

# **Xylem Inc. (XYL) Q1 2024 Earnings Call Transcript**

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**Body**

Xylem Inc. (XYL)

Q1 2024 Earnings Conference Call

May 02, 2024 09:00 AM ET

Company Participants

Andrea van der Berg - Vice President, Investor Relations

Matthew Pine - Chief Executive Officer

Bill Grogan - Chief Financial Officer

Conference Call Participants

Deane Dray - RBC Capital Markets

Mike Halloran - Baird

Scott Davis - Melius Research

Andy Kaplowitz - Citigroup

Bryan Blair - Oppenheimer

Nathan Jones - Stifel

Joe Giordano - TD Cowen

Presentation

Operator

Welcome to Xylem's First Quarter 2024 Results Conference Call. All participants will be in listen-only mode. [Operator Instructions]. Please note this event is being recorded.

I would now like to turn the conference over to Andrea van der Berg, Vice President of Investor Relations. Please go ahead.

Andrea van der Berg

Thank you, operator. Good morning everyone and welcome to Xylem's first quarter 2024 earnings call. With me today are Chief Executive Officer, Matthew Pine; and Chief Financial Officer, Bill Grogan. They will provide their perspective on Xylem's first quarter 2024 results and discuss the second quarter and full year outlook. .

Following our prepared remarks, we will address questions related to the information covered on the call. I'll ask that you please keep to one question and a follow-up and then return to the queue.

As a reminder, this call and our webcast are accompanied by a slide presentation available in the Investors section of our website. A replay of today's call will be available until midnight May 9th. Additionally the call will be available for playback via the Investors section of our website under the heading Investor Events.

Please turn to Slide 2. We will make some forward-looking statements on today's call including references to future events or developments that we anticipate will or may occur in the future. These statements are subject to future risks and uncertainties such as those factors described in Xylem's most recent annual report on Form 10-K and in subsequent reports filed with the SEC.

Please note that the company undertakes no obligation to update any forward-looking statements publicly to reflect subsequent events or circumstances and actual events or results could differ materially from those anticipated.

Please turn to Slide 3. We have provided you with a summary of our key performance metrics including both GAAP and non-GAAP metrics with references to prior year segment metrics being made on a comparative basis reflecting the change in segment as of the beginning of the year.

For purposes of today's call, all references will be on an organic and/or adjusted basis unless otherwise indicated. And non-GAAP financials have been reconciled for you and are included in the Appendix section of the presentation.

Now, please turn to Slide 4 and I'll turn the call over to our CEO, Matthew Pine.

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Matthew Pine

Thanks Andrea. Good morning everyone and thank you for joining us today. The Xylem team delivered a very strong first quarter, outperforming expectations on all metrics. The team drove high single-digit organic revenue growth reflecting a healthy balance of both volume and price. And the team also expanded adjusted EBITDA margin, almost 300 basis points. And without outperformance, we delivered EPS growth of 14%.

The story is pretty straightforward. We have strong commercial and operational momentum with resilient underlying demand in the majority of our segments in end markets. I want to thank all our teams for doing a great job.

But I want to highlight two teams in particular Measurement & Control Solutions and Water Solutions and services. In both segments, focused effort paid off in really outstanding numbers. In MCS organic, revenue grew more than 20% and margins are up over 500 basis points year-over-year.

And in its first quarter as a combined segment, WSS stayed focused on serving our customers and deliver both the highest orders growth of all segments and made a significant contribution to Xylem's overall margin mix. In addition to operational and commercial performance, the first quarter also reflected continued momentum on integration synergies with Evoqua. We saw a very solid Q1 run rate on cost capture and we're confident in how we're tracking both on revenue and cost synergies.

On the basis of our momentum, the team's disciplined performance and continuing resilient demand, we're raising our full year guidance for both revenue and margin and lifting our EPS guidance $0.08 from the midpoint.

As we look forward operationally we're focused on maximizing value from every additional incremental volume we deliver. The team's impressive first quarter margin performance reflects our increasing operational discipline.

We're driving simplification across our business, doing the few things that matter most, even more efficiently. To solve water, we have to simplify water, both for our customers and for ourselves.

Strategically, our demand outlook continues to be supported by secular trends that are set to continue across economic cycles. As the headlines reflect, we're seeing an increasingly water-challenged world. And just as with energy, the water economy is intertwined with every part of business and life. So as water security becomes pressing, we'll continue to see increasing demand for the solutions that can help make companies and communities more water secure, and Xylem's platform of capabilities is uniquely positioned to meet this demand.

We recently announced we'll be hosting our Investor Day on May 30 to take place both virtually and here at our headquarters in Washington. We're looking forward to the opportunity to provide updates on our strategic outlook, long-term growth and financial framework and our 2030 sustainability goals.

And with that, I'll hand it over to Bill to cover the quarter's results, our financial position and our outlook in more detail. Bill?

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Bill Grogan

Thanks, Matthew. Please turn to slide 5. Q1 was an excellent start to the year, exceeding expectations across revenue, margin and earnings per share. I want to echo Matthew's thanks to all of our teams for remaining focused and turning in an outstanding quarter. We continue to see resilient demand with our backlog increasing 4% to $5.3 billion. Organic orders grew 3% in the quarter with book-to-bill above 1%, supported by strength across developed markets, particularly in WSS.

Total revenues grew 40%, and organic revenues rose 7%, exceeding our guidance and a healthy combination of volume and price. Our performance was led by M&CS and WSS and we saw growth in all regions led by double-digit growth in the US.

EBITDA margin was 19.2%, up 290 basis points from the prior year with productivity savings, strong volume, price and mix more than offsetting inflation and investments. This reflects incrementals of 26% on a consolidated basis and 57% on an organic basis.

Our EPS in the quarter was $0.90, above the high end of our guide by $0.05, up 14% over the prior year. Our balance sheet remains healthy with ample liquidity to support capital deployment. We started the year with free cash flow conversion of 9%. This represents significant improvement versus typical seasonality of negative Q1 free cash flow conversion. This year, we delivered higher net income, offset slightly by increased CapEx.

Please turn to slide 6. Measurement & Control Solutions had a great quarter and exceeded our expectations. Orders grew 3% on continued smart metering demand. Backlog rose to $2.2 billion, up 6% organically and book-to-bill came in slightly under one due to greater backlog conversion.

M&CS revenue was up 22%, driven by smart metering demand and backlog execution. We finished the quarter with EBITDA margins of 22.7%, up 550 basis points versus the prior year and up 440 basis points sequentially. Margin expansion was driven by productivity, higher volume and price and favorable mix more than offsetting inflation.

In Water Infrastructure, orders grew 6% in the quarter, led by robust transport demand. Revenue exceeded our expectations with total growth of 40% and organic growth of 6%, driven by healthy demand across all regions and applications.

EBITDA margin for the segment was up 320 basis points driven by productivity, mix, volume and price offsetting inflation. In Applied Water, although orders declined versus a year ago, book-to-bill was greater than one, reflective of a few large project wins.

Revenues were down 4%, in line with our expectations against strong growth in the first quarter last year, primarily driven by a decline in developed markets. Segment EBITDA margin declined 380 basis points year-over-year, an unfavorable mix, higher inflation and volume declines, partly offset by productivity savings.

Wrapping up with water solutions and services. Orders grew 7% organically led by dewatering and 19% on a pro forma basis with book-to-bill well above one in the quarter, driven by a large order for a 20-year outsourced water contract, but even excluding that large order, pro forma demand increased.

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Organic revenue was up 6%, while pro forma revenue increased 9%, with healthy growth across most of the businesses. Adjusted EBITDA margin was strong at 22.3%, driven by favorable mix in volume and price and productivity. The outperformance across WSS is a great reflection of our team staying focused on what matters, serving our customers throughout this integration and re-segmentation.

Now, let's turn to slide 7 for our updated full year and second quarter guidance. Given our first quarter outperformance and both commercial and operational momentum, we are raising our full year guidance. We are increasing our revenue guide to approximately $8.5 billion. This reflects an additional point of growth versus prior guidance. That will put total revenue growth at 15% to 16% and organic revenue growth at 4% to 6%.

We are confident about driving further margin expansion with operational productivity and are raising our EBITDA margin guidance to about 20%. That represents 110 basis points of expansion versus the prior year driven by higher volume, productivity, including cost synergies and price offsetting inflation. Our updated EPS guidance of $4.10 to $4.25 reflects an increase of $0.08 at the midpoint.

We continue to expect around $100 million of exit rate cost synergies in 2024. And free cash flow conversion for the year is still expected to be 115% of net income. The full year outlook at the segment levels remain largely unchanged from our comments in February.

For the second quarter, we anticipate total revenue growth will be 23% to 25% on a reported basis and 5% to 7% organically. We expect second quarter EBITDA margin to be approximately 20%, up 90 basis points, driven by higher volumes, continued price realization and productivity gains. This yields second quarter EPS of $1 to $1.05.

We came into 2024 at a healthy pace, and we've had a strong start to the year, building further momentum. Our diversified portfolio positions us well to address our customers' evolving needs, and we anticipate healthy demand across most end markets and applications. While we are closely monitoring the macro environment, including inflation, higher interest rates for longer, a strengthening dollar and geopolitical uncertainty, our overall outlook for the year remains positive.

With that, please turn to Slide 8, and I'll turn the call back over to Matthew for closing comments.

Matthew Pine

Thanks, Bill. Two things I want to mention before we close. First, it's been such a privilege in my first 100 days as CEO to spend time with so many Xylem colleagues around the world. You can see they're doing fantastic work, and it's evident in today's results. And our integration progress is a great indicator of how smoothly the Xylem and Evoqua teams have come together. As a combined company, there is so much potential for growth and impact, especially as we pivot to even stronger execution of our strategy.

To achieve our potential, we're being very intentional about the culture we're building. Specifically, we're creating a culture centered on behaviors that drive empowerment, accountability and innovation. We call it our high-impact culture, and it's the heart of our how, how we are creating the next phase of Xylem's growth and impact. Of course, culture change takes time, and it starts with myself and the leadership team.

So it's incredibly energizing to see the cultural alignment already coming to life in our town halls and business reviews at all levels in the organization. We'll talk a bit more about how we're fostering our high-impact culture when we gather together for Investor Day at the end of May.

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Lastly, on Investor Day, we'll also be launching our 2023 sustainability report. We're very proud of what we've achieved and even more motivated by the work ahead. In this year's report, we'll be introducing our combined company goals for the first time, setting our ambition for impact through 2030. Given how fundamental sustainability is to Xylem's business model, I invite you to give it as much attention as you give our financial results. And as always, we welcome your feedback.

And with that, I'll turn it over to the operator to lead us through Q&A.

Question-and-Answer Session

Operator

We will now begin the question-and-answer session. [Operator Instructions] The first question comes from Deane Dray with RBC Capital Markets. Please go ahead.

Deane Dray

Thank you. Good morning everyone.

Matthew Pine

Hey, good morning, Deane.

Deane Dray

Maybe we can start with the Evoqua integration and just lots of focus here on the potential revenue synergies, the rollout of the European business. Just any color there in terms of what the potential is on some new outsourcing contracts? And then also can you just – any color on that large outsourced contract that would be helpful too?

Matthew Pine

Yes, I can start us off, Deane. I'll have Bill cover the big win that we had in our newest WSS segment on the long-term build on operate contract. But maybe just broadly on Evoqua integration update. It's really hard to believe that we closed about a year ago. We – just to remind everybody we closed that in what I call record time, announced in January, closed in May of last year. And I would characterize this as great momentum.

Obviously, we've got an Investor Day coming up in about four weeks. And we're going to have some real tangible proof points to the progress that the teams are making. Just briefly cost synergies are tracking well to meet the $100 million run rate that we've talked about in our 2024 plan. And Deane on revenue synergies, we're ramping. That was the last thing that we were able to really focus on. Obviously on the cost side, you can do a lot of work before the close.

You can't gun jump on the revenue synergies before closing. But the teams have really ramped up. And again we're going to have some nice proof points to share in a few weeks here in D.C. but I don't want to steal the team's thunder there. But great momentum. And you're going to get examples across three of our four segments of those revenue synergies. And maybe specifically on international expansion to your point, we are making really I'd say quicker progress on the capital side of that. But we're starting to build momentum on the services side.

We've got three or four large scale projects that we're working in the Americas that are kind of outside the US and we've got some work that we're starting to investigate in probe in Europe. And so that's always been the longer part of our tail of the synergy. But I just – I'm really happy with the momentum that the teams are making.

Maybe just one other comment before I hand it to Bill. You've seen in the quarter one results, we have not been slowed by integration. And that's an important point to make. This can be very distracting. And specifically with our WSS segment, where we recently did what I call a reverse integration with dewatering and assessment services, you can just see the outstanding results that the team posted in Q1 and more to come. So Bill maybe?

Bill Grogan

Yes. And Deane, maybe just to that project. I mean great win by the team. It's a $100-plus million 20-year outsourced water project to support a large hydrogen plant investment with one of our key customers. Obviously, there's an upfront revenue recognition over the first 18 months and it's about one-third of it and the balance will be recognized over the next 20 years. So excited about that. Sticky recurring revenue that that project will provide. The team has got a really strong funnel of large opportunities that continue to work through and we look to see continued wins as we progress through the year.

Deane Dray

That's all really good to hear. And just as a second question and I'm not asking to front run anything about the analyst meeting that's coming up. But just there's an expectation that there's portfolio optimization coming, there's margin improvement that will be targeted. And I would just want to get a sense of – I know that's going to be very inward looking at the four walls of the company. But what about the growth algorithm. Just during this period are you still focused on M&A? Are you looking at new opportunities? And I just don't want to miss any of that growth upside during this period of kind of portfolio optimization?

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Matthew Pine

No, it's a great question and you pretty much hit on three of my key messages that I'll be taking up in the Investor Day with me. Look we're extremely focused on executing on the platform that's been built over the past decade, especially over the past year with the acquisition of Evoqua to drive above-market growth. I mean that's our mantra. This is our number one execution priority in our goal deployment process this year and it will be in the future years. And it's really obviously bolstered by the Evoqua synergies.

Look, Q1 is one data point with our new leadership team in place here. But look, we're up 6% in volume and 1% in price. I think that's a good beginning of what we're building here on the top line and I'm super proud of our team's top line mindset. It's not a secret. I've been very vocal about our operating leverage and so of our investors, quite frankly. And so we want to make sure that we're driving profitable growth in expanding our margins.

And again, Q1 is a good example of that. We're at roughly 60% almost incrementals on a pro forma basis. And the thing Deane, I would leave you with when we talk about some of the inward focus, it's really about we have to simplify our business to grow our business. And we're doing both. And so that's really the mantra and the focus.

And from a capital deployment standpoint, we'll get into more into that here in a few weeks, but we're going to be focused on high-growth markets with accretive margin and we're going to be more consistent in our capital deployment. And we've just wrapped up some value mapping work that's going to inform where those opportunities are. So we look forward and the team looks forward to sharing that with you and others here in a few weeks.

Deane Dray

All good to hear. See you in a couple.

Matthew Pine

Thank you.

Operator

The next question comes from Mike Halloran with Baird. Please go ahead.

Mike Halloran

Hi. Good morning, everyone.

Matthew Pine

Good morning, Mike.

Mike Halloran

So a couple here. First maybe just taking a step back here you've been -- year-to-date 100-plus days, Bill you've been there what six, seven months now. What are the initial impressions as far as the momentum you're seeing, how the messaging to pushing through or starting to sinking into the culture sinking to the people? And what kind of impressions do you have so far?

Matthew Pine

No that's a great question. I did mention that in my opening remarks about the first 100 days. We not this me, but we as a team feel good about where we are. And we believe we've got -- we had good momentum coming into 2024. We believe now we're continuing to build on that momentum that you've seen in Q1. We're executing on a great platform, which I just teed up with Deane here.

I'd say we did not have a cold start. We didn't start this January 1 and figure out how to start turning the crank. With COO last year having the opportunity to refine the strategic priorities is a part of our strategy session with the Board. And those themes were really around value capture from our Evoqua transaction, simplification not only in service of margins but growth, which I just mentioned to Deane. And we're deploying that more systematically through the business, through goal deployment.

I'm really proud of what I'm seeing when I'm out and about with the teams and scaling services. So that I'm pleased to see the progress there. Obviously, I'm pleased to see the progress on our Evoqua integration both economically and the results we're seeing. But culturally, the teams are coming together and working fantastically and we're seeing obviously momentum there.

I think the last thing that's most important to me is the how, because you can have all these objectives and strategies and things you want to go do, but if you don't have the right culture then it's hard to execute consistently. And so the work we're doing on our high-impact culture are how, it started last year with our senior leadership team probably about a year ago this time. And we just engaged our top 150 in the organization at the end of last year coming into 2024. And we're seeing great alignment.

I've spent a lot of time on the road the past 100 days globally. And I'm really pleased about where we are but it's a long journey. We have a lot of work to do ahead of us. But with that focus and intention, I believe we can achieve great things. So look I'm happy where we are. We're not satisfied, but I think we're off to a good start.

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Mike Halloran

Thanks for that. And then kind of a broad question on underlying dynamics in orders. One, kind of, twofold here. One, can you give the pro forma organic overall orders for the company or give some proxy for it?

And then second, if I listen to the messaging here, it feels like not a lot has changed in terms of what you're seeing from an end market perspective across the various segments. I'd like to just understand if there are any notable puts and takes that they inflected more so or less so than you thought in the quarter or from a trend line perspective?

Matthew Pine

Maybe I'll let Bill open up on your orders question, I'll give you some commentary and color on the markets.

Bill Grogan

Yeah. So, obviously, organic was reported at 3%. The pro forma organic was 7%, so more than 2x there.

Matthew Pine

Yeah. So good momentum on orders in Q1. The book-to-bill was greater than one and backlog up 4%. Not a lot has changed. Demand remains healthy, Mike, in the majority of our end markets. And it's supported by a lot of the favorable drivers that we've been talking about around the secular trends. Government funding is trickling in globally across different parts of our coverage, still a lot of resiliency in municipalities or utilities, OpEx and CapEx for that matter.

I know that there's been questions about with rates especially in the US and in Europe with that slowdown, we're not seeing any slowdown. And you've seen with our results in the WSS segment this quarter the durability of that business model.

And I'm really proud of the M&CS team with their backlog conversion. We continue to win orders though and our orders are up year-over-year and we've got good momentum there.

So, I think a lot of what we talked about is the same. The watch areas continue to be Applied Water. It largely was what we expected. We got a better second half comp and we're working on some things in the business that I think will continue to improve performance there. Yes so I think that would be my commentary on where we are right now from a demand point of view.

Mike Halloran

Appreciate it. Thank you.

Matthew Pine

Thank you.

Operator

The next question comes from Scott Davis with Melius Research. Please go ahead.

Scott Davis

Hey, good morning everybody.

Matthew Pine

Hey good morning Scott.

Scott Davis

Congrats on the -- getting through the first 100 days and having a good quarter here.

Matthew Pine

Thank you.

Scott Davis

Big picture Matthew when you see a synergy target after a deal like yours, I have to wonder is it input or output, meaning are you trying to find $100 million in synergies? Or is it a natural output of the actions that are taken integration-wise that's a little theoretical but I guess somewhat kind of the second derivative of the question is, is that if those synergies track above the $100 million, will you likely be more likely to invest that back into the business or show it on the margin line?

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Matthew Pine

Yes. If you're referring to the cost synergies as a part of the Evoqua transaction?

Scott Davis

Yes.

Matthew Pine

Yes. So, look we did announce $140 million when we did the deal. So, it is a little bit more than $100 million. Look we're running to a target much higher than $140 million. And we're going to land the plane for sure at $140 million and we're going to make sure that we put that upside probably somewhat to the bottom-line, but also somewhat investing in growth. It's probably a mixed bag of whatever the overage would be would kind of fall half to the bottom-line and half the top line growth.

It's easy when you do these deals to look at cost synergies and they're on paper and they look like okay they're easy to do their procurement back office their lift and shift factories it looks pretty straightforward but there's a lot of work that goes into this and a lot of tracking.

And I'm really impressed Scott of the capability that we have built through this transaction. And that's only going to help us as we go forward and deploy more capital in the future. So, I think we're tracking well we're going to deliver above $140 million and we're going to use that to help continue to expand margins, but also to fuel growth in the future.

Scott Davis

That makes sense. And the second question I'd probably only get an opportunity to ask this once when you get a newer CEO. But -- when you think about the buckets of where Xylem is historically perhaps overinvested or underinvested or over loved or under-loved, what stands out to you as areas of perhaps improvement that you'd like to see?

I mean you mentioned the cultural changes and some of the operational rigor. But if you could be more specific around maybe some areas where you feel like you guys could use a little bit more love or the--?

Matthew Pine

Yes, I think you hit the first one. It's culturally and I think we're making good progress there. But you've heard me talk about Simplify Water. I think that's what it boils down to -- over the years as we've built this incredible platform, we have had some complexity conspired against us to some extent.

And you can see a little bit of that in our margin profile. So, it's not that we're going to be like super inwardly focused, but we do have to focus inwards, so we can better serve our customers and our colleagues. And that's where we're focused.

It's just making it simple to do business internally at Xylem as well as for our customers, so customer-backed mentality. 80/20 is one tool to do that. There's other tools that we're leveraging.

But I think putting this finer focus on what I would call the commercial execution of our business which has probably been the area that we haven't focused enough around customers and product SKUs and things of that nature really to simplify the business is the mantra and I think it's going to pay big dividends for us going forward.

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Scott Davis

Super helpful. Thank you, Matthew. We'll see you all in a few weeks.

Matthew Pine

Thank you.

Operator

The next question comes from Andy Kaplowitz with Citigroup. Please go ahead.

Andy Kaplowitz

Hey good morning everyone.

Matthew Pine

Morning Andy.

Andy Kaplowitz

Matt I know you mentioned you continue to watch Applied Water. I think you did say that you won a couple of larger projects there that led to book-to-bill over 1 time. So maybe what does that say about the market? Is it like you thought, better than you thought, worse than you thought? How would you sort of characterize what's going on there?

Matthew Pine

Yes. I'd say it's largely what we thought. If you look at the prior Q1s, we're up 10% in each 1 of those. So it's a tough compare. But it's our most cyclical segment, we do continue to expect low single-digit decline this year. It's kind of in line with what we planned. We did, to your point, have good Q1 orders performance. There were a few larger projects in that, that are a little bit out in the future.

So it's not something that's book and ship. It's more of future projects. But we do continue to see soft markets, especially in Europe and emerging markets is where our orders were down. Obviously, we're watching developed markets as well, but obviously, Europe plays into that. But our really weakness in Q1 was emerging markets and in Europe for Applied Water.

The comps continue in Q2 to be difficult, and we're closely monitoring the funnel, and leading indicators on Applied Water. But look, we feel good about the business long term. It's just a little bit of a headwind in the first half. It will resolve itself in the second half. And we've got a lot of initiatives in place to reduce complexity and redeploy that effort in growth, and we feel confident about that going forward.

Andy Kaplowitz

Helpful. And then obviously, it was expected, but can you talk a little bit more about how the new EPA rules regarding PFAS affect Xylem. Did they change the time line at all when PFAS may be impactful? Or is it just kind of slow and steady wins the race for how to think about your impact?

Matthew Pine

Yeah, it's the latter. It's slow, steady race. Look, we're glad to see the rule be final. Now we have some clarity on the rules of the road, the time line. Look, I'm really proud of our teams in providing clarity just 24 hours after the final rule on LinkedIn Live that really shows that we're customer-centric, we're focused. We're being a leader in the space to educate our customers. But again, to your point, this is a long journey. It will take time for the impacted utilities to comply.

They've had three years for testing, five for PFAS removal, and that's a little bit longer than we initially anticipated in terms of when they need to be compliant. And we're really well positioned today and ready to partner with utilities on PFAS and other emerging contaminants for that matter.

One thing I don't know a lot of people -- if a lot of people know this, we have over 80 PFAS installations that we've done over the years, and we have long-standing relationships and really a differentiated offering through our service capabilities for our customers. And maybe the last thing I'd say also is we do continue to work on destruction technology. Obviously, the capture technologies out there, it's commercially viable, but there's still work to do when you capture the PFAS, how you destroy it. And so we've got a lot of great work going on with our combined company now and our Innovation Labs team to get after that solution.

Andy Kaplowitz

Appreciate all the color.

Matthew Pine

Thank you.

Operator

The next question comes from Bryan Blair with Oppenheimer. Please go ahead.

Bryan Blair

Thank you. Good morning, everyone.

Matthew Pine

Hey, Bryan.

Bill Grogan

Hey, Bryan.

Bryan Blair

Great to drill down on M&CS margin performance, kind of eye-catching step up in profitability there. Maybe offer some finer points on the drivers, seem kind of broad-based in terms of productivity, volume price mix in the quarter? And whether there's anything that we should consider one-time-ish that benefited results? And then lastly on that front, is it still the expectation that margin will improve sequentially throughout the year?

Bill Grogan

Yeah. No, Bryan, I'll take that one. I'd say, you might be guarantee team delivered an outstanding quarter. Obviously, EBITDA margin is up 550 basis points with almost 50% incrementals. That team has been on a journey over the last few quarters, dealing with some pretty significant external challenges relative to the supply chain and then internal challenges to ramp up production levels that they haven't been able to realize historically to deliver for their customers to make up for that past due backlog. They drove significant labor and material productivity to drive efficiencies to increase our output. They went out with incremental pricing, price cost negative for a while. They're back to price material cost positive. It took restructuring actions to address some underperforming parts of the business just to build a stronger financial foundation that they're now leveraging extremely well with this incremental volume.

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The first quarter was a bit higher than our original expectations as I did see a little bit better mix towards North American water meters. We think that mix holds plus or minus here in the second quarter, but do see some unfavorable mix impacts in the back half as some lower-margin projects, especially in the energy space ship and that mix normalizes a bit. But we're really encouraged with the teams on momentum that they'll exit the year at record margins. They've started their 80/20 initiatives.

So they're just in that phase, which I think will produce additional tailwinds as we exit the year. So really happy with their performance. I think it's -- we probably won't see as big of a step up as we progress through the year. It's probably more normalized now. It's just the strength there in the first quarter, but volumes will slightly sequentially increase as we go through the balance of the year.

Bryan Blair

Okay. Very helpful detail and encouraging trends. Matthew, you mentioned that government money is starting to trickle in. And you touched on the outlook for PFAS and your team's positioning there. It would be great to hear just updated perspective on IIJA related growth opportunities overall. You've been pretty consistent in tempering expectations to date, understandably so, given the phasing of the rollout, but we have seen some acceleration in obligations and outlays, front-end reads are certainly very encouraging. And looking at the categories of funding and ultimate spend, I would have to assume that your team is going to participate in just about everything. So curious how your views are evolving there and how we should think about the forward opportunity?

Matthew Pine

Yes. I wish I could turn and stick on that hose nozzle and make it go a little faster, but look, it's -- I've been pretty consistent about this, whether it's in the U.S. or other markets, U.K., in Europe, with their funding. It's just going to be a slow drift and it's going to drip in and really help support our market growth over the next three to five years. And so that's how we continue to look at it. We don't have a big jump in our long-range plan in terms of incentives or subsidies that are coming in. So it's just going to trickle in and be kind of a layer on top of the market growth. And that's how we look at it.

Bryan Blair

Understood. Appreciate the color.

Matthew Pine

Thank you.

Operator

The next question comes from Nathan Jones with Stifel. Please go ahead.

Nathan Jones

Good morning everyone.

Matthew Pine

Hey, good morning Nathan.

Nathan Jones

I wanted to pick up on one of Bill's comments and something I know I've talked to Matthew about before, which was the anticipation that in the future price will offset inflation. Several years ago, it had been Xylem's target for price plus productivity to offset inflation. So there's a significant change there. So just looking for some color on how you look to go about implementing that and what you think will give to Xylem the entitlement to be, I guess, a little more aggressive with price versus inflation than it has been historically?

Bill Grogan

Yes. I think, obviously, price capture has been a focus with rising inflation. We're going to talk more about that at the end of the month, just a new approach to strategic pricing. I mean, I think for us, it's really -- we're looking to offset our material inflation with price and then let productivity handle the balance of indirect and SG&A inflation and fund our investments. I think the teams have got the operational productivity down, and now it's for us just to continue to refine and our process relative to value capture for the products that we offer to our customers. We were price cost positive. We're looking to really manage that spread going forward, and that's really the target of the teams.

Nathan Jones

I guess my follow-up question for Matthew. You talked about government funding kind of trickling in. There's I think, an increased focus in Europe on non-revenue water, big increases in the focus for that in the next half cycle and parts of Western Europe and Southern Europe after the 2022 drought. Can you talk about if there's any material opportunities from that increased focus on non-revenue water for Xylem's business over the next several years?

Matthew Pine

Yes, I do. I think first with our Idrica platform is a great entree into that. There's a lot of opportunities to leverage the Idrica platform to help visualize that data through AMI systems. So that's a big focus area that we're working with utilities on across Europe and across the globe, but especially Europe. And you're right, there's a lot of funding in Europe and in the U.K. with the AMP cycle in the U.K. on non-revenue water. And also, there's a lot of focus on analytical instrumentation, especially out in the environment where they're holding polluters liable for contaminated water. So we see a great opportunity on smart metering and analytical instrumentation in that region with an overlay of our Idrica partnership and platform.

Nathan Jones

Great. Beast of luck. Thanks for taking my questions.

Matthew Pine

Thank you.

Operator

The next question comes from Joe Giordano with TD Cowen. Please go ahead.

Joe Giordano

Hey, good morning, guys.

Matthew Pine

Hey, good morning, Joe.

Joe Giordano

So on PFAS I know we talked a lot about it but can you maybe just talk us through exactly where you're exposed on that? And if there's capabilities that you don't currently have maybe like sampling or destruction that you're currently exploring either internally or maybe through acquisition?

Matthew Pine

Yes. So – we're obviously we have the technology to capture through our acquisition with Evoqua coming together at Xylem. And we have over 80 PFAS installations to date. Actually we just had one written up in Newsweek, I believe it was Newsweek a month or so ago up in Maine, where we were capturing PFAS from a well that they had dug to serve the increasing population. So we've got proven technology on the capture side. Where the innovation needs to happen and get to commercial liabilities on destruction. And then sensing we can sense and bring it to a lab and get the sensing part of PFAS but need to get sensors that can be in real-time flow. So those are the areas on destruction and real-time sensing – whether it's innovation needed and our teams are working on that through our innovation labs. And with the two teams coming together from a legacy of Xylem and Evoqua, we believe that we can move faster and obviously spend less money getting there.

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Joe Giordano

And then the last question I guess is one I never really thought I'd be talking to you guys about but we're getting questions about Xylem is like a data center play now on the water side. So can you maybe explain the opportunity set in front of you either on the power side as we have to ramp up generation capabilities to support a huge buildout or we're like in the buildings themselves on the data center side how that opportunity kind of scales for you?

Matthew Pine

Yes. I mean look on the power side we're excited. It's one of our high-growth verticals. You heard Bill talk about the big win $130 million build on operate win in hydrogen – and so we see that energy mix shift driving lots of opportunity for us. Specific to data centers, I do think it is a growth opportunity. We're starting to see it. Actually one of our examples. I won't steal the thunder here at Investor Day coming up in a few weeks is about the data center where we have synergy win there. But it's currently a small part of our revenue probably less than $50 million.

Data centers do need a significant amount of water for cooling and many of them are being built in water-stressed areas putting a lot of pressure on water resources. So we have a lot of solutions to help them from comprehensive treatment solutions to enable reuse. We've got obviously outsourced services for water management to help as well. So we do believe it's going to be an opportunity for us. It's probably not like maybe some of the other coverage that you folks have but it definitely will be a tailwind.

Joe Giordano

Fair enough. Thank you, guys.

Matthew Pine

Thank you.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Matthew Pine for any closing remarks.

Matthew Pine

Well, we'll wrap it up there. Thank you for your questions and thanks to everyone who joined today. We hope to see many of you either in person or online at Xylem's Investor Day on May 30. And we look forward to sharing further insights into our priorities and strategic direction then. Until then all the best.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

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