. The program's objective is to deploy our capital in a mann benefits our shareholders and maintains our focus on growth. There were no shares repu under this program during the three months ended December 31, 2018. There are up to $ million in shares that may still be purchased under this plan as of December 31, 2018.

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PERFORMANCE GRAPH
CUMULATIVE TOTAL RETURN

The following graph compares the relative performance of our common stoc
S&P 500 Index and the S&P 500 Industrials Index. This graph covers the pe
from December 31, 2013 through December 31, 2018 and assumes that $1
invested on December 31, 2013 in our common stock, the S&P 500 and the
500 Industrials with the reinvestment of any dividends.

	XYL	S&P 500	S&P 500 Industrials Index
December 31, 2013	100	100	100
December 31, 2014	112	114	110
December 31, 2015	109	115	107
December 31, 2016	150	129	127
December 31, 2017	209	157	153
December 31, 2018	206	150	132

The graph is not, and is not intended to be, indicative of future performance
common stock.

This performance graph shall not be deemed "filed" with the SEC or subject
liabilities of Section 18 of the Securities Exchange Act of 1934, and should r
deemed incorporated by reference into any of our prior or subsequent filings
the Securities Act of 1933 or the Securities Exchange Act of 1934, except a
be expressly set forth by specific reference in such filing.

ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth selected consolidated financial data for the fiv ended December 31, 2018. This selected consolidated financial data shoulc read in conjunction with “Management’s Discussion and Analysis of Financi Condition and Results of Operations” and the consolidated financial stateme the notes thereto included in this Report.

(in millions, except per share data)	Year Ended December 31, 2018 (a)		2017 (b) (c)		2016 (b) (c)		2015 (c)		201
Results of Operations Data:									
Revenue	**$5,207**		$4,707		$3,771		$3,653		$3
Gross profit	**2,026**		1,847		1,462		1,407		1,5
Gross margin	***38.9***	***%***	*39.2*	*%*	*38.8*	*%*	*38.5*	*%*	*38*
Operating income	**654**		552		408		454		469
Operating margin	***12.6***	***%***	*11.7*	*%*	*10.8*	*%*	*12.4*	*%*	*12*
Net income attributable to Xylem	**549**		331		260		340		337
Per Share Data:									
Earnings per share:									
Basic	**$3.05**		$1.84		$1.45		$1.88		$1
Diluted	**3.03**		1.83		1.45		1.87		1.8
Basic shares outstanding	**179.8**		179.6		179.1		180.9		183
Diluted shares outstanding	**181.1**		180.9		180.0		181.7		184
Cash dividends per share	**$0.8400**		$0.7200		$0.6196		$0.5632		$0
Balance Sheet Data (at period end):									
Cash and cash equivalents	**$296**		$414		$308		$680		$6
Working capital*	**988**		873		878		810		882
Total assets	**7,222**		6,860		6,474		4,657		4,8
Total debt	**2,308**		2,200		2,368		1,274		1,2

* The Company calculates Working capital as follows: net accounts receivable + inventories - accounts payable - customer advances.

(a) The amounts for the year ended December 31, 2018 reflects the acquisitions of both Pure Sensus. Refer to Note 3 to the Consolidated Financial Statements for further information acquisitions.

(b) The amounts for the years ended December 31, 2017 and December 31, 2016 reflect the acquisition of Sensus. Refer to Note 3 to the Consolidated Financial Statements for furthe information regarding acquisitions.

(c) The amounts for the years ended December 31, 2017, December 31, 2016, December 31 and December 31, 2014 reflect a re-classification related to prior year pension and post re accounting. Refer to Note 2 to the Consolidated Financial Statements for further informati regarding this prior year re-classification.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANC CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with our consolidate financial statements and the notes thereto. This discussion summarizes the significant factors affecting our results of operations and the financial condit our business during each of the fiscal years in the three-year period ended December 31, 2018. Except as otherwise indicated or unless the context ot requires, "Xylem," "we," "us," "our" and "the Company" refer to Xylem Inc. a subsidiaries.

Overview

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

- *Water Infrastructure* serves the water infrastructure sector with pump syste transport water from aquifers, lakes, rivers and seas; with filtration, ultraviol ozone systems that provide treatment, making the water fit to use; and pum solutions that move the wastewater to treatment facilities where our mixers, biological treatment, monitoring and control systems provide the primary fu in the treatment process. We also provide sales and rental of specialty dew pumps and related equipment and services. Additionally, our offerings use monitoring & control, smart and connected technologies to allow for remote monitoring of performance and enable products to self-optimize pump oper maximizing energy efficiency and minimizing unplanned downtime and maintenance for our customers. In the Water Infrastructure segment, we pr the majority of our sales directly to customers along with strong applications expertise, while the remaining amount is through distribution partners.
- *Applied Water* serves the usage applications sector with water pressure bo systems for heating, ventilation and air conditioning, and for fire protection s to the residential and commercial building services markets. In addition, ou pumps, heat exchangers and controls provide cooling to power plants and manufacturing facilities, circulation for food and beverage processing, as we boosting systems for agricultural irrigation. In the Applied Water segment, w provide the majority of our sales through long-standing relationships with m the leading independent distributors in the markets we serve, with the rema going directly to customers.
- *Measurement & Control Solutions* primarily serves the utility infrastructure s and services sector by delivering communications, smart metering, measur and control technologies and critical infrastructure technologies that allow customers to more effectively use their distribution networks for the delivery monitoring and control of critical resources such as water, electricity and na gas. We also provide analytical instrumentation used to measure water qua flow and level in clean water, wastewater, surface water and coastal enviro Additionally, we offer software and services including cloud-based analytics remote monitoring and data management, leak detection, condition assess

asset management and pressure monitoring solutions. We also offer smart
solutions that improve efficiency and public safety efforts across communiti
the Measurement & Control Solutions segment, we generate our sales thro
combination of long-standing relationships with leading distributors and ded
channel partners as well as direct sales depending on the regional availabil
distribution channels and the type of product.

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Key Performance Indicators and Non-GAAP Measures

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

- "organic revenue" and "organic orders" defined as revenue and orders, respectively, excluding the impact of fluctuations in foreign currency transla contributions from acquisitions and divestitures. Divestitures include sales o insignificant portions of our business that did not meet the criteria for classif as a discontinued operation. The period-over-period change resulting from f currency translation impacts is determined by translating current period and period activity using the same currency conversion rate.
- "constant currency" defined as financial results adjusted for foreign cu translation impacts by translating current period and prior period activ using the same currency conversion rate. This approach is used for c whose functional currency is not the U.S. dollar.
- "adjusted net income" and "adjusted earnings per share" defined as net inc and earnings per share, respectively, adjusted to exclude restructuring and realignment costs, Sensus acquisition related costs, special charges, tax-re special items and gains and losses from the sale of businesses, as applicab reconciliation of adjusted net income is provided below.

(in millions, except per share data)	**2018**	2017
Net income attributable to Xylem	**$549**	$331
Earnings per share - diluted	**$3.03**	$1.83
Restructuring and realignment, net of tax of $12, $13 and $13, respectively	**36**	28
Sensus acquisition related costs, net of tax of $8 and $15, respectively	**—**	14
Special charges, net of tax of $1, $4 and $7, respectively	**12**	8
Tax-related special items	**(75)**	40
Loss (gain) from sale of businesses, net of tax benefit of $2	**—**	12
Adjusted net income	**$522**	$433
Adjusted earnings per share	**$2.88**	$2.40

"adjusted operating expenses" and "adjusted gross profit" defined as operat
expenses and gross profit, respectively, adjusted to exclude restructuring a
realignment costs, Sensus acquisition related costs and special charges.
"adjusted operating income" defined as operating income, adjusted to exclu
"adjusted operating expenses", and "adjusted operating margin" defined as
adjusted operating income divided by total revenue.
“realignment costs” defined as costs not included in restructuring costs that
incurred as part of actions taken to reposition our business, including items
as professional fees, severance, relocation, travel, facility set-up and other c
"Sensus acquisition related costs" defined as costs incurred by the Compan
associated with the acquisition of Sensus that are being reported within ope
income. These costs include integration costs, acquisition

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costs, costs related to the recognition of the backlog intangible asset amorti recorded in purchase accounting.

"special charges" defined as costs incurred by the Company, such as acqui and integration related costs not included in "Sensus acquisition related cos non-cash impairment charges, due diligence costs and other special non-op items.

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

"free cash flow" defined as net cash from operating activities less capital expenditures. Free cash flow is further adjusted for other significant items th impact current results which management believes are not related to our or operations and performance. Our definition of free cash flow does not consi certain non-discretionary cash payments, such as debt. The following table provides a reconciliation of free cash flow.

(in millions)	**2018**	2017
Net cash provided by operating activities	**$586**	$686
Capital expenditures	**(237)**	(170
Free cash flow	**$349**	$516
Cash paid for Sensus acquisition related costs	**1**	28
Free cash flow, excluding Sensus acquisition related costs	**$350**	$544

"EBITDA" defined as earnings before interest, taxes, depreciation and amor expense and "Adjusted EBITDA" reflects the adjustment to EBITDA to exclu share-based compensation, restructuring and realignment costs, Sensus acquisition related costs, special charges and gain or loss from sale of busi

(in millions)	**2018**	2017	2016
Net Income	**$549**	$330	$260
Income tax expense	**36**	136	80
Interest expense (Income), net	**78**	79	68
Depreciation	**117**	109	87
Amortization	**144**	125	64
EBITDA	**$924**	$779	$559
Share-based compensation	**30**	21	18
Restructuring and realignment	**47**	41	47
Sensus acquisition related costs	**—**	14	46
Special charges	**12**	13	5
Loss (gain) from sale of business	**—**	10	—
Adjusted EBITDA	**$1,013**	$878	$675

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Executive Summary

Xylem reported revenue of $5,207 million for 2018, an increase of $500 mill 10.6%, from $4,707 million reported in 2017. On a constant currency basis, revenue increased by $477 million, or 10.1%, primarily consisting of organic revenue growth of $390 million, or 8.3%, driven by growth in all end markets well as across all major geographic regions. Acquisition revenue of $111 mi also contributed to the increase, partially offset by revenue related to divesti $24 million.

Operating income for 2018 was $654 million, reflecting an increase of $102 or 18.5%, compared to $552 million in 2017. Operating margin was 12.6% f versus 11.7% for 2017, an increase of 90 basis points. The increase in oper income and margin included favorable impacts from decreased Sensus acq related costs of $22 million, partially offset by an increase in restructuring ar realignment costs of $7 million and increased special charges of $1 million. Excluding the impact of these items, adjusted operating income was $714 m with an adjusted operating margin of 13.7% in 2018 as compared to adjuste operating income of $626 million with an adjusted operating margin of 13.3% 2017. The increase in adjusted operating margin was primarily due to cost reductions from our global procurement and productivity initiatives, favorabl volume impacts and price realization, which were partially offset by cost infla increased spending on strategic investments and unfavorable mix. Purchas accounting and currency impacts also negatively affected operating margin.

Additional financial highlights for 2018 include the following:

- Net income attributable to Xylem of $549 million, or $3.03 per diluted share million or $2.88 per diluted share on an adjusted basis, up 20.6% from 2017
- Cash from operating activities of $586 million, and free cash flow, excluding Sensus acquisition related costs, of $350 million down 35.7% from 2017
- Orders of $5,437 million, up 11.7% from $4,868 million in 2017 (up 9.3% on organic basis)
- Dividends paid to shareholders increased 17% in 2018.

2019 Business Outlook

We anticipate total revenue growth in the range of 2% to 4% in 2019, with o revenue growth anticipated to be in the range of 4% to 6%. The following is summary of our 2018 organic revenue performance and 2019 organic rever outlook by end market.

- Utilities increased approximately 10% for 2018 on an organic basis driven b strength across all regions globally, particularly in North America and Asia F For 2019, we expect organic growth in the mid-single-digit range driven by water and wastewater spending in the U.S., smart meter and infrastructure analytics growth opportunities and mixed but stable low-single-digit growth Europe. We also anticipate a healthy infrastructure investment focus in the emerging markets will continue in China and India.
- Industrial increased by roughly 6% for 2018 on an organic basis driven by s in North America, western Europe and Latin America, partially offset by wea in Asia Pacific. For 2019, we expect organic growth in the low to mid-single- driven by continued solid industrial conditions in the U.S. as the oil and gas markets begin to stabilize after a strong 2018. We also anticipate mixed em market conditions with strength in India and Latin America, offset by softnes Middle East and slowing growth in China.
-

In the commercial markets, organic growth was approximately 11% for 2018 primarily driven by strength in the United States and Asia Pacific. For 2019, expect organic growth in the low to mid-single-digit range as the overall ma begin to moderate after two years of strong performance. Organic growth w driven by continued strength in the U.S., especially during the first half of th and the emerging markets led by initiatives in the China and India building markets.

In residential markets, organic growth was approximately 2% in 2018 prima driven by strength in western Europe which was partially offset by weaknes Asia Pacific. For 2019, we expect low-single-digit growth primarily driven by continued competition in the U.S. replacement market as the housing mark begins to stabilize. We also anticipate stability in Europe and modest growt opportunities in China and other Asia Pacific countries for secondary clean sources.

We will continue to strategically execute restructuring and realignment actio primarily to reposition our European and North American businesses in an e optimize our cost structure and improve our operational efficiency and effectiveness. During 2018, we incurred \$20 million and \$28 million in restru and realignment costs,

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respectively. We realized approximately $13 million of incremental net savin
2018 from actions initiated in 2017, and an additional $3 million of net savin
our 2018 actions. As a result of our 2017 and 2018 actions we expect to rea
approximately $8 million of incremental net savings in 2019 and beyond. Du
2019, we currently expect to incur approximately $30 million in restructuring
realignment costs.

We plan to continue to take actions and focus spending in 2019 on actions t
allow us to make progress on our top strategic priorities. The priority of
accelerating profitable growth encompasses our initiatives to drive commerc
excellence, grow in emerging markets and strengthen innovation and techn
through creation of new centers of excellence, a streamlined approach to pr
development and strategic acquisitions. The priority of driving continuous
improvement is an area where we will continue to work to create new oppor
to unlock savings by eliminating waste and increasing efficiencies, which is
supported by efforts to expand and further deepen our talent pool. We plan
continue to deploy capital in smart, disciplined ways to develop and acquire
solutions to address our customers' challenges. Finally, we continue to wor
improve cash performance and generate capital to return to our shareholde

Results of Operations

(in millions)	**2018**		2017		2016		2018 v. 2017		20 20
Revenue	**$5,207**		$4,707		$3,771		10.6	%	2
Gross profit	**2,026**		1,847		1,462		9.7	%	2
Gross margin	**38.9**	**%**	39.2	%	38.8	%	(30	)bp	4
Restructuring and realignment costs	**5**		3		3		66.7	%	—
Sensus acquisition related charges	**—**		8		26		NM		(6
Adjusted gross profit	**2,031**		1,858		1,491		9.3	%	2
Adjusted gross margin	**39.0**	**%**	39.5	%	39.5	%	(50	)bp	—
Total operating expenses	**1,372**		1,295		1,054		5.9	%	2
Expense to revenue ratio	**26.3**	**%**	27.5	%	28.0	%	(120	)bp	(5
Restructuring and realignment costs	**(43**	**)**	(38	)	(44	)	13.2	%	(1
Sensus acquisition related charges	**—**		(14	)	(27	)	NM		(4
Special charges	**(12**	**)**	(11	)	(5	)	9.1	%	1
Adjusted operating expenses	**1,317**		1,232		978		6.9	%	2
Adjusted operating expense to revenue ratio	**25.3**	**%**	26.2	%	25.9	%	(90	)bp	3
Operating income	**654**		552		408		18.5	%	3
Operating margin	**12.6**	**%**	11.7	%	10.8	%	90	bp	9
Interest and other non-operating expense (income), net	**69**		76		68		(9.2	)%	1
(Loss)/gain from sale of businesses	**—**		(10	)	—		NM		N
Income tax expense	**36**		136		80		(73.5	)%	7
Tax rate	**6.1**	**%**	29.2	%	23.5	%	(2,310	)bp	5
Net income	**$549**		$330		$260		66.4	%	2

NM Not Meaningful

2018 versus 2017

Revenue

Revenue generated for 2018 was $5,207 million, an increase of $500 million 10.6%, compared to $4,707 million in 2017. On a constant currency basis, r grew 10.1% during 2018. This increase in revenue at constant currency was primarily driven by an increase in organic revenue of $390 million reflecting organic growth across all major regions, with the vast majority of growth co from North America, the emerging markets, particularly in China and Latin America, as well as in western Europe. Acquisition revenue of $111 million contributed to the increase, partially offset by a reduction in revenue related divestitures of $24 million during the period.

The following table illustrates the impact on 2018 revenue from organic grow recent acquisitions and divestitures, and foreign currency translation in relat revenue:

	Water Infrastructure		**Applied Water**		**Measurement & Control Solutions**		**To**
(in millions)	$ Change	% Change	$ Change	% Change	$ Change	% Change	$ C

2017 Revenue	$2,004		$1,421		$1,282		$4
Organic Growth	176	8.8 %	113	8.0 %	101	7.9 %	39
Acquisitions/(Divestitures)	—	— %	(10)	(0.7)%	97	7.6 %	87
Constant Currency	176	8.8 %	103	7.2 %	198	15.4%	47
Foreign currency translation (a)	(4)	(0.2)%	10	0.7 %	17	1.3 %	23
Total change in revenue	172	8.6 %	113	8.0 %	215	16.8%	50
2018 Revenue	**$2,176**		**$1,534**		**$1,497**		**$5**

(a) Foreign currency translation impact for the year primarily due to strength in the value of th British Pound, Chinese Yuan and various other currencies against the U.S. Dollar. This in partially offset by the weakening in value of the Argentine Peso, Indian Rupee, Swedish K Australian dollar against the U.S. Dollar.

Water Infrastructure

Water Infrastructure's revenue increased$172 million, or 8.6%, in 2018 (8.8 increase on a constant currency basis) compared to 2017. Revenue was ne impacted by $4 million of foreign currency translation, with the change at co currency coming entirely from organic growth during the year of $176 million 8.8%. Organic growth for the year was driven by strength in the utility end m across all geographic regions, with particularly strong growth coming from t emerging markets, especially China, as well as from the United States. Org growth during the year was also driven by strength in the industrial end mar primarily in North America and Europe, while emerging market industrial str Latin America was partially offset by declines in Asia Pacific due to the lapp large ozone project delivery in China last year.

From an application perspective, organic revenue growth for the year was la attributable to our transport application. The transport application grew due strength across all geographic regions. Growth in North America was driven modest share gains and continued focus by utility customers on improving infrastructure, as well as strong dewatering rental sales and oil and gas grow Project deliveries in western Europe and product localization in China also contributed to the transport application growth during the period with China 35.6% organic growth for the year. Organic revenue from our treatment app also contributed significantly to the segment's growth across all regions, par from strong utility project deliveries in China, with 42.1% growth for the year

Applied Water

Applied Water's revenue increased$113 million, or 8.0%, in 2018, with reve benefiting from $10 million of foreign currency translation during the year. T revenue growth at constant currency was $103 million, or 7.2%, and consist organic growth of $113 million, or 8.0%, partially offset by $10 million of red in revenue related to divestitures. Organic growth for the year was driven pr by strength in the commercial and industrial end markets, primarily in the Un States and Asia Pacific, as well as modest growth in the residential end mar

From an application perspective, commercial building services revenue was primarily driven by distributor strength and commercial building construction growth, coupled with price realization, in the United States and project deployments in China and India. Organic revenue growth in the industrial w application was driven primarily by recovery in large project business and he general industrial demand in the United States, as well as strong strength in emerging markets, particularly China and Latin America. Residential buildin services also had modest organic growth, primarily from strength in western Europe, partially offset by declines in Asia Pacific.

Measurement & Control Solutions

Measurement & Control Solutions revenue increased $215 million, or 16.8% 2018 (15.4% increase on a constant currency basis), with revenue benefitin $17 million of foreign currency translation during the year. Revenue growth constant currency consisted of revenue contributed by acquisitions of $111 and organic revenue growth of $101 million, or 7.9%, which was partially off $14 million of reduction in revenue related to divestitures during the year. O

revenue growth for the year was primarily driven by strength in the utility en
market in North America.

From an application perspective, organic revenue from the gas application contributed the most organic growth for the segment, driven entirely by larg project deployments in North America. The water application also drove org growth, with large project deployments and increased water shipments in th Unites States and Asia Pacific, partially offset by declines in Europe. Softwa service & other also had significant growth from large deployments in the U States and the United Kingdom. Additional organic revenue growth came fr test application, which saw growth in both the utility and industrial end mark primarily in western Europe and the United States, partially offset by decline emerging markets. The electric application also had modest organic growth North America during the year.

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Orders/Backlog

	Water Infrastructure		Applied Water		Measurement & Control Solutions		Total
(in millions)	$ Change	% Change	$ Change	% Change	$ Change	% Change	$ Cha
2017 Orders	$2,112		$1,476		$1,280		$4,8
Organic Growth	140	6.6%	83	5.6 %	231	18.0%	454
Acquisitions/(Divestitures)	—	— %	(12)	(0.8)%	100	7.8 %	88
Constant Currency	140	6.6%	71	4.8 %	331	25.9%	542
Foreign currency translation (a)	3	0.1%	10	0.7 %	14	1.1 %	27
Total change in revenue	143	6.8%	81	5.5 %	345	27.0%	569
2018 Orders	**$2,255**		**$1,557**		**$1,625**		**$5,4**

(a) Foreign currency translation impact for the year primarily due to strength in the value of th British Pound, Chinese Yuan and various other currencies against the U.S. Dollar. This in partially offset by the weakening in value of the Argentine Peso, Indian Rupee, Swedish K Australian dollar against the U.S. Dollar.

Orders received during 2018 increased by $569 million, or 11.7%, to $5,437 (11.1% increase on a constant currency basis). Order growth was favorably impacted by $27 million of foreign currency translation during the year. The increase on a constant currency basis included organic order growth of $45 million, or 9.3%, over the prior year. Orders from acquisitions of $115 million contributed to the growth at constant currency, partially offset by a reduction orders related to divestitures of $27 million during the year.

Water Infrastructure segment orders increased $143 million, or 6.8%, to $2, million (6.6% increase on a constant currency basis). Orders growth for the segment benefited from $3 million of foreign currency translation for the yea order increase on a constant currency basis consisted entirely of an increas organic orders. Organic orders grew in both of the segment applications. Th treatment application had very strong order intake, driven by orders in China United States and India. Transport order growth was driven by increased str in North America, primarily from dewatering rental and equipment orders alo overall strong market conditions, and order strength in Europe. Transport or growth during the year was partially offset by custom pump project timing in

Orders increased in our Applied Water segment by $81 million, or 5.5%, to $ million (4.8% increase on a constant currency basis). Orders growth for the segment benefited from $10 million of foreign currency translation for the ye order increase on a constant currency basis included organic order growth o million, or 5.6%, driven by strong commercial and industrial performance in United States, as well as modest strength in Europe and the emerging mark partially offset by the reduction in orders from divestitures of $12 million.

Orders increased in our Measurement & Control Solutions segment by $345 million, or 27.0%, to $1,625 million (25.9% increase on a constant currency Orders growth for the segment benefited from $14 million of foreign currenc translation for the year. The order increase on a constant currency basis inc orders from recent acquisitions of $115 million, partially offset by the reducti orders from divestitures of $15 million, and organic order growth of $231 mi 18.0%. Organic order growth primarily driven by orders within the water app

in North America and a large order in India. The gas and software as a serv
other applications also had strong organic order growth in North America as
Asia Pacific, while electric orders were only slightly up for the year.
Backlog includes contractual customer commitments as well as orders on h
of the end of the period. Delivery schedules vary from customer to custome
upon their requirements. Annual or multi-year contracts are subject to resch
and cancellation by customers due to the long-term nature of the contracts.
such, beginning total backlog, plus orders, minus revenues will not equal en
total backlog due to contract adjustments, foreign currency fluctuations and
factors. Typically, large projects require longer lead production cycles and
deployment schedules, and delays can occur from time to time. Total backlo
$1,689 million at December 31, 2018 and $1,513 million at December 31, 20
increase of 11.6%. This year over year increase in backlog of $176 million in
approximately $42 million of backlog from 2018 acquisitions. We anticipate
approximately 65% of our total backlog at December 31, 2018 will be recogn
as revenue during 2019.

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Gross Margin

Gross margins as a percentage of consolidated revenue decreased 30 basi to 38.9% in 2018 as compared to 39.2% in 2017. The gross margin decreas primarily driven by the negative impact of cost inflation, unfavorable mix, inc amortization of external sale software, net negative currency impacts and pu accounting impacts. These unfavorable impacts were partially offset by cost reductions from global procurement and productivity improvement initiatives realization, and reductions in Sensus acquisition related costs and realignm costs.

Operating Expenses

(in millions)	2018		2017		C
Selling, general and administrative expenses ("SG&A")	**$1,161**		$1,089		6
SG&A as a % of revenue	**22.3**	**%**	23.1	%	(
Research and development expenses ("R&D")	**189**		181		4
R&D as a % of revenue	**3.6**	**%**	3.8	%	(
Restructuring and asset impairment charges	**22**		25		(
Operating expenses	**$1,372**		$1,295		5
Expense to revenue ratio	**26.3**	**%**	27.5	%	(

Selling, General and Administrative Expenses

SG&A increased by $72 million (increase of 6.6%) to 22.3% of revenue in 2(compared to 23.1% of revenue in 2017. The improvement in SG&A as a per revenue for the year was primarily driven by favorable volume impacts, part offset by the absence of Sensus acquisition related charges that did not rec 2018. Additional SG&A from recent acquisitions also added to the increase SG&A expenses as compared to the prior year.

Research and Development Expenses

R&D spending was $189 million, or 3.6% of revenue, in 2018 as compared million, or 3.8% of revenue, in 2017. Additionally, we capitalized R&D on ex sale software of $60 million in 2018 as compared to $46 million in 2017. Ou increased spending on R&D is driven by our continued commitment to innov and technology development.

Restructuring Charges and Asset Impairment

Restructuring Charges

During 2018, we incurred restructuring costs of $9 million, $2 million and $9 in our Water Infrastructure, Applied Water and Measurement & Control Solu segments, respectively. We incurred these charges related to actions taken primarily as a continuation of our efforts to reposition our European and Nor American businesses to optimize our cost structure and improve our operat efficiency and effectiveness. The charges included the reduction of headcou consolidation of facilities within our Measurement & Control Solutions and W Infrastructure segments, as well as headcount reductions within our Appliec segment.

During 2017, we recognized restructuring costs of $7 million, $8 million and million in our Water Infrastructure, Applied Water and Measurement & Cont Solutions, respectively. These charges were incurred primarily in an effort to realign our organizational structure in Europe and North America to optimize cost structure. The charges included the reduction of headcount and consol of facilities within our Applied Water and Water Infrastructure segments, as headcount reductions within our Measurement & Control Solutions segment

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The following table presents expected restructuring spend:

(in millions)	Water Infrastructure	Applied Water	Measurement & Control Solutions	Corporate	Tota
Actions Commenced in 2018:					
Total expected costs	$ 9	$ 1	$ 7	$ —	$1
Costs incurred during 2018	7	1	7	—	15
Total expected costs remaining	**$ 2**	**$ —**	**$ —**	**$ —**	**$2**
Actions Commenced in 2017:					
Total expected costs	$ 18	$ 12	$ 3	$ —	$3
Costs incurred during 2017	5	4	2	—	11
Costs incurred during 2018	2	1	1	—	4
Total expected costs remaining	**$ 11**	**$ 7**	**$ —**	**$ —**	**$1**
Actions Commenced in 2016:					
Total expected costs	$ 13	$ 14	$ 10	$ 2	$3
Costs incurred during 2016	11	10	6	2	29
Costs incurred during 2017	2	4	3	—	9
Costs incurred during 2018	—	—	1	—	1
Total expected costs remaining	**$ —**	**$ —**	**$ —**	**$ —**	**$—**

The Water Infrastructure, Applied Water, and Measurement & Control Solut actions commenced in 2018 consist primarily of severance charges and are expected to continue through the third quarter of 2019. The Water Infrastruc Applied Water, and Measurement & Control Solutions actions commenced i consist primarily of severance charges and are expected to continue throug second quarter of 2020. The Water Infrastructure, Applied Water, Measurer Control Solutions and Corporate actions commenced in 2016 consist primar severance charges and are complete. As a result of the actions initiated in 2 we achieved savings of approximately $2 million in 2018 and estimate annu future net savings beginning in 2019 of approximately $7 million, resulting ir million of incremental savings from the 2018 actions.

Asset Impairment Charges

During the fourth quarter of 2018 we determined that certain software asset our Water Infrastructure segment were impaired. Accordingly we recognizec impairment charge of $2 million.

During the first quarter of 2017 we determined that certain assets within our Applied Water segment, including a tradename, were impaired. Accordingly recognized an impairment charge of $5 million. Refer to Note 11, "Goodwill Other Intangible Assets," for additional information.

Operating Income

We generated operating income of $654 million (operating margin of 12.6% 2018, reflecting an increase of $102 million, or 18.5%, when compared to op income of $552 million (operating margin of 11.7%) during the prior year. Th increase in operating margin was primarily due to cost reductions resulting f our global procurement and productivity initiatives, favorable volume impact price realization and a decrease in Sensus acquisition related costs. These favorable impacts on operating margin were partially offset by cost inflation increases, increased spending on strategic investments, unfavorable mix, a increase in restructuring and realignment costs and an increase in special c Purchase accounting impacts also negatively affected operating margin.

Adjusted operating income was $714 million (adjusted operating margin of 1
for 2018, reflecting an increase of $88 million, or 14.1%, when compared to
adjusted operating income of $626 million (adjusted operating margin of 13.
during the prior year. The increase in adjusted operating margin was mostly
the same factors impacting operating income, except for the decrease in Se
acquisition related costs, the increase in restructuring and realignment costs
the increase in special charges as these costs were not included in adjusted
operating income.

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

(In millions)	2018	2017	Change	
Water Infrastructure				
Operating income	**$359**	$312	15.1	%
Operating margin	***16.5 %***	*15.6 %*	*90*	*bp*
Restructuring and realignment costs	**20**	16	25.0	%
Special charges	**2**	—	NM	
Adjusted operating income	**$381**	$328	16.2	%
Adjusted operating margin	***17.5 %***	*16.4 %*	*110*	*bp*
Applied Water				
Operating income	**$236**	$194	21.6	%
Operating margin	***15.4 %***	*13.7 %*	*170*	*bp*
Restructuring and realignment costs	**10**	17	(41.2)	%
Special charges	**—**	5	(100.0)	%
Adjusted operating income	**$246**	$216	13.9	%
Adjusted operating margin	***16.0 %***	*15.2 %*	*80*	*bp*
Measurement & Control Solutions				
Operating income	**$118**	$110	7.3	%
Operating margin	***7.9 %***	*8.6 %*	*(70)*	*bp*
Sensus acquisition related costs	**—**	15	(100.0)	%
Restructuring and realignment costs	**18**	8	125.0	%
Special charges	**5**	—	NM	
Adjusted operating income	**$141**	$133	6.0	%
Adjusted operating margin	***9.4 %***	*10.4 %*	*(100)*	*bp*
Corporate and other				
Operating loss	**$(59)**	$(64)	(7.8)	%
Sensus acquisition related costs	**—**	7	(100.0)	%
Special charges	**5**	6	(16.7)	%
Adjusted operating loss	**$(54)**	$(51)	5.9	%
Total Xylem				
Operating income	**$654**	$552	18.5	%
Operating margin	***12.6 %***	*11.7 %*	*90*	*bp*
Restructuring and realignment costs	**48**	41	17.1	%
Sensus acquisition related costs	**—**	22	(100.0)	%
Special charges	**12**	11	9.1	%
Adjusted operating income	**$714**	$626	14.1	%
Adjusted operating margin	***13.7 %***	*13.3 %*	*40*	*bp*

NM Not Meaningful

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Water Infrastructure

Operating income for our Water Infrastructure segment increased $47 millio 15.1%, with operating margin also increasing from 15.6% to 16.5%, a 90 ba point increase as compared to the prior year. Operating margin was negativ impacted year over year by increased restructuring and realignment costs o million and special charges of $2 million incurred in 2018. Excluding these it adjusted operating income increased $53 million, or 16.2%, with adjusted op margin increasing from 16.4% to 17.5%, a 110 basis point increase as comp the prior year. The increase in adjusted operating margin was primarily due reductions from our global procurement and productivity initiatives, favorabl volume and price realization, which were partially offset by cost inflation, unfavorable mix, increased spending on strategic investments and negative currency impacts.

Applied Water

Operating income for our Applied Water segment increased $42 million, or 2 with operating margin also increasing from 13.7% to 15.4%, a 170 basis poi increase as compared to the prior year. Operating margin was positively imp by special charges of $5 million incurred in 2017 that did not recur and decr restructuring and realignment costs of $7 million in 2018. Excluding these ite adjusted operating income increased $30 million, or 13.9%, with adjusted op margin increasing from 15.2% to 16.0%, an 80 basis point increase as comp the prior year. The increase in adjusted operating margin was primarily due reductions from our global procurement and productivity initiatives, favorabl volume and price realization, which were partially offset by cost inflation, ne transactional currency impacts and unfavorable mix.

Measurement & Control Solutions

Operating income for our Measurement & Control Solutions segment increa million, or 7.3%, with operating margin decreasing from 8.6% to 7.9%, a 70 point decrease as compared to the prior year. Operating margin was negati impacted by an increase of $10 million in restructuring and realignment cost $5 million in special charges incurred in 2018. This impact was offset by $15 of Sensus acquisition related costs incurred during the year in 2017 that did recur. Excluding these items, adjusted operating income increased $8 millio 6.0%, with adjusted operating margin decreasing from 10.4% to 9.4%, a 10 point decrease as compared to the prior year. The decrease in adjusted op margin was primarily due to increases in cost inflation, spending on strategi investments and unfavorable mix impacts due to large energy project deplo Purchase accounting impacts also negatively affected operating margin. Th impacts were partially offset by favorable volume and price realization and c reductions from our global procurement and productivity initiatives.

Corporate and other

Operating expense for corporate and other decreased $5 million, or 7.8%, compared to the prior year, primarily due to a reduction of Sensus acquisitio related costs and special charges. Excluding these costs, adjusted operatin expense increased $3 million, or 5.9%, compared to the prior year, mostly c by an increase in employee related, non-cash share-based compensation c

Interest Expense

Interest expense remained constant at $82 million for both 2018 and 2017. S Note 14, "Credit Facilities and Debt" of our consolidated financial statement description of our credit facilities and long-term debt and related interest.

Income Tax Expense

Tax Act

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the "Tax Ac Tax Act makes broad and complex changes to the U.S. tax code. As noted year end, we reasonably estimated certain effects and, therefore, as permit SAB 118, recorded provisional estimates associated with the reduction of U federal corporate tax rate and deemed repatriation transition tax. Our accou for the reduction of U.S. federal corporate tax rate is complete. We recorde provisional tax benefit for corporate tax rate reduction of $107 million as of December 31, 2017. Upon further analysis of our deferred tax assets and lia we recognized a measurement-period adjustment of $1.5 million as an addi decrease of the net deferred tax liabilities and recorded a corresponding de tax benefit of $1.5 million during the period ended December 31, 2018. The of this measurement period adjustment on the 2018 effective tax rate was a 0.3%. A total decrease of the net deferred tax liabilities of $108 million has b recorded for the corporate rate reduction, with a corresponding deferred tax of $108 million.

Our accounting for the Deemed Repatriation Transition Tax ("Transition Tax
complete. We made an estimate of the Transition Tax and recorded a provis
Transition Tax liability of $153 million as of December 31, 2017. On the bas
revised E&P computations that were completed and additional guidance, we
recognized a measurement-period adjustment of a $9 million decrease to th
income tax expense in 2018. The effect of the measurement-period adjustm
the 2018 effective tax rate was approximately 1.6%. A total Transition Tax
obligation to date of $144 million has been recorded, with a corresponding
adjustment of $144 million to income tax expense.

The income tax provision for 2018 was $36 million at an effective tax rate of
compared to $136 million at an effective tax rate of 29.2% in 2017. The 2018
effective tax rate is lower than 2017 primarily due to the impact of an interco
sale of assets, the reduction of the Transition Tax and the reduction of the U
federal corporate rate in 2018, partially offset by the 2017 benefit from the
remeasurement of deferred tax assets and liabilities.

See Note 7, "Income Taxes" of our consolidated financial statements for fur
discussion of the Tax Act.

Other Comprehensive (Loss) Income

Other comprehensive loss was $111 million in 2018 as compared to income
$108 million in 2017. This decrease was primarily driven by unfavorable fore
currency translation impacts due to the weakening of the Euro, Great British
Pound, Canadian Dollar, South African rand, Polish Zloty, Swedish Krona,
amongst other various currencies, against the U.S. Dollar in the current yea
versus strengthening for the same period in the prior year. These decreases
partially offset by the favorable impact from movement in our Euro net inves
hedges. The tax impact on the movement in the net investment hedges also
contributed to the year over year decrease.

2017 versus 2016

Revenue

Revenue generated for 2017 was $4,707 million, an increase of $936 millior
24.8%, compared to $3,771 million in 2016. On a constant currency basis, r
grew 23.9%. This increase in revenue was primarily driven by additional rev
$790 million from acquisitions. There was also strong organic growth of $12
million during the year, driven primarily by North America as well as strengt
emerging markets, particularly in China and India. Additionally, to a lesser e
Europe contributed to this organic growth despite ongoing weakness in the
Kingdom during the year.

The following table illustrates the impact on 2017 revenue from organic grov
recent acquisitions and divestitures, and foreign currency translation in relat
revenue.

	Water Infrastructure		**Applied Water**		**Measurement & Control Solutions**		**Tota**
(in millions)	$ Change	% Change	$ Change	% Change	$ Change	% Change	$ Ch
2016 Revenue	$1,932		$1,393		$446		$3,
Organic Growth	56	2.9%	34	2.4 %	32	7.2 %	122
Acquisitions/(Divestitures)	—	— %	(10)	(0.7)%	790	177.1%	780
Constant Currency	56	2.9%	24	1.7 %	822	184.3%	902
Foreign currency translation (a)	16	0.8%	4	0.3 %	14	3.1 %	34

Total change in revenue	72	3.7%	28	2.0 %	836	187.4%	936
2017 Revenue	**$2,004**		**$1,421**		**$1,282**		**$4,**

(a) Foreign currency translation impact primarily due to strength in the value of the Euro, Car dollar, Russian Ruble, Australian dollar, South African Rand and various other currencies offset by weakness in the British Pound against the U.S. Dollar.

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Water Infrastructure

Water Infrastructure’s revenue increased $72 million, or 3.7%, in 2017 (2.9% increase on a constant currency basis) compared to 2016. Revenue benefit $16 million of foreign currency translation for the year and included organic of $56 million, or 2.9%.

Organic growth for the year was driven by strength in the industrial end mar and to a lesser extent in the utility end market. The growth in both of these e markets was driven by strength from Asia Pacific and North America.

From an application perspective, organic revenue growth was driven primar our transport application. The transport application grew in the industrial enc market due to strength in the dewatering business which benefited from the recovery of the industrial construction market, particularly within the distribu channel and recovery of oil and gas and mining markets in North America a Latin America. The transport application also grew in the utility end market d by increased municipal spending in North America and increased projects ir Middle East and India. Organic revenue from our treatment application also contributed to the segment's growth primarily from growth in China from ind treatment project deliveries as well as growth in Europe from municipal trea projects.

Applied Water

Applied Water’s revenue increased $28 million, or 2.0%, in 2017 (1.7% incre a constant currency basis) compared to 2016. Revenue benefited from $4 n of foreign currency translation for the year and the constant currency increa included organic growth of $34 million, or 2.4%.

Organic growth for the year was driven by strength in the residential and commercial end markets in the United States, Asia Pacific and western Eur which were partially offset by declines in the industrial market.

From an application perspective, growth in residential building services was primarily driven by strength in the United States, where we benefited from th timing of promotions and market share gains, and continued strength in Asi Pacific. Commercial building services also grew, primarily in North America, western Europe and Asia Pacific, driven by new product traction and sales c investments. This growth was partially offset by a decline in industrial applic primarily driven by unfavorable weather conditions impacting the agriculture business in the United States, partially offset by strength in western Europe

Measurement & Control Solutions

Measurement & Control Solutions revenue increased $836 million, or 187.4 2017 (184.3% on a constant currency basis) compared to 2016. The revenu increase for the year was almost entirely from $790 million of revenue relate acquisitions that we did not have in the prior year. Most of the additional rev contributed by the Sensus business was generated in the United States with additional revenue coming primarily from western Europe and China. The m of the Sensus business revenue came from water applications with gas and electric applications making up most of the remaining sales for the year. Org revenue growth in the Measurement & Control Solutions segment was $32 or 7.2%, for the year. Organic growth was driven primarily by growth across applications, except electric which had slight declines. Much of the organic r increase was in the water application, which had increased AMI deploymen North America as well as higher demand for iPerl product in eastern Europe the Middle East. Organic revenue also increased in the gas application, prir

due to AMI deployments in North America, as well as in the software and se
application, primarily driven by a couple of major contract upgrades. The tes
application also contributed to the increase in organic revenue as a result of
strength from the environmental monitoring business in the United States.

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Orders/Backlog

	Water Infrastructure		Applied Water		Measurement & Control Solutions		Tota
(in millions)	$ Change	% Change	$ Change	% Change	$ Change	% Change	$ Ch
2016 Orders	$1,957		$1,405		$462		$3,
Organic Growth	139	7.1%	79	5.6 %	42	9.1 %	26(
Acquisitions/(Divestitures)	—	— %	(11)	(0.8)%	762	164.9%	75
Constant Currency	139	7.1%	68	4.8 %	804	174.0%	1,0
Foreign currency translation (a)	16	0.8%	3	0.2 %	14	3.0 %	33
Total change in revenue	155	7.9%	71	5.1 %	818	177.1%	1,0
2017 Orders	**$2,112**		**$1,476**		**$1,280**		**$4,**

(a) Foreign currency translation impact primarily due to strength in the value of the Euro, Car dollar, Russian Ruble, Australian dollar, South African Rand and various other currencies offset by weakness in the British Pound against the U.S. Dollar.

Orders received during 2017 increased by $1,044 million, or 27.3%, to $4,8 million (26.4% increase on a constant currency basis). The order growth on constant currency basis was primarily driven by additional orders from recen acquisitions, primarily Sensus, of $762 million. Organic order growth was $2 million, or 6.8%, over the prior year.

Water Infrastructure segment orders increased $155 million, or 7.9%, to $2, million (7.1% growth on a constant currency basis). Orders benefited from $ million of foreign currency translation for the year and included organic grow $139 million, or 7.1%. The majority of the organic order growth for the segm came from the transport application, driven by the utility sector in the United as well as strong project orders in China and India. Additionally, dewatering distributor orders increased driven by storm related activity and the strength of the oil and gas markets. Treatment applications also had strong order inta primarily from projects in the emerging markets, Latin America and North Ar

Orders increased in our Applied Water segment by $71 million, or 5.1%, to $ million (4.8% increase on a constant currency basis). The order increase wa primarily due to organic order growth of $79 million, or 5.6%, driven by stren the emerging markets and strong commercial building and industrial perforn in North America, which was partially offset by the loss of orders related to c businesses of $11 million.

Orders increased in our Measurement & Control Solutions segment by $818 million, or 177.1%, to $1,280 million (174.0% growth on a constant currency This increase included orders from recent acquisitions, primarily Sensus, of million and organic order growth of $42 million, or 9.1%, primarily from Sens order increases in North America for most applications, as well as increased from test application strength in the United States and China.

Backlog includes contractual customer commitments as well as orders on h of the end of the period. Delivery schedules vary from customer to custome upon their requirements. Annual or multi-year contracts are subject to resch and cancellation by customers due to the long-term nature of the contracts. such, beginning total backlog, plus orders, minus revenues will not equal en total backlog due to contract adjustments, foreign currency fluctuations and factors. Typically, large projects require longer lead production cycles and deployment schedules, and delays can occur from time to time. Total backlo $1,513 million at December 31, 2017 and $1,292 million at December 31, 2

increase of 17%. The December 31, 2016 backlog balance has been revise
include contractual agreements that Sensus has with customers that do not
minimum commitments but which we believe will be executed upon over the
of the contracts. This year over year increase in backlog of $221 million is d
strong order growth in the fourth quarter across all of our segments as well
benefits from currency translation impacts. We anticipate that over 60% of c
backlog at December 31, 2017 will be recognized as revenue during 2018.

Gross Margin

Gross margins as a percentage of consolidated revenue increased to 39.2%
2017 from 38.8% in 2016. The gross margin increase was primarily due to t
benefits realized from cost reductions from global procurement and continuo
improvement initiatives, as well as a decrease in the inventory step-up char
Sensus in 2017. These positive impacts on gross margin were partially offse
cost inflation and unfavorable product mix.

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Operating Expense

(in millions)	2017	2016	Change
Selling, general and administrative expenses	**$1,089**	$914	19.1 %
SG&A as a % of revenue	**23.1 %**	24.2 %	(110)bp
Research and development expenses	**181**	110	64.5 %
R&D as a % of revenue	**3.8 %**	2.9 %	90 bp
Restructuring and asset impairment charges	**25**	30	(16.7)%
Operating expenses	**$1,295**	$1,054	22.9 %
Expense to revenue ratio	**27.5 %**	28.0 %	(50)bp

Selling, General and Administrative Expenses

SG&A increased by $175 million (increase of 19.1%) to 23.1% of revenue in as compared to 24.2% of revenue in 2016. The increase in SG&A expenses includes approximately $160 million of incremental SG&A spending for the S business that we did not have prior to the acquisition in the fourth quarter of The remaining increases in SG&A expenses were primarily due to inflation, investments in regional sales channels and operational capabilities and fore currency impacts, which were partially offset by savings from restructuring a other cost actions.

Research and Development Expenses

R&D spending increased $71 million or 64.5% to 3.8% of revenue in 2017 a compared to 2.9% of revenue in 2016 primarily due to additional R&D spen our recent acquisitions and investments in new products and technologies.

Restructuring Charges

Restructuring Charges

During 2017, we incurred restructuring costs of $7 million, $8 million and $5 in our Water Infrastructure, Applied Water and Measurement & Control Solu segments, respectively. We incurred these charges related to actions taken 2017 primarily as a continuation of our efforts to reposition our European ar American businesses to optimize our cost structure and improve our operat efficiency and effectiveness. The charges included the reduction of headcou consolidation of facilities within our Applied Water and Water Infrastructure segments, as well as headcount reductions within our Measurement & Cont Solutions segment.

During 2016, we recognized restructuring costs of $12 million, $10 million, $ million and $2 million in our Water Infrastructure, Applied Water, Measurem Control Solutions and Corporate, respectively. These charges were incurred primarily in an effort to realign our organizational structure in Europe and No America to optimize our cost structure. The charges relate to the reduction i structural costs, including a decrease in headcount and consolidation of fac

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The following table presents expected restructuring spend:

(in millions)	Water Infrastructure	Applied Water	Measurement & Control Solutions	Corporate	Tota
Actions Commenced in 2017:					
Total expected costs	$ 18	$ 12	$ 3	$ —	$33
Costs incurred during 2017	5	4	2	—	11
Total expected costs remaining	**$ 13**	**$ 8**	**$ 1**	**$ —**	**$22**
Actions Commenced in 2016:					
Total expected costs	$ 13	$ 14	$ 10	$ 2	$39
Costs incurred during 2016	11	10	6	2	29
Costs incurred during 2017	2	4	3	—	9
Total expected costs remaining	**$ —**	**$ —**	**$ 1**	**$ —**	**$1**

The Water Infrastructure, Applied Water, Measurement & Control Solutions, Corporate actions commenced in 2017 consist primarily of severance charg are expected to continue through the end of 2018. The Water Infrastructure Applied Water, Measurement & Control Solutions and Corporate actions commenced in 2016 consist primarily of severance charges and are largely complete. The Water Infrastructure, Applied Water and Measurement & Cor Solutions actions commenced in 2015 consist primarily of severance charge are complete. As a result of these actions initiated in 2017, we achieved sav approximately $4 million in 2017 and estimate annual future net savings beg in 2018 of approximately $15 million, resulting in $11 million of incremental from the 2017 actions.

Asset Impairment Charges

During the first quarter of 2017 we determined that certain assets within our Applied Water segment, including a tradename, were impaired. Accordingly recognized an impairment charge of $5 million. Refer to Note 11, "Goodwill Other Intangible Assets," for additional information.

Operating Income

We generated operating income of $552 million (operating margin of 11.7% 2017, reflecting an increase of $144 million, or 35.3%, when compared to op income of $408 million (operating margin of 10.8%) during the prior year. Th increase in operating income was largely driven by the inclusion of Sensus operating income for the full year in 2017. Sensus acquisition related costs restructuring and realignment costs decreased $31 million and $6 million, respectively, while special charges increased $6 million when compared to prior year period. Excluding these costs, adjusted operating income was $6 million (adjusted operating margin of 13.3%) for 2017 as compared to $513 (adjusted operating margin of 13.6%) for 2016. The decrease in adjusted op margin was mostly due to cost inflation increases, increased spending on st investments and Sensus purchase accounting impacts, which were largely by cost savings from our global procurement and productivity initiatives and restructuring savings. The non-cash Sensus purchase accounting impact or adjusted operating margin for the year was 50 basis points.

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

(In millions)	**2017**	2016	Change	
Water Infrastructure				
Operating income	$312	$295	5.8	%
Operating margin	*15.6 %*	*15.3 %*	*30*	*bp*
Restructuring and realignment costs	16	16	—	%
Special charges	—	2	(100.0)	%
Adjusted operating income	$328	$313	4.8	%
Adjusted operating margin	*16.4 %*	*16.2 %*	*20*	*bp*
Applied Water				
Operating income	$194	$188	3.2	%
Operating margin	*13.7 %*	*13.5 %*	*20*	*bp*
Restructuring and realignment costs	17	16	6.3	%
Special charges	5	—	NM	
Adjusted operating income	$216	$204	5.9	%
Adjusted operating margin	*15.2 %*	*14.6 %*	*60*	*bp*
Measurement & Control Solutions				
Operating income	$110	$—	NM	
Operating margin	*8.6 %*	*— %*	NM	
Sensus acquisition related costs	15	25	(40.0)	%
Restructuring and realignment costs	8	13	(38.5)	%
Special charges	—	$3	(100.0)	%
Adjusted operating income	$133	$41	224.4	%
Adjusted operating margin	*10.4 %*	*9.2 %*	*120*	*bp*
Corporate and other				
Operating loss	$(64)	$(75)	(14.7)	%
Restructuring and realignment costs	—	2	(100.0)	%
Sensus acquisition related costs	7	28	(75.0)	%
Special charges	6	—	NM	
Adjusted operating loss	$(51)	$(45)	13.3	%
Total Xylem				
Operating income	$552	$408	35.3	%
Operating margin	*11.7 %*	*10.8 %*	*90*	*bp*
Restructuring and realignment costs	41	47	(12.8)	%
Sensus acquisition related costs	22	53	(58.5)	%
Special charges	11	5	120.0	%
Adjusted operating income	$626	$513	22.0	%
Adjusted operating margin	*13.3 %*	*13.6 %*	*(30)*	*bp*

NM Not Meaningful

Water Infrastructure

Operating income for our Water Infrastructure segment increased $17 millio 5.8%, with operating margin also increasing from 15.3% to 15.6%, a 30 bas increase as compared to the prior year. Operating margin was positively imp year over year by special charges of $2 million in 2016 that did not recur, wh restructuring and realignment costs remained flat. Excluding these items, ad operating income increased $15 million, or 4.8%, with adjusted operating m increasing from 16.2% to 16.4%, a 20 basis point increase as compared to prior year. The increase in adjusted operating margin was primarily due to c reductions from global procurement and continuous improvement initiatives as restructuring savings and favorable volume. These drivers were partially by increases in cost inflation and spending on strategic investments, as wel unfavorable transactional foreign currency impacts.

Applied Water

Operating income for our Applied Water segment increased $6 million, or 3. with operating margin also increasing from 13.5% to 13.7%, a 20 basis poin increase as compared to the prior year. Operating margin was negatively im by higher special charges for a non-cash impairment of $5 million and a $1 increase in restructuring and realignment costs. Excluding these items, adju operating income increased $12 million, or 5.9%, with adjusted operating m increasing from 14.6% to 15.2%, an 60 basis point increase as compared to prior year. The increase in adjusted operating margin was primarily due to c reductions from global procurement and continuous improvement initiatives restructuring savings, which were partially offset by increases in cost inflatio unfavorable mix and the impact from the change in accounting for pension c

Measurement & Control Solutions

Operating income for our Measurement & Control Solutions segment increa $110 million (operating margin of 8.6%) for the year as compared to operati income and margin of zero in 2016. Operating margin was positively impact decreases in Sensus acquisition related costs, restructuring and realignmen and special charges of $10 million, $5 million and $3 million, respectively. Excluding these items, adjusted operating income increased $92 million, or 224.4%, with most of the increase coming from the inclusion of the increme adjusted operating income for Sensus in 2017. Adjusted operating margin increased from 9.2% to 10.4%, a 120 basis point increase as compared to t year. The increase in adjusted operating margin was primarily due to cost reductions from global procurement and continuous improvement initiatives restructuring savings and favorable volume impacts. These drivers were pa offset by the inclusion of Sensus margins, which were negatively impacted b purchase accounting. Non-cash Sensus purchase accounting negatively im the segment's full year adjusted operating margin by 200 basis points.

Corporate and other

Operating expense for corporate and other decreased $11 million, or 14.7% compared to the prior year, primarily due to a $21 million decrease in Sensu acquisition related costs and a $2 million decrease in restructuring and reali costs. This was partially offset by $6 million of special charges incurred duri year which we did not have in the prior year. Excluding these costs, adjuste operating expense increased $6 million compared to the prior year, driven m by employee related costs as well as the impact from the change in accoun pension costs.

Interest Expense

Interest expense was $82 million and $70 million for 2017 and 2016, respec
The increased interest expense for the year includes additional interest exp
2017 related to debt entered into in the fourth quarter of 2016 to fund our
acquisition of Sensus. The increase in interest expense was partially offset
reduction in special interest charges incurred in 2016 of $8 million in connec
with the early extinguishment of our Senior Notes due in 2016 and $5 millior
financing charges on the bridge loan related to the Sensus acquisition, neith
which recurred in 2017, as well as a lower interest rate on the Senior Notes
2023 which effectively replaced the Senior Notes due in 2016. See Note 14
Facilities and Debt" of our consolidated financial statements for a descriptio
credit facilities and long-term debt and related interest.

Income Tax Expense

The income tax provision for 2017 was $136 million at an effective tax rate o
29.2% compared to $80 million at an effective tax rate of 23.5% in 2016. Th
effective tax rate is higher than 2016 due to the provisional one time deeme
repatriation transition tax under the newly enacted Tax Cuts and Jobs Act, p
offset by the benefit from the remeasurement of deferred tax assets and liab
and the release of valuation allowances.

See Note 7, "Income Taxes" of our consolidated financial statements for fur
discussion of the Tax Act.

Other Comprehensive Income

Other comprehensive income was $108 million in 2017 as compared to an $ million loss in 2016. This increase was driven primarily by favorable foreign currency translation impacts, primarily due to the strengthening of the Euro, British Pound, Chinese Yuan, Polish Zloty, amongst other various currencie against the U.S. Dollar as compared to the weakening of these same curren the prior year. Partially offsetting these favorable movements, was the Euro movement on the Company's net investment hedge as compared to the prio The tax impact on the foreign currency translation related to the net investm hedge also contributed to the year over year increase. Finally, year over yea movement in foreign currency translation on postretirement benefit plans pa offset the increase in other comprehensive income.

Liquidity and Capital Resources

The following table summarizes our sources and uses of cash:

	Year Ended December 31,		
(in millions)	**2018**	2017	2016
Operating activities	**$586**	$686	$497
Investing activities	**(643)**	(181)	(1,886)
Financing activities	**(40)**	(421)	1,034
Foreign exchange (a)	**(21)**	22	(17)
Total	**$(118)**	$106	$(372)

(a) 2018 impact is primarily due to the weakness of the Chinese Yuan, Argentine Peso, India and various other currencies against the U.S. Dollar. 2017 impact is primarily due to the strengthening of the Euro and the Chinese Yuan against the U.S. Dollar. 2016 impact is p due to the weakness of the Euro and the Chinese Yuan against the U.S. dollar.

Sources and Uses of Liquidity

Operating Activities

During 2018, net cash provided by operating activities was $586 million, com to $686 million in 2017. The $100 million year-over-year decrease was prim driven by an increased use of working capital for inventory, which was built year end to maintain service levels impacted by component shortages as w make strategic purchases to manage tariff impacts. Operating cash also dec during the period as a result of increased receivables from higher growth lev These negative impacts to operating cash flow were partially offset by incre cash from earnings during the year.

During 2017, net cash provided by operating activities was $686 million, com to $497 million in 2016. The $189 million year-over-year increase was prima driven by increased cash from operating activities of the Sensus business a in the fourth quarter of 2016 and strong operating cash performance across rest of the business.

Investing Activities

Cash used in investing activities was $643 million in 2018, compared to $18 million in 2017. This increase of $462 million was primarily driven by the $43 million spent on 2018 acquisitions, primarily the acquisition of Pure Technol Ltd., versus the $33 million spent for various acquisition activities in the prio Spending on capital expenditures also increased by $67 million over the prio primarily due to increased spending on software development, building up o dewatering rental fleet, as well as increased spending on other strategic cap investments to meet increasing demand.

Cash used in investing activities was $181 million in 2017 compared to $1,8
million in 2016. The decrease of $1,705 million was primarily driven by the $
million spent on the acquisition of Sensus and two other businesses in 2016
compared to the $33 million spent for acquisitions in 2017. This impact is pa
offset by increased spending of $46 million over the prior year on capital pro
including spending on capitalized software in the Sensus business.

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Financing Activities

Cash used by financing activities was $40 million in 2018, compared to cash by financing activities of $421 in 2017. The decrease in cash used during th was primarily due to the net issuance of $335 million in short term debt in th current year, which was largely used for acquisition financing. Additionally, s term debt repaid during the year was $52 million versus $282 million during prior year period (see Note 14, "Credit Facilities and Long-Term Debt" of ou consolidated financial statements for a full discussion of debt activities). The drivers are partially offset by the higher net repayment of $120 million of lon debt in the current year, an increase in share repurchase activity of $34 mill an increase in dividends paid of $22 million as compared to the prior year.

Cash generated by financing activities was $421 million in 2017, compared generated by financing activities of $1,034 in 2016. In 2017, the net decreas cash provided was primarily due to the issuance of long-term and short-term related to acquisition financing in 2016 versus the net repayment of short-te in 2017 (see Note 14, "Credit Facilities and Long-Term Debt" of our consolid financial statements for a full discussion of debt activities). Also contributing decrease in cash generated by financing activities were increased share repurchases and higher dividend payments in 2017.

Funding and Liquidity Strategy

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

We monitor our global funding requirements and seek to meet our liquidity r on a cost effective basis. Based on our current global cash positions, cash f from operations and access to the commercial paper markets, we believe th sufficient liquidity to meet our funding requirements. In addition, our existing committed credit facilities and access to the public debt markets would prov further liquidity if required.

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

Credit Facilities & Long-Term Contractual Commitments

See Note 14, "Credit Facilities and Long-Term Debt" of our consolidated fin statements for a description of our credit facilities and long-term debt.

Non-U.S. Operations

For 2018 and 2017, we generated 53% and 54% of our revenue from non-U operations, respectively. As we continue to grow our operations in the emer markets and elsewhere outside of the United States, we expect to continue generate significant revenue from non-U.S. operations and expect that a substantial portion of our cash will be predominately held by our foreign subsidiaries. We expect to manage our worldwide cash requirements consid available funds among the many subsidiaries through which we conduct bus and the cost effectiveness with which those funds can be accessed. We ma transfer cash from certain international subsidiaries to the U.S. and other international subsidiaries when we believe it is cost effective to do so. We continually review our domestic and foreign cash profile, expected future ca generation and investment opportunities and reassess whether there is a ne repatriate funds held internationally to support our U.S. operations. As of December 31, 2018, we have provided a deferred tax liability of $13 million foreign withholding taxes and state income taxes on $1.9 billion expected to repatriated to the U.S. parent.

Contractual Obligations

The following table summarizes our contractual commitments as of Decemb
2018:

(in millions)	2019	2020 - 2021	2022 - 2023	Thereafter
Debt and capital lease obligations (1)	$257	$600	$570	$900
Interest payments (1) (2)	76	152	93	451
Operating lease obligations	76	104	55	64
Purchase obligations (3)	154	2	—	—
Other long-term obligations reflected on the balance sheet	1	16	17	27
Total commitments	$564	$874	$735	$1,442

In addition to the amounts presented in the table above, we have recorded liabilities for net investment hedges of $46 million and employee severance indemnity of $16 million. These a have been excluded from the contractual obligations table due to an inability to reasonably e the timing or amounts of such payments in individual years. Further, benefit payments which expected future service related to the Company's pension and other postretirement employe obligations are presented in Note 15, “Postretirement Benefit Plans” of the consolidated fina statements and deferred income tax liabilities and uncertain tax positions are presented in N "Income Taxes" of the consolidated financial statements, and as such, these obligations are included in the above table. Finally, estimated environmental payments and workers' compe and general liability reserves are excluded from the table above. We estimate, based on hist experience, that we will spend approximately $2 million to $3 million per year on environmen investigation and remediation and approximately $4 million to $5 million per year on workers compensation and general liability. At December 31, 2018, we had estimated and accrued $ and $21 million related to environmental matters, and workers' compensation and general lia respectively.

(1) Refer to Note 14, “Credit Facilities and Long-Term Debt,” of the consolidated financial sta for discussion of the use and availability of debt and revolving credit agreements. Amount represent principal payments of short-term and long-term debt including current maturities exclude unamortized discounts.

(2) Amounts represent estimates of future interest payments on short-term and long-term deb outstanding as of December 31, 2018.

(3) Represents unconditional purchase agreements that are enforceable and legally binding a specify all significant terms to purchase goods or services, including fixed or minimum qu be purchased; fixed, minimum or variable price provisions; and the approximate timing of transaction. Purchase agreements that are able to cancel without penalty have been excl

Off-Balance Sheet Arrangements

As of December 31, 2018, we have issued guarantees for the debt and othe obligations of consolidated subsidiaries in the normal course of business. W determined that none of these arrangements has a material current effect o reasonably likely to have a material future effect on our consolidated financi statements, financial condition, changes in financial condition, revenues or expenses, liquidity, capital expenditures or capital resources.

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

Critical Accounting Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported a of assets, liabilities, revenue and expenses, and the disclosure of contingen liabilities. Management bases its estimates on historical experience and on other assumptions that it believes to be reasonable under the circumstance results of which form the basis for making judgments about the carrying valu assets and liabilities that are not readily apparent from other sources.

Significant accounting policies used in the preparation of the Consolidated Financial Statements are discussed in Note 1, "Summary of Significant Acc Policies," of the consolidated financial statements. Accounting estimates an assumptions discussed in this section are those that we consider most critic understanding of our financial statements because they are inherently unce involve significant judgments, include areas where different estimates reaso could have been used, and changes in the estimate that are reasonably pos could materially impact the financial statements. Management believes that accounting estimates employed and the resulting balances are reasonable; however, actual results in these areas could differ from management's estin under different assumptions or conditions.

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Revenue Recognition. As discussed in Note 2, "Recently Issued Accountin
Pronouncements", Xylem adopted the new guidance on recognizing revenu
contracts with customers as of January 1, 2018. In accordance with this nev
guidance Xylem recognizes revenue in a manner that depicts the transfer of
promised goods and services to customers in an amount that reflects the
consideration to which it expects to be entitled to for providing those goods
services. For each arrangement with a customer, we identify the contract, th
associated performance obligations within the contract, determine the trans
price of that contract, allocate the transaction price to each performance obl
and recognize revenue as each performance obligation is satisfied.

The satisfaction of performance obligations in a contract is based upon whe
customer obtains control over the asset. Depending on the nature of the
performance obligation, control transfers either at a particular point in time,
time which determines the recognition pattern of revenue.

For product sales, other than long-term construction-type contracts, we reco
revenue once control has passed at a point in time, which is generally wher
products are shipped. In instances where contractual terms include a provis
customer acceptance, revenue is recognized when either (i) we have previo
demonstrated that the product meets the specified criteria based on either s
customer specified objective criteria or (ii) upon formal acceptance received
the customer where the product has not been previously demonstrated to m
customer specified objective criteria. We recognize revenue on product sale
channel partners, including resellers, distributors or value-added solution pr
at the point in time when the risks and rewards, possession, and title have
transferred to the customer, which usually occurs at the point of delivery.

Revenue from performance obligations related to services is recognized ove
as the performance obligations are satisfied. In these instances, the custom
consumes the benefit of the service as Xylem performs.

Certain businesses also enter into long-term construction-type sales contrac
where revenue is recognized over time. In these instances, revenue is recog
using a measure of progress that applies an input method based on costs in
in relation to total estimated costs. We also recognize revenue for certain of
arrangements using the output method and measure progress based on shi
of product where control has transferred to the customer.

For all contracts with customers, we determine the transaction price in the
arrangement and allocate the transaction price to each performance obligat
identified in the contract. Judgment is required to determine the appropriate
account, and we separate out the performance obligations if they are capab
being distinct and if they are distinct within the context of the contract. The
transaction price is adjusted for our estimate of variable consideration which
include a right of return, discounts, rebates, penalties and retainage. To esti
variable consideration, we apply the expected value or the most likely amou
method, based on whichever method most appropriately predicts the amour
consideration we expect to be entitled to. The method applied is typically ba
historical experience and known trends. We constrain the amounts of variab
consideration that are included in the transaction price, to the extent that it i
probable that a significant reversal in the amount of cumulative revenue rec
will not occur or when uncertainties around the variable consideration are re
The adoption of the new revenue guidance did not provide materially differe
results from historical revenue guidance.

Income Taxes. Deferred tax assets and liabilities are determined based on
temporary differences between the financial reporting and tax bases of asse
liabilities, applying enacted tax rates in effect for the year in which we expec
differences will reverse. Based on the evaluation of available evidence, we
recognize future tax benefits, such as net operating loss carryforwards, to th
extent that we believe it is more likely than not we will realize these benefits
periodically assess the likelihood that we will be able to recover our deferred
assets and reflect any changes to our estimate of the amount we are more l
than not to realize in the valuation allowance, with a corresponding adjustm
earnings or other comprehensive income, as appropriate.

In assessing the need for a valuation allowance, we look to the future revers
existing taxable temporary differences, taxable income in carryback years a
feasibility of tax planning strategies and estimated future taxable income. Th
valuation allowance can be affected by changes to tax laws, changes to sta
tax rates and changes to future taxable income estimates.

Due to the Tax Act, we have recorded net foreign withholding taxes and sta
income taxes on earnings that are expected to be repatriated to the U.S. pa
We have not recorded any deferred taxes on the amounts that the Compan
currently does not intend to repatriate as the determination of any deferred t
on this amount is not practicable.

The calculation of our tax liabilities involves dealing with uncertainties in the
application of complex tax regulations in a multitude of jurisdictions across o
global operations. We recognize potential liabilities and record tax liabilities

for anticipated tax audit issues in the U.S. and other tax jurisdictions based
estimate of whether, and to the extent to which, additional taxes will be due.
Furthermore, we recognize the tax benefit from an uncertain tax position on
more likely than not that the tax position will be sustained on examination by
taxing authorities or litigation, based on the technical merits of the position.
benefits recognized in the financial statements from such a position are mea
based on the largest benefit that has a greater than 50% likelihood of being
realized upon ultimate resolution.

We adjust our liability for uncertain tax positions in light of changing facts an
circumstances; however, due to the complexity of some of these uncertainti
ultimate resolution may result in a payment that is materially different from o
current estimate of the tax liabilities. If our estimate of tax liabilities proves to
less than the ultimate assessment, an additional tax expense would result. I
payment of these amounts ultimately proves to be less than the recorded an
the reversal of the liabilities would result in tax benefits being recognized in
period when we determine the liabilities are no longer necessary.

Business Combinations. We record acquisitions using the purchase meth
accounting. All of the assets acquired, liabilities assumed, contractual
contingencies and contingent consideration is recorded at fair value as of th
acquisition date. The excess of the purchase price over the estimated fair va
the net tangible and intangible assets acquired is recorded as goodwill. The
application of the purchase method of accounting for business combinations
requires management to make significant estimates and assumptions in the
determination of the fair value of assets acquired and liabilities assumed, in
to properly allocate purchase price consideration between assets that are
depreciated and amortized from goodwill. These assumptions and estimate
include a market participant's use of the asset and the appropriate discount
for a market participant. Our estimates are based on historical experience,
information obtained from the management of the acquired companies and,
appropriate, includes assistance from independent third-party appraisal firm
Significant assumptions and estimates include, but are not limited to, the ca
flows that an asset is expected to generate in the future, the cost to build/re
certain technology, the appropriate weighted-average cost of capital, and th
savings expected to be derived from acquiring an asset. These estimates ar
inherently uncertain and unpredictable. In addition, unanticipated events an
circumstances may occur which may affect the accuracy or validity of such
estimates.

Goodwill and Intangible Assets. We review goodwill and indefinite-lived
intangible assets for impairment annually and whenever events or changes
circumstances indicate the carrying value of an asset may not be recoverab
also review the carrying value of our finite-lived intangible assets for potenti
impairment when impairment indicators arise. We conduct our annual impai
test as of the first day of the fourth quarter. For goodwill, the estimated fair v
each reporting unit is compared to the carrying value of the net assets assig
that reporting unit. If the estimated fair value of the reporting unit exceeds its
carrying value, goodwill is not impaired. If the carrying value of the reporting
exceeds its estimated fair value, then an impairment charge is recognized fo
excess up to the amount of recorded goodwill. We estimate the fair value of
reporting units using an income approach. We estimate the fair value of our
intangible assets with indefinite lives using either the income approach or th

market approach. Under the income approach, we calculate fair value base
the present value of estimated future cash flows. Under the market approac
calculate fair value based on recent sales and selling prices of similar asset
Determining the fair value of a reporting unit or an indefinite-lived intangible
is judgmental in nature and involves the use of significant estimates and
assumptions, particularly related to future operating results and cash flows.
estimates and assumptions include, but are not limited to, revenue growth r
and operating margins used to calculate projected future cash flows, risk-ad
discount rates, assumed royalty rates, future economic and market conditio
identification of appropriate market comparable data. In addition, the identifi
of reporting units and the allocation of assets and liabilities to the reporting u
when determining the carrying value of each reporting unit also require judg
Goodwill is tested for impairment at either the operating segment identified i
21, “Segment and Geographic Data,” of the consolidated financial statemen
one level below. The fair value of our reporting units and indefinite-lived inta
assets is based on estimates and assumptions that are believed to be reaso
Significant changes to these estimates and assumptions could adversely im
our conclusions. Actual future results may differ from those estimates.

During the fourth quarter of 2018, we performed our annual impairment
assessment and determined that the estimated fair values of our goodwill re
units were in excess of their carrying values. Future goodwill impairment tes
could result in a charge to earnings. Our AIA business within our Measurem
Control Solutions segment was the only goodwill reporting unit whose fair va
was not substantially in excess of its carrying value. The majority of this bus
was purchased during 2018 and was recorded at fair value in Xylem’s financ
statements. As a result, our 2018 assessment indicated that the fair value o
AIA business exceeded its carrying

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value by less than 10%. The goodwill associated with the AIA business was
million at December 31, 2018. We will continue to evaluate goodwill on an a
basis as of the beginning of our fourth quarter and whenever events and ch
in circumstances require us to do so.

We determined that no impairment of the indefinite-lived intangibles existed
the measurement date in 2018. However, future indefinite-lived intangible
impairment tests could result in a charge to earnings. We will continue to ev
indefinite-lived intangibles on an annual basis as of the beginning of our fou
quarter and whenever events and changes in circumstances indicate there
a potential impairment.

Contingent Liabilities. As discussed in Note 19, "Commitments and Contingencies" of the consolidated financial statements, the Company is, fr
to time, involved in legal and regulatory proceedings that are incidental to th
operation of our businesses (or the business operations of previously owne
entities). The Company recognizes a liability for any contingency that is kno
probable of occurrence and reasonably estimable. These assessments requ
judgments concerning matters such as litigation developments and outcome
anticipated outcome of negotiations, the number of future claims and the co
both pending and future claims. In addition, because most contingencies ar
resolved over long periods of time, liabilities may change in the future due to
various factors, including those discussed in Note 19 of the consolidated fin
statements. If the liabilities established by the Company with respect to thes
contingencies are inadequate, the Company would be required to incur an e
equal to the amount of the loss incurred in excess of the recorded liability, w
would adversely affect the Company’s financial statements.

Receivables and Allowance for Doubtful Accounts and Discounts.
Receivables primarily comprise uncollected amounts owed to us from transa
with customers and are presented net of allowances for doubtful accounts a
early payment discounts.

We determine our allowance for doubtful accounts using a combination of fa
to reduce our trade receivable balances to their estimated net realizable am
We maintain an allowance for doubtful accounts based on a variety of facto
including the length of time receivables are past due, macroeconomic trend
conditions, significant one-time events, historical experience and the financi
condition of customers. In addition, we record a specific reserve for individu
accounts when we become aware of specific customer circumstances, such
the case of bankruptcy filings or deterioration in the customer’s operating re
financial position. The past due or delinquency status of a receivable is bas
the contractual payment terms of the receivable. If circumstances related to
specific customer change, we adjust estimates of the recoverability of receiv
as appropriate. We determine our allowance for early payment discounts pr
based on historical experience with customers.

Credit risk with respect to accounts receivable is generally diversified due to
large number of entities comprising our customer base and their dispersion
many different geographical regions. We perform ongoing credit evaluations
financial condition of our third-party distributors, resellers and other custome
require collateral, such as letters of credit and bank guarantees, in certain
circumstances. As of December 31, 2018 and 2017 we do not believe we ha
significant concentrations of credit risk.

Postretirement Plans. Company employees around the world participate in numerous defined benefit plans. The determination of projected benefit oblig and the recognition of expenses related to these plans are dependent on va assumptions. These major assumptions primarily relate to discount rates, ex long-term rates of return on plan assets, rate of future compensation increas mortality, health care inflation and years of service (some of which are discl Note 15, “Postretirement Benefit Plans,” of the consolidated financial statem and other factors. Actual results that differ from our assumptions are accum and amortized on a straight-line basis only to the extent they exceed 10% o higher of the market-related value or projected benefit obligation, over the a remaining service period of active plan participants, or for plans with all or substantially all inactive participants, over the average remaining life expect

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Significant Assumptions

Management develops each assumption using relevant Company experienc conjunction with market-related data for each individual country in which su plans exist. All assumptions are reviewed annually with third-party consulta adjusted as necessary. The table included below provides the weighted ave assumptions used to estimate our defined benefit pension obligations and c of and for the years ended 2018 and 2017.

	2018		2017	
	U.S.	Int'l	U.S.	Int'l
Benefit Obligation Assumptions				
Discount rate	**4.50%**	**2.60%**	3.75%	2.43%
Rate of future compensation increase	**NM**	**2.92%**	NM	2.93%
Net Periodic Benefit Cost Assumptions				
Discount rate	**3.75%**	**2.43%**	4.25%	2.63%
Expected long-term return on plan assets	**8.00%**	**7.23%**	8.00%	7.20%
Rate of future compensation increase	**NM**	**2.93%**	NM	2.76%

NM Not meaningful. The pension benefits for future service for all the U.S. pension plans are on years of service and not impacted by future compensation increases.

We determine the expected long-term rate of return on plan assets by evalu both historical returns and estimates of future returns. Specifically, the Com analyzes the estimated future returns based on independent estimates of as class returns and evaluates historical broad market returns over long-term timeframes based on the strategic asset allocation, which is detailed in Note "Postretirement Benefit Plans," of the consolidated financial statements.

Based on the approach described above, the chart below shows weighted a actual returns versus the weighted average expected long-term rates of retu our pension plans that were utilized in the calculation of the net periodic per cost for each respective year.

	2018	2017	2016
Expected long-term rate of return on plan assets	**7.34 %**	7.30%	7.32 %
Actual rate of return on plan assets	**(3.85)%**	5.70%	12.20%

For the recognition of net periodic pension cost, the calculation of the expec return on plan assets is generally derived by applying the expected long-ter of return to the market-related value of plan assets. The market-related valu plan assets is based on average asset values at the measurement date ove last five years. The use of fair value, rather than a calculated value, could materially affect net periodic pension cost. The weighted average expected long-term rate of return for all of our plan assets to be used in determining n periodic benefit costs for 2019 is estimated at 7.09%. We estimate that ever basis point change in the expected return on plan assets impacts the expen $1 million.

The discount rate reflects our expectation of the present value of expected f cash payments for benefits at the measurement date. A decrease in the dis rate increases the present value of benefit obligations and increases pensio expense. We base the discount rate assumption on current investment yiel high-quality fixed income investments during the retirement benefits maturit period. The pension discount rate was determined by considering an interes yield curve comprising AAA/AA bonds, with maturities between zero and 30 developed by the plan's actuaries. Annual benefit payments are then discou present value using this yield curve to develop a single-point discount rate matching the plan’s characteristics. Our weighted average discount rate for pension plans effective January 1, 2019, is 2.82%. We estimate that every 2 point change in the discount rate impacts the expense by $1 million.

The rate of future compensation increase assumption reflects our long-term experience and future and near-term outlook. Effective January 1, 2019, ou expected rate of future compensation is 3.02% for all pension plans. The es impact of a 25 basis point change in the expected rate of future compensati less than $1 million.

The assumed rate of future increases in the per capita cost of health care (t health care trend rate) is 8.24% for 2019, decreasing ratably to 4.48% in 20 increase or decrease in the health care trend rates by one percent per year impact the aggregate annual service and interest components by less than million, and impact the benefit obligation by approximately $3 million.

We currently anticipate making contributions to our pension and postretirem benefit plans in the range of $15

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million to $25 million during 2019, of which $5 million is expected to be mad
first quarter.

Funded Status

Funded status is derived by subtracting the respective year-end values of th
projected benefit obligations from the fair value of plan assets. We estimate
every 25 basis point change in the discount rate impacts the funded status b
approximately $29 million.

Fair Value of Plan Assets

The plan assets of our pension plans comprise a broad range of investment
including domestic and foreign equity securities, interests in private equity a
hedge funds, fixed income investments, insurance contracts, and cash and
equivalents.

A portion of our pension benefit plan assets portfolio comprises investments
private equity and hedge funds. The private equity and hedge fund investme
generally measured at net asset value. However, in certain instances, the v
reported by the asset managers were not current at the measurement date.
Accordingly, we made estimate adjustments to the last reported value wher
necessary to measure the assets at fair value at the measurement date. Th
adjustments consider information received from the asset managers, as we
general market information. The adjustment recorded at December 31, 201
2017 for these assets represented less than one percent of total plan assets
each respective year. Asset values for other positions were generally measu
using market observable prices. We estimate that a 5% change in asset val
impact funded status by approximately $26 million.

New Accounting Pronouncements

See Note 2, "Recently Issued Accounting Pronouncements," of the consolid
financial statements for a complete discussion of recent accounting
pronouncements.

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ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risk, primarily related to foreign currency exchan rates and interest rates. These exposures are actively monitored by manag
Our exposure to foreign exchange rate risk is due to certain costs, revenue borrowings being denominated in currencies other than one of our subsidia functional currency. Similarly, we are exposed to market risk as the result o changes in interest rates which may affect the cost of our financing. It is our and practice to use derivative financial instruments only to the extent neces manage exposures.

Foreign Currency Exchange Rate Risk

We conduct approximately 53% of our business in various locations outside United States.

Our economic foreign currency risk primarily relates to receipts from custom payments to suppliers and intercompany transactions denominated in foreig currencies. We may use derivative financial instruments to offset risk relate receipts from customers and payments to suppliers, when it is believed that exposure will not be limited by our normal operating and financing activities enter into currency forward contracts periodically in order to manage the ex rate fluctuation risk on certain intercompany transactions associated with th party sales and purchases. These risks are also mitigated by natural hedge including the presence of manufacturing facilities outside the United States, sourcing and other spending which occurs in foreign countries. Our principa foreign currency transaction exposures primarily relate to the Euro, Swedish Polish Zloty, Canadian Dollar, British Pound, and Australian Dollar. We esti that a hypothetical 10% movement in foreign currency exchange rates woul have a material economic impact to Xylem's financial position and results o operations.

Additionally, we are subject to foreign exchange translation risk due to chan the value of foreign currencies in relation to our reporting currency, the U.S. The translation risk is primarily concentrated in the exchange rate between U.S. Dollar and the Euro, Chinese Yuan, British Pound, Canadian Dollar, S Krona and Australian Dollar. As the U.S. Dollar strengthens against other currencies in which we transact business, revenue and income will generall negatively impacted, and if the U.S. Dollar weakens, revenue and income w generally be positively impacted. We expect to continue to generate signific revenue from non-U.S. operations and we expect our cash will be predomin held by our foreign subsidiaries. We expect to manage our worldwide cash requirements considering available funds among the many subsidiaries thro which we conduct business and the cost effectiveness with which those fun be accessed. We may transfer cash from certain international subsidiaries t U.S. and other international subsidiaries when it is cost effective to do so, th we continually review our domestic and foreign cash profile, expected future generation and investment opportunities and reassess whether there is a ne repatriate funds held internationally to support our U.S. operations. We also our investment in certain foreign subsidiaries via the use of cross currency s and the designation of our 2.25% Senior Notes of €500 million aggregate pr amount due March 2023 as a net investment hedge. Accordingly, we estima a 10% movement of the U.S. Dollar to various foreign currency exchange ra translate from, in aggregate would not have a material economic impact on financial position and results of operations.

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

Interest Rate Risk

As of December 31, 2018, our long-term debt portfolio is primarily comprise four series of fixed-rate senior notes that total $2.1 billion. The senior notes exposed to interest rate risk as the bonds are at a fixed rate until maturity. E on current interest rate market we do not anticipate material risk associated our debt refinancing within the target time frame of completion.

Commodity Price Exposures

For a discussion of risks relating to commodity prices, refer to “Item 1A. Ris Factors.”

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Board of Directors of
Xylem Inc.
Rye Brook, New York

Opinion on the Financial Statements
We have audited the accompanying consolidated balance sheets of Xylem subsidiaries (the "Company") as of December 31, 2018 and 2017, the relate consolidated statements of income, comprehensive income, stockholders' e and cash flows, for each of the three years in the period ended December 3 2018, and the related notes (collectively referred to as the "financial stateme In our opinion, the financial statements present fairly, in all material respects financial position of the Company as of December 31, 2018 and 2017, and results of its operations and its cash flows for each of the three years in the ended December 31, 2018, in conformity with accounting principles general accepted in the United States of America.
We have also audited, in accordance with the standards of the Public Comp Accounting Oversight Board (United States) (PCAOB), the Company's inter control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission and report dated February 22, 2019, expressed an unqualified opinion on the Company's internal control over financial reporting.
Basis for Opinion
These financial statements are the responsibility of the Company's manage Our responsibility is to express an opinion on the Company's financial state based on our audits. We are a public accounting firm registered with the PC and are required to be independent with respect to the Company in accorda with the U.S. federal securities laws and the applicable rules and regulation Securities and Exchange Commission and the PCAOB.
We conducted our audits in accordance with the standards of the PCAOB. standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that to those risks. Such procedures included examining, on a test basis, eviden regarding the amounts and disclosures in the financial statements. Our aud included evaluating the accounting principles used and significant estimates by management, as well as evaluating the overall presentation of the financ statements. We believe that our audits provide a reasonable basis for our o
/s/ Deloitte & Touche LLP
Stamford, Connecticut
February 22, 2019
We have served as the Company's auditor since 2010.

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XYLEM INC. AND SUBSIDIARIES
CONSOLIDATED INCOME STATEMENTS
(In Millions, except per share data)

Year Ended December 31,	**2018**	2017	2
Revenue	**$5,207**	$4,707	$
Cost of revenue	**3,181**	2,860	2
Gross profit	**2,026**	1,847	1
Selling, general and administrative expenses	**1,161**	1,089	9
Research and development expenses	**189**	181	1
Restructuring and asset impairment charges	**22**	25	3
Operating income	**654**	552	4
Interest expense	**82**	82	7
Other non-operating income, net	**13**	6	2
(Loss)/gain on sale of businesses	**—**	(10)	–
Income before taxes	**585**	466	3
Income tax expense	**36**	136	8
Net income	**549**	330	2
Less: Net loss attributable to non-controlling interests	**—**	(1)	–
Net income attributable to Xylem	**$549**	$331	$
Earnings per share:			
Basic	**$3.05**	$1.84	$
Diluted	**$3.03**	$1.83	$
Weighted average number of shares:			
Basic	**179.8**	179.6	1
Diluted	**181.1**	180.9	1
Dividends declared per share	**$0.8400**	$0.7200	$

See accompanying notes to consolidated financial statements.

XYLEM INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In Millions)

Year Ended December 31,	**2018**	2017
Net income	**$549**	$330
Other comprehensive (loss) income, before tax:		
Foreign currency translation adjustment	**(85)**	79
Net change in derivative hedge agreements:		
Unrealized (loss) gain	**(8)**	9
Amount of loss (gain) reclassified into net income	**4**	(5
Net change in postretirement benefit plans:		
Net loss	**(37)**	(19
Prior service credit	**—**	1
Amortization of prior service credit cost	**(4)**	(3
Amortization of net actuarial loss into net income	**13**	13
Settlement	**1**	1
Foreign currency translation adjustment	**15**	(18
Other comprehensive (loss) income, before tax	**(101)**	58
Income tax expense (benefit) related to other comprehensive loss	**10**	(50
Other comprehensive (loss) income, net of tax	**(111)**	108
Comprehensive income	**$438**	$438
Less: comprehensive loss attributable to noncontrolling interests	**(2)**	—
Comprehensive income attributable to Xylem	**$440**	**$438**

See accompanying notes to consolidated financial statements.

XYLEM INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In Millions, except per share amounts)

December 31,	2018
ASSETS	
Current assets:	
Cash and cash equivalents	**$296**
Receivables, less allowances for discounts, returns and doubtful accounts of $35 and $35 in 2018 and 2017, respectively	**1,031**
Inventories	**595**
Prepaid and other current assets	**172**
Total current assets	**2,094**
Property, plant and equipment, net	**656**
Goodwill	**2,976**
Other intangible assets, net	**1,232**
Other non-current assets	**264**
Total assets	**$7,222**
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current liabilities:	
Accounts payable	**$586**
Accrued and other current liabilities	**546**
Short-term borrowings and current maturities of long-term debt	**257**
Total current liabilities	**1,389**
Long-term debt, net	**2,051**
Accrued postretirement benefits	**400**
Deferred income tax liabilities	**303**
Other non-current accrued liabilities	**297**
Total liabilities	**4,440**
Commitment and Contingencies (Note 19)	
Stockholders' equity:	
Common stock — par value $0.01 per share:	
Authorized 750.0 shares, issued 192.9 and 192.3 shares in 2018 and 2017, respectively	**2**
Capital in excess of par value	**1,950**
Retained earnings	**1,639**
Treasury stock – at cost 13.2 shares and 12.4 shares in 2018 and 2017, respectively	**(487)**
Accumulated other comprehensive loss	**(336)**
Total stockholders' equity	**2,768**
Non-controlling interest	**14**
Total equity	**2,782**
Total liabilities and stockholders' equity	**$7,222**

See accompanying notes to consolidated financial statements.

XYLEM INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (In Millions)

Year Ended December 31,	**2018**	2017
Operating Activities		
Net income	**$549**	$330
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	**117**	109
Amortization	**144**	125
Deferred income taxes	**(47)**	(33)
Share-based compensation	**30**	21
Restructuring and asset impairment charges	**22**	25
Loss/(gain) from sale of businesses	**—**	10
Other, net	**9**	19
Payments for restructuring	**(21)**	(28)
Contributions to postretirement benefit plans	**(41)**	(33)
Changes in assets and liabilities (net of acquisitions):		
Changes in receivables	**(103)**	(79)
Changes in inventories	**(97)**	27
Changes in accounts payable	**51**	50
Changes in accrued liabilities	**(6)**	28
Changes in accrued taxes	**—**	104
Net changes in other assets and liabilities	**(21)**	11
Net Cash — Operating activities	**586**	686
Investing Activities		
Capital expenditures	**(237)**	(170)
Proceeds from the sale of property, plant and equipment	**—**	1
Acquisitions of businesses and assets, net of cash acquired	**(433)**	(33)
Proceeds from sale of businesses	**22**	16
Cash received from investments	**11**	10
Cash paid for investments	**(11)**	(11)
Other, net	**5**	6
Net Cash — Investing activities	**(643)**	(181)
Financing Activities		
Short-term debt issued	**335**	—
Short-term debt repaid, net	**(52)**	(282)
Long-term debt issued, net	**1**	—
Long-term debt repaid	**(120)**	—
Repurchase of common stock	**(59)**	(25)
Proceeds from exercise of employee stock options	**7**	16
Dividends paid	**(152)**	(130)
Other, net	**—**	—
Net Cash — Financing activities	**(40)**	(421)
Effect of exchange rate changes on cash	**(21)**	22
Net change in cash and cash equivalents	**(118)**	106
Cash and cash equivalents at beginning of year	**414**	308
Cash and cash equivalents at end of year	**$296**	$414
Supplemental disclosure of cash flow information:		
Cash paid during the year for:		
Interest	**$78**	$78

Income taxes (net of refunds received)	**$75**	$57

See accompanying notes to consolidated financial statements.

XYLEM INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQ
(In Millions, except per share amounts)

	Common Stock	Capital in Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Non-Contr Interest
Balance at December 31, 2015	$ 2	$ 1,834	$ 885	$ (238)	$ (399)	$ —
Net income			260			
Other comprehensive loss, net				(80)		
Dividends declared ($0.6196 per share)			(112)			
Stock incentive plan activity		42				
Repurchase of common stock					(4)	
Acquisition activity						$ 17
Balance at December 31, 2016	$ 2	$ 1,876	$ 1,033	$ (318)	$ (403)	$ 17
Cumulative effect of change in accounting principle			(7)			
Net income			331			(1)
Other comprehensive income, net				108		
Dividends declared ($.72 per share)			(130)			
Stock incentive plan activity		36			(5)	
Repurchase of common stock					(20)	
Balance at December 31, 2017	$ 2	$ 1,912	$ 1,227	$ (210)	$ (428)	$ 16
Cumulative effect of change in accounting principle			**14**	**(17)**		
Net income			**549**			
Other comprehensive loss, net				**(109)**		**(2)**
Dividends declared ($.84 per share)			**(151)**			
Stock incentive plan activity		**38**			**(9)**	
Repurchase of common stock					**(50)**	
Balance at December 31, 2018	**$ 2**	**$ 1,950**	**$ 1,639**	**$ (336)**	**$ (487)**	**$ 14**

See accompanying notes to consolidated financial statements.

XYLEM INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies

Xylem Inc. ("Xylem" or the "Company") is a leading equipment and service p
water and wastewater applications with a broad portfolio of products and se
addressing the full cycle of water, from collection, distribution and use to the
of water to the environment.

Xylem operates in three segments, Water Infrastructure, Applied Water and
Measurement & Control Solutions. The Water Infrastructure segment focuse
the transportation and treatment of water, offering a range of products incluc
water and wastewater pumps, treatment equipment, and controls and syste
The Applied Water segment serves many of the primary uses of water and f
on the residential, commercial and industrial markets. The Applied Water se
major products include pumps, valves, heat exchangers, controls and dispe
equipment. The Measurement & Control Solutions segment focuses on dev
advanced technology solutions that enable intelligent use and conservation
critical water and energy resources as well as analytical instrumentation use
the testing of water. The Measurement & Control Solutions segment's major
products include smart metering, networked communications, measuremen
control technologies, critical infrastructure technologies, software and servic
including cloud-based analytics, remote monitoring and data management,
detection and pressure monitoring solutions and testing equipment.

On October 31, 2011 (the "Distribution Date"), ITT Corporation ("ITT") comp
Spin-off (the "Spin-off") of Xylem, formerly ITT's water equipment and servic
businesses. The Spin-off was completed pursuant to the Distribution Agreem
dated as of October 25, 2011 (the "Distribution Agreement"), among ITT (no
LLC), Exelis Inc., acquired by Harris Inc. on May 29, 2015, ("Exelis") and Xy
Xylem Inc. was incorporated in Indiana on May 4, 2011 in connection with th
Spin-off.

Hereinafter, except as otherwise indicated or unless the context otherwise
requires, "Xylem," "we," "us," "our" and "the Company" refer to Xylem Inc. ar
subsidiaries. References in the notes to the consolidated financial statemen
"ITT" or " former parent" refers to ITT Corporation (now ITT LLC) and its cor
subsidiaries (other than Xylem Inc.).

Basis of Presentation

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

Use of Estimates

The preparation of financial statements in conformity with GAAP requires
management to make estimates and assumptions that affect the reported a
of assets and liabilities, the disclosure of contingent assets and liabilities at
date of the financial statements, and the reported amounts of revenue and
expenses during the reporting period. Estimates are revised as additional
information becomes available. Estimates and assumptions are used for, bu
limited to, postretirement obligations and assets, revenue recognition, incon
contingency accruals and valuation allowances, valuation of intangible asse
goodwill and indefinite lived intangible impairment testing and contingent lia

Actual results could differ from these estimates.

Consolidation Principles

We consolidate companies in which we have a controlling financial interest when Xylem is considered the primary beneficiary of a variable interest entit account for investments in companies over which we have the ability to exe significant influence but do not hold a controlling financial interest under the method, and we record our proportionate share of income or losses in the Consolidated Income Statements. Equity method investments are reviewed impairment when events or circumstances indicate the investment may be c than temporarily impaired. This requires significant judgment, including an assessment of the investee's financial condition, the possibility of subseque rounds of financing, and the investee's historical and projected results of operations. If the actual results of operations for the investee are significant different from projections, we may incur future charges for the impairment o investments.

Foreign Currency Translation

The national currencies of our foreign companies are generally the functiona
currencies. Balance sheet accounts are translated at the exchange rate in e
the end of each period; income statement accounts are translated at the ave
rates of exchange prevailing during the period. Gains and losses on foreign
currency translations are reflected in the cumulative translation adjustments
component of stockholders' equity. Net gains or losses from foreign currenc
transactions are reported currently in selling, general and administrative exp

Revenue Recognition

As discussed in Note 2, "Recently Issued Accounting Pronouncements", Xy
adopted the new guidance on recognizing revenue from contracts with custo
as of January 1, 2018. In accordance with this new guidance Xylem recogni
revenue in a manner that depicts the transfer of promised goods and servic
customers in an amount that reflects the consideration to which it expects to
entitled to for providing those goods and services. For each arrangement wi
customer, we identify the contract, the associated performance obligations w
the contract, determine the transaction price of that contract, allocate the
transaction price to each performance obligation and recognize revenue as
performance obligation is satisfied.

The satisfaction of performance obligations in a contract is based upon whe
customer obtains control over the asset. Depending on the nature of the
performance obligation, control transfers either at a particular point in time,
time which determines the recognition pattern of revenue.

For product sales, other than long-term construction-type contracts, we reco
revenue once control has passed at a point in time, which is generally when
products are shipped. In instances where contractual terms include a provis
customer acceptance, revenue is recognized when either (i) we have previo
demonstrated that the product meets the specified criteria based on either s
customer specified objective criteria or (ii) upon formal acceptance received
the customer where the product has not been previously demonstrated to m
customer specified objective criteria. We recognize revenue on product sale
channel partners, including resellers, distributors or value-added solution pr
at the point in time when control is transferred which is determined based on
the risks and rewards, possession, and title have transferred to the custome
which usually occurs at the point of delivery.

Revenue from performance obligations related to services is recognized ove
as the performance obligations are satisfied. In these instances, the custom
consumes the benefit of the service as Xylem performs.

Certain businesses also enter into long-term construction-type sales contrac
where revenue is recognized over time. In these instances, revenue is recog
using a measure of progress that applies an input method based on costs in
in relation to total estimated costs. We also recognize revenue for certain of
arrangements using the output method and measure progress based on shi
of product where control has transferred to the customer.

If shipping and handling activities are performed after a customer obtains co
a good, we account for the shipping and handling activities as activities to fu
promise to transfer a good. Shipping and handling related costs are accrued
revenue is recognized.

For all contracts with customers, we determine the transaction price in the
arrangement and allocate the transaction price to each performance obligat

identified in the contract. Judgment is required to determine the appropriate
account, and we separate out the performance obligations if they are capab
being distinct and if they are distinct within the context of the contract. We b
allocation of the transaction price to the performance obligations on the rela
standalone selling prices for the goods or services contained in a particular
performance obligation. The standalone selling prices are determined first b
reference to observable prices. In the event observable prices are not availa
estimate the stand-alone selling price by maximizing observable inputs and
an adjusted market assessment approach, expected cost plus margin appro
a residual approach in limited situations. Revenue in these instances is reco
on individual performance obligations within the same contract as they are
satisfied.

The transaction price is adjusted for our estimate of variable consideration w
may include a right of return, discounts, rebates, penalties and retainage. To
estimate variable consideration, we apply the expected value or the most lik
amount method, based on whichever method most appropriately predicts th
amount of consideration we expect to receive. The method applied is typica
based on historical experience and known trends. We constrain the amount
variable consideration that are included in the transaction price, to the exter
is probable that a significant reversal in the amount of cumulative revenue
recognized will not occur or when uncertainties around the variable conside
are resolved.

We exclude from the measurement of the transaction price all taxes assess governmental authority that are both imposed on and concurrent with specif revenue-producing transaction and collected from a customer, for example use, value added and some excise taxes.

For all contracts with customers, payment received for our products and ser may not necessarily follow the same pattern of revenue recognition to which relates and are dictated by the terms and conditions of our contracts with customers. Payments received for product sales typically occur following de and the satisfaction of the performance obligation based upon the terms out the contracts. Payments received for services typically occur following the s being rendered. For long-term construction-type projects, payments are typi made throughout the contract as progress is made.

In limited situations, contracts with customers include financing components payment terms exceed one year, however, we believe that the financing eff not significant to Xylem. In addition, we apply a practical expedient and do n adjust the promised amount of consideration in a contract for the effects of significant financing components when we expect payment terms to be one less from the time the goods or services are transferred until ultimate payme

We offer standard warranties for our products to ensure that our products co with agreed-upon specifications in our contracts. For standard warranties, th not give rise to performance obligations and represent assurance-type warr In certain instances, product warranty terms are adjusted to account for the nature of the contract. In these instances, we assess the warranties to deter whether they represent service-type warranties, and should be accounted fo separate performance obligation in the contract.

Costs to obtain a contract include incremental costs that the Company has i which it expects to recover. Incremental costs only include costs that the Co would not have incurred had the contract not been obtained. Costs that wou been incurred regardless of whether or not the contract was obtained are expensed as incurred, unless they are explicitly chargeable to the customer whether or not the contract is obtained.

Costs to obtain contracts are capitalized when incurred. The costs to obtain contracts are then amortized in a manner that is consistent with the pattern transfer of the related goods or services provided in the contract. The Comp elects to apply the practical expedient to expense costs to obtain contracts the associated amortization period of those costs would be one year or less

For annual periods prior to January 1, 2018, revenue is recognized when persuasive evidence of an arrangement exists, the price is fixed or determin collectability is reasonably assured and delivery has occurred or services ha been rendered. For product sales, other than long-term construction-type contracts, we recognize revenue at the time title, and risks and rewards of ownership pass, which is generally when products are shipped. Certain con with customers require delivery, installation, testing, certification or other acceptance provisions to be satisfied before revenue is recognized. We rec revenue on product sales to channel partners, including resellers, distributo value-added solution providers at the time of sale when the channel partner economic substance apart from Xylem and Xylem has completed its obligat related to the sale. Revenue from the rental of equipment is recognized ove rental period. Service revenue is recognized as services are performed.

For agreements that contain multiple deliverables, we recognize revenue ba
the relative selling price if the deliverable has stand-alone value to the custo
and, in arrangements that include a general right of return relative to the del
element, performance of the undelivered element is considered probable ar
substantially in the Company's control. The selling price for a deliverable is
on vendor-specific objective evidence of selling price ("VSOE"), if available,
third-party evidence of selling price ("TPE") if VSOE is not available, or best
estimated selling price, if neither VSOE nor TPE is available.

The deliverables in our arrangements with multiple elements include various
products and may include related services, such as installation and start-up
services. Generally, these elements are satisfied within the same reporting
although certain contracts may be completed over 6 months. We allocate
arrangement consideration based on the relative selling prices of the separa
units of accounting determined in accordance with the hierarchy described a
For deliverables that are sold separately, we establish VSOE based on the
when the deliverable is sold separately. We establish TPE, generally for ser
based on prices similarly situated customers pay for similar services from
third-party vendors. For those deliverables for which we are unable to estab
VSOE or TPE, we estimate the selling price considering various factors incl
market and pricing trends, geography, product customization, and profit obj
Revenue for multiple element arrangements is recognized when the approp
revenue recognition criteria for the individual deliverable have been satisfied

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Certain businesses enter into long-term construction-type sales contracts fo
revenue is recognized under the percentage-of-completion method based u
percentage of costs incurred to total estimated costs.

Shipping and Handling Costs

Shipping and handling costs are recorded as a component of cost of revenu

Share-Based Compensation

Share-based awards issued to employees and members of the Board of Dir
include non-qualified stock options, restricted stock unit awards and perform
share unit awards. Compensation costs resulting from share-based paymen
transactions are recognized primarily within selling, general and administrat
expenses, at fair value over the requisite service period (typically three year
straight-line basis. The calculated compensation cost is adjusted based on a
estimate of awards ultimately expected to vest. For performance awards, th
calculated compensation cost is adjusted based on an estimate of awards
ultimately expected to vest and our assessment of the probable outcome of
performance condition. The fair value of a non-qualified stock option is dete
on the date of grant using a binomial lattice pricing model incorporating mul
and variable assumptions over time, including assumptions such as employ
exercise patterns, stock price volatility and changes in dividends. The fair va
restricted stock unit awards is determined using the closing price of our com
stock on date of grant. The fair value of Return on Invested Capital ("ROIC"
performance share units at 100% target is determined using the closing pric
our common stock on date of grant. The fair value of Total Shareholder Ret
("TSR") performance share units is calculated on the date of grant using a M
Carlo simulation model utilizing several key assumptions, including expecte
Company and peer company share price volatility, correlation coefficients b
peers, the risk-free rate of return, the expected dividend yield and other awa
design features.

Research and Development

We conduct research and development activities, which consist primarily of
development of new products, product applications, and manufacturing proc
To the extent these activities are related to developing software that is sold
customers, we capitalize the applicable development costs. All other resear
development costs are charged to expense as incurred.

Exit and Disposal Costs

We periodically initiate management-approved restructuring activities to ach
cost savings through reduced operational redundancies and to position ours
strategically in the market in response to prevailing economic conditions and
associated customer demand. Costs associated with restructuring actions c
include severance, infrastructure charges to vacate facilities or consolidate
operations, contract termination costs and other related charges. For involu
separation plans, a liability is recognized when it is probable and reasonably
estimable. For voluntary separation plans, a liability is recognized when the
employee irrevocably accepts the voluntary termination. For one-time termi
benefits, such as additional severance pay or benefit payouts, and other exi
such as lease termination costs, the liability is measured and recognized ini
fair value in the period in which the liability is incurred, with subsequent cha
the liability recognized as adjustments in the period of change.

Deferred Financing Costs

Deferred financing costs represent costs incurred in conjunction with our de financing activities and are capitalized in long-term debt and amortized over of the related financing arrangements. If the debt is retired early, the related unamortized deferred financing costs are written off in the period the debt is and are recorded in the results of operations under the caption “interest exp

Income Taxes

Income taxes are calculated using the asset and liability method. Deferred t assets and liabilities are determined based on the estimated future tax effec temporary differences between the financial statement carrying amounts an tax bases of assets and liabilities, as measured by the current enacted tax r We maintain valuation allowances when it is more likely than not that all or a portion of a deferred asset will not be realized. The valuation allowance is in in part to provide for the uncertainty regarding the ultimate utilization of our capital loss carryforwards, U.S. foreign tax credit carryovers, and foreign ne operating loss carryforwards. In determining whether a valuation allowance warranted, we consider all positive and negative evidence and all sources o taxable income such as prior earnings history, expected future earnings, ca and carryforward periods and tax strategies to estimate if sufficient future ta income will be generated to realize the

deferred tax asset. The assessment of the adequacy of our valuation allowa
based on our estimates of taxable income by jurisdiction in which we operat
the period over which our deferred tax assets will be recoverable. In the eve
actual results differ from these estimates, or we adjust these estimates in fu
periods for current trends or expected changes in our estimating assumption
may need to modify the level of valuation allowance that could materially im
our business, financial condition and results of operations.

Due to the U.S. Tax Cuts and Jobs Act (the "Tax Act"), we have recorded n
foreign withholding taxes and state income taxes on earnings that are expec
be repatriated to the U.S. parent. We have not recorded any deferred taxes
amounts that the Company currently does not intend to repatriate as the
determination of any deferred taxes on this amount is not practicable.

Tax benefits are recognized for an uncertain tax position when, in managem
judgment, it is more likely than not that the position will be sustained upon
examination by a taxing authority. For a tax position that meets the
more-likely-than-not recognition threshold, the tax benefit is measured as th
largest amount that is judged to have a greater than 50% likelihood of being
realized upon ultimate settlement with a taxing authority. The liability associ
with unrecognized tax benefits is adjusted periodically due to changing
circumstances and when new information becomes available. Such adjustm
are recognized in the period in which they are identified. The effective tax ra
includes the net impact of changes in the liability for unrecognized tax bene
subsequent adjustments as considered appropriate by management. While
often difficult to predict the final outcome or the timing of resolution of any p
tax matter, we believe our liability for unrecognized tax benefits is adequate
classify interest relating to unrecognized tax benefits as a component of oth
non-operating (expense) income, net and tax penalties as a component of in
tax expense in our Consolidated Income Statements.

Earnings Per Share

We present two calculations of earnings per share (“EPS”). “Basic” EPS equ
income divided by weighted average shares outstanding during the period.
EPS equals net income divided by the sum of weighted average common sh
outstanding during the period plus potentially dilutive shares. Potentially dilu
common shares that are anti-dilutive are excluded from diluted EPS.

Cash Equivalents

We consider all liquid investments purchased with an original maturity of thr
months or less to be cash equivalents.

Receivables and Allowance for Doubtful Accounts and Discounts

Receivables primarily comprise uncollected amounts owed to us from transa
with customers and are presented net of allowances for doubtful accounts, r
and early payment discounts.

We determine our allowance for doubtful accounts using a combination of fa
to reduce our trade receivable balances to their estimated net realizable am
We maintain an allowance for doubtful accounts based on a variety of facto
including the length of time receivables are past due, macroeconomic trend
conditions, significant one-time events, historical experience and the financi
condition of customers. In addition, we record a specific reserve for individu
accounts when we become aware of specific customer circumstances, such
the case of bankruptcy filings or deterioration in the customer’s operating re
financial position. The past due or delinquency status of a receivable is base

the contractual payment terms of the receivable. If circumstances related to
specific customer change, we adjust estimates of the recoverability of recei
as appropriate. We determine our allowance for early payment discounts pr
based on historical experience with customers.

Credit risk with respect to accounts receivable is generally diversified due to
large number of entities comprising our customer base and their dispersion
many different geographical regions. We perform ongoing credit evaluations
financial condition of our third-party distributors, resellers and other custome
require collateral, such as letters of credit and bank guarantees, in certain
circumstances. As of December 31, 2018 and 2017 we do not believe we ha
significant concentrations of credit risk.

Inventories

Inventories, which include the costs of material, labor and overhead, are sta
the lower of cost or net realizable value using the first in, first out ("FIFO") m
Estimated losses from obsolete and slow-moving inventories are recorded t
reduce inventory values to their estimated net realizable value. Our manufa
operations recognize costs of sales using standard costs with full overhead
absorption, which generally approximates actual cost.

Property, Plant and Equipment

These assets are recorded at historical cost and are depreciated using the straight-line method of depreciation over the estimated useful lives as follow

	Estimated Life
Buildings and improvements	5 to 40 years
Machinery and equipment	2 to 10 years
Furniture and fixtures	3 to 7 years
Equipment held for lease or rental	2 to 10 years

Leasehold improvements are depreciated over the shorter of their estimatec life or the term of the lease. Costs related to maintenance and repairs that c prolong the assets' useful lives are expensed as incurred.

Goodwill and Intangible Assets

Goodwill represents purchase consideration paid in a business combination exceeds the values assigned to the net assets of acquired businesses. Intar assets include customer relationships, proprietary technology, brands and trademarks, patents, software and other intangible assets. Intangible assets finite life are amortized on a straight-line basis over an estimated economic life which ranges from 1 to 25 years and is included in cost of revenue or se general and administrative expense. Certain of our intangible assets, namel certain brands and trademarks, as well as FCC licenses, have an indefinite are not amortized.

Long-Lived Asset Impairment

Long-lived assets, including intangible assets with finite lives, are amortized tested for impairment whenever events or changes in circumstances indicat carrying value may not be recoverable. We assess the recoverability of long assets based on the undiscounted future cash flow the assets are expected generate and recognize an impairment loss when estimated undiscounted f cash flows expected to result from the use of the asset plus net proceeds ex from disposition of the asset, if any, are less than the carrying value of the a When an impairment is identified, we reduce the carrying amount of the ass estimated fair value based on a discounted cash flow approach or, when av and appropriate, to comparable market values.

Goodwill and indefinite-lived intangible assets are not amortized, but rather tested for impairment annually (or more frequently if impairment indicators a such as changes to the reporting unit structure, significant adverse changes business climate or an adverse action or assessment by a regulator). We co our annual impairment testing on the first day of our fourth quarter. For good the estimated fair value of each reporting unit is compared to the carrying va the net assets assigned to that reporting unit. If the estimated fair value of th reporting unit exceeds its carrying value, goodwill is not impaired. If the carr value of the reporting unit exceeds its estimated fair value, then an impairm charge is recognized for that excess up to the amount of recorded goodwill. estimate the fair value of our reporting units using an income approach. We estimate the fair value of our intangible assets with indefinite lives using eith income approach or the market approach. Under the income approach, we calculate fair value based on the present value of estimated future cash flow Under the market approach, we calculate fair value based on recent sales a selling prices of similar assets.

Product Warranties

For assurance-type warranties, we accrue for the estimated cost of product warranties at the time revenue is recognized and record it as a component c of revenue. Our product warranty liability reflects our best estimate of proba liability under the terms and conditions of our product warranties offered to customers. We estimate the liability based on our standard warranty terms, historical frequency of claims and the cost to replace or repair our products warranty. Factors that impact our warranty liability include the number of un the length of warranty term, historical and anticipated rates of warranty clair cost per claim. We also record a warranty liability for specific matters. We a the adequacy of our recorded warranty liabilities quarterly and adjust amour necessary.

For service-type warranties (i.e. non-standard warranties) costs incurred to the extended or service warranty are recognized/recorded as the costs are incurred.

Postretirement Benefit Plans

The determination of defined benefit pension and postretirement plan obliga and their associated costs requires the use of actuarial computations to esti participant plan benefits to which the employees wil

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l be entitled. The significant assumptions primarily relate to discount rates, expected long-term rates of return on plan assets, rate of future compensati increases, mortality, years of service and other factors. We develop each assumption using relevant company experience in conjunction with market- data for each individual country in which such plans exist. All actuarial assu are reviewed annually with third-party consultants and adjusted as necessa the recognition of net periodic postretirement cost, the calculation of the exp return on plan assets is generally derived by applying the expected long-ter of return on the market-related value of plan assets. The market-related valu plan assets is based on average asset values at the measurement date ove last five years. Actual results that differ from our assumptions are accumula amortized on a straight-line basis only to the extent they exceed 10% of the of the market-related value or the projected benefit obligation, over the aver remaining service period of active participants, or for plans with all or substa all inactive participants, over the average remaining life expectancy. The fai of plan assets is determined based on market prices or estimated fair value measurement date.

We consider changes to a plan’s benefit formula that eliminate the accrual f service but continue to allow for future salary increases (i.e. “soft freeze”) to curtailment.

Business Combinations

We allocate the purchase price of acquisitions to the tangible and intangible acquired, liabilities assumed, and non-controlling interests in the acquiree b on their estimated fair value at the acquisition date. The excess of the acqui price over those estimated fair values is recorded as goodwill. Changes to t acquisition date provisional fair values prior to the expiration of the measure period, a period not to exceed 12 months from date of acquisition, are recor an adjustment to the associated goodwill. Acquisition-related expenses and restructuring costs, if any, are recognized separately from the business combination and are expensed as incurred.

Derivative Financial Instruments

We record all derivatives on the balance sheet at fair value. The accounting changes in the fair value of derivatives depends on whether we have electe designate a derivative in a hedging relationship and apply hedge accounting whether the hedging relationship has satisfied the criteria necessary to appl hedge accounting. Derivatives designated and qualifying as a hedge of the exposure to changes in the fair value of an asset, liability, or firm commitme attributable to a particular risk are considered fair value hedges. Derivatives designated and qualifying as a hedge of the exposure to variability in expec future cash flows, including forecasted transactions, are considered cash flo hedges. Derivatives may also be designated as hedges of the foreign curren exposure of a net investment in a foreign operation. Hedge accounting gene provides for the matching of the timing of gain or loss recognition on the hec instrument with the recognition of the changes in the fair value of the hedge or liability that are attributable to the hedged risk in a fair value hedge or the earnings effect of the hedged forecasted transactions in a cash flow hedge. may enter into derivative contracts that are intended to hedge certain risks economically, even though hedge accounting does not apply or we elect no apply hedge accounting.

During the fourth quarter of 2018 we adopted new accounting guidance that
eliminates the concept of ineffectiveness for cash flow and net investment h
(refer to Note 2, “Recently Issued Accounting Pronouncements”). Prior to th
adoption, the effective portion of changes in the fair value of derivatives des
and that qualify as cash flow hedges of foreign exchange risk was recorded
other comprehensive income ("OCI") and was subsequently reclassified into
revenue or cost of revenue (hedge of sales classified into revenue and hedg
purchases classified into cost of revenue) in the period that the hedged fore
transaction affects earnings. Any ineffective portion of the change in fair val
the derivative was recognized directly in selling, general and administrative
expenses. Our policy was to de-designate cash flow hedges at the time fore
transactions are recognized as assets or liabilities on a business unit’s bala
sheet and report subsequent changes in fair value through selling, general a
administrative expenses where the gain or loss due to movements in curren
rates on the underlying asset or liability is revalued. If it became probable th
originally forecasted transaction would not occur, the gain or loss related to
hedge recorded within accumulated other comprehensive income ("AOCI")
immediately recognized into net income.

Prior to the adoption of the new guidance, changes in the fair value of deriva
designated and that qualify as net investment hedges of foreign exchange r
were recorded in OCI. Amounts in AOCI were reclassified into earnings at th
the hedged net investment is sold or substantially liquidated. Effectiveness o
derivatives designated as net investment hedges was assessed using the fo
method.

Subsequent to adopting the new hedge guidance, changes in the fair value
derivatives designated and that qualify as cash flow hedges of foreign excha
risk are recorded in other comprehensive income ("OCI") and are subseque
reclassified into either revenue or cost of revenue (hedge of sales classified
revenue and hedge

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of purchases classified into cost of revenue) in the period that the hedged forecasted transaction affects earnings. Our policy is to de-designate cash f hedges at the time forecasted transactions are recognized as assets or liab on a business unit's balance sheet and report subsequent changes in fair va through selling, general and administrative expenses where the gain or loss movements in currency rates on the underlying asset or liability is revalued. becomes probable that the originally forecasted transaction will not occur, th or loss related to the hedge recorded within accumulated other comprehens income ("AOCI") is immediately recognized into net income.

Subsequent to adopting the new hedge guidance effectiveness of derivative designated as net investment hedges is assessed using the spot method. T changes in the fair value of these derivatives due to movements in spot exc rates are recorded in OCI. Amounts in AOCI are reclassified into earnings a time the hedged net investment is sold or substantially liquidated. Furtherm will recognize interest income based on the interest rate differential embedd the derivative instrument.

Commitments and Contingencies

We record accruals for commitments and loss contingencies for those which both probable and for which the amount can be reasonably estimated. In ad legal fees are accrued for cases where a loss is probable and the related fe be reasonably estimated. Significant judgment is required to determine both probability and the estimated amount of loss. We review these accruals qua and adjust the accruals to reflect the impact of negotiations, settlements, ru advice of legal counsel, and other current information.

Accruals for environmental matters are recorded on a site-by-site basis whe probable that a liability has been incurred and the amount of the liability can reasonably estimated, based on current law and existing technologies. Our estimated liability is reduced to reflect the anticipated participation of other potentially responsible parties in those instances where it is probable that su parties are legally responsible and financially capable of paying their respec shares of the relevant costs. These accruals are reviewed quarterly and are adjusted as assessment and remediation efforts progress or as additional te or legal information becomes available. Actual costs to be incurred at identi sites in future periods may vary from the estimates, given inherent uncertai evaluating environmental exposures. Accruals for environmental liabilities a primarily included in other non-current liabilities at undiscounted amounts a exclude claims for recoveries from insurance companies or other third partie

Concentrations of Credit Risk

Financial instruments that potentially subject us to significant concentrations credit risk consist principally of cash and cash equivalents, and accounts receivable from trade customers. We maintain cash and cash equivalents a derivative contracts with various financial institutions. These financial institu are located in many different geographical regions, and our policy is design limit exposure with any one institution. As part of our cash and risk manage processes, we perform periodic evaluations of the relative credit standing of financial institutions. We have not sustained any material credit losses durin previous three years from instruments held at financial institutions. We may forward contracts to protect against the effects of foreign currency fluctuatio Such contracts involve the risk of non-performance by the counterparty. Cre with respect to accounts receivable is generally diversified due to the large

of entities comprising our customer base and their dispersion across many o
industries and geographic regions. We perform ongoing credit evaluations o
financial condition of our third-party distributors, resellers and other custome
require collateral, such as letters of credit and bank guarantees, in certain
circumstances.

Substantially all of the cash and cash equivalents, including foreign cash ba
at December 31, 2018 and 2017 were uninsured. Foreign cash balances at
December 31, 2018 and 2017 were $274 million and $373 million, respectiv

Fair Value Measurements

We determine fair value as the price that would be received to sell an asset
to transfer a liability in an orderly transaction between market participants at
measurement date. We use a hierarchical structure to prioritize the inputs to
valuation techniques used to measure fair value into three broad levels defi
follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical or liabilities.
- Level 2 inputs are other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 input include quoted prices (in non-active markets or in active markets for similar or liabilities), inputs other than quoted prices that are observable, and inputs are derived principally from or corroborated by observable market data by correlation or other means.

Level 3 inputs are unobservable inputs for the assets or liabilities.
The fair value hierarchy is based on maximizing the use of observable input
minimizing the use of unobservable inputs when measuring fair value.
Classification within the fair value hierarchy is based on the lowest level inp
is significant to the fair value measurement.
NAV Practical Expedient is the measurement of fair value using the net ass
("NAV") per share (or its equivalent) as an alternative to the fair value hierar
discussed above.

Note 2. Recently Issued Accounting Pronouncements

Pronouncements Not Yet Adopted

In August 2018, the Financial Accounting Standards Board ("FASB") issued guidance regarding the accounting for implementation costs of a hosting arrangement that is a service contract. The guidance establishes the require to capitalize certain implementation costs incurred in a hosting arrangement a service contract, effectively aligning with the requirement to capitalize cert implementation costs incurred to develop or obtain internal-use software. Th guidance is effective for interim and annual periods beginning after Decemb 2019 with early adoption permitted. The requirements of the amended guida may be applied using either a retrospective or prospective approach. We ar evaluating the impact of the guidance on our financial condition and results operations.

In June 2016, the FASB issued guidance amending the accounting for the impairment of financial instruments, including trade receivables. Under curre guidance, credit losses are recognized when the applicable losses are prob occurring and this assessment is based on past events and current conditio amended guidance eliminates the "probable" threshold and requires an enti a broader range of information, including forecast information when estimati expected credit losses. Generally, this should result in a more timely recogn credit losses. This guidance is effective for interim and annual periods begin after December 15, 2019 with early adoption permitted for interim and annu periods beginning after December 15, 2018. The requirements of the amen guidance should be applied using a modified retrospective approach except debt securities, which require a prospective transition approach. We are eva the impact of the guidance on our financial condition and results of operatio

In February 2016, the FASB issued guidance amending the accounting for l Specifically, the amended guidance requires all lessees to record a lease lia lease inception, with a corresponding right of use asset ("ROU"), except for short-term leases. Lessor accounting is not fundamentally changed. This am guidance is effective for interim and annual periods beginning after Decemb 2018 using a modified retrospective approach. Early adoption is permitted. apply the modified retrospective approach by recording a cumulative effect adjustment as of the date of adoption, whereby prior comparative periods w be retrospectively presented in the consolidated financial statements. As a r adoption of the standard will result in the recognition of ROU assets and lea liabilities for operating leases of between $255 million and $285 million, as o January 1, 2019, the date of initial application. The guidance will not have a material impact on our consolidated income statements and statements of c flow.

Recently Adopted Pronouncements

In August 2017, the FASB issued amended guidance on hedging activities. amendment better aligns a company's risk management activities and finan reporting for hedging relationships through changes to both the designation measurement guidance for qualifying for hedging relationships and the presentation of hedge results. Specifically, the guidance:

(1) Eliminates the concept of recognizing periodic hedge ineffectiveness for flow and net investment hedges;

(2) Eliminates the benchmark interest rate concept of variable - rate instrume cash flow hedges and allows companies to designate the contractually sp interest rate as the hedged risk;

(3) Requires a company to present the earnings effect of the hedging instrur the same income statement line item in which the earnings effect of the h item is reported; and

(4) Provides the ability to perform subsequent hedge effectiveness tests qualitatively.

This guidance is effective for fiscal years beginning after December 15, 201 including interim periods within those annual periods. Early adoption is perm with the effect of adoption reflected as of the beginning of the fiscal year of adoption. For cash flow and net investment hedges existing at the date of a a cumulative-effect

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adjustment related to eliminating the separate measurement of ineffectivene
required. Other presentation and disclosure guidance is required only prospectively. We adopted this guidance in the fourth quarter of 2018. The adoption resulted in the recognition of $2 million of interest income as a resu
our transition from the forward rate method to the spot rate method in accou
for our net investment hedges.

In February 2018, the FASB issued new guidance on the reclassification of tax effects in Accumulated Other Comprehensive Income ("AOCI"). The gu
allows a reclassification from AOCI to retained earnings for stranded tax eff
resulting from the Tax Cuts and Jobs Act (the "Tax Act"). This guidance is e
for fiscal years beginning after December 15, 2018, including interim period
those annual periods. Early adoption is permitted. The guidance may be ap
either in the period of adoption or retrospectively to each period (or periods)
which the effect of the change in the U.S. federal corporate income tax rate
Tax Act is recognized. We early adopted this guidance effective the first qua
2018, and elected to reclassify the income tax effects of the Tax Act from A
retained earnings. As a result of adopting the guidance, AOCI was reduced
million and retained earnings increased by $17 million. This amount include
effect of the change in the US federal corporate income tax rate.

In March 2017, the FASB issued amended guidance on the presentation of periodic benefit costs. The amendment requires that an employer report the
service cost component in the same line item or items as other compensatio
arising from services rendered by the pertinent employees during the period
other components are required to be presented in the income statement sep
and outside a subtotal of income from operations, if one is presented. The amendment also requires entities to disclose the income statement lines tha
contain the other components if they are not appropriately described. This guidance is effective retrospectively for periods beginning after December 1
2017, including interim periods within those annual periods. Early adoption i
permitted. We adopted this guidance effective the first quarter of 2018. The period consolidated income statements and segment results have been retrospectively adjusted in accordance with the new guidance. The impact t
presentation between operating income and other non-operating income wi
Xylem's Consolidated Income Statements was approximately $4 million and
million for the years ended December 31, 2017 and 2016, respectively.

In May 2014, the FASB issued guidance on recognizing revenue from contr
with customers. The guidance outlines a single comprehensive model to us
accounting for revenue arising from contracts with customers and supersed
current revenue recognition guidance, including industry-specific guidance.
core principle of the model is that an entity recognizes revenue to portray th
transfer of goods and services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for thos
or services. The standard also expands disclosure requirements regarding r
recognition. This guidance is effective for interim and annual reporting perio
beginning after December 15, 2017 and may be applied retrospectively to e
prior period presented or using a modified retrospective approach with the cumulative effect recognized as of the date of initial application. Early adopt
permitted for interim and annual reporting periods beginning after Decembe
2016. We adopted this guidance as of January 1, 2018 using the modified retrospective transition method. The adoption of the guidance did not have a

material impact on our financial condition and results of operations. See No
"Revenue", for further details.

In May 2017, the FASB issued guidance, which amends the scope of modif
accounting guidance for share-based payment arrangements. The guidance
outlines the types of changes to the terms or conditions of share-based pay
arrangements that would require the use of modification accounting. Specifi
modification accounting would not apply if the fair value, vesting conditions,
classification of the award as equity or liability are the same immediately be
and after the modification. This guidance is effective prospectively for interi
annual reporting periods beginning December 15, 2017 and early adoption
permitted. We elected to early adopt this guidance effective the second qua
2017. The adoption of this guidance did not impact our financial condition o
from operations.

In January 2017, the FASB issued guidance amending the impairment testi
goodwill. Under current guidance, the testing of goodwill for impairment is
performed at least annually using a two-step test. Step one involves compa
fair value of a “reporting unit” to its carrying amount. If the applicable book v
exceeds the reporting unit’s fair value then step two must be performed. Ste
involves comparing the fair value of the reporting unit’s goodwill to the applic
carrying amount of the asset and recognizing an impairment charge equal t
amount by which the carrying amount of the goodwill exceeds its implied fai
The amended guidance eliminates step two of the impairment test and allov
entity to record an impairment charge equal to the amount that the carrying
of the applicable reporting unit exceeds its fair value, up to the value of the
recorded goodwill. This guidance is effective prospectively for interim and a
goodwill impairment tests beginning after December 15, 2019 with early ad
permitted for interim or annual tests after January 1, 2017. We elected to

early adopt this guidance effective the first quarter of 2017. The adoption of guidance did not impact our financial condition or results of operations.

In October 2016, the FASB issued guidance amending the accounting for in taxes. Under current guidance the recognition of current and deferred incom taxes for an intra-entity asset transfer is prohibited until the asset has been an outside party. The amended guidance eliminates the prohibition against immediate recognition of current and deferred income tax amounts associat intra-entity transfers of assets other than inventory. This guidance is effectiv interim and annual periods beginning after December 15, 2017 with early ac permitted as of the beginning of an annual reporting period for which financi statements (interim or annual) have not been issued or made available for issuance. The requirements of the amended guidance should be applied on modified retrospective basis through a cumulative-effect adjustment directly retained earnings as of the beginning of the period of adoption. We elected adopt this guidance effective the first quarter of 2017. As a result of adoptin amended guidance, prepaid tax assets were reduced by $14 million, long-te deferred tax assets increased $3 million, and accrued taxes were reduced b million. The net impact of these adjustments on retained earnings was a dec of $7 million.

In July 2015, the FASB issued guidance regarding simplifying the measurem inventory. Under prior guidance, inventory is measured at the lower of cost market, where market is defined as replacement cost, with a ceiling of net realizable value and a floor of net realizable value less a normal profit marg amended guidance requires the measurement of inventory at the lower of c net realizable value. Net realizable value is the estimated selling prices in th ordinary course of business, less reasonably predictable costs of completion disposal, and transportation. This guidance is effective prospectively for inte and annual periods beginning after December 15, 2016 and early applicatio permitted. We adopted this guidance effective the first quarter of 2017. The adoption of this guidance did not impact our financial condition or results of operations.

Note 3. Acquisitions and Divestitures

2018 Acquisitions and Divestitures

Pure Technologies Ltd.

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

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

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

(in millions)	Amount
Cash	$ 14

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

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During the fourth quarter of 2018 we finalized the Pure purchase price alloc
The fair values of Pure's assets and liabilities were determined based on es
and assumptions which management believes are reasonable.

Goodwill arising from the acquisition consists largely of synergies and econ
of scale expected from combining the operations of Pure and Xylem. All of t
goodwill was assigned to the Measurement & Control Solutions segment ar
deductible for tax purposes.

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

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

The following table summarizes, on an unaudited pro forma basis, the cond
combined results of operations of the Company for the years ended Decem
2018 and 2017, respectively, assuming the acquisition of Pure was made or
January 1, 2017.

(in millions)	Year Ended December 31,	
	2018	2017
Revenue	$5,212	$4,809
Net income	$546	$323

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

- Amortization expense of acquired intangibles

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

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

During the eleven month period ended December 31, 2018 Pure had revenu an operating loss of $96 million and $2 million, respectively.

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Other Acquisition Activity

During the twelve months ended December 31, 2018 we spent approximate
million, net of cash received on other acquisition activity.

During the third quarter we divested our Precision Die Casting business for
approximately $22 million, net of cash assumed. The sale resulted in an imm
gain, which is reflected in gain from sale of business in our Consolidated Inc
Statement. The business, which was part of our Measurement & Controls S
segment, provided aluminum die casting products primarily to customers in
automotive sector. The business reported 2017 annual revenue of approxim
$32 million.

2017 Acquisitions and Divestitures

Acquisition Activity

During 2017 we spent approximately $33 million on acquisition activity, inclu
the acquisition of EmNet LLC (“EmNet”), a developer of software and data a
solutions for municipalities.

Divestitures

On October 31, 2017, we divested our Flowtronex and Water Equipment
Technologies (WET) businesses for $6 million. The sale resulted in a gain o
approximately $1 million, which is reflected in gain from sale of business in o
Consolidated Income Statement. The business, which was part of our Appli
Water segment, provided turf and reverse osmosis packages to customers
agricultural and industrial sectors. The business reported approximately $9
of revenue in the first 10 months of 2017.

On February 17, 2017, we divested our United Kingdom and Poland based
membranes business for approximately $10 million. The sale resulted in a g
$5 million, which is reflected in gain from sale of business in our Consolidate
Income Statement. The business, which was part of our Applied Water segn
provided membrane filtration products primarily to customers in the municip
and industrial sectors. The business reported 2016 annual revenue of
approximately $8 million.

Assets Held for Sale

During the fourth quarter of 2017 two of our businesses qualified as held for
treatment. Accordingly an estimated loss of $16 million was recognized.

2016 Acquisitions

Sensus Worldwide Limited

On October 31, 2016, we acquired all of the outstanding equity interests of S
Worldwide Limited (other than Sensus Industries Limited) (“Sensus”) effecti
October 31, 2016 for $1,766 million ($1,710 million net of cash acquired), in
a $6 million payment in 2017 for a working capital adjustment. Sensus deve
advanced technology solutions that enable intelligent use and conservation
critical water and energy resources. Sensus' major products include smart
metering, networked communications, measurement and control technologi
software and services including cloud-based analytics, remote monitoring a
management. The Company acquired Sensus because it believes that, with
market category, its products have superior qualities and usefulness to cust
The Company also acquired Sensus on the strength of its developed techno

that we plan to leverage across our existing base of products and customer

Acquisition costs of $19 million were reflected as a component of selling, ge
and administrative expenses in our Consolidated Income Statements.

Sensus results of operations were consolidated with the Company effective
November 1, 2016 and it is part of the Measurement & Control Solutions se
Refer to Note 21, "Segment and Geographic Data" for Measurement & Con
Solutions segment information.

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The Sensus purchase price allocation as of October 31, 2016 is shown in th
following table.

(in millions)	Amount
Cash	$56
Receivables	104
Inventories	79
Prepaid and other current assets	19
Property, plant and equipment	176
Intangible assets	782
Other long-term assets	5
Accounts payable	(69)
Accrued and other current liabilities	(90)
Deferred income tax liabilities	(198)
Accrued post retirement benefits	(84)
Other non-current accrued liabilities	(60)
Total identifiable net assets	720
Goodwill	1,063
Non-controlling interest	(17)
Total consideration	$1,766

In the third quarter of 2017 we finalized the Sensus purchase price allocatio
fair values of Sensus' assets and liabilities were determined based on estim
and assumptions which management believes are reasonable.

Goodwill arising from the acquisition consists largely of synergies and econ
of scale expected from combining the operations of Sensus and Xylem. All
goodwill was assigned to the Measurement & Control Solutions segment an
deductible for tax purposes.

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

Category	**Life**	**Amount (in millions)**
Customer and Distributor Relationships	2 - 18 years	$ 543
Tradenames	10 - 25 years	98
Internally Developed Network Software	7 years	60
FCC Licenses	Indefinite lived	24
Technology	5 - 15 years	39
Other	1 - 16 years	18

Total	$ 782

The following table summarizes, on an unaudited proforma basis, the conde
combined results of operations of the Company for the year ended Decemb
2016 assuming the acquisition of Sensus was made on January 1, 2015.

(in millions)	Year Ended December 31, 2016
Revenue	$ 4,528
Net income	$ 286

The foregoing unaudited proforma results are for informational purposes on
are not necessarily indicative of the actual results of operations that might h
occurred had the acquisition occurred on January 1, 2015, nor are they nec
indicative of future results. The pro forma financial information includes the
of purchase accounting and other nonrecurring items directly attributable to
acquisition, which include:

- Adjustments to revenue resulting from the valuation of the acquired d revenue balance to fair value as part of purchase accounting
- Amortization expense of acquired intangibles
- Amortization of the fair value step-up in inventory
- Adjustments to the depreciation of property, plant and equipment reflecting impact of the calculated fair value of those assets in accordance with purch accounting
- Amortization of the fair value adjustment for warranty liabilities
- Adjustments to interest expense to remove historical Sensus interest costs reflect Xylem's current debt profile
- The related tax impact of the above referenced adjustments

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

For the two month period ended December 31, 2016 Sensus had revenue a
operating loss of $132 million and $13 million, respectively.

Visenti Pte. Ltd

On October 18, 2016, we acquired Visenti Pte. Ltd. ("Visenti"), a smart wate
analytics company focused on leak detection and pressure monitoring solut
help water utilities manage their water networks for $8 million. Visenti, a
privately-owned company headquartered in Singapore, has approximately 2
employees. Our consolidated financial statements include Visenti's results o
operations prospectively from October 18, 2016 within the Measurement & C
Solutions segment.

Tideland Signal Corporation

On February 1, 2016, we acquired Tideland Signal Corporation ("Tideland")
leading producer of analytics solutions in the coastal and ocean manageme

sectors, for $70 million. Tideland, a privately-owned company headquartere
Texas, has approximately 160 employees. Our consolidated financial staten
include Tideland's results of operations prospectively from February 1, 2016
the Measurement & Control Solutions segment.

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Note 4. Revenue

Disaggregation of Revenue

The following table illustrates the sources of revenue:

(in millions)	Twelve Months Ended December 31, 2018
Revenue from contracts with customers	$ 4,963
Other	244
Total	$ 5,207

The following table reflects revenue from contracts with customers by applic

(in millions)	Twelve Months Ended December 31, 2018
Water Infrastructure	
Transport	$ 1,535
Treatment	397
Applied Water	
Commercial Building Services	596
Residential Building Services	232
Industrial Water	706
Measurement and Control Solutions	
Water	692
Electric	143
Gas	195
Software and Services/Other	123
Test	344
Total	$ 4,963

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

(in millions)	Twelve Months Ended December 31, 2018
Water Infrastructure	
United States	$ 539
Europe	758
Emerging Markets & Other	635
Applied Water	
United States	797
Europe	386
Emerging Markets & Other	351
Measurement and Control Solutions	
United States	913
Europe	273
Emerging Markets & Other	311
Total	$ 4,963

Contract Balances

We receive payments from customers based on a billing schedule as establ
in our contracts. Contract assets relate to revenue recognized in advance o
scheduled billings. Contract liabilities relate to payments received in advanc
performance under the contracts. Change in contract assets and liabilities a
to our performance under the contract.

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

(in millions)	Contract Assets (a)	Contract Liabilities
Balance at 1/1/2018	$ 89	$ 107
Additions, net	87	101
Revenue recognized from opening balance	—	(89)
Billings	(76)	—
Foreign currency and other	(4)	(6)
Balance at 12/31/2018	$ 96	$ 113

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

Performance obligations

Delivery schedules vary from customer to customer based upon their
requirements. Typically, large projects require longer lead production cycles
delays can occur from time to time. As of December 31, 2018, the aggregat
amount of the transaction price allocated to performance obligations that ar
unsatisfied or partially unsatisfied for contracts with performance obligations

amount to $258 million. We expect to recognize revenue upon the completio
satisfying the majority of these performance obligations in the following 12 t
months. The Company elects to apply the practical expedient to exclude fro
disclosure revenue related to performance obligations that are part of a con
whose original expected duration is less than one year.

Note 5. Restructuring and Asset Impairment Charges

From time to time, the Company will incur costs related to restructuring actic order to optimize our cost base and more strategically position ourselves ba the economic environment and customer demand. During 2018, 2017 and 2 the costs incurred primarily relate to an effort to reposition our European an American businesses to optimize our cost structure and improve our operat efficiency and effectiveness. In 2018, the charges included the reduction of headcount and consolidation of facilities within our Measurement & Control Solutions and Water Infrastructure segments, as well as headcount reductio within our Applied Water segment. In 2017 and 2016 the charges included t reduction of headcount and consolidation of facilities within our Applied Wat Water Infrastructure, and Measurement & Control Solutions segments, as w Corporate headcount reductions. The components of restructuring charges incurred during each of the previous three years ended are presented belov

	Year Ended December 31,		
(in millions)	**2018**	2017	2016
By component:			
Severance and other charges	**$19**	$20	$28
Lease related charges	**1**	—	2
Other restructuring charges	**1**	2	1
Reversal of restructuring accruals	**(1)**	(2)	(1)
Total restructuring charges	**20**	20	30
Asset impairment charges	**2**	5	—
Total restructuring and asset impairment charges	**$22**	$25	$30
By segment:			
Water Infrastructure	**$11**	$7	$12
Applied Water	**2**	13	10
Measurement & Control Solutions	**9**	5	6
Corporate and other	**—**	—	2

Restructuring

The following table displays a rollforward of the restructuring accruals, prese on our Consolidated Balance Sheets within accrued and other current liabili the years ended December 31, 2018 and 2017.

(in millions)	**2018**	2017
Restructuring accruals - January 1	**$7**	$15
Restructuring charges	**20**	20
Cash payments	**(21)**	(28)
Foreign currency and other	**(1)**	—
Restructuring accruals - December 31	**$5**	$7
By segment:		
Water Infrastructure	**$1**	$1
Applied Water	**1**	1
Measurement & Control Solutions	**2**	2
Regional selling locations (a)	**1**	3
Corporate and other	**—**	—

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

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The following is a rollforward of employee position eliminations associated v
restructuring activities for the years ended December 31, 2018 and 2017.

	2018	2017
Planned reductions - January 1	**47**	188
Additional planned reductions	**206**	151
Actual reductions and reversals	**(184)**	(292)
Planned reductions - December 31	**69**	47

The following table presents expected restructuring spend:

(in millions)	Water Infrastructure	Applied Water	Measurement & Control Solutions	Corporate	Tota
Actions Commenced in 2018:					
Total expected costs	$ 9	$ 1	$ 7	$ —	$ 17
Costs incurred during 2018	7	1	7	—	15
Total expected costs remaining	**$ 2**	**$ —**	**$ —**	**$ —**	**$ 2**
Actions Commenced in 2017:					
Total expected costs	$ 18	$ 12	$ 3	$ —	$ 33
Costs incurred during 2017	5	4	2	—	11
Costs incurred during 2018	2	1	1	—	4
Total expected costs remaining	**$ 11**	**$ 7**	**$ —**	**$ —**	**$ 18**
Actions Commenced in 2016:					
Total expected costs	$ 13	$ 14	$ 10	$ 2	$ 39
Costs incurred during 2016	11	10	6	2	29
Costs incurred during 2017	2	4	3	—	9
Costs incurred during 2018	—	—	1	—	1
Total expected costs remaining	**$ —**	**$ —**	**$ —**	**$ —**	**$ —**

The Water Infrastructure, Applied Water and Measurement & Control Soluti
actions commenced in 2018 consist primarily of severance charges and are
expected to continue through the third quarter of 2019. The Water Infrastruc
Applied Water and Measurement & Control Solutions actions commenced i
consist primarily of severance charges and are expected to continue throug
second quarter of 2020. The Water Infrastructure, Applied Water, Measurer
Control Solutions and Corporate actions commenced in 2016 consist primar
severance charges and are complete.

Asset Impairment Charges

During the fourth quarter of 2018 we determined that certain assets within o
Water Infrastructure segment, including certain software, were impaired.
Accordingly we recognized an impairment charge of $2 million.

During the first quarter of 2017 we determined that certain assets within our
Applied Water segment, including a tradename, were impaired. Accordingly
recognized an impairment charge of $5 million. Refer to Note 11, "Goodwill
Other Intangible Assets," for additional information.

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Note 6. Other Non-Operating Income, Net

The components of other non-operating income, net are as follows:

(in millions)	Year Ended December 31, 2018	2017	2016
Interest income	**$4**	$ 3	$2
Income from joint ventures	**5**	3	3
Other income (expense) – net	**4**	—	(3)
Total other non-operating income, net	**$13**	$ 6	$2

Note 7. Income Taxes

The source of pre-tax income and the components of income tax expense a
follows:

(in millions)	Year Ended December 31, 2018	2017	2016
Income components:			
Domestic	**$208**	$162	$80
Foreign	**377**	304	260
Total pre-tax income	**$585**	$466	$340
Income tax expense components:			
Current:			
Domestic – federal	**$9**	$109	$19
Domestic – state and local	**13**	9	5
Foreign	**61**	51	42
Total Current	**83**	169	66
Deferred:			
Domestic – federal	**$17**	$(29)	$19
Domestic – state and local	**5**	10	1
Foreign	**(69)**	(14)	(6)
Total Deferred	**(47)**	(33)	14
Total income tax provision	**$36**	$136	$80
Effective income tax rate	**6.1 %**	29.2 %	23.5 %

Reconciliations between taxes at the U.S. federal income tax rate and taxes
effective income tax rate on earnings before income taxes are as follows:

	Year Ended December 31, 2018	2017	2016
Tax provision at U.S. statutory rate	**21.0 %**	35.0 %	35.0 %
Increase (decrease) in tax rate resulting from:			
State income taxes	**2.3**	1.6	0.8
Uncertain tax positions	**2.6**	1.6	(6.4)
Valuation allowance	**(47.1)**	3.3	18.5
Tax exempt interest	**(1.4)**	(10.6)	(14.3)
Foreign tax rate differential	**2.9**	(6.7)	(7.9)
Impact of foreign earnings, net	**(1.7)**	37.0	5.9
Tax incentives	**(6.2)**	(6.6)	(8.9)
Intercompany sale of assets	**35.5**	—	—
Other – net	**(1.8)**	(2.5)	0.8
Rate change	**—**	(22.9)	—
Effective income tax rate	**6.1 %**	29.2 %	23.5 %

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We operate under tax incentives, which are effective January 2013 through December 2023 and may be extended if certain additional requirements are satisfied. The tax incentives are conditional upon our meeting and maintaini certain employment thresholds. The inability to meet the thresholds would h prospective impact and at this time we continue to believe we will meet the requirements.

Deferred tax assets and liabilities are determined based on temporary differ between the financial reporting and tax bases of assets and liabilities, apply enacted tax rates in effect for the year in which we expect the differences w reverse.

The following is a summary of the components of the net deferred tax asset liabilities recognized in the Consolidated Balance Sheets:

	December 31,	
(in millions)	**2018**	2017
Deferred tax assets:		
Employee benefits	**$97**	$108
Accrued expenses	**30**	34
Loss and other tax credit carryforwards	**279**	419
Inventory	**7**	8
Other	**11**	24
	424	593
Valuation allowance	**(234)**	(350)
Net deferred tax asset	**$190**	$243
Deferred tax liabilities:		
Intangibles	**$247**	$300
Investment in foreign subsidiaries	**8**	20
Property, plant, and equipment	**69**	57
Other	**29**	49
Total deferred tax liabilities	**$353**	$426

Management assesses the available positive and negative evidence to esti sufficient future taxable income will be generated to realize existing deferred assets. On the basis of this evaluation, as of December 31, 2018, a valuatio allowance of $234 million has been established to reduce the deferred incor asset related to certain U.S. and foreign net operating losses and U.S. and capital loss carryforwards.

A reconciliation of our valuation allowance on deferred tax assets is as follo

(in millions)	**2018**	2017	2016
Valuation allowance — January 1	**$350**	$311	$248
Change in assessment (a)	**1**	(28)	17
Current year operations	**(271)**	48	38
Foreign currency and other (b)	**154**	19	(32)
Acquisitions	**—**	—	40
Valuation allowance — December 3	**$234**	$350	$311

(a) Increase in assessment in 2018 is primarily attributable to loss positions in various jurisdic Decrease in assessment in 2017 is primarily attributable to Foreign Tax Credits utilization from the Tax Act.

(b) Included in foreign currency and other in 2018 is an increase in net operating losses due amended prior year tax returns for which a valuation allowance was recorded.

Deferred taxes are classified net of unrecognized tax benefits in the Consol
Balance Sheets as follows:

	December 31,	
(in millions)	**2018**	2017
Non-current assets	**$140**	$69
Non-current liabilities	**(303)**	(252)
Total net deferred tax liabilities	**$(163)**	$(183)

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Tax attributes available to reduce future taxable income begin to expire as f

(in millions)	December 31, 2018	First Year of Expiration
U.S. net operating loss	$ 12	December 31, 2024
State net operating loss	98	December 31, 2019
State excess interest expense	12	Indefinitely
State tax credits	2	Indefinitely
Foreign net operating loss	1,119	December 31, 2019
Foreign tax credits	3	December 31, 2030

The Company has provided a deferred tax liability of $13 million for net fore withholding taxes and state income taxes on $1.9 billion of earnings expecte repatriated to the U.S. parent, as of December 31, 2018. The Company curr does not intend to repatriate approximately $1.1 billion taxed under the Tax and has not recorded any deferred taxes related to such amounts as the determination of the amount is not practicable.

Unrecognized Tax Benefits

We recognize tax benefits from uncertain tax positions only if it is more likel not that the tax position will be sustained on examination by the taxing autho or litigation, based on the technical merits of the position. The tax benefits recognized in the consolidated financial statements from such positions are measured based on the largest benefit that has a greater than 50% likelihoo being realized upon ultimate resolution. A reconciliation of the beginning an ending amount of unrecognized tax benefits is as follows:

(in millions)	**2018**	2017	2016
Unrecognized tax benefits — January 1	**$130**	$67	$47
Current year tax positions	**—**	56	12
Prior year tax positions	**7**	7	(22)
Acquisitions	**—**	—	30
Settlements	**(1)**	—	—
Unrecognized tax benefits — December 3	**$136**	$130	$67

The amount of unrecognized tax benefits at December 31, 2018 which, if ul recognized, will reduce our annual effective tax rate is $136 million. We beli it is reasonably possible that the unrecognized tax benefits will be reduced b approximately $8 million within the next 12 months as a result of the expirat certain statute of limitations.

We classify interest relating to unrecognized tax benefits as a component o non-operating (expense) income, net and tax penalties as a component of i tax expense in our Consolidated Income Statements. The amount of accrue interest relating to unrecognized tax benefits as of December 31, 2018 and was $7 million and $4 million.

The following table summarizes our earliest open tax years by major jurisdic

Jurisdiction	Earliest Open Year
Italy	2013
Luxembourg	2016
Sweden	2013
Germany	2009
United Kingdom	2011
United States	2016

Switzerland	2013

Tax Act

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the "Tax Ac Tax Act makes broad and complex changes to the U.S. tax code. The SEC issued SAB 118, which provided guidance on accounting for the tax effects Tax Act. SAB 118 provides a measurement period that should not extend b one year from the Tax Act enactment date for companies to complete the accounting under ASC 740.

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Our accounting for the reduction of U.S. federal corporate tax rate is comple recorded a provisional tax benefit for corporate tax rate reduction of $107 m of December 31, 2017. Upon further analysis of our deferred tax assets and liabilities, we recognized a measurement-period adjustment of $1.5 million a additional decrease of the net deferred tax liabilities and recorded a corresp deferred tax benefit of $1.5 million during the period ended December 31, 2 The effect of this measurement period adjustment on the 2018 effective tax was about 0.3%. A total decrease of the net deferred tax liabilities of $108 m has been recorded for the corporate rate reduction, with a corresponding de tax benefit of $108 million.

Our accounting for the Deemed Repatriation Transition Tax ("Transition Tax complete. We made an estimate of the Transition Tax and recorded a provis Transition Tax liability of $153 million as of December 31, 2017. On the bas revised E&P computations that were completed and additional guidance, we recognized a measurement-period adjustment of a $9 million decrease to th income tax expense in 2018. The effect of the measurement-period adjustm the 2018 effective tax rate was approximately 1.6%. A total Transition Tax obligation to date of $144 million has been recorded, with a corresponding adjustment of $144 million to income tax expense.

The FASB has indicated that a company can make an accounting policy ch either (1) treating taxes due on future U.S. inclusions in taxable income rela GILTI as a current-period expense when incurred (the “period cost method” factoring such amounts into a company’s measurement of its deferred taxes “deferred method”). During the third quarter of 2018, we adopted the period method to treat the tax effects of future U.S. inclusions in taxable income re GILTI as a current-period expense when incurred.

Note 8. Earnings Per Share

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

	Year Ended Decemb	
	2018	2017
Net income attributable to Xylem (in millions)	**$549**	$ 331
Shares (in thousands):		
Weighted average common shares outstanding	**179,750**	179,602
Add: Participating securities (a)	**27**	27
Weighted average common shares outstanding — Basic	**179,777**	179,629
Plus incremental shares from assumed conversions: (b)		
Dilutive effect of stock options	**876**	712
Dilutive effect of restricted stock units and performance share units	**479**	516
Weighted average common shares outstanding — Diluted	**181,132**	180,857
Basic earnings per share	**$3.05**	$ 1.84
Diluted earnings per share	**$3.03**	$ 1.83

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

(b) Incremental shares from stock options, restricted stock units and performance share units computed by the treasury stock method. The weighted average shares listed below were not in the computation of diluted earnings per share because to do so would have been anti-dilut the periods presented or were otherwise excluded under the treasury stock method. The trea stock method calculates dilution assuming the exercise of all in-the-money options and vesti

restricted stock units and performance share units, reduced by the repurchase of shares with
proceeds from the assumed exercises and unrecognized compensation expense for outstan
awards. Performance share units are included in the treasury stock calculation of diluted ear
share based upon achievement of underlying performance and market conditions at the end
reporting period, as applicable. See Note 16, "Stock-Based Compensation Plans" for further
the performance share units.

	Year Ended December 31,		
(in thousands)	**2018**	2017	2016
Stock options	**1,300**	1,626	1,892
Restricted stock units	**333**	379	514
Performance share units	**465**	504	373

Note 9. Inventories

The components of total inventories are summarized as follows:

	December 31,	
(in millions)	**2018**	2017
Finished goods	**$248**	$223
Work in process	**45**	42
Raw materials	**302**	259
Total inventories	**$595**	$524

Note 10. Property, Plant and Equipment

The components of total property, plant and equipment, net are as follows:

	December 31,	
(in millions)	**2018**	2017
Land, buildings and improvements	**$326**	$329
Machinery and equipment	**819**	799
Equipment held for lease or rental	**249**	241
Furniture and fixtures	**109**	101
Construction work in progress	**107**	85
Other	**22**	21
Total property, plant and equipment, gross	**1,632**	1,576
Less accumulated depreciation	**976**	933
Total property, plant and equipment, net	**$656**	$643

Depreciation expense was $117 million, $109 million, and $87 million for 20
2017, and 2016, respectively.

Note 11. Goodwill and Other Intangible Assets

Changes in the carrying value of goodwill by reportable segment during the
ended December 31, 2018 and 2017 are as follows:

(in millions)	Water Infrastructure	Applied Water	Measurement & Control Solutions	Total
Balance as of December 31, 2016	$ 640	$ 505	$ 1,487	$2,632
Activity in 2017				
Divested/acquired	—	(3)	10	7
Foreign currency and other	27	24	78	129
Balance as of December 31, 2017	$ 667	$ 526	$ 1,575	$2,768
Activity in 2018				
Acquired	**—**	**—**	**279**	**279**
Foreign currency and other	**(14)**	**(10)**	**(47)**	**(71**
Balance as of December 31, 2018	**$ 653**	**$ 516**	**$ 1,807**	**$2,976**

During the fourth quarter of 2018, we performed our annual impairment
assessment and determined that the estimated fair values of our goodwill re
units were in excess of each of their carrying values. However, future goodw
impairment tests could result in a charge to earnings. We will continue to ev
goodwill on an annual basis as of the beginning of our fourth quarter and wh
events and changes in circumstances indicate there may be a potential
impairment.

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Other Intangible Assets

Information regarding our other intangible assets is as follows:

(in millions)	**December 31, 2018**			December 31, 2017	
	Carrying Amount	**Accumulated Amortization**	**Net Intangibles**	Carrying Amount	Accumulated Amortization
Customer and distributor relationships	**$951**	**$ (286)**	**$ 665**	$906	$ (241)
Proprietary technology and patents	**198**	**(93)**	**105**	163	(75)
Trademarks	**148**	**(41)**	**107**	138	(37)
Software	**355**	**(164)**	**191**	277	(130)
Other	**24**	**(19)**	**5**	26	(20)
Indefinite-lived intangibles	**159**	**—**	**159**	161	—
Other intangibles	**$1,835**	**$ (603)**	**$ 1,232**	$1,671	$ (503)

We determined that no impairment of the indefinite-lived intangibles existed the measurement date of our impairment assessment in 2018 or 2017. Futu impairment tests could result in a charge to earnings. We will continue to ev the indefinite-lived intangible assets on an annual basis as of the beginning fourth quarter and whenever events and changes in circumstances indicate may be a potential impairment.

Customer and distributor relationships, proprietary technology and patents, trademarks, software and other are amortized over weighted average lives c approximately 14 years, 14 years, 13 years, 5 years and 5 years, respective Total amortization expense for intangible assets was $144 million, $125 mill and $64 million for 2018, 2017 and 2016, respectively.

Estimated amortization expense for each of the five succeeding years is as

(in millions)	
2019	$135
2020	127
2021	112
2022	102
2023	97

During the first quarter of 2017 we determined that the intended use of a fin trade name within our Applied Water segment had changed. Accordingly we recorded a $4 million impairment charge. The charge was calculated using t income approach, which is considered a Level 3 input for fair value measure purposes, and is reflected in "Restructuring and asset impairment charges" Consolidated Income Statements.

Note 12. Derivative Financial Instruments

Risk Management Objective of Using Derivatives

We are exposed to certain risks arising from both our business operations a economic conditions, and principally manage our exposures to these risks t management of our core business activities. Certain of our foreign operation expose us to fluctuations of interest rates and exchange rates that may imp revenue, expenses, cash receipts, cash payments, and the value of our stockholders' equity. We enter into derivative financial instruments to protec value or fix the amount of certain cash flows in terms of the functional curre the business unit with that exposure and reduce the volatility in stockholders equity.

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Cash Flow Hedges of Foreign Exchange Risk

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

Certain business units with exposure to foreign currency exchange risks hav designated certain currency forward agreements as cash flow hedges of forecasted intercompany inventory purchases and sales. Our principal curre exposures relate to the Euro, Swedish Krona, British Pound, Canadian Doll Polish Zloty, and Australian Dollar. We had foreign exchange contracts with purchase notional amounts totaling $506 million and $455 million as of Dece 31, 2018 and 2017, respectively. As of December 31, 2018, our most signifi foreign currency derivatives included contracts to sell U.S. Dollar and purch Euro, purchase Swedish Krona and sell Euro, sell British Pound and purcha Euro, purchase Polish Zloty and sell Euro, purchase U.S. Dollar and sell Ca Dollar and to sell Canadian Dollar and purchase Euro. The purchase notion amounts associated with these currency derivatives were $191 million, $168 million, $52 million, $37 million, $29 million and $22 million, respectively. As December 31, 2017, the purchase notional amounts associated with these currency derivatives were $147 million, $149 million, $66 million, $34 million million and $25 million, respectively.

Hedges of Net Investments in Foreign Operations

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

Cross Currency Swaps

We enter into cross currency swaps to manage our exposure to fluctuations Euro-U.S. Dollar exchange rate. The total notional amount of derivative instruments designated as net investment hedges was $426 million and $44 million as of December 31, 2018 and 2017, respectively.

Foreign Currency Denominated Debt

On March 11, 2016, we issued 2.250% Senior Notes of €500 million aggreg principal amount due March 2023. We designated the entirety of the outstar balance, or $566 million and $592 million as of December 31, 2018 and 201 respectively, net of unamortized discount, as a hedge of a net investment in foreign subsidiaries.

Forward Contracts

On September 23, 2016, we entered into forward contacts with a total notion amount of €300 million to manage our exposure to fluctuations in the Euro-U Dollar exchange rate. The contracts were designated as net investment hed and were settled in 2016.

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The table below presents the effect of our derivative financial instruments o
Consolidated Income Statements and Consolidated Statements of Compreh
Income.

(in millions)	Year Ended Dec 31, 2018	2017
Derivatives in Cash Flow Hedges		
Foreign Exchange Contracts		
Amount of (loss) gain recognized in OCI (a)	**$(8)**	$9
Amount of (gain) reclassified from OCI into revenue (a)	**—**	(6)
Amount of loss reclassified from OCI into cost of revenue (a)	**4**	1
Derivatives in Net Investment Hedges		
Cross Currency Swaps		
Amount of (loss) gain recognized in OCI (a)	**$22**	$(53)
Amount income recognized in Interest Expense	**2**	—
Foreign Currency Denominated Debt		
Amount of (loss) gain recognized in OCI (a)	**$27**	$(74)
Forward Contracts		
Amount of gain recognized in OCI (a)	**$—**	$—

(a) Effective portion

As of December 31, 2018, $1 million of the net losses on cash flow hedges
expected to be reclassified into earnings in the next 12 months.
As of December 31, 2018, no gains or losses on the net investment hedges
expected to be reclassified into earnings over the next 12 months.
The ineffective portion of the change in fair value of a cash flow hedge was
material for 2018, 2017, and 2016.
The net investment hedges did not experience any ineffectiveness in 2018,
and 2016.

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

The fair values of our derivative contracts currently included in our hedging
program were as follows:

(in millions)	December 31, 2018	2017
Derivatives designated as hedging instruments		
Assets		
Cash Flow Hedges		
Other current assets	**$3**	$3
Liabilities		
Cash Flow Hedges		
Other current liabilities	**(1)**	(1)
Net Investment Hedges		
Other non-current liabilities	**(46)**	(64)

The fair value of our long-term debt, due in 2023, designated as a net inves
hedge was $599 million and $638 million as of December 31, 2018 and 201
respectively.

Note 13. Accrued and Other Current Liabilities

(in millions)	December 31, 2018	2017
Compensation and other employee-benefits	**$194**	$203
Customer-related liabilities	**129**	119
Accrued warranty costs	**44**	55
Accrued taxes	**85**	75
Other accrued liabilities	**94**	99
Total accrued and other current liabilities	**$546**	$551

Note 14. Credit Facilities and Long-Term Debt

Total debt outstanding is summarized as follows:

(in millions)	December 3 2018
4.875% Senior Notes due 2021 (a)	**$600**
2.250% Senior Notes due 2023 (a)	**570**
3.250% Senior Notes due 2026 (a)	**500**
4.375% Senior Notes due 2046 (a)	**400**
Research and development finance contract	**—**
Term loan	**257**
Debt issuance costs and unamortized discount (b)	**(19)**
Total debt	**2,308**
Less: short-term borrowings and current maturities of long-term debt	**257**
Total long-term debt	**$2,051**

(a) The fair value of our Senior Notes (as defined below) was determined using quoted prices markets for identical securities, which are considered Level 1 inputs. The fair value of our Notes due 2021 (as defined below) was $620 million and $648 million as of December 31 and 2017, respectively. The fair value of our Senior Notes due 2023 (as defined below) w million and $638 million as of December 31, 2018 and 2017, respectively. The fair value o Senior Notes due 2026 (as defined below) was $476 million and $498 million as of Decem 2018 and 2017, respectively. The fair value of our Senior Notes due 2046 (as defined bel $397 million and $431 million as of December 31, 2018 and 2017, respectively.

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

Senior Notes

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

The Senior Notes include covenants that restrict our ability, subject to excep to incur debt secured by liens and engage in sale and leaseback transactio well as provide for customary events of default (subject, in certain cases, to of notice of default and/or customary grace and cure periods). We may rede

Senior Notes, as applicable, in whole or in part, at any time at a redemption
equal to the principal amount of the Senior Notes to be redeemed, plus a
make-whole premium. We may also redeem the Senior Notes in certain oth
circumstances, as set forth in the applicable Senior Notes indenture.
If a change of control triggering event (as defined in the applicable Senior N
indenture) occurs, we will be required to make an offer to purchase the Sen
Notes at a price equal to 101% of their principal amount plus accrued and u
interest to the date of repurchase.

Interest on the Senior Notes due 2021 is payable on April 1 and October 1 o
year. Interest on the Senior Notes due 2023 is payable on March 11 of each
Interest on the Senior Notes due 2026 and the Senior Notes due 2046 is pa
on May 1 and November 1 of each year beginning on May 1, 2017. As of
December 31, 2018, we were in compliance with all covenants for the Senio
Notes.

We used the net proceeds of the Senior Notes due 2026 and the Senior No
2046, together with cash on hand, proceeds from issuances under our exist
commercial paper program and borrowings under the Term Facility (as desc
below), to fund the acquisition of Sensus (refer to Note 3 for further informat
the Sensus acquisition).

Credit Facilities

Five-Year Revolving Credit Facility

Effective March 27, 2015, Xylem entered into a Five-Year Revolving Credit
(the "Credit Facility") with Citibank, N.A., as administrative agent, and a syn
of lenders. The Credit Facility provides for an aggregate principal amount of
$600 million of: (i) revolving extensions of credit (the "revolving loans") outst
at any time and (ii) the issuance of letters of credit in a face amount not in e
of $100 million outstanding at any time. The Credit Facility provides for incre
up to $200 million for a possible maximum total of $800 million in aggregate
principal amount at our request and with the consent of the institutions prov
such increased commitments.

At our election, the interest rate per annum applicable to the revolving loans
based on either (i) a Eurodollar rate determined by reference to LIBOR, adju
for statutory reserve requirements, plus an applicable margin or (ii) a fluctua
rate of interest determined by reference to the greatest of: (a) the prime rate
Citibank, N.A., (b) the U.S. Federal funds effective rate plus half of 1% or (c
Eurodollar rate determined by reference to LIBOR, adjusted for statutory res
requirements, in each case, plus an applicable margin.

In accordance with the terms of an amendment to the Credit Facility dated A
30, 2016, we may not exceed a maximum leverage ratio of 4.00 to 1.00 (bas
a ratio of total debt to earnings before interest, taxes, depreciation and
amortization) for a period of 12-months following the Sensus acquisition and
maximum leverage ratio of 3.50 to 1.00 through the rest of the term. The Cr
Facility also contains limitations on, among other things, incurring secured d
granting liens, entering into sale and leaseback transactions, mergers,
consolidations, liquidations, dissolutions and sales of assets. In addition, the
Facility contains other terms and conditions such as customary representati
and warranties, additional covenants and customary events of default. As of
December 31, 2018 the Credit Facility was undrawn and we are in complian
all covenants.

European Investment Bank - R&D Finance Contract

On October 28, 2016, the Company entered into a Finance Contract (the “F
Contract”) with the European Investment Bank (the “EIB”). The Company's w
owned subsidiaries in Luxembourg, Xylem Holdings S.á r.l. and Xylem
International S.á r.l., are the borrowers under the Finance Contract and Xyle
is the Guarantor. The Finance Contract provides for up to €105 million
(approximately $120 million) to finance research, development and innovati
projects in the field of sustainable water and wastewater solutions during the
from 2017 through 2019 in Sweden, Germany, Italy, the United Kingdom, H

and Austria. The Company has unconditionally guaranteed the performance
borrowers under the Finance Contract. Under the Finance Contract, the bor
are able to draw loans on or before April 28, 2018, with a maturity of no long
11 years.

The Finance Contract is subject to the same leverage ratio as the Credit Fa
Both agreements also contain limitations on, among other things, incurring
granting liens, and entering into sale and leaseback transactions, as well as
terms and conditions, such as customary representations and warranties,
additional covenants and customary events of default.

The Finance Contract provides for fixed rate loans and floating rate loans. U
the Finance Contract, the interest rate per annum applicable to fixed rate lo
at a fixed percentage rate per annum specified by the EIB which includes th
applicable margin. The interest rate per annum applicable to floating rate lo
at the rate determined by reference to EURIBOR for loans drawn in Euros a
LIBOR for loans drawn in Pounds Sterling or U.S. Dollars, plus an applicabl
spread specified by the EIB which includes the applicable margin. The appli
margin is 59 basis points (0.59%). As of December 31, 2017, there was $12
million outstanding under the Finance Contract. On November 28, 2018, the
Finance Contract was repaid and settled for $120 million.

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Term Loan Facility

On January 26, 2018, the Company’s subsidiary, Xylem Europe GmbH (the
“borrower”) entered into a 12-month €225 million (approximately $257 million) t
loan facility (the “Term Facility”) the terms of which are set forth in a term loa
agreement, among the borrower, the Company, as parent guarantor and IN
Bank. The Company has entered into a parent guarantee in favor of ING Ba
dated January 26, 2018 to secure all present and future obligations of the b
under the Term Loan Agreement. The Term Facility was used to partially fu
acquisition of Pure Technologies Ltd.. On January 25, 2019, the Company
extended the Term Facility for another month and intends to further extend t
Term Facility at the next maturity.

Commercial Paper

Our commercial paper program generally serves as a means of short-term f
and has a combined outstanding limit of $600 million inclusive of the Five-Y
Revolving Credit Facility. As of December 31, 2018 and December 31, 2017
of the Company's $600 million commercial paper program was outstanding.
periodically borrow under this program and may borrow under it in future pe

Note 15. Postretirement Benefit Plans

Defined contribution plans – Xylem and certain of our subsidiaries mainta
various defined contribution savings plans, which allow employees to contri
portion of their pre-tax and/or after-tax income in accordance with specified
guidelines. Several of the plans require us to match a percentage of the em
contributions up to certain limits, generally between 3.0% – 7.0% of employe
eligible pay. Matching obligations, the majority of which were funded in cash
connection with the plans, and other company contributions are as follows:

(in millions)	**Defined Contribution**	
2018	**$**	**39**
2017	38	
2016	35	

The Xylem Stock Fund, an investment option under the defined contribution
which Company employees participate is considered an Employee Stock
Ownership Plan. As a result, participants in the Xylem Stock Fund may rece
dividends in cash or may reinvest such dividends into the Xylem Stock Fund
Company employees held approximately 328 thousand and 344 thousand s
of Xylem Inc. common stock in the Xylem Stock Fund at December 31, 201
2017, respectively.

Defined benefit pension plans and other postretirement plans – We his
have maintained qualified and nonqualified defined benefit retirement plans
covering certain current and former employees, including hourly and union p
as well as salaried plans, which generally require up to 5 years of service to
vested and for which the benefits are determined based on years of credited
service and either specified rates, final pay, or final average pay. The other
postretirement benefit plans are all unfunded plans in the U.S. and Canada.
During 2018 and 2017, we made several amendments to plans that had no
material impact to the Company's financial statements.

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Amounts recognized in the Consolidated Balance Sheets for pension and o
employee-related benefit plans (collectively, postretirement plans) reflect th
funded status of the postretirement benefit plans. The following table provid
summary of the funded status of our postretirement plans, the presentation
balances and a summary of amounts recorded within accumulated other
comprehensive income.

(in millions)	**December 31, 2018**			December 31, 2017	
	Pension	**Other**	**Total**	Pension	Other
Fair value of plan assets	**$567**	**$—**	**$567**	$628	$—
Projected benefit obligation	**(862)**	**(52)**	**(914)**	(950)	(55)
Funded status	**$(295)**	**$(52)**	**$(347)**	$(322)	$(55)
Amounts recognized in the balance sheet					
Other non-current assets	**$68**	**$—**	**$68**	$81	$—
Accrued and other current liabilities	**(12)**	**(3)**	**(15)**	(13)	(3)
Accrued postretirement benefits	**(351)**	**(49)**	**(400)**	(390)	(52)
Net amount recognized	**$(295)**	**$(52)**	**$(347)**	$(322)	$(55)
Accumulated other comprehensive income (loss):					
Net actuarial losses	**$(260)**	**$(24)**	**$(284)**	$(251)	$(24)
Prior service credit	**(4)**	**12**	**8**	(1)	12
Total	**$(264)**	**$(12)**	**$(276)**	$(252)	$(12)

The unrecognized amounts recorded in accumulated other comprehensive
will be subsequently recognized as expense on a straight-line basis only to
extent they exceed 10% of the higher of the market-related value or the pro
benefit obligation, over the average remaining service period of active partic
or for plans with all or substantially all inactive participants, over the averag
remaining life expectancy. Actuarial gains and losses incurred in future peri
not recognized as expense in those periods will be recognized as increase
decreases in other comprehensive income, net of tax.

The net actuarial loss included in accumulated other comprehensive incom
end of 2018 and expected to be recognized in net periodic benefit cost duri
is $12 million ($9 million, net of tax). The prior service credit included in
accumulated other comprehensive income to be recognized in 2019 is $4 m
($3 million, net of tax).

The benefit obligation, fair value of plan assets, funded status, and amounts recognized in the consolidated financial statements for our defined benefit domestic and international pension plans were:

	Domestic Plans		**International Pl**	
	December 31,		**December 31,**	
(in millions)	**2018**	2017	**2018**	2017
Change in benefit obligation:				
Benefit obligation at beginning of year	**$107**	$100	**$843**	$75
Service cost	**3**	3	**9**	12
Interest cost	**4**	4	**19**	21
Benefits paid	**(5)**	(5)	**(36)**	(30
Actuarial loss (gain)	**(10)**	5	**(20)**	10
Plan amendments, settlements and curtailments	**—**	1	**3**	(2
Foreign currency translation/other	**—**	(1)	**(55)**	78
Benefit obligation at end of year	**$99**	$107	**$763**	$84
Change in plan assets:				
Fair value of plan assets at beginning of year	**$84**	69	**$544**	$49
Employer contributions	**22**	10	**16**	20
Actual return on plan assets	**(4)**	10	**(20)**	21
Benefits paid	**(5)**	(5)	**(36)**	(30
Plan amendments, settlements and curtailments	**—**	—	**—**	(3
Foreign currency translation/other	**—**	—	**(34)**	43
Fair value of plan assets at end of year	**$97**	$84	**$470**	$54
Unfunded status of the plans	**$(2)**	$(23)	**$(293)**	$(2

The following table provides a rollforward of the projected benefit obligation other postretirement employee benefit plans:

(in millions)	**2018**	2017
Change in benefit obligation:		
Benefit obligation at beginning of year	**$55**	$64
Service cost	**—**	1
Interest cost	**2**	2
Benefits paid	**(3)**	(3)
Actuarial gain/(loss)	**1**	(5)
Plan Amendment and other	**(3)**	(4)
Benefit obligation at the end of year	**$52**	$55

The accumulated benefit obligation (“ABO”) for all the defined benefit pensio was $829 million and $916 million at December 31, 2018 and 2017, respect For defined benefit pension plans in which the ABO was in excess of the fai of the plans’ assets, the projected benefit obligation, ABO and fair value of t plans’ assets were as follows:

	December 31,	
(in millions)	**2018**	2017
Projected benefit obligation	**$500**	$528
Accumulated benefit obligation	**470**	499
Fair value of plan assets	**137**	126

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

(in millions)	Year Ended December 31, 2018	2017	2016
Domestic defined benefit pension plans:			
Service cost	**$3**	$3	$3
Interest cost	**4**	4	4
Expected return on plan assets	**(7)**	(6)	(5)
Amortization of net actuarial loss	**2**	2	2
Net periodic benefit cost	**$2**	$3	$4
International defined benefit pension plans:			
Service cost	**$9**	$12	$10
Interest cost	**19**	21	21
Expected return on plan assets	**(35)**	(34)	(30)
Amortization of net actuarial loss	**9**	9	8
Settlement	**1**	1	—
Net periodic benefit cost	**$3**	$9	$9
Total net periodic benefit cost	**$5**	$12	$13

The components of net periodic benefit cost other than the service cost com
are included in the line item "other non-operating income (expense), net" in
Consolidated Income Statements.

Other changes in assets and benefit obligations recognized in other
comprehensive loss, as they pertain to our defined benefit pension plans ar
follows:

(in millions)	Year Ended I 31, 2018	2017
Domestic defined benefit pension plans:		
Net (gain) loss	**$1**	$1
Prior service cost	**—**	1
Amortization of net actuarial loss	**(2)**	(2
(Gains) losses recognized in other comprehensive loss	**$(1)**	$—
International defined benefit pension plans:		
Net (gain) loss	**$35**	$23
Prior service credit	**3**	1
Amortization of net actuarial loss	**(9)**	(9
Settlement	**(1)**	(1
Foreign Exchange	**(15)**	19
(Gains) losses recognized in other comprehensive loss	**$13**	$33
Total (gains) losses recognized in other comprehensive loss	**$12**	$33
Total (gains) losses recognized in comprehensive income	**$17**	$45

The components of net periodic benefit cost for other postretirement employ
benefit plans are as follows:

(in millions)	Year Ended December 31, 2018	2017	2016
Service cost	**$—**	$1	$1
Interest cost	**2**	2	3

Amortization of prior service credit	**(4)**	(3)	(3)
Amortization of net actuarial loss	**2**	2	3
Net periodic benefit cost	**$—**	$2	$4

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Other changes in benefit obligations recognized in other comprehensive los
they pertain to other postretirement employee benefit plans are as follows:

	Year Ended December 31,		
(in millions)	**2018**	2017	20
Net loss (gain)	**$1**	$(5)	$
Prior service credit	**(3)**	(3)	—
Amortization of prior service credit	**4**	3	3
Amortization of net actuarial loss	**(2)**	(2)	(3
Foreign Exchange/Other	**—**	(1)	1
Losses (gains) recognized in other comprehensive loss	**$—**	$(8)	$
Total losses (gains) recognized in comprehensive income	**$—**	$(6)	$

Assumptions

The following table provides the weighted-average assumptions used to det
projected benefit obligations and net periodic benefit cost, as they pertain to
pension plans.

	2018		2017		2016
	U.S.	Int'l	U.S.	Int'l	U.S.
Benefit Obligation Assumptions					
Discount rate	**4.50%**	**2.60%**	3.75%	2.43%	4.25%
Rate of future compensation increase	**NM**	**2.92%**	NM	2.93%	NM
Net Periodic Benefit Cost Assumptions					
Discount rate	**3.75%**	**2.43%**	4.25%	2.63%	4.27%
Expected long-term return on plan assets	**8.00%**	**7.23%**	8.00%	7.20%	8.00%
Rate of future compensation increase	**NM**	**2.93%**	NM	2.76%	NM

NM Not meaningful. The pension benefits for future service for all the U.S. pension plans are
on years of service and not impacted by future compensation increases.

Management develops each assumption using relevant company experienc
conjunction with market-related data for each individual country in which pla
exist. Assumptions are reviewed annually and adjusted as necessary.

The expected long-term rate of return on assets reflects the expected return
each major asset class in which the plans hold investments, the weight of e
asset class in the target mix, the correlations among asset classes and thei
expected volatilities. The assets of the pension plans are held by a number
independent trustees, managed by several investment institutions and are
accounted for separately in the Company's pension funds.

Our expected return on plan assets is estimated by evaluating both historica
returns and estimates of future returns. Specifically, we analyze the plans' a
historical annual return on assets, net of fees, over the past 15, 20 and 25 y
estimate future returns based on independent estimates of asset class retur
evaluate historical broad market returns over long-term timeframes based o
asset allocation range. For the U.S. Master Trust which has only existed sin
2011, historical returns were estimated using a constructed portfolio that ref
the Company's strategic asset allocation and the historical compound geom
returns of each asset class for the longest time period available. Based on t
approach, the weighted average expected long-term rate of return for all of
plan assets to be used in determining net periodic benefit costs for 2019 is

estimated at 7.09%.

The table below provides the weighted average actual rate of return genera
all of our plan assets during each of the years presented as compared to th
weighted average expected long-term rates of return utilized in calculating t
periodic benefit costs.

	2018	2017	2016
Expected long-term rate of return on plan assets	**7.34 %**	7.30%	7.32 %
Actual rate of return (loss) on plan assets	**(3.85)%**	5.70%	12.20%

The assumed rate of future increases in the per capita cost of health care (t
health care trend rate) is 8.24% for 2019, decreasing ratably to 4.48% in 20
increase or decrease in the health care trend rates by one percent per year
impact the aggregate annual service and interest components by less than
million, and impact the benefit obligation by approximately $3 million.

Investment Policy

The investment strategy for managing worldwide postretirement benefit plan
is to seek an optimal rate of return relative to an appropriate level of risk for
plan. Investment strategies vary by plan, depending on the specific characte
of the plan, such as plan size and design, funded status, liability profile and
requirements. In general, the plans are managed closely to their strategic
allocations.

On April 3, 2017 the liquid assets in two United Kingdom Plans transitioned
new fund structure. The restructuring involved transferring a portion of the a
into pooled diversified growth funds, while some investments were sold off a
some were kept in place. At December 31, 2018, the pooled funds make up
the assets of the two United Kingdom Plans. Liability hedging and illiquid as
remain outside of this arrangement.

The following table provides the actual asset allocations of plan assets as o
December 31, 2018 and 2017, and the related asset target allocation range
asset category.

	2018	2017	Target Allocation Ranges
Equity securities	**29.7%**	35.6%	10-50%
Fixed income	**24.5%**	23.4%	10-40%
Hedge funds	**11.8%**	17.0%	0-40%
Private equity	**1.1 %**	1.6 %	0-30%
Cash, insurance contracts and other	**32.9%**	22.4%	0-60%

Fair Value of Plan Assets

In measuring plan assets at fair value, the fair value hierarchy is applied wh
categorizes and prioritizes the inputs used to estimate fair value into three le
See Note 1 "Summary of Significant Accounting Policies" for further detail o
value hierarchy.

In certain instances, fair value is estimated using quoted market prices obta
from external pricing services. In obtaining such data from the pricing servic
have evaluated the methodologies used to develop the estimate of fair valu
order to assess whether such valuations are representative of fair value, inc
net asset value ("NAV"). Additionally, in certain circumstances, the NAV rep
by an asset manager may be adjusted when sufficient evidence indicates N
not representative of fair value.

The following is a description of the valuation methodologies and inputs use
measure fair value for major categories of investments.

- Equity securities — Equities (including common and preferred shares, dom
listed and foreign listed, closed end mutual funds and exchange traded fun
generally valued at the closing price reported on the major market on which
individual securities are traded at the measurement date. Equity securities h
the Company that are publicly traded in active markets are classified within
of the fair value hierarchy. Those equities that are held in proprietary funds
with other investor accounts measured at fair value using the NAV per shar
practical expedient are not classified in the fair value hierarchy.
- Fixed income — United States government securities are generally valued
quoted prices of securities with similar characteristics. Corporate bonds and
are generally valued by using pricing models (e.g.

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discounted cash flows), quoted prices of securities with similar characteristi
broker quotes. Fixed income securities listed on active markets are classifie
Level 1. Fixed income held in proprietary funds pooled with other investor a
measured at fair value using the NAV per share practical expedient are not
classified in the fair value hierarchy. Hedging Instruments are collateralized
with either cash or government bonds, have daily liquidity and pricing base
observable inputs from over-the-counter markets, and are classified as Lev

- Hedge funds — Hedge funds are pooled funds that employ a range of inves strategies including equity and fixed income, credit driven, macro and multi oriented strategies. The valuation of limited partnership interests in hedge f may require significant management judgment. Generally, hedge funds are using the NAV reported by the asset manager, and are adjusted when it is determined that NAV is not representative of fair value. In making such an assessment, a variety of factors is reviewed, including, but not limited to, th timeliness of NAV as reported by the asset manager and changes in genera economic and market conditions subsequent to the last NAV reported by th manager. All of the hedge funds held have lockups and/or gates. Hedge fu have unfunded commitments of $0 million and $5 million at December 31, 2 and 2017, respectively.
- Private equity — Private equity includes a diversified range of strategies, in buyout funds, distressed funds, venture and growth equity funds and mezza funds with long-term commitments, and redemptions beginning no earlier th 2018. The valuation of limited partnership interests in private equity funds m require significant management judgment. Generally, private equity is value the NAV reported by the asset manager, and is adjusted when it is determi NAV is not representative of fair value. In making such an assessment, a v factors is reviewed, including, but not limited to, the timeliness of NAV as r by the asset manager and changes in general economic and market condit subsequent to the last NAV reported by the asset manager. Private equity i liquid and has unfunded commitments of $3 million and $4 million at Decem 2018 and 2017, respectively.
- Cash, insurance contracts and other — Primarily comprised of insurance c and cash. Insurance contracts are valued at contract value, which approxim fair value, and is calculated using the prior year balance adjusted for invest returns and cash flows and are generally classified as Level 3. Insurance c are held by certain foreign pension plans. Cash and cash equivalents are h accounts with brokers or custodians for liquidity and investment collateral a classified as Level 1.

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The following table provides the fair value of plan assets held by our pensio
benefit plans by asset class.

(in millions)	2018 Level 1	Level 2	Level 3	NAV Practical Expedient	Total	2017 Level 1	Level 2	Level 3	NAV Practic Exped
Equity securities									
Global stock funds/securities	**$88**	**$—**	**$—**	**$ 29**	**$117**	$101	$—	$—	$ 29
Index funds	**—**	**—**	**—**	**1**	**1**	—	—	—	3
Diversified Growth and Income Funds	**—**	**—**	**—**	**51**	**51**	—	—	—	92
Fixed income									
Corporate bonds	**34**	**—**	**—**	**25**	**59**	24	—	—	8
Government bonds	**31**	**—**	**—**	**20**	**51**	48	—	—	5
Hedging Instruments	**5**	**22**	**—**	**—**	**27**	5	36	—	—
Diversified Growth and Income Funds	**—**	**—**	**—**	**2**	**2**	—	—	—	20
Hedge funds	**—**	**—**	**—**	**67**	**67**	—	—	—	107
Private equity	**—**	**—**	**—**	**6**	**6**	—	—	—	10
Cash, insurance contracts and other	**104**	**—**	**12**	**70**	**186**	90	—	17	33
Total plan assets subject to leveling	**$262**	**$ 22**	**$ 12**	**$ 271**	**$567**	$268	$ 36	$ 17	$ 30

The following table presents a reconciliation of the beginning and ending ba
of fair value measurement within our pension plans using significant unobse
inputs (Level 3).

(in millions)	Insurance Contracts and Other
Balance, December 31, 2016	$ 24
Purchases, sales, settlements	(8)
Currency impact	1
Balance, December 31, 2017	$ 17
Purchases, sales, settlements	**(5)**
Currency impact	**—**
Balance, December 31, 2018	**$ 12**

Contributions and Estimated Future Benefit Payments

Funding requirements under governmental regulations are a major consider
making contributions to our postretirement plans. We made contributions of
million and $33 million to our pension and postretirement defined benefit pla
during 2018 and 2017, respectively. Discretionary contributions were made
U.S. Plan in the third quarter of 2017 for $6 million and the third quarter of 2
$19 million to increase the funding ratio and reduce regulatory fees. We cur
anticipate making contributions to our pension and postretirement defined b
plans in the range of $15 million to $25 million during 2019, of which approx
$5 million is expected to be made in the first quarter.

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The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid as follows:

(in millions)	Pension	Other Benefits
2019	$ 35	$ 3
2020	36	4
2021	36	4
2022	37	4
2023	39	4
Years 2023 - 2027	205	19

Note 16. Stock-Based Compensation Plans

Our stock-based compensation program is a broad-based program designe attract and retain employees while also aligning employees' interests with th interests of our shareholders. In addition, members of our Board of Director participate in our stock-based compensation program in connection with the service on our board. Share-based awards issued to employees include non-qualified stock options, restricted stock unit awards and performance sh unit awards. Under the 2011 Omnibus Incentive Plan, the number of shares available for awards was 18 million. As of December 31, 2018, there were approximately 6 million shares of common stock available for future grants.

Total share-based compensation costs recognized for 2018, 2017 and 2016 $30 million, $21 million, and $18 million, respectively. The unamortized compensation expense at December 31, 2018 related to our stock options, restricted share units and performance share units was $6 million, $20 millio $16 million, respectively, and is expected to be recognized over a weighted average period of 1.8, 1.9 and 1.7 years, respectively.

The amount of cash received from the exercise of stock options was $7 mill 2018 with a tax benefit of $11 million realized associated with stock option exercises and vesting of restricted stock units. We classify as an operating a the cash flows attributable to excess tax benefits arising from stock option exercises and restricted stock unit vestings.

Stock Option Grants

Options are awarded with a contractual term of ten years and generally vest three-year period and are exercisable within the contractual term, except in instances of death, retirement or disability. The exercise price per share is t market value of the underlying common stock on the date each option is gra At December 31, 2018, there were options to purchase an aggregate of 2.1 shares of common stock. The following is a summary of the changes in outstanding stock options for 2018:

	Share units (In thousands)	**Weighted Average Exercise Price / Share**	**Weighted Average Remaining Contractual Term (Years)**
Outstanding at January 1, 2018	2,076	$ 37.44	7.0
Granted	316	$ 75.11	
Exercised	(214)	$ 34.08	
Forfeited and expired	(53)	$ 49.36	
Outstanding at December 31, 2018	**2,125**	**$ 43.08**	**6.5**
Options exercisable at December 31, 2018	**1,403**	**$ 35.46**	**5.5**
	2,065	**$ 42.37**	**6.4**

Vested and non-vested expected to vest as of December 31, 2018

The amount of non-vested options outstanding was 0.7 million, 0.9 million a
million at a weighted average fair value of $58.00, $42.84 and $37.10 as of
December 31, 2018, 2017 and 2016, respectively. The total intrinsic value o
options exercised (which is the amount by which the stock price exceeded t
exercise price of the options on the date of exercise) during 2018, 2017 and
was $9 million, $14 million and $12 million, respectively.

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The fair value of each option grant was estimated on the date of grant using binomial lattice pricing model which incorporates multiple and variable assu over time, including assumptions such as employee exercise patterns, stock volatility and changes in dividends. The following are weighted-average assumptions used for 2018, 2017, and 2016:

	2018	2017	2016
Dividend yield	**1.12 %**	1.49 %	1.63 %
Volatility	**23.41 %**	25.39 %	28.87 %
Risk-free interest rate	**2.76 %**	2.07 %	1.41 %
Expected term (in years)	**5.1**	5.10	5.60
Weighted-average fair value per option	**$17.80**	$10.66	$9.05

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

Restricted Stock Unit Grants

Restricted shares granted to employees in 2018 vest over a three-year peri Restricted shares granted to employees prior to 2017 generally become full vested upon the third anniversary of the date of grant. Prior to the time a res share becomes fully vested, the awardees cannot transfer, pledge, hypothe encumber such shares. Prior to the time a restricted share is fully vested, th awardees do not have certain rights of a stockholder, such as the right to vo receive dividends; however, dividends accrue during the vesting period and paid upon vesting. If an employee leaves prior to vesting, whether through resignation or termination for cause, the restricted stock unit and related acc dividends are forfeited. If an employee retires, a pro rata portion of the restr stock unit may vest in accordance with the terms of the grant agreements. Restricted stock units granted to Board members become fully vested upon day prior to the next annual meeting. The fair value of the restricted share u awards is determined using the closing price of our common stock on date c Our restricted stock units activity was as follows for 2018:

	Share Units (in thousands)	**Weighted Average Grant Date Fair Value / Share**
Outstanding at January 1, 2018	779	$ 35.39
Granted	274	74.81
Vested	(458)	40.39
Forfeited	(58)	53.09
Outstanding at December 31, 2018	**537**	**59.41**

Performance Share Units

Performance share units granted under the long-term incentive plan vest ba upon performance by the Company over a three-year period against targets approved by the Compensation Committee of the Company's Board of Dire prior to the grant date. For the performance periods, the performance share were granted at a target of 100% with actual payout contingent upon the achievement of a pre-set, three-year adjusted Return on Invested Capital ar cumulative adjusted net income performance target for ROIC performance s units and a relative TSR performance for TSR performance share units. The calculated compensation cost for ROIC performance share units is adjustec on an estimate of awards ultimately expected to vest and our assessment o probable outcome of the performance condition.

ROIC Performance Share Unit Grants

The fair value of the ROIC performance share unit awards is determined us closing price of our common stock on date of grant.

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Our ROIC performance share unit activity was as follows for 2018:

	Share units (in thousands)	Weighted Average Grant Date Fair Value / Share
Outstanding at January 1, 2018	298	$ 41.48
Granted	77	75.12
Forfeited	(101)	38.39
Outstanding at December 31, 2018	**274**	**52.11**

TSR Performance Share Unit Grants

The following is a summary of our TSR performance share unit grants for 20

	Share units (in thousands)	Weighted Average Grant Date Fair Value /Share
Outstanding at January 1, 2018	213	$ 47.04
Granted	77	98.86
Forfeited	(16)	51.39
Outstanding at December 31, 2018	**274**	**61.04**

The fair value of TSR performance share units were calculated on the date using a Monte Carlo simulation model utilizing several key assumptions, inc expected Company and peer company share price volatility, correlation coe between peers, the risk-free rate of return, the expected dividend yield and award design features. The following are weighted-average key assumptio 2018 grants.

Volatility	**26.80%**
Risk-free interest rate	**2.44 %**

Note 17. Capital Stock

The Company has the authority to issue an aggregate of 750 million shares common stock having a par value of $0.01 per share. The stockholders of X common stock are entitled to receive dividends as declared by the Xylem B Directors. Dividends declared were $0.8400, $0.7200 and $0.6196 during 2 2017 and 2016, respectively.

The changes in shares of common stock outstanding for the three years en December 31 are as follows:

(share units in thousands)	**2018**	2017	2016
Beginning Balance, January 1	**179,862**	179,367	178,377
Stock incentive plan net activity	**672**	985	1,085
Repurchase of common stock	**(810)**	(490)	(95)
Ending Balance, December 31	**179,724**	179,862	179,367

For the years ended December 31, 2018 and December 31, 2017 the Comp repurchased 0.8 million shares for $59 million of common stock and repurch 0.5 million shares for $25 million of common stock, respectively. Repurchas include both share repurchase programs approved by the Board of Director repurchases in relation to settlement of employee income tax withholding obligations due as a result of the vesting of restricted stock units. The detail repurchases by each program are as follows:

On August 24, 2015, our Board of Directors authorized the repurchase of up $500 million in shares with no expiration date. The program's objective is to our capital in a manner that benefits our shareholders and maintains our foc growth. For the year ended December 31, 2018 we repurchased 0.7 million for $50 million. For the year ended December 31, 2017 we repurchased 0.1 shares for $7 million. There are up to $363 million in shares that may still be purchased under this plan as of December 31, 2018.

On August 18, 2012, the Board of Directors authorized the repurchase of up
million shares of common stock with no expiration date. The program's obje
to offset dilution associated with various Xylem employee stock plans by ac
shares in the open market from time to time. For the year ended December
2017 we repurchased 0.3 million shares for $13 million. As of June 2017, w
exhausted the authorized amount to repurchase shares under this plan.
Aside from the aforementioned repurchase programs, we repurchased 0.1 m
and 0.1 million shares for $9 million and $5 million during 2018 and 2017, respectively, in relation to settlement of employee income tax withholding obligations due as a result of the vesting of restricted stock units. These repurchases are included in the stock incentive plan net activity in the above

Note 18. Accumulated Other Comprehensive Loss

The following table provides the components of accumulated other compreh
loss for 2018, 2017 and 2016:

(in millions)	Foreign Currency Translation	Postretirement Benefit Plans	Derivative Instruments
Balance at January 1, 2016	$ (43)	$ (185)	$ (10)
Foreign currency translation adjustment	(65)		
Foreign currency gain reclassified into gain on sale of business	(21)		
Changes in postretirement benefit plans		(19)	
Income tax expense on changes in postretirement benefit plans		3	
Foreign currency translation adjustment for postretirement benefit plans		19	
Amortization of prior service cost and net actuarial loss on postretirement benefit plans into other non-operating income (expense), net		10	
Income tax impact on amortization of postretirement benefit plan items		(5)	
Reclassification of unrealized loss on derivative hedge agreements into revenue			(2)
Reclassification of unrealized loss on derivative hedge agreements into cost of revenue	(11)		11
Balance at December 31, 2016	$ (140)	$ (177)	$ (1)
Foreign currency translation adjustment	79		
Income tax impact on foreign currency translation adjustment	46		
Changes in postretirement benefit plans		(18)	
Income tax expense on changes in postretirement benefit plans		7	
Foreign currency translation adjustment for postretirement benefit plans		(18)	
Amortization of prior service cost and net actuarial loss on postretirement benefit plans into other non-operating income (expense), net		11	
Income tax impact on amortization of postretirement benefit plan items		(3)	
Unrealized loss on derivative hedge agreements			9
Reclassification of unrealized (gain) loss on foreign exchange agreements into revenue			(6)
Reclassification of unrealized (gain) loss on foreign exchange agreements into cost of revenue	—		1
Balance at December 31, 2017	$ (15)	$ (198)	$ 3

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(in millions)	Foreign Currency Translation	Postretirement Benefit Plans	Derivative Instruments
Cumulative effect of change in accounting principle	**(11)**	**(6)**	
Foreign currency translation adjustment	**(83)**		
Income tax impact on foreign currency translation adjustment	**(12)**		
Changes in postretirement benefit plans		**(36)**	
Foreign currency translation adjustment for postretirement benefit plans		**15**	
Income tax expense on changes in postretirement benefit plans		**5**	
Amortization of prior service cost and net actuarial loss on postretirement benefit plans into other non-operating income (expense), net		**9**	
Income tax impact on amortization of postretirement benefit plan items		**(3)**	
Unrealized loss on derivative hedge agreements			**(8)**
Reclassification of unrealized (gain) loss on foreign exchange agreements into cost of revenue			**4**
Balance at December 31, 2018	**$ (121)**	**$ (214)**	**$ (1)**

Note 19. Commitments and Contingencies

Legal Proceedings

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

From time to time claims may be asserted against Xylem alleging injury cau
any of our products resulting from asbestos exposure. We believe there are
numerous legal defenses available for such claims and would defend ourse
vigorously. Pursuant to the Distribution Agreement among ITT Corporation (
ITT LLC), Exelis and Xylem, ITT Corporation (now ITT LLC) has an obligatio
indemnify, defend and hold Xylem harmless for asbestos product liability ma
including settlements, judgments, and legal defense costs associated with a
pending and future claims that may arise from past sales of ITT's legacy pro
Although the ultimate outcome of any legal matter cannot be predicted with
certainty, based on present information, including our assessment of the me
the particular claims, we do not expect that any asserted or unasserted lega
claims or proceedings, individually or in the aggregate, will have a material a
effect on our results of operations, or financial condition.

We have estimated and accrued $7 million and $10 million as of December
2018 and 2017, respectively for these general legal matters.

Indemnifications

As part of our 2011 spin-off from our former parent, ITT Corporation (now IT
LLC), Exelis Inc. and Xylem will indemnify, defend and hold harmless each
other parties with respect to such parties' assumed or retained liabilities und
Distribution Agreement and breaches of the Distribution Agreement or relate
agreements. The former parent's indemnification obligations include asserte
unasserted asbestos and silica liability claims that relate to the presence or
presence of asbestos or silica in products manufactured, repaired or sold pr
October 31, 2011, the Distribution Date, subject to limited exceptions with re
to certain employee claims, or in the structure or material of any building or
subject to exceptions with respect to employee claims relating to Xylem bui
or facilities. The indemnification associated with pending and future asbesto
claims does not expire. Xylem has not recorded a liability for material matte
which we expect to be indemnified by the former

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parent or Exelis Inc. through the Distribution Agreement and we are not awa
any claims or other circumstances that would give rise to material payments
us under such indemnifications. On May 29, 2015, Harris Inc. acquired Exel
the parent of Exelis, Harris Inc. is responsible for Exelis's indemnification
obligations under the Distribution Agreement.

Guarantees

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

Environmental

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

Accruals for environmental matters are recorded on a site-by-site basis whe
probable that a liability has been incurred and the amount of the liability can
reasonably estimated, based on current law and existing technologies. Our
accrued liabilities for these environmental matters represent the best estima
related to the investigation and remediation of environmental media such as
soil, soil vapor, air and structures, as well as related legal fees. These estim
and related accruals, are reviewed quarterly and updated for progress of
investigation and remediation efforts and changes in facts and legal circums
Liabilities for these environmental expenditures are recorded on an undisco
basis. We have estimated and accrued $4 million and $4 million as of
December 31, 2018 and 2017, respectively, for environmental matters.

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

Operating Leases

We lease certain offices, manufacturing buildings, machinery, computers an
equipment. We often pay maintenance, insurance and tax expense related t
leased assets. Total rent expense for the three years ended December 31, 2
was as follows:

(in millions) **Total**

2018	**$81**
2017	70
2016	63

At December 31, 2018, we are obligated to make minimum rental payments
operating leases which are as follows:

(in millions)	2019	2020	2021	2022	2023	Thereafter
Minimum rental payments	$76	$61	$43	$33	$22	$ 64

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Warranties

We warrant numerous products, the terms of which vary widely. In general, warrant products against defect and specific non-performance. Warranty ex was $20 million, $28 million, and $32 million for 2018, 2017 and 2016, respe The table below provides changes in the combined current and non-current product warranty accruals over each period.

(in millions)	**2018**	2017
Warranty accrual – January 1	**$82**	$99
Net charges for product warranties in the period	**20**	28
Settlement of warranty claims	**(42)**	(48)
Foreign currency and other	**—**	3
Warranty accrual – December 31	**$60**	$82

Note 20. Related Party Transactions

Sales to and purchases from unconsolidated entities for 2018, 2017 and 20 as follows:

(in millions)	**2018**	2017	2016
Sales to unconsolidated affiliates	**$10**	$12	$11
Purchases from unconsolidated affiliates	**22**	17	22

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Note 21. Segment and Geographic Data

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

The accounting policies of each segment are the same as those described i summary of significant accounting policies (see Note 1). The following table contain financial information for each reportable segment:

	Year Ended December 31,		
(in millions)	**2018**	2017	2016
Revenue:			
Water Infrastructure	**$2,176**	$2,004	$1,932
Applied Water	**1,534**	1,421	1,393
Measurement & Control Solutions	**1,497**	1,282	446
Total	**$5,207**	$4,707	$3,771
Operating income:			
Water Infrastructure	**$359**	$312	$295
Applied Water	**236**	194	188
Measurement & Control Solutions	**118**	110	—
Corporate and other	**(59)**	(64)	(75)
Total operating income	**654**	552	408
Interest expense	**82**	82	70
Other non-operating income (expense)	**13**	6	2
(Loss)/gain from sale of businesses	**—**	(10)	—
Income before taxes	**$585**	$466	$340
Depreciation and amortization:			
Water Infrastructure	**$66**	$64	$66
Applied Water	**22**	23	24
Measurement & Control Solutions	**144**	122	41
Regional selling locations (a)	**20**	17	11
Corporate and other	**9**	8	9
Total	**$261**	$234	$151
Capital expenditures:			
Water Infrastructure	**$84**	$58	$62
Applied Water	**28**	20	21
Measurement & Control Solutions	**101**	69	13

Regional selling locations (b)	**16**	18	24
Corporate and other	**8**	5	4
Total	**$237**	$170	$124

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

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

The following table illustrates revenue by product category, net of intercomp revenue.

	Year Ended December 31,		
(in millions)	**2018**	2017	2016
Pumps, accessories, parts and service	**$3,322**	$2,998	$2,888
Other (a)	**1,885**	1,709	883
Total	**$5,207**	$4,707	$3,771

(a) Other includes treatment equipment, analytical instrumentation, heat exchangers, valves, and smart meters.

The following table contains the total assets for each reportable segment as December 31, 2018, 2017 and 2016.

	Total Assets		
(in millions)	**2018**	2017	2016
Water Infrastructure	**$1,233**	$1,232	$1,179
Applied Water	**1,051**	1,002	990
Measurement & Control Solutions	**3,576**	3,198	3,102
Regional selling locations (a)	**1,181**	1,119	965
Corporate and other (b)	**181**	309	238
Total	**$7,222**	$6,860	$6,474

(a) The Regional selling locations have assets that consist primarily of cash, accounts receiv inventory which are not allocated to the segments.

(b) Corporate and other consists of items pertaining to our corporate headquarters function, v principally consist of cash, deferred tax assets, pension assets and certain plant and equi

Geographical Information

Revenue is attributed to countries based upon the location of the customer. Property, Plant & Equipment is attributed to countries based upon the locati the assets.

	Revenue Year Ended December 31,		
(in millions)	**2018**	2017	2016
United States	**$2,424**	$2,161	$1,574
Europe	**1,449**	1,335	1,195
Asia Pacific	**660**	611	518
Other	**674**	600	484
Total	**$5,207**	$4,707	$3,771

	Property, Plant & Equipment December 31,		
(in millions)	**2018**	2017	2016
United States	**$ 281**	$ 258	$ 255
Europe	**250**	259	237
Asia Pacific	**66**	85	87
Other	**59**	41	37
Total	**$ 656**	$ 643	$ 616

Note 22. Valuation and Qualifying Accounts

The table below provides changes in the allowance for doubtful accounts ov
each period.

(in millions)	**2018**	2017	2016
Balance at beginning of year	**$25**	$21	$22
Additions charged to expense	**5**	5	4
Deductions/other	**(5)**	(1)	(5)
Balance at end of year	**$25**	$25	$21

Note 23. Quarterly Financial Data (Unaudited)

Our quarterly financial periods end on the Saturday closest to the last day o
calendar quarter, except
for the fourth quarter which ends on December 31.

	2018 Quarter Ended			
(in millions, except per share amounts)	**Dec. 31**	**Sept. 30**	**June 30**	**Mar. 31**
Revenue	**$1,386**	**$1,287**	**$1,317**	**$1,217**
Gross profit	**542**	**505**	**519**	**460**
Operating income	**194**	**176**	**171**	**113**
Net income attributable to Xylem	**$225**	**$130**	**$115**	**$79**
Earnings per share:				
Basic	**$1.25**	**$0.73**	**$0.64**	**$0.44**
Diluted	**$1.24**	**$0.72**	**$0.64**	**$0.43**

	2017 Quarter Ended			
(in millions, except per share amounts)	Dec. 31	Sept. 30	June 30	Mar. 31
Revenue	$1,277	$1,195	$1,164	$1,071
Gross profit	507	471	457	412
Operating income	177	152	137	86
Net income attributable to Xylem	$71	$105	$99	$56
Earnings per share:				
Basic	$0.40	$0.58	$0.55	$0.31
Diluted	$0.40	$0.58	$0.55	$0.31

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANT
ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, with the Chief Executive Officer ("CEO") and Chief Finan
Officer ("CFO") of the Company, has evaluated the effectiveness of the des
operation of our disclosure controls and procedures as of the end of the yea
ended December 31, 2018 pursuant to Rule 13a-15(b) and 15d-15(e) of the
Securities Exchange Act of 1934 (“the Exchange Act”). Based upon that ev
our CEO and our CFO concluded that our disclosure controls and procedur
the year ended December 31, 2018 were effective, in all material respects, a
designed to provide reasonable assurance that the information required to b
disclosed by us in the reports we file or submit under the Exchange Act is (1

recorded, processed, summarized and reported, within the time periods spe
in the SEC's rules and forms and (2) accumulated and communicated to ou
management, including our CEO and CFO, as appropriate to allow timely de
regarding required disclosures.

Management's Annual Report on Internal Control Over Financial Repo

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As required by the SEC's rules and regulations for the implementation of Se
404 of the Sarbanes-Oxley Act, the Company's management is responsible
establishing and maintaining adequate internal control over financial reporti
defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. The Com
internal control over financial reporting is a process designed to provide rea
assurance regarding the reliability of financial reporting and the preparation
financial statements for external purposes in accordance with GAAP.

The Company's management, including the CEO and CFO, conducted an
assessment of the effectiveness of our internal control over financial reporti
December 31, 2018 based on the framework established in Internal Control
Integrated Framework issued by the Committee of Sponsoring Organization
Treadway Commission (2013). This assessment included an evaluation of t
design of our internal control over financial reporting and testing of the oper
effectiveness of those controls. Based on our assessment, the Company's
management has concluded that our internal control over financial reporting
effective as of December 31, 2018. Management's assessment of the effect
of the Company's internal control over financial reporting as of December 3
excluded Pure Technologies Ltd. ("Pure"), which was acquired by the Comp
January 31, 2018. Pure is a wholly-owned subsidiary of the Company whos
assets and total net sales represented less than 6% of consolidated total as
and less than 2% of consolidated net sales, respectively, of the Company a
for the year ended December 31, 2018. As permitted by guidelines establis
the Securities and Exchange Commission, companies are allowed to exclu
certain acquisitions from their assessments of internal control over financial
reporting during the first year of an acquisition while integrating the acquire
companies.

The effectiveness of the Company's internal control over financial reporting
December 31, 2018 has been audited by Deloitte & Touche LLP, an indepe
registered public accounting firm, as stated in their report which appears fol
Item 9B of this Annual Report on Form 10-K.

Changes in Internal Control Over Financial Reporting

There were no changes in the Company's internal control over financial rep
that occurred during the quarter ended December 31, 2018 that have mater
affected, or are reasonably likely to materially affect, our internal control ove
financial reporting.

ITEM 9B. OTHER INFORMATION

None

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and the Board of Directors of
Xylem Inc.
Rye Brook, New York

Opinion on Internal Control over Financial Reporting

We have audited the internal control over financial reporting of Xylem Inc. a
subsidiaries (the "Company") as of
December 31, 2018, based on criteria established in *Internal Control - Integ*
Framework (2013) issued by the Committee of Sponsoring Organizations o
Treadway Commission (COSO). In our opinion, the Company maintained, i
material respects, effective internal control over financial reporting as of De
31, 2018, based on criteria established in *Internal Control - Integrated Fram*
(2013) issued by COSO.

We have also audited, in accordance with the standards of the Public Comp
Accounting Oversight Board (United States) (PCAOB), the consolidated fina
statements as of and for the year ended December 31, 2018, and the relate
(collectively referred to as the “financial statements”), of the Company and o
dated February 22, 2019, expressed an unqualified opinion on those financi
statements.

As described in Management’s Annual Report on Internal Control over Fina
Reporting, management excluded from its assessment the internal control o
financial reporting at Pure Technologies (“Pure”), which was acquired on Ja
31, 2018 and whose financial statements constitute less than 6% and 2% o
assets and total revenue, respectively, of the consolidated financial stateme
amounts as of and for the year ended December 31, 2018. Accordingly, our
did not include the internal control over financial reporting at Pure.

Basis of Opinion

The Company’s management is responsible for maintaining effective interna
control over financial reporting and for its assessment of the effectiveness o
internal control over financial reporting, included in the accompanying
Management’s Report on Internal Control over Financial Reporting. Our
responsibility is to express an opinion on the Company’s internal control ove
financial reporting based on our audit. We are a public accounting firm regis
with the PCAOB and are required to be independent with respect to the Co
in accordance with the U.S. federal securities laws and the applicable rules
regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. T
standards require that we plan and perform the audit to obtain reasonable
assurance about whether effective internal control over financial reporting w
maintained in all material respects. Our audit included obtaining an underst
of internal control over financial reporting, assessing the risk that a material
weakness exists, testing and evaluating the design and operating effective
internal control based on the assessed risk, and performing such other pro
as we considered necessary in the circumstances. We believe that our audi
provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control over Financial Reporting

A company's internal control over financial reporting is a process designed t provide reasonable assurance regarding the reliability of financial reporting preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to maintenance of records that, in reasonable detail, accurately and fairly refle transactions and dispositions of the assets of the company; (2) provide reas assurance that transactions are recorded as necessary to permit preparatio financial statements in accordance with generally accepted accounting prin and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the compar (3) provide reasonable assurance regarding prevention or timely detection c unauthorized acquisition, use, or disposition of the company's assets that co have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting m prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may beco inadequate because of changes in conditions, or that the degree of complia with the policies or procedures may deteriorate.

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/s/ Deloitte & Touche LLP
Stamford, Connecticut
February 22, 2019

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PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this Item is incorporated herein by reference to information in our Definitive Proxy Statement to be filed with the SEC in con with our 2019 Annual Meeting of Shareholders (the "2019 Proxy Statement" the captions "Proposal 1 - Election of Directors," "Identifying and Evaluating Nominees," "Board Committees - Audit Committee" and "Section 16(a) Ben Ownership Reporting Compliance."

The information called for by Item 10 with respect to executive officers is se in Part I of this Report under the caption "Executive Officers of the Registra incorporated by reference in this section.

We have adopted corporate governance principles and charters for each of board committees. The principles address director qualification standards, responsibilities, access to management and independent advisors, compen orientation and continuing education, succession planning and board and committee self-evaluation. The corporate governance principles and board committee charters are available on the Company's website at *www.investors.xyleminc.com*. A copy of the corporate governance principles board committee charters are also available to any shareholder who reques copy from the Company's Corporate Secretary at our Principal Executive Of

We have also adopted a written code of conduct which is applicable to all of directors, officers and employees, including the Company's Chief Executive and Chief Financial Officer and other executive officers identified pursuant t Item 10. In accordance with the SEC's rules and regulations, a copy of the C Conduct has been posted to our website and it is also available to any shar who requests a copy from the Company's Corporate Secretary. We intend t disclose any changes in our Code of Conduct and waivers of the Code of C on our website at *www.xylem.com* within four business days following the d the amendment or waiver.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item is incorporated herein by reference to information in our 2019 Proxy Statement set forth under captions "Executive Compensation," "Director Compensation", "Board Committees - Leadership Development and Compensation Committee" and "Leadership Developmen Compensation Committee Report."

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNER AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this Item is incorporated herein by reference to information in our 2019 Proxy Statement set forth under the captions "Stock Ownership of Directors, Executive Officers and Certain Beneficial Owners" "Equity Compensation Plan Information."

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTION DIRECTOR INDEPENDENCE

The information required by this Item is incorporated herein by reference to information in our 2019 Proxy Statement set forth under the captions "Gove - Director Independence" and "Governance - Related Party Transactions."

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by this Item is incorporated herein by reference to
information in our 2019 Proxy Statement set forth under the captions “Fees
and Other Services Fees” and "Pre-Approval of Audit and Non-Audit Servic

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PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a)(1) The Index to Consolidated Financial Statements of the Registrant unc Item 8 of this Report is incorporated herein by reference as the list of Financial Statements required as part of this Report.

(2) Financial Statement Schedules — All financial statement schedules h omitted because they are not applicable or the required information is in the financial statements or notes thereto.

(3) Exhibits — See exhibits listed under Part (b) below.

EXHIBIT INDEX

Exhibit Number	Description	Location
2.1	Distribution Agreement, dated as of October 25, 2011, among ITT Corporation, Exelis Inc. and Xylem Inc.	Incorporated by reference Exhibit 10.1 of ITT Corpor Form 10-Q Quarterly Rep on October 28, 2011 (CIK 216228, File No. 1-5672).
2.2	Share Purchase Agreement, dated as of August 15, 2016, by and among Xylem Inc., Xylem Luxembourg S.à r.l., Sensus Worldwide Limited, Sensus Industries Limited, and Sensus USA Inc.	Incorporated by reference Exhibit 2.1 to Xylem Inc.'s Report on Form 8-K filed August 15, 2016 (CIK No. 1524472, File No. 1-3522
2.3	First Amendment to Share Purchase Agreement, dated as of October 31, 2016, by and among Xylem Inc., Xylem Luxembourg S.à r.l., Sensus Worldwide Limited, Sensus Industries Limited, and Sensus USA Inc.	Incorporated by reference Exhibit 2.2 to Xylem Inc.'s Report on Form 8-K filed November 1, 2016 (CIK N 1524472, File No. 1-3522
3.1	Fourth Amended and Restated Articles of Incorporation of Xylem Inc.	Incorporated by reference Exhibit 3.1 of Xylem Inc.'s 8-K filed on May 15, 2017 No. 1524472, File No. 1-3
3.2	Fourth Amended and Restated By-laws of Xylem Inc.	Incorporated by reference Exhibit 3.1 of Xylem Inc.'s 8-K filed on May 15, 2017 No. 1524472, File No. 1-3
4.1	Indenture, dated as of September 20, 2011, between Xylem Inc., ITT Corporation, as initial guarantor, and Union Bank, N.A., as trustee.	Incorporated by reference Exhibit 4.2 of ITT Corpora Form 8-K Current Report September 21, 2011 (CIK 216228, File No. 1-5672).

4.2	Senior Indenture, dated March 11, 2016, by and between the Company and Deutsche Bank Trust Company Americas, as trustee.	Incorporated by reference Exhibit 4.1 of Xylem Inc.'s 8-K filed on March 11, 201 No. 1524472, File No. 1-3
4.3	First Supplemental Indenture, dated March 11, 2016, by and between the Company and Deutsche Bank Trust Company Americas, as trustee.	Incorporated by reference Exhibit 4.2 of Xylem Inc.'s 8-K filed on March 11, 201 No. 1524472, File No. 1-3
4.4	Second Supplemental Indenture, dated March 11, 2016, by and between the Company and Deutsche Bank Trust Company Americas, as trustee.	Incorporated by reference Exhibit 4.3 of Xylem Inc.'s 8-K filed on March 11, 201 No. 1524472, File No. 1-3
4.5	Third Supplemental Indenture, dated October 11, 2016, by and between the Company and Deutsche Bank Trust Company Americas, as trustee.	Incorporated by reference Exhibit 4.1 of Xylem Inc.'s 8-K filed on October 11, 2 (CIK No. 1524472, File No 1-35229).
4.6	Form of Xylem Inc. 4.875% Senior Notes due 2021.	Incorporated by reference Exhibit 4.6 of Xylem Inc.'s S-4 Registration Statemen on May 24, 2012 (CIK No 1524472, File No. 333-18

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Exhibit Number		Description	Location
4.7		Form of Xylem Inc. 2.250% Senior Notes due 2023.	Incorporated by referenc Exhibit 4.3 of Xylem Inc. Current Report on Form dated March 11, 2016 (C 1524472, File No. 1-352
4.8		Form of Xylem Inc. 3.250% Senior Notes due 2026.	Incorporated by referenc Exhibit 4.1 of Xylem Inc. 8-K filed on October 11, (CIK No. 1524472, File N 1-35229).
4.9		Form of Xylem Inc. 4.375% Senior Notes due 2046.	Incorporated by referenc Exhibit 4.1 of Xylem Inc. 8-K filed on October 11, (CIK No. 1524472, File N 1-35229).
10.1	#	Form of Xylem 2011 Omnibus Incentive Plan Non-Qualified Stock Option Award Agreement (2015).	Incorporated by referenc Exhibit 10.1 of Xylem Inc Form 10-K Annual Repo on February 26, 2015 (C 1524472, File No. 1-352
10.3		Tax Matters Agreement, dated as of October 25, 2011, among ITT Corporation, Exelis Inc. and Xylem Inc.	Incorporated by referenc Exhibit 10.3 of ITT Corporation's Form 10-C Quarterly Report filed on October 28, 2011 (CIK N 216228, File No. 1-5672
10.5		Five-Year Revolving Credit Facility Agreement, dated as of March 27, 2015, among Xylem Inc., the Lenders Named Therein, Citibank, N.A., as Administrative Agent and J.P. Morgan Chase Bank, N.A., as Syndication Agent.	Incorporated by referenc Exhibit 10.1 of Xylem Inc Form 8-K filed on March 2015 (CIK No. 1524472 No. 1-35229).
10.6	#	Xylem 2011 Omnibus Incentive Plan (Amended as of February 24, 2016).	Incorporated by referenc Exhibit 10.6 of Xylem Inc Form 10-K filed on Febr 26, 2016 (CIK No. 1524 File No. 1-35229).
10.7	#	Form of Xylem Non-Qualified Stock Option Award Agreement (Amended as of February 24, 2016).	Incorporated by referenc Exhibit 10.7 of Xylem Inc Form 10-K filed on Febr 26, 2016 (CIK No. 1524

			File No. 1-35229).
10.8	#	Form of Xylem Restricted Stock Unit Agreement (Amended as of February 24, 2016).	Incorporated by referenc Exhibit 10.8 of Xylem Inc Form 10-K filed on Febr 26, 2016 (CIK No. 1524 File No. 1-35229).
10.9	#	Form of Xylem Performance Share Unit Agreement (Amended as of February 24, 2016).	Incorporated by referenc Exhibit 10.9 of Xylem Inc Form 10-K filed on Febr 26, 2016 (CIK No. 1524 File No. 1-35229).
10.10	#	Xylem Retirement Savings Plan.	Incorporated by referenc Exhibit 10.1 of Xylem Inc Form 10-Q filed on July 2013 (CIK No. 1524472 No. 1-35229).
10.11	#	Xylem Supplemental Retirement Savings Plan.	Incorporated by referenc Exhibit 10.11 of Xylem I Form 10-Q Quarterly Re filed on November 21, 2 (CIK No. 1524472, File No. 1-35229).
10.12	#	Xylem Deferred Compensation Plan.	Incorporated by referenc Exhibit 10.12 of Xylem I Form 10-K Annual Repo on February 23, 2017 (C 1524472, File No. 1-352
10.13	#	Xylem Deferred Compensation Plan for Non-Employee Directors.	Incorporated by referenc Exhibit 10.13 of Xylem I Form 10-Q Quarterly Re filed on November 21, 2 (CIK No. 1524472, File No. 1-35229).
10.14	#	Form of Non-Employee Director Restricted Stock Unit Award Agreement.	Incorporated by referenc Exhibit 10.1 of Xylem Inc Form 10-Q Quarterly Re filed on July 30, 2015 (C 1524472, File No. 1-352
10.15	#	Xylem Special Senior Executive Severance Pay Plan (Amended as of February 24, 2016).	Incorporated by referenc Exhibit 10.15 of Xylem I Form 10-K filed on Febr 26, 2016 (CIK No. 1524 File No. 1-35229).

10.16 #	Xylem Senior Executive Severance Pay Plan (Amended as of May 10, 2017).	Incorporated by referenc Exhibit 10.1 of Xylem In Form 10-Q filed on Augu 2017 (CIK No. 1524472 No. 1-35229).

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Exhibit Number		Description	Location
10.17	#	Form of Xylem 2011 Omnibus Incentive Plan 2011 Non-Qualified Stock Option Award Agreement — Founders Grant.	Incorporated by reference to Exh 10.17 of Xylem Inc.'s Form 10-Q Quarterly Report filed on Novemb 2011 (CIK No. 1524472, File No. 1-35229).
10.18	#	Form of Xylem 2011 Omnibus Incentive Plan Non-Qualified Stock Option Award Agreement — General Grant.	Incorporated by reference to Exh 10.18 of Xylem Inc.'s Form 10-Q Quarterly Report filed on Novemb 2011 (CIK No. 1524472, File No. 1-35229).
10.19	#	Xylem Annual Incentive Plan for Executive Officers (Amended as of February 24, 2016).	Incorporated by reference to Exh 10.16 of Xylem Inc.'s Form 10-K February 26, 2016 (CIK No. 1524 File No. 1-35229).
10.20	#	Form of Director's Indemnification Agreement.	Incorporated by reference to Exh 10.16 of Xylem Inc.'s Form 10-K February 26, 2016 (CIK No. 1524 File No. 1-35229).
10.21	#	Form of Xylem 2011 Omnibus Incentive Plan Non-Qualified Stock Option Award Agreement (2013).	Incorporated by reference to Exh of Xylem Inc.'s Form 10-Q Quarte Report filed on April 30, 2013 (CI 1524472, File No. 1-35229).
10.22	#	Letter Agreement between Xylem Inc. and Patrick K. Decker.	Incorporated by reference to Exh of Xylem Inc.'s Form 10-Q Quarte Report filed on April 29, 2014 (CI 1524472, File No. 1-35229).
10.30		Term Loan Agreement, dated as of January 26, 2018 among Xylem Europe GmbH, as borrower, Xylem Inc., as parent guarantor and ING Bank, as lender (including Form of Parent Guarantee).	Incorporated by reference to Exh 10.30 of Xylem Inc.'s Form 10-K February 23, 2018 (CIK No. 1524 File No. 1-35229
10.31	#	Form of Xylem Restricted Stock Unit Agreement (Amended as of February 21, 2018).	Incorporated by reference to Exh 10.31 of Xylem Inc.'s Form 10-K February 23, 2018 (CIK No. 1524 File No. 1-35229
10.32	#		

	Form of Xylem Performance Share Unit Agreement (Amended as of February 21, 2018).	Incorporated by reference to Exh 10.32 of Xylem Inc.'s Form 10-K February 23, 2018 (CIK No. 1524 File No. 1-35229
10.33	Amendment to Term Loan Agreement, dated as of January 26, 2018 among Xylem Europe GmbH, as borrower, Xylem Inc., as parent guarantor and ING Bank, as lender (including Form of Parent Guarantee).	Filed herewith.
21.0	Subsidiaries of the Registrant.	Filed herewith.
23.1	Consent of Independent Registered Public Accounting Firm.	Filed herewith.
31.1	Certification pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	Filed herewith.
31.2	Certification pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	Filed herewith.
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	This Exhibit is intended to be furn in accordance with Regulation S- 601(b) (32) (ii) and shall not be d to be filed for purposes of Sectio the Securities Exchange Act of 1 incorporated by reference into an under the Securities Act of 1933 Securities Exchange Act of 1934 as shall be expressly set forth by specific reference.

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Exhibit Number	Description	Location
32.2	Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	This Exhibit is intended to b furnished in accordance wit Regulation S-K Item 601(b) and shall not be deemed to for purposes of Section 18 o Securities Exchange Act of incorporated by reference i filing under the Securities A 1933 or the Securities Exch Act of 1934, except as shal expressly set forth by speci reference.
(101)	The following materials from Xylem Inc.'s Annual Report on Form 10-K for the year ended December 31, 2018, are formatted in XBRL (Inline Extensible Business Reporting Language): (i) Consolidated Income Statements, (ii) Consolidated Statements of Comprehensive Income, (iii) Consolidated Balance Sheets, (iv) Consolidated Statements of Cash Flows, (v) Consolidated Statement of Stockholder's Equity and (vi) Notes to Consolidated Financial Statements.	The instance document doe appear in the interactive da because its XBRL tags are embedded within the Inline document.

#Management contract or compensatory plan or arrangement

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ITEM 16. FORM 10-K SUMMARY

None

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Excha
of 1934, the Registrant has duly caused this Report to be signed on its beha
the undersigned, thereunto duly authorized.

XYLEM INC.

(Registrant)

/s/ Paul A. Stellato
Paul A. Stellato
Vice President, Controller and Chief Accounting Officer

February 22, 2019

Pursuant to the requirements of the Securities Exchange Act of 1934, this F
has been signed below by the following persons on behalf of the Registrant
the capacities and on the dates indicated:

February 22, 2019	/s/ Patrick K. Decker Patrick K. Decker President and Chief Executive Officer (Principal Executive Officer)
February 22, 2019	/s/ Markos I. Tambakeras Markos I. Tambakeras, Chairman
February 22, 2019	/s/ Jeanne Beliveau-Dunn Jeanne Beliveau-Dunn, Director
February 22, 2019	/s/ Curtis J. Crawford Curtis J. Crawford, Director
February 22, 2019	/s/ Robert F. Friel Robert F. Friel, Director
February 22, 2019	/s/ Victoria D. Harker Victoria D. Harker, Director
February 22, 2019	/s/ Sten E. Jakobsson Sten E. Jakobsson, Director
February 22, 2019	/s/ Steven R. Loranger Steven R. Loranger, Director
February 22, 2019	/s/ Surya N. Mohapatra Surya N. Mohapatra, Director
February 22, 2019	/s/ Jerome A. Peribere Jerome A. Peribere, Director