

# **Xylem Inc. (XYL) Q2 2024 Earnings Call Transcript**

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**Body**

Xylem Inc. (XYL)

Q2 2024 Earnings Conference Call

July 30, 2024 9:00 a.m. 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 - Robert W. Baird

Scott Davis - Melius Research

Nathan Jones - Stifel Nicolaus

Joseph Giordano - TD Cowen

Andrew Kaplowitz - Citigroup

Bryan Blair - Oppenheimer

Presentation

Operator

Good day, everyone, and welcome to the Xylem's Second Quarter 2024 Results Conference Call. All participants will be in listen-only mode. [Operator Instructions] Please note that 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 second 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 second quarter 2024 results, and discuss the third 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 August 6. Additionally, the call will be available for playback via the Investors section of our website under the heading Investor Events.

Please turn to slide two. 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 three. 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 four, and I will turn the call over to our CEO, Matthew Pine.

Matthew Pine

Thanks, Andrea. Good morning everyone, and thank you for joining us today. It's a pleasure to report the achievements of the Xylem team in the second quarter. As you've seen in this morning's release, the team delivered another very strong quarter, outperforming expectations on all metrics. With high single-digit organic growth reflecting gains in both volume and price, the team also expanded adjusted EBITDA margin 170 basis points. And with that outperformance, we delivered adjusted EPS growth of 11%. The story of the second quarter is similar to Q1. On the demand side, our largest markets continue to be resilient.

Internally, our outperformance is driven by increasingly disciplined operational execution by the team. This kind of performance momentum is only possible when the whole team is engaged in line to make a difference. And I want to say a big thank you to the whole Xylem team for the dedication and drive they've demonstrated through the first-half of the year. While there were a lot of highlights across the team, I particularly want to mention the standout performance in Measurement & Control Solutions. MCS segment revenue was up 26%, and EBITDA margins are up 700 basis points versus this time last year. The team is doing an outstanding job.

Our first-half performance is a reflection of the value creation direction we set early in the year and discussed at Xylem's Investor Day, in May. That direction includes both resilient above-market growth and accelerated margin expansion. It's gratifying to see the kind of momentum reflected in our quarterly performance. In addition, our simplification initiatives in our work on 80/20 are progressing well, and are set to pay off beginning in 2025.

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Turning to the integration of Evoqua, in late May, we passed the one-year anniversary of our combination with Evoqua. The combination continues to reveal its value. Cost synergies are well on track, and the team is looking to accelerate our pace wherever possible. And our commercial teams are successfully taking Xylem's combined capabilities to the many customers who will benefit from our integrated solutions, both in utility and industrial end markets. With Evoqua integration on track, strong momentum from the first-half, resilient demand, and the team's increasing operational commercial discipline, we're raising our full-year guide for both revenue and margin, increasing our EPS guidance $0.06 from the prior midpoint.

In a moment I'll provide an update on our high-impact culture and our leadership alignment, and also on our industry-leading 2030 sustainability goals, but first I'm going to turn it over to Bill to double-click on the quarter's results, our financial position and our outlook. Bill?

Bill Grogan

Thanks, Matthew. Please turn to slide five. Q2 was another great quarter, and I want to thank our entire organization for their amazing work. We outperformed against our guide across revenue, margin, and earnings per share. We continue to see resilient demand, and our backlog is at $5.2 billion, a modest decline from prior year as we execute on MCS past due backlog. Book-to-bill was approximately one, supported by strength in water infrastructure, while organic orders were down 1% in the quarter driven by project timing within MCS and WSS. Total revenues grew 26%, and organic revenue rose 9%, exceeding our guidance on a healthy combination of volume and price.

Outperformance was led by MCS and WSS, as we saw growth in all regions led by double-digit growth in the U.S. EBITDA margin was 20.8%, up 170 basis points from the prior year, with productivity savings, strong volume and price more than offsetting inflation, investments, and mix. This reflects incrementals of 28% on a consolidated basis, and 50% on a pro forma basis. Our EPS in the quarter was $1.09, above the high end of our guidance by $0.04 and up 11% over the prior year.

Our balance sheet is strong with net debt to adjusted EBITDA at 0.7 times. Year-to-date free cash flow was up 200% versus the prior year. And conversion of 62% is strong given seasonality. This year-over-year improvement was driven by higher net income, offset slightly by increased CapEx. And, we continue to benefit from improved working capital efficiency.

Please turn to slide six. Measurement and Control Solutions had another great quarter, and again, exceeded our expectations. MCS revenue is up 26% driven by smart metering demand and backlog execution. However, due to project timing orders were down 18% and book-to-bill came in under 1. We worked down past to backlog. And total backlog for MCS now sits at roughly $2 billion, A 12% organic decrease from prior year.

We finished the quarter with impressive EBITDA margins of 23.4%, up 700 basis points versus the prior year and up 70 bps sequentially. Margin expansion was driven by volume, price, productivity, and favorable mix, more than offsetting inflation. As a reminder, we continue to expect a margin headwind from mix in the second-half as energy meters account for a larger portion of our sales.

In Water Infrastructure, orders were up strong, 8% in the quarter, led by robust treatment demand. Revenue exceeded our expectations with total growth of 22% and organic growth of 7%, driven by healthy demand across all regions and applications. Adjusted EBITDA margin for the segment was down 60 basis points with roughly 40% pro forma incrementals. This decline was driven by inflation and acquisition, but was offset partially by productivity, volume, and price.

Without the impact of acquisitions, adjusted EBITDA margin improved 40 basis points for the quarter. In Applied Water, orders were up 5% and book-to-bill was greater than 1, reflective of a few large project wins which will ship next year. Revenues were down 4% in line with our expectations lapping strong comps and 12% growth in the second quarter of last year. Decline was primarily driven by softness in developed markets. Segment EBITDA margin declined 200 basis points year over year, but increased 100 basis points sequentially. Higher inflation and unfavorable mix was partially offset by productivity savings.

Closing the segments with Water Solutions and Services, orders declined 1% organically driven by timing of large capital projects, offset by strength in the watering. Organic revenue was up 12% with healthy growth across most of the business. Adjusted EBITDA margin was strong at 23.8%. Up 60 basis points and driven by volume, productivity, and price. Offset in part by unfavorable mix and inflation. Two quarters in re-segmentation, we continue to see synergy momentum and benefits for our customers in combining our service-based offerings.

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Now, let's turn to slide seven for updated full-year and Q3 guidance. Given our first-half outperformance and both commercial and operational momentum, we are raising our full-year guide. We are increasing our revenue guide by approximately $50 million, up from $8.5 billion. This reflects an additional 0.5 point of growth at the midpoint versus our prior guidance. That will put total revenue growth at approximately 16% and organic revenue growth at 5% to 6%. The integration is going smoothly and we continue to expect $100 million of exist run rate cost synergies in 2024 with a potential to accelerate by yearend.

We are confident about driving further margin expansion with operational productivity and are raising our EBITDA margin guidance to about 20.5%. That represents 160 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 $4.18 to $4.28 reflects an increase of $0.06 at the midpoint.

Free cash flow conversion for the year is now expected to be over 120% of net income. The full-year outlook at the segment level remains largely unchanged with the exception of MCS, which we now expect to grow at high teens during our first-half performance versus our previous outlook of low teens. For the quarter, we anticipate revenue growth will be 3% to 5% on a reported and organic basis.

We expect third quarter EBITDA margin to be in the range of 20.5% to 21%, up 70 to 120 basis points, driven by higher volumes, continued price realization, and productivity gains. This yields third quarter EPS of $1.07 to $1.12. Our diversified portfolio of mission-critical products and services positions us well to address our customers' evolving needs, and we anticipate healthy demand across most end markets and applications. And we talked about our driving profitability through simplification efforts and our 80/20 implementations at the Investor Day in May. We are progressing well on those initiatives, and I want to reiterate our commitment to systematic margin improvement through operational excellence, supporting our long-term profitability framework. While we are closely monitoring the macro environment, including geopolitical, election uncertainty, and tariffs, our overall outlook for the year remains positive.

With that, please turn to slide eight. And I'll turn the call back over to Matthew for closing comments.

Matthew Pine

Thanks, Bill. I'd like to mention two events in the quarter that don't show up in the financial results but are fundamental to Xylem's success and impact. First, in June, just a few weeks after our Investor Day, we gathered Xylem's global leadership team in Washington, D.C. This was the first time we had our top 150 executives in one room, spanning legacy Xylem and legacy Evoqua. It was an energizing two days of collaboration focused on the work of leadership alignment and culture. I've spoken before about culture as the fundamental how Xylem -- how we'll deliver stronger execution of our strategy? How we'll realize our aspirations? How we'll create our next chapter of Xylem's impact. You can see in our second quarter results that the team is already working well and winning.

What our Leadership Summit reinforced was how much more value creation potential we have ahead of us, with an aligned team and a high-impact culture. It was fantastic to see the team so engaged by the opportunities ahead of us. Last quarter also saw the publication of our annual sustainability report. We're very pleased to be tracking well towards our 2025 goals, but we took the opportunity presented by this year's report to set out our aspirations beyond 2025.

We're raising the bar again by setting 2030 sustainability goals in three strategic areas. The first is decarbonization, reducing our own greenhouse gas emissions and enabling our customers to decarbonize. Secondly is water stewardship aimed at reducing water demand, and finally, we'll provide access to water, sanitation, and hygiene for 80 million people. All three strengthen our customer relationships and increase our impact. Before turning to your questions, I have one more special note. This is Andrea van der Berg's last quarterly earnings call at the helm of Investor Relations.

We're happy to announce that Andrea's taking on a new role within Xylem, and it's an exciting new opportunity for her. Over the years, so many of you have told me you deeply value Andrea's energy, accessibility, and professionalism, and I've benefited from her insightful counsel and positive encouragement in every circumstance.

So, thank you, Andrea. Some of you have already met Keith Muller, who's taking the reins as our investor relations leader. Keith has had great impact as the Head of Finance in Water Solutions and Services segment, having joined us with the Evoqua combination more than a year ago. He brings deep knowledge of the business to his leadership of IR. And I'm confident you'll enjoy getting to know Keith and will find great value in his insights and perspectives.

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And with that, let's go to your questions.

Question-and-Answer Session

Operator

And we will now begin the question-and-answer session. [Operator Instructions] And at this time, we'll pause momentarily for the first question. And our first question today will come from Deane Dray with RBC Capital Markets. Please go ahead.

Deane Dray

Thank you. Good morning, everyone.

Matthew Pine

Hey, good morning, Dean.

Deane Dray

Hey, I'll add my welcome to Keith, and wish Andrea best of luck and thanks for all your help.

Andrea van der Berg

Thank you, Dean.

Deane Dray

Hey, maybe we can start with 80/20, and I'll also make the observation you can see 80/20 at work in your conference call prepared remark and slides, and how much they've been slimmed down, and you get right to the point. So, really appreciate that. So, 80/20, I know you say the payoff is likely a 2025 of that, but we heard lots of specifics at the Analyst Day on the rollout. So, any updates you can share, I know we're still in the early innings, but you had Applied Water North America initially, MCS initially, any early actions, and what can you share? Thanks.

Matthew Pine

Yes. No, no, happy to give an update. So, again, the teams are progressing well. Like you said, we have three businesses in the thick of implementing the toolset. North American AWS and North American M&CS smart metering businesses, they're a few months ahead of global transport that kicked off in the second quarter. And we actually just had a kickoff for Applied Water, in Europe, that started on their journey last week.

AWS and smart metering have gone through their initial quads and quartile analysis. And now they're working through the [need] (ph) of segmenting their businesses, how they want to support their ongoing customer base, and building their [zoom up] (ph) P&Ls really highlighting the appropriate level of resources they need to run those businesses. They've come out with some initial price increases. Again, those benefits take a little while to work their way through the backlog. So, again, no material short-term benefit, but we see a significant pickup at the end of this year, leading into 2025, where we'll see a more material P&L hit or pickup. The teams are focusing on communicating with their customers and how their toolset is going to impact them, really talking to their largest customers on how these changes will benefit them in the long-term, really improving the overall experience with Xylem as we bring new product innovation to them faster, improve our delivery and quality to them, so a lot of excitement around the toolset externally for their customer bases.

So, progress continues. I think we're right on schedule. Again, confident in the value 80/20 is going to bring and provide for us over the next several years, really in line with what we highlighted in the additional impact the toolset is going to have in the framework we laid out back in Investor Day.

Deane Dray

That's a really helpful update, Bill. Thanks. And given that most of the operating results, so are either as expected or a little bit better. I could ask a broader industry question, if I could, just implications on the Supreme Court overruling the Chevron doctrine, I know we're still in the early innings, but any kind of high level thoughts what the ripple effects might be in PFAS remediation at the federal level, the super-fun timing? And look, I know it's not in your numbers, it's not in your three-year guide, but just the idea here is what might the implications be? And I can see that, at state level, that's where all the remediation efforts have been going in any way. And the states, like California, are not waiting for the federal government to lead the way. So, just from your perspective and insight, how do you think this plays out?

Matthew Pine

Thanks for your question, Deane. We didn't see this one coming. If you asked us three months ago, this was not on our radar. So, we're reacting to lots of different volatility out in the marketplace. But the Supreme Court striking this down, the Chevron doctrine, it does introduce some uncertainty in some regulations and federal laws, there's the risk of being challenged, much like the EPA's final rule on PFAS, to your point. Additionally beyond that, Deane, there's litigation ongoing already that's challenging EPA's cost estimates used to set the MCL level, the maximum contaminate level, that four parts per trillion, as you're aware. And it's only going to potentially push out what's already a long phasing timeline of three years to test and five years to mitigate PFAS.

So, to your point, we think, ultimately, the states are going to fill in the gaps if the national PFAS regulation is reversed. We don't really anticipate that, but if it does you've got about 11 states today that have MCL, the maximum contaminate level for PFAS in drinking water already, even another 12 states that have some kind of PFAS regulation around guidance health or notification levels, things of that nature, and that's over half the U.S. population. So, while it may stumble a little bit out of the gates and there's going to be some challenges, that we're already seeing challenges in litigation, that's why we didn't bake it into our long-term framework. We just think it's too far out. But we stand ready to and well-positioned to partner with utilities, and we have partnered with utilities, as you know, and helping them manage this and other emerging contaminants. So, more to come, but that's kind of what we think.

Deane Dray

It's real helpful. Thank you.

Matthew Pine

Thank you.

Operator

And our next question will come from Mike Halloran with Baird. Please go ahead.

Mike Halloran

Hey, morning, everyone. Thanks, Andrea.

Matthew Pine

Morning.

Andrea van der Berg

Thanks, Mike.

Mike Halloran

So, just level-setting some stuff here, if I look at -- obviously very healthy margins on the quarter, and Bill's earlier comment on the momentum there holds. But if you think about your demand commentary as well as how you're characterizing the second-half of the year, it doesn't feel like much has changed from a trend, thought process on how you're guiding the second-half of the year. Just want to clarify that and any thoughts around that?

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Matthew Pine

Yes, Mike. No change or expectations for the second-half. Yes, I think it's playing out exactly how we thought when we gave our update last quarter. Yes, with the exception that we had some accelerated performance in M&CS, which drove us to take up our full-year guide, we increased our full-year revenue guidance up to 5% to 6% and some timing of capital projects in WSS that drove better results in the second quarter. Sequentially, Q3 looks a lot like Q2 from a dollars perspective, which is more challenging year-over-year comps really driving the lower implied organic growth rate. So, we're still confident, bullish in most of our end markets. The macro noise that we highlighted is there's things out there, but from our perspective, we don't see material impact or any signaling of expected slowdown for us.

M&CS, there's still high demand for our smart metering products and our differentiated AMI network. Orders were down, but again, that's primarily just project timing. There's still a strong funnel of large deals in the U.S. and Europe and we had several wins recently, a really good one that leverages synergy sale with the [Adrica] (ph). So, the team continues to do an excellent job of finding new projects and winning new business. WSS, again, really strong growth, just really the timing of capital projects there, but they still have strong demand across the legacy ISS and the watering business. They had some orders lumpiness. Again, we had a huge build on operate project last quarter. We have a couple more of those in the funnel that could be realized in the orders here over the back-half of the year. So, really nothing there that is any concern, so bullish around kind of their high growth verticals.

Water Infrastructure, again, really strong performance on healthy demand, high-single-digit orders with growth across all the regions, treatment was up over 20% with some large project wins. The Transport business is one of our most differentiated business, and continues to perform well. So, our developed markets and pretty much all our applications within WI are doing extremely well.

AWS obviously is the one market that remains a little bit challenged. Again, it's our shortest cycle, most cyclical group of businesses. But what we've seen there has been pretty consistent with our expectations, kind of low-single-digit, second-half comps get a little bit easier, so they'll gradually get to a lower organic decline. And then some of the project wins that we highlighted in the prepared remarks, we'll start to get them back on the road to growth in 2025.

Mike Halloran

Super helpful. And then maybe some thoughts on how you think backlog tracks from here and what normal looks like once you work through the pass through backlog across a couple of segments, and how we think book-to-bill should track?

Matthew Pine

Yes. I would say backlog is still really strong. It declined slightly organically, that's primarily just us continue to work down the MCS past due backlog. That's a tough one to forecast just because of the lumpiness of some of the large projects within MCS and again just the new business opportunities within WSS on the build on operate. So, I think we'll bleed a little bit here as we progress the year, but still confident in kind of our long-term growth frameworks for the individual segments getting into 2025. So, I would say lumpiness probably gives us a little bit of caution to give you a specific number, but again, robust demand and outlook for most of our end markets.

Mike Halloran

And Bill, you mean bleed to a more normalized level because of the past due backlog normalization? Are you suggesting something different?

Bill Grogan

No, exactly. That's spot on.

Mike Halloran

Awesome, great. Thanks, everyone. Appreciate it.

Bill Grogan

Thank you.

Operator

And our next question will come from Scott Davis with Melius Research. Please go ahead.

Scott Davis

Hey, good morning everybody and congrats Andrea, on your move. Hey, guys, you didn't talk at all about capital deployment, which is fine because you still have Evoqua coming in. But is there a certain tipping point where you get more confident being able to do deals? Are we close to that? Are we there? Just some commentary would be helpful.

Matthew Pine

Good question. Again, like you mentioned, Scott, our first priority is to focus on the integration of Evoqua. And I think you can see from the results that we're doing a great job on both the cost synergies, they're tracking well as well as the revenue synergies. We have, Scott, built a lot of muscle on M&A over the past 18 months with the planning of Evoqua, now the passing one year of execution. So, we've started to build that muscle in the organization, which is going to help us going forward. Maybe the other thing I'd just reiterate that I said at Investor Day is that we've also put in place what I would call a strong bottoms up process in our M&A kind of acquisition process to drive more consistent organic growth and deployment. And I think that's going to help us over the cycle.

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So, obviously, we just laid out the three year framework. It's not going to happen overnight, but I can tell you that we're very active and we have a very strong pipeline that we're managing. And it aligns well to the value mapping that we just finished up. So, again, we're going to continue to run those targets through our decision criteria, that strategic fit, financials has got to make sense. We're not going to do anything silly. And really to your point kind of organizational readiness, I think we're trending well, we've got good momentum and ready to execute our M&A pipeline. Some of it's just timing, but it is an important piece as we outlined at Investor Day to our EPS growth at mid-teens over the cycle. So, we're very active, but some of it's just timing and we're still in early innings.

Scott Davis

Okay. Good question or a good answer. Thank you. And guys, I don't I'm sure you don't want to give a lot of detail here, but you referenced the large project wins. I assume those are domestic. Are they related to mega projects? Can you give us a little bit of color on kind of the scope and size historically versus how you kind of think about what large looks like? I mean, there're so many big semi plants, just stuff out there of scope that we've never seen before that love to get a little color from you on those projects, if you can.

Matthew Pine

Yes, I think back in Investor Day, we talked about data centers that's starting to ramp up for us, and especially in our applied water business. But I think we're positioned uniquely to, Scott in the fact that we also move water through pumping, we treat it and then we also sense for it.

So, as we're winning these kind of data centers, we can offer a more turnkey solution and we're kind of working at bottoms up as well as some of the actual providers that are building the data centers themselves. So, that's started to pick up some momentum. We had a nice win in applied water. We've had a couple actually kind of at the $7 million to $10 million range. And so, that's going well. Also, I'd say on the power transition, we highlighted a big win last quarter with green hydrogen.

And so, the water needed for that over a 20 year contract is big. We've got some other ones that have not kind of fit within the quarter that are in the pipeline that we have got a lot of momentum around as well around power and we see more and more consistency in the semiconductor space with microelectronics and the need for clean water. And a lot of these places have water scarcity issues. And so, the water reuse is super important there. So, I would say that, some of these high growth verticals, we're seeing momentum in big projects. And we don't see that slowing, we see it only continuing and it will be a little lumpy within WSS specifically, but we see good momentum and a good pipeline.

Scott Davis

Okay. Thank you, and congrats on the first couple of quarters of the year here, well done. I'll pass it on.

Matthew Pine

Thank you.

Operator

And our next question will come from Nathan Jones with Stifel. Please go ahead.

Nathan Jones

Good morning, everyone.

Matthew Pine

Good morning.

Nathan Jones

I want to start off with some follow-up questions on MCS. Orders down in the quarter, I understand there's some lumpiness around that, but orders have been down have declined a little bit last couple of years, burning off some backlog in '23 and '24. Maybe you could just talk about the visibility into the order pipeline that you have to see that turnaround and start heading in the right direction to support growth. And with that, I know high-single-digits to long-term kind of guidance here, but you are burning a fairly significant amount of backlog down in 2024. Should we expect the 2025 growth to be a little bit lower than the long-term average because you're comping against that backlog burn?

Matthew Pine

Yes. I'd start us out here and then maybe turn it over to Bill. Again, just a reminder, we're still in fairly early innings to mid innings in AMI adoption. So, there's a lot of runway out there. And although it doesn't always show up in orders, we do obviously put some of the orders in backlog and it's or some of the contracts in backlog and how they convert to orders can be a little lumpy. And this is also a reminder that only 20% of that business is kind of big deals, 80% of it is book and ship or what we call flow. But Nate, just looking at the pipeline that I see, we've got a lot of room for continued growth in that business. And we don't see it slowing down. It's just a matter of timing, more than anything.

Bill Grogan

Yes. No, our expectation next year is that it will be in line with our long-term framework. It's just the backlog league to get us there. So, may be a little bit stronger before we get to kind of that high single-digits at some point in time next year.

Matthew Pine

Yes. And I think you had asked a few calls ago about where we are in past due. We expect to be almost complete with the past due backlog by the end of the year and probably wrap that up in Q1 of next year. So, that burn is happening and obviously leading to the increased guide and M&CS revenue at the high teens.

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Nathan Jones

Second one I wanted to ask was on cash conversion. Obviously, the guidance has taken up to 120%. And I would think that 80/20 in the simplification initiatives should have an impact on working capital probably over the next at least couple of years that maybe drive cash conversion higher than the long-term average as you simplify the business, take inventory out, work on receivables and payables and stuff like that. So, any commentary you can give us on opportunities you're seeing in working capital as a result of these 80/20 and simplification initiatives. Thanks.

Bill Grogan

Yes. No, Nate, I think you're exactly right. That's a big part of the tool set as you start to reduce a lot of the complexity of the product portfolio. We get a lot more efficiency through just faster-moving inventory. Obviously, you reduced the complexity of a tremendous amount of long-tail customers and your DSO improves from that perspective. So, I totally agree, we'll see some benefits. The team does a phenomenal job right now with our overall cash conversion. But I think 80/20 will be able to take it to the next level. But I think that will be on the back end of the P&L benefits that we get. So, probably looking at as you get through the implementation, we said, hey, 12 to 18 months to realize the P&L benefits, it's probably in that 18 to 24 months. That's the second phase of simplification on the back end.

Nathan Jones

Made sense. Thanks very much for taking my questions.

Bill Grogan

Thanks, Nate.

Operator

And our next question will come from Joe Giordano with TD Cowen. Please go ahead.

Joseph Giordano

Hey, good morning, guys.

Bill Grogan

Hey, good morning, Joe.

Joseph Giordano

Andrea, thanks for everything. You've been a huge help. If we -- if anything happens with water infrastructure, we'll now know who to blame on it.

Andrea van der Berg

Thank you, Joe. It's been a project.

Joseph Giordano

A lot of my questions have been asked already, but maybe if you could touch on since moving the service business and combining it with WSS, like any like concrete kind of examples of how this is changing like conditions on the ground for you guys and leading to better results.

Matthew Pine

Yes, I can start this out. I mean I think that obviously, we did it for a few reasons. One is to increase our synergies because there is a lot of synergies when you now can move water and treat water. And so, now we're able to go in with the turnkey solution. We're already seeing probably that segment be the quickest to drive synergies, some of those we highlighted at the Investor Day. So, also, I'd say just a common tool set. When you think about back office, we had two service companies when we put the two companies together, the legacy vocal business was much more mature, had good processes and tools.

And now leveraging that across the entire services business has been a big help. And I think probably the biggest thing is, over time will be our technician utilization, being able to utilize technicians across the entire portfolio. Now everybody is not completely spungable, but say a third to half of your technicians now can flex and do other types of work that they were doing before. And it also gives our Aqua Pros as what we call them, a broader career path. So, I'd say there's different aspects of how we're seeing it play out, but it's the fastest part of our revenue synergy right now, and it's working well.

Joseph Giordano

And then if I can ask maybe you talked about data center and stuff like that. If I think about like the large project pipeline at WSS and maybe also like general industrial-type exposure to infrastructure, are you seeing any bifurcation there because data center is definitely strong, but the commentary around large project activity in other sectors is kind of weakening. So, curious if you're seeing like puts and takes in any of those businesses there?

Matthew Pine

Not really. I mean, data centers that I think as I've mentioned, is not a huge part of our portfolio. It mainly shows up in Applied Water, although we've seen some synergies that we mentioned one of those in China at our Investor Day, but we've seen some other synergies where managing water at a data center as well as doing treatment. But it's not something that's going to be a big swing for us because it's not a large part of our business.

But in general, we're seeing high growth verticals like pharma, life sciences, microelectronics, power, continue to be really robust. And look, no matter what regulations are, whatever's happening from that perspective, what's happening around climate and water scarcity is driving a lot of interest. I mean, I get phone calls all the time from leaders and CEOs in different parts of the world that are dealing with some real challenging stuff in terms of being able to keep their operations open, or the quality of their water, because of maybe saltwater intrusion, dealing with a different type of water they're trying to treat. So, we don't see any real slowdown. We're in really strong high growth verticals. And datacenters is one that's not big for us, but we're going to take advantage of it while it's hot.

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Joseph Giordano

Thanks, guys.

Matthew Pine

Thank you.

Operator

And our next question will come from Andrew Kaplowitz with Citigroup. Please go ahead.

Andrew Kaplowitz

Good morning, everyone. Andrea, thanks so much for your help.

Andrea van der Berg

Thank you, Andrew.

Andrew Kaplowitz

So, Matthew, Bill, you mentioned inflation and water infrastructure and margin that segment after being up nicely in Q1, year-over-year was down a bit in Q2. I know you said that acquisition, that was acquisition-related, but could you give more color into what you're seeing on the price versus cost side, particularly in that segment? Did anything materially change or is it just lumpiness? And we know you have some China exposure in there, so maybe you could talk about the competitive environment in China?

Matthew Pine

Price-cost was positive there. I think the biggest impact, and that's why we highlighted just the acquisition element, second quarter last year, during the short time that APT was part of that segment, it had an unusually high margin. It was in the low 20s versus its normalized rate of the teens. So, that was the biggest difference. That's why we added in the pro forma margin expansion, 40 bps, and it was at 40% performance incremental. So, fundamentally, the profit there is still strong. It's sequentially improved. We expect it to continue to sequentially improve as we progress to the back-half and have year-over-year margin expansion.

I would say from a water infrastructure perspective, they do have probably the largest piece of our China exposure. China's been a little bit lumpy for us. It's actually the first-half it's been positive from a revenue perspective. The orders were down, but we see some of the larger projects, especially within treatment, continue to get delayed just as I think China is trying to figure out the overall economic situation and how they're going to fund several things across their investment framework. So, that's probably the one area we are continuing to keep our eye on as things just seem to be perpetually shifting to the right.

Andrew Kaplowitz

Very helpful. And then, just maybe focusing a little more on applied water, orders; as you said, look good, they were for long cycle projects, maybe talk about the short cycle market as you see it. Is the business sort of bouncing along the bottom? What's the channel telling you? And you obviously mentioned the easier comparison in the second-half of the year. So, I know you talked about applied water returning growth in 2025, but it couldn't do that before the end of the year.

Matthew Pine

Yes, I think third quarter is still down, low single digits. Fourth quarter is probably closer to zero. Again, it's relatively in line, I mean, sequentially, the dollar amounts. The decline is largely seen in developed markets and primarily in our commercial and industrial space. Again, from a macro perspective, the institutional ABI has been negative for 16 consecutive months. And we continue to see manufacturing PMI, which are good indicators for us for that business. But I give the teams a lot of credit. Matthew highlighted; they're making their own luck. They're leveraging their differentiated technology to win some of these larger projects to get back on a growth track into next year.

Andrew Kaplowitz

I appreciate all the color.

Matthew Pine

Thanks, Andy.

Operator

And our next question will come from Bryan Blair with Oppenheimer. Please go ahead.

Bryan Blair

Thank you. Good morning, everyone. Andrea, thank you very much for your help.

Matthew Pine

Good morning Bryan.

Andrea van der Berg

Thank you, Bryan.

Bryan Blair

Very solid quarter and MCS again, MCS's margin again stood out. I'm sorry if I missed this detail, but Bill, you have called out and been very upfront about there being some mixed headwinds going into the back-half with energy deployments. Are you willing to size that sequential headwind relative to the strength of 1H?

Bill Grogan

Yes, I mean, we think it could be around 100 basis points in the back-half, sequential decrease from where we finished the first-half.

Bryan Blair

Okay, understood. Appreciate that. Something you offer a little more color on how treatment orders phase through the quarter. I think you cited around 20% growth there, so very robust for a business that tends to be leading indicator. Any meaningful differences by region that you would call out, and how does treatment moment influence your team's confidence in the back-half of that one?

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Matthew Pine

Yes. This is Matthew, Bryan. We have seen really good momentum in treatment across all regions. Like you said, we are up roughly 22% for the entire business, and probably led by the U.S. and emerging markets. And China, as Bill pointed out, it's been a little bit weak, and actually that was a little bit of right spot on orders themselves that we are up slightly low single-digits in China on treatment. So, all in all, it's a really good indicator that capital continues to flow. The funding, we see capital investment continuing, and good momentum for treatment, which is a big part of not only water quality, but also scarcity of water. So, we see those trends continuing.

Bryan Blair

Very encouraging. Thank you again.

Matthew Pine

Thank you.

Operator

And this concludes the Q2 earnings call. I would like to turn it back to Matthew Pine for any closing remarks.

Matthew Pine

Thank you. We will wrap it there. Thanks for your questions, and thanks for everyone who joined today. As always, we appreciate your interest in Xylem, and all the very best.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect your lines at this time.

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