# UNITED STATES SECURITIES AND EXCHANGE COMMISSION
## WASHINGTON, D.C. 20549
# FORM 10-K

(Mark One)

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

**For the fiscal year ended December 31, 2017**

**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 405 of the Securities Act. Yes ☑ No ☐

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

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 ☑ 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 ☑ No ☐

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

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 definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer ☑ Accelerated Filer ☐ Non-Accelerated Filer ☐ (do not check if a smaller reporting company) Smaller reporting company ☐ Emerging growth company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards 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 of the Act). Yes ☐ No ☑

The aggregate market value of the common stock of the registrant held by non-affiliates of the registrant as of June 30, 2017 was approximately $10.0 billion. As of February 16, 2018, there were 179,893,045 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 2018 Annual Meeting of Shareowners, to be held in May 2018, 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, 2017**

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

## PART I

*The following discussion should be read in conjunction with the consolidated financial statements, including the notes thereto, included in this Annual Report on Form 10-K (this "Report"). Xylem Inc. was incorporated in Indiana on May 4, 2011. Except as otherwise indicated or unless the context otherwise requires, "Xylem," "we," "us," "our" and "the Company" refer to Xylem Inc. and its subsidiaries. References in the consolidated financial statements to "ITT" or the "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 statements" within the meaning of the Private Securities Litigation Act of 1995. Forward-looking statements by their nature address matters that are, to different degrees, uncertain. Generally, the words "anticipate," "estimate," "expect," "project," "intend," "plan," "forecast," "believe," "target," "will," "could," "would," "should" and similar expressions identify forward-looking statements, which generally are not historical in nature. However, the absence of these words or similar expressions does not mean that a statement is not forward-looking. These forward-looking statements include statements about the capitalization of the Company, the Company's restructuring and realignment, future strategic plans and other statements that describe the Company's business strategy, outlook, objectives, plans, intentions or goals. All statements that address operating or financial performance, events or developments that we expect or anticipate will occur in the future - including statements relating to orders, revenue, operating margins and earnings per share growth, and statements expressing general views about future operating results - are forward-looking statements. Forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause actual 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 include: overall economic and business conditions, political and other risks associated with our international operations, including military actions, economic sanctions or trade embargoes that could affect customer markets, and non-compliance with laws, including foreign corrupt practice laws, export and import laws and competition laws; potential for unexpected cancellations or delays of customer orders in our reported backlog; our exposure to fluctuations in foreign currency exchange rates; competition and pricing pressures in the markets we serve; the strength of housing and related markets; weather conditions; ability to retain and attract key members of management; our relationship with and the performance of our channel partners; our ability to successfully identify, complete and integrate acquisitions; our ability to borrow or to refinance our existing indebtedness and availability of liquidity sufficient to meet our needs; changes in the value of goodwill or intangible assets; risks relating to product defects, product liability and recalls; governmental investigations; security breaches or other disruptions of our information technology systems; litigation and contingent liabilities; and other factors set forth below under "Item 1A. Risk Factors" and those described from time to time in subsequent reports filed with the Securities and Exchange Commission ("SEC").

All forward-looking statements made in this Report are based on information available to the Company as of the date of this Report. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

## ITEM 1. BUSINESS

### Business Overview

Xylem, with 2017 revenue of $4.7 billion and approximately 16,200 employees, is a leading global water technology company. We design, manufacture and service highly engineered solutions ranging across a wide variety of critical applications primarily in the water sector, but also in electric and gas. Our broad portfolio of solutions addresses customer needs across the water cycle, from the delivery, measurement and use of drinking water to the 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, condition assessment and leak detection, building services and industrial processing. Setting us apart is a unique set of global assets which include:

- Fortress brands with leading positions, some of which have been in use for more than 100 years
- Far-reaching global distribution networks consisting of direct sales forces and independent channel

partners that collectively serve a diverse customer base in 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 fund strategic organic and inorganic growth initiatives, and consistently return capital to shareholders

Key pillars of our long-term strategy include (1) accelerate profitable growth; (2) increase profitability by driving continuous improvement initiatives; (3) leadership and talent development; and (4) focus on execution and accountability.

**Company History and Certain Relationships**

On October 31, 2011 (the "Distribution Date"), ITT completed the Spin-off (the “Spin-off”) of Xylem, formerly ITT’s water equipment and services businesses. The Spin-off was completed pursuant to a Distribution Agreement, dated as of October 25, 2011 (the “Distribution Agreement”), among ITT (now ITT LLC), Exelis Inc., acquired by Harris Inc. on May 29, 2015, (“Exelis”) and Xylem.

On October 31, 2016, Xylem Inc. completed the acquisition of all of the direct and indirect subsidiaries of Sensus Worldwide Limited (other than Sensus Industries) (“Sensus”), pursuant to the terms of the Share Purchase Agreement dated as of August 15, 2016, and the first Amendment to the Share Purchase Agreement dated as of October 31, 2016 (together, the “Purchase Agreement”). The aggregate consideration paid for the acquisition was approximately $$1,766 million ($1,710 million net of cash acquired).

**Our Industry**

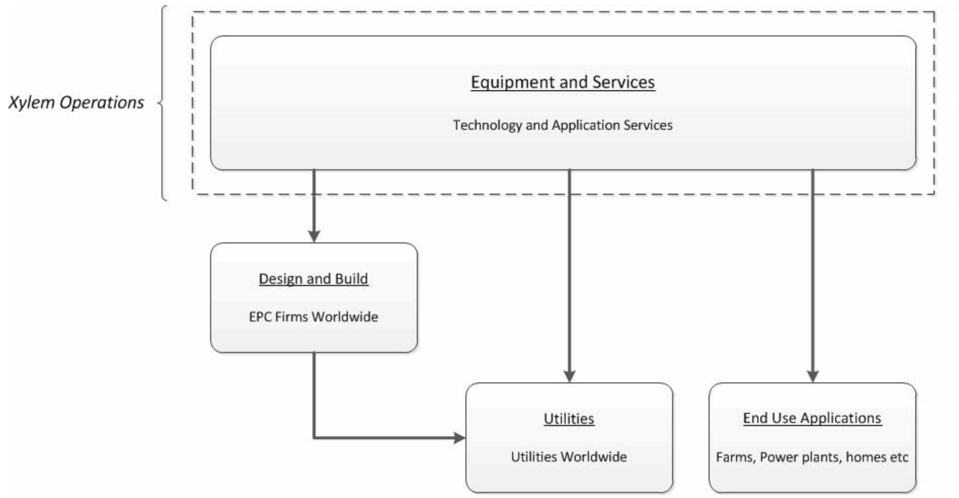
Our planet faces serious water challenges. Less than 1% of the total water available on earth is fresh water, and these supplies are under threat due to factors such as the draining of aquifers, increased pollution and the effects of climate change. Demand for fresh water is rising rapidly due to population growth, industrial expansion, and increased agricultural development, with consumption 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 in developed countries with sufficient clean water supply, existing infrastructure for water supply is aging and inadequately funded. In the United States, deteriorating pipe systems, theft or inaccurate meters result in approximately one out of every six gallons of water being lost between the treatment plant and the end customer. This problem of "non-revenue" water is a major financial challenge of many utilities globally, especially in developing markets where non-revenue water can represent 15% to 60% or more of net water produced. These and other challenges create 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 quality and resilience. Water productivity refers to the more efficient delivery and use of clean water. Water quality refers to the efficient and effective management of wastewater. Resilience refers to the management of water-related risks and the resilience of water infrastructure. Our customers often face all three of these challenges, ranging from inefficient and aging water distribution networks (which require increases in “water productivity”); energy-intensive or unreliable wastewater management systems (which require increases in “water quality”); or exposure to natural disasters such as floods or droughts (which require increases in “resilience”). Additionally, through the 2016 acquisition of Sensus, we also provide solutions to enhance efficiency, improve safety and conserve resources to customers in the electric, gas, and lighting sectors. Delivering value in these areas creates significant opportunity for the Company. We estimate our total served market size to be approximately $54 billion.

*The Global Water Industry Value Chain*

The water industry value chain includes Equipment and Services companies, like Xylem, which address the unique challenges and demands of a diverse customer base. This customer base includes utilities that supply water through an infrastructure network, and engineering, procurement and construction or (EPC) firms, which work with utilities to design and build water and wastewater infrastructure networks, as depicted below. Utilities and EPC customers are looking for technology and application expertise from their Equipment and Services providers to address trends such as rising pollution, stricter regulations, and the increased outsourcing of process knowledge. In addition to utilities and EPC customers, Equipment and Service providers also provide distinct technologies to a wide array of entities, including farms, mines, power plants, industrial facilities and residential and commercial customers seeking to address similar trends.

*Water Industry Supply Chain*




**Business Strategy**

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

- **Accelerate Profitable Growth.** To accelerate growth, we are focusing on several priorities:
    - ***Emerging Markets*** - We seek to accelerate our growth in priority emerging markets through increased focus on product localization and channel development.
    - ***Innovation & Technology*** - We seek to enhance our innovation efforts with increased focus on smart technologies and innovation that can significantly improve customers’ productivity, quality and resilience.
    - ***Commercial Leadership*** - We are strengthening our capabilities by simplifying our commercial processes and supporting information technology systems.
    - ***Mergers and Acquisitions*** - We continue to evaluate and, where appropriate, will act upon attractive acquisition candidates to accelerate our growth, including into adjacent markets.
- **Drive Continuous Improvement.** We seek to embed continuous improvement into our culture and simplify our organization to make the Company more agile, more profitable and create room to reinvest in growth. To accomplish this, we will continue to strengthen our lean six sigma and global procurement capabilities, while also continuing to optimize our cost structure through business simplification, which aims to eliminate structural, process and product complexity.
- **Leadership and Talent Development.** We seek to continue to invest in attracting, developing and retaining world-class talent with an increased focus on leadership and talent development programs. We will continue to align individual performance with the objectives of the Company and its shareholders.
- **Focus on Execution and Accountability.** We seek to ensure the impact of these strategic focus areas by holding our people accountable and streamlining our performance management and goal deployment systems.

**Business Segments, Distribution and Competitive Landscape**

We have three reportable business segments that are aligned around the critical market applications they provide: Water Infrastructure, Applied Water, and Measurement & Control Solutions. See Note 20, “Segment and

Geographic Data," in our consolidated financial statements for financial information about segments and geographic areas.

The table and descriptions below provide an overview of our business segments.

| | Market Applications | 2017 Revenue (in millions) | % Revenue | Major Products | Primary Brands |
|---|---|---|---|---|---|
| **Water Infrastructure** | Transport | $ 1,660 | 83% | • Water and wastewater pumps<br>• Filtration, disinfection and biological treatment equipment | • Flygt<br>• Godwin<br>• Wedeco<br>• Sanitaire<br>• Leopold |
| | Treatment | 344 | 17% | | |
| | | $ 2,004 | 100% | | |
| **Applied Water** | Industrial Water | $ 593 | 42% | • Pumps<br>• Valves<br>• Heat exchangers<br>• Controls<br>• Dispensing equipment systems | • Goulds Water Technology<br>• Bell & Gossett<br>• A-C Fire Pump<br>• Standard Xchange<br>• Lowara<br>• Jabsco<br>• Flojet |
| | Commercial Building Services | 568 | 40% | | |
| | Residential Building Services | 260 | 18% | | |
| | | $ 1,421 | 100% | | |
| **Measurement & Control Solutions** | Water | $ 573 | 45% | • Smart meters<br>• Networked communication devices<br>• Data analytics<br>• Test equipment<br>• Controls<br>• Sensor Devices<br>• Software & managed services | • Sensus<br>• Smith Blair<br>• WTW<br>• Visenti<br>• YSI |
| | Test | 325 | 25% | | |
| | Gas | 134 | 11% | | |
| | Electric | 132 | 10% | | |
| | Software as a Service/Other | 118 | 9% | | |
| | | $ 1,282 | 100% | | |

***Water Infrastructure***

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

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

Water Infrastructure provides the majority of its sales through direct channels with remaining sales through indirect channels and service capabilities. Both water utility and industrial facility customers increasingly require our teams' global but locally proficient expertise to use our equipment in their specific applications. Several trends are increasing demand for this application expertise: (i) the increase in both the type and amount of contaminants found in the water supply, (ii) increasing environmental regulations, (iii) the need to increase system efficiencies to optimize energy costs, (iv) the retirement of a largely aging water industry workforce that has not been systematically replaced at utilities and other end-user customers, and (v) the build-out of water infrastructure in the emerging markets. We estimate our served market size in this sector to be approximately $17 billion.

Given the highly fragmented nature of the water industry, the Water Infrastructure segment competes with a large number of businesses. We differentiate ourselves in the market by focusing on product performance, reliability and innovation, application expertise, brand reputation, energy efficiency, product life-cycle cost, timeliness of delivery, proximity of service centers, effectiveness of our distribution channels and price. In the sale or rental of products and provision of services, we benefit from our large installed base, which requires maintenance, repair and replacement parts due to the critical application and nature of the products and the conditions under which they operate. Timeliness of delivery, quality and the proximity of service centers are important customer considerations when selecting a provider for after-market products and services as well as equipment rentals. In geographic regions where we are locally positioned to provide a quick response, customers have historically relied on us, rather than our competitors, for after-market products relating to our highly engineered and customized solutions. Our key competitors within the Water Infrastructure segment include KSB Inc., Sulzer Ltd., Evoqua Water Technologies, United Rentals and Danaher Corporation.

***Applied Water***

Applied Water encompasses the uses of water and serves a diverse set of end markets including: residential, commercial, and industrial. Residential consumers represent the end users in the residential market, while owners and managers of 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 as electrical power generators, chemical manufacturers, machine shops, clothing manufacturers, beverage dispensing and food processing firms, and car washes.

In the Applied Water segment, end markets vary widely and, as a result, specialized distribution partners are often preferred. As such, the Applied Water segment provides the majority of its sales through strong indirect channels with the remaining sales going through our global direct sales channels. We have long-standing relationships with many of the leading independent distributors in the markets we serve, and we provide incentives to distributors, such as specialized loyalty and training programs.

We estimate our served market size in this sector to be approximately $19 billion. Population growth, urbanization and regulatory requirements are macro growth drivers of these markets, driving the need for housing, food, community services and retail goods within growing city centers.

Competition in the Applied Water segment focuses on brand equity, application expertise, product delivery and performance, quality, and 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 product offerings has enabled us to compete effectively, to cultivate and maintain customer relationships and to serve and expand into many niche and new markets. Our key competitors within the Applied Water segment include Grundfos, Wilo SE, Pentair Ltd. and Franklin Electric Co., Inc.

***Measurement & Control Solutions***

Measurement & Control Solutions develops advanced technology solutions that enable intelligent use and conservation of critical water and energy resources. The segment delivers communications, smart metering, measurement and control technologies and services that allow customers to more effectively use their distribution networks for the delivery of critical resources such as water, electricity and natural gas. We also provide analytical instrumentation used to measure water quality, flow and level in wastewater, surface water and coastal environments. Additionally, we sell software and services including cloud-based analytics, remote monitoring and data management, leak detection and pressure monitoring solutions, as well as smart lighting products and solutions that improve efficiency and public safety efforts across communities.

At the heart of our leading technologies is automation and information. Communications networks automate and optimize meter reading, monitor flow rates and detect and enable rapid response to unsafe conditions. In short, they provide insight into operations and enable our customers to manage the entire scope of their operations remotely through their networks. At the center of our offering is the FlexNet communication network, which provides a common communications platform and infrastructure for essential services. This two-way communication technology remotely connects a wide variety of smart points in a given network with protocols, frequently on FCC licensed spectrum that enable reliable, resilient and secure transmissions. These technologies allow our customers to remotely and continuously monitor infrastructure, prioritize and manage maintenance and use data to optimize all aspects of their networks.

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

We estimate our served market size in this sector to be approximately $18 billion. Macro growth drivers include increasing regulation and worldwide movement towards smart grid implementation. Water scarcity and conservation, as well as the need to prevent revenue loss (via inaccurate meter readings, leaks or theft) are among the drivers of smart meter and leak detection technologies.

Our Sensus-branded meters are well positioned in the smart metering sector, the fastest growing sector of the global meter industry. We set ourselves apart in the industry by focusing on our communication network, new product development and service offerings that are driving tangible savings of non-revenue water through improved meter accuracy, reduced theft and identification of leaks. Our key competitors within the Measurement & Control Solutions segment include Itron, Badger Meter, Landis+Gyr, Neptune (Roper) and Elster (Honeywell).

**Geographic Profile**

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

| | Revenue | | | | | |
|---|---|---|---|---|---|---|
| (in millions) | **2017** | | 2016 | | 2015 | |
| | **$ Amount** | **% of Total** | $ Amount | % of Total | $ Amount | % of Total |
| United States | **$ 2,161** | **46%** | $ 1,574 | 42% | $ 1,490 | 41% |
| Europe | **1,335** | **28%** | 1,195 | 31% | 1,179 | 32% |
| Asia Pacific | **611** | **13%** | 518 | 14% | 482 | 13% |
| Other | **600** | **13%** | 484 | 13% | 502 | 14% |
| Total | **$ 4,707** | | $ 3,771 | | $ 3,653 | |

In addition to the traditional markets of the United States and western Europe, opportunities in emerging markets within Asia Pacific, eastern Europe, Latin America and other countries are growing. Revenue derived from emerging markets comprised approximately 21% of our revenue in each of the last three years.

The table below illustrates the property, plant & equipment and percentage of property, plant & equipment by geographic area for each of the three years ended December 31.

| | Property, Plant & Equipment | | | | | |
|---|---|---|---|---|---|---|
| (in millions) | **2017** | | 2016 | | 2015 | |
| | **$ Amount** | **% of Total** | $ Amount | % of Total | $ Amount | % of Total |
| United States | **$ 258** | **40%** | $ 255 | 41% | $ 168 | 38% |
| Europe | **259** | **40%** | 237 | 39% | 189 | 43% |
| Asia Pacific | **85** | **13%** | 87 | 14% | 56 | 13% |
| Other | **41** | **7%** | 37 | 6% | 26 | 6% |
| Total | **$ 643** | | $ 616 | | $ 439 | |

**Supply and Seasonality**

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

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

We may experience price volatility or supply constraints for materials that are not available from multiple sources. From time to time, we acquire certain inventory in anticipation of supply constraints or enter into longer-term pricing commitments with vendors to improve the priority, price and availability of supply. There have 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 business. This seasonality is dependent on factors such as capital spending of customers as well as weather conditions, including heavy flooding, droughts, and fluctuations in temperatures, which can positively or negatively impact portions of our business.

**Customers**

Our business is not dependent on any single customer or a few customers the loss of which would have a material adverse effect on our Company. No individual customer accounted for more than 10% of our consolidated 2017, 2016 or 2015 revenue.

**Backlog**

Backlog includes orders on hand as well as contractual customer agreements at the end of the period. Delivery schedules vary from customer to customer based on their requirements. Annual or multi-year contracts are subject to rescheduling and cancellation by customers due to the long-term nature of the contracts. As such, beginning total backlog, plus orders, minus revenues, will not equal ending total backlog due to contract adjustments, foreign currency fluctuations, and other factors. Typically, large projects require longer lead production cycles and deployment schedules and delays can occur from time to time. Total backlog was $1,513 million at December 31, 2017 and $1,292 million at December 31, 2016. The December 31, 2016 backlog balance has been revised to include contractual agreements that Sensus has with customers that do not have minimum commitments but which we believe will be executed upon over the terms of the contracts. We anticipate that over 60% of the backlog at December 31, 2017 will be recognized as revenue during 2018.

**Research and Development**

Research and development (“R&D”) is a key foundation of our growth strategy and we focus on the design and development of products and application know-how that anticipate customer needs and emerging trends. Our engineers are involved in new product development as well as improvement of existing products to increase 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 promote a steady flow of innovative, high-quality and reliable products and applications to further strengthen our position in the markets we serve. We continue to increase our R&D investments as a percentage of revenue year over year, with 3.8% in 2017 when compared to 2.9% in 2016 and 2.6% in 2015.

We have R&D and product development capabilities around the world. R&D activities are initially conducted in our technology centers, located in conjunction with some of our major manufacturing facilities to ensure an efficient and robust development process. We have several global technical centers and local development teams around the world where we are supporting global needs and accelerating the customization of our products and solutions to local needs. In some cases, our R&D activities are conducted at our piloting and testing facilities and at strategic customer sites. These piloting and testing facilities enable us to serve our strategic markets globally.

*Capitalized Software*

We capitalize software developed for sale to external customers, which is included within "Other intangible assets, net" on our Consolidated Balance Sheets. As of December 31, 2017 and 2016 we had net capitalized software for sale to external customers of $89 million and $54 million, respectively.

*Intellectual Property*

We generally seek patent protection for those inventions and improvements that we believe will improve our competitive position. We believe that our patents and applications are important for maintaining the competitive differentiation of our products and improving our return on research and development investments. While we own, control or license a significant number of patents, trade secrets, proprietary information, trademarks, trade names, copyrights, and other intellectual property rights which, in the aggregate, are of material importance to our business, management believes that our business, as a whole, as well as each of our core business segments, is not materially dependent on any one intellectual property right or related group of such rights.

Patents, patent applications, and license agreements expire or terminate over time by operation of law, in accordance with their terms or otherwise. As the portfolio of our patents, patent applications, and license agreements has evolved over time, we do not expect the expiration of any specific patent to have a material adverse effect on our financial position or results of operations.

**Environmental Matters and Regulation**

Our manufacturing operations worldwide are subject to many requirements under environmental laws. In the United States, the Environmental Protection Agency and similar state agencies administer laws and regulations concerning air emissions, water discharges, waste disposal, environmental remediation, and other aspects of environmental protection. Such environmental laws and regulations in the United States include, for example, the federal Clean Air Act, the Clean Water Act, the Resource, Conservation and Recovery Act, and the Comprehensive Environmental Response, Compensation and Liability Act. Environmental requirements significantly affect our operations. We have established an internal program to address compliance with applicable environmental requirements and, as a result, management believes that we are in substantial compliance with current environmental regulations.

While environmental laws and regulations are subject to change, such changes can be difficult to predict reliably and the timing of potential changes is uncertain. Management does not believe, based on current circumstances, that compliance costs pursuant to such regulations will have a material adverse effect on our financial position or results of operations. However, the effect of future legislative or regulatory changes could be material to our financial condition or results of operations.

Accruals for environmental matters are recorded on a site-by-site basis when it is probable that a liability has been incurred and the amount of the liability can be reasonably estimated, based on current law and existing technologies. It can be difficult to estimate reliably the final costs of investigation and remediation due to various factors. Our accrued liabilities for these environmental matters represent the best estimates related to the investigation and remediation of environmental media such as water, soil, soil vapor, air and structures, as well as related legal fees based upon the facts and circumstances as currently known to us. These estimates, and related accruals, are reviewed quarterly and updated for progress of investigation and remediation efforts and changes in facts and legal circumstances. Liabilities for these environmental expenditures are recorded on an undiscounted basis. We do not anticipate these liabilities will have a material adverse effect on our consolidated financial position or results of operations. At December 31, 2017, we had estimated and accrued $4 million related to environmental matters.

**Commitment to Sustainability**

At Xylem, sustainability is at the very center of who we are and what we do. As a leading global water technology company, we deal with one of the world’s most urgent sustainability issues on a daily basis; responsible stewardship of our shared water resources. We believe that technology is a key link in how the world can solve water. We have a long history of innovation, but today, we’re focusing more than ever on the powerful capabilities of smart technology, integrated management and big data. These solutions will allow us to transport, treat, test and use water smarter, and more sustainably, than in the past. Our link to this enormous challenge informs how we think about sustainability and drives us to become a more sustainable company.

**Employees**

As of December 31, 2017, Xylem had approximately 16,200 employees worldwide. We have approximately 5,400 employees in the United States, of whom approximately 16% are represented by labor unions. In certain foreign countries, our employees are represented by work councils. We believe that our facilities are in favorable labor markets with ready access to adequate numbers of workers and believe our relations with our employees are good.

**Available Information**

We are required to file annual, quarterly and current reports, proxy statements and 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.xyleminc.com* as soon as reasonably practicable after such reports are electronically filed with or furnished to the SEC. The information on our website is not, and shall not be deemed to be, a part hereof or incorporated into this or any of our other filings with the SEC.

In addition, the public may read or copy any materials filed with the SEC at the SEC’s Public Reference Room located at 100 F Street NE, Washington, D.C. 20549. The public may also obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. These reports and other information are also available, free of charge, at *www.sec.gov.*

## 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 other filings with the SEC. Should any of these risks and uncertainties develop into actual events, our business, financial condition or results of operations could be materially and adversely affected.*

### Risks Related to Operational and External Factors

***Failure to compete successfully in our markets 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 performance, reliability and innovation, application expertise, brand reputation, energy efficiency, product life cycle cost, timeliness of delivery, proximity of service centers, effectiveness of our distribution channels and price. Maintaining and improving our competitive position will require successful management of these factors, including continued investment by us in manufacturing, research and development, engineering, marketing, customer service and support, and our distribution networks. Our future growth rate depends upon a number of factors, including our ability to (i) identify emerging technological trends in our target end-markets, (ii) develop and maintain competitive products and defend our market share against an ever-expanding number of competitors including many new and non-traditional competitors, (iii) enhance our products by adding innovative features that differentiate our products from those of our competitors and prevent commoditization of our products, (iv) develop, manufacture and bring compelling new products to market quickly and cost-effectively, and (v) attract, develop and retain individuals with the requisite technical expertise and understanding of customers' needs to develop new technologies and introduce new products.

We may not be successful in maintaining our competitive position. Our competitors or third parties from outside of our industry may develop disruptive technologies or products that are superior to our products, or may develop more efficient or effective methods of providing products and services or may adapt more quickly than we do to new technologies or evolving customer requirements. The failure of our technologies or products to maintain and gain market acceptance due to more attractive offerings could significantly reduce our revenues and adversely affect our competitive standing and prospects. Pricing pressures also could cause us to adjust the prices of certain products to stay competitive, which could adversely affect our financial performance. Failure to continue competing successfully or to win large contracts could adversely affect our business, financial condition or results of operations.

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

We compete around the world in various geographic and product markets. In 2017, 46%, 26% and 21% of our total revenue was from customers located in the United States, western Europe and emerging markets, respectively. We expect revenue from these markets to be significant for the foreseeable future. Important factors impacting our businesses include the overall strength of these economies and our customers' confidence in both local and global macro-economic conditions; industrial and 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 financing for our customers and end-users; the availability of funding for our public sector customers; and unemployment rates. A slowdown or prolonged downturn in our markets could have a material adverse effect on our business, financial condition and results of operations.

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

In 2017, 54% of our total revenue was from customers outside the United States, with 21% of total revenue generated in emerging markets. We expect our sales from international operations and export sales to continue to be a significant portion of our revenue. We have placed a particular emphasis on increasing our growth and presence in emerging markets. Both our sales from international operations and export sales are subject, in varying degrees, to risks inherent to doing business outside the United States. These risks include the following:

- changes in trade protection measures, including tariff and trade barriers and import and export licensing requirements;
- potential negative consequences from changes to taxation policies;
- unanticipated changes in other laws and regulations or in how such provisions are 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 repatriation;
- disruption of operations from labor and political disturbances;
- regional safety and security considerations;
- increased costs and risks of developing, staffing and simultaneously managing a number of global operations as a result of distance as well as language and cultural differences; and
- insurrection, armed conflict, terrorism or war.

Any payment of distributions, loans or advances to us by our foreign subsidiaries could be subject to restrictions on, or taxation of, dividends on repatriation of earnings under applicable local law, monetary transfer restrictions 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 limitations on our ability to repatriate funds; governments may impose withholding or other taxes on remittances and other payments to us, or the amount of any such taxes may increase; an outbreak or escalation of any insurrection or armed conflict may occur; governments may seek to nationalize our assets; or governments may impose or increase investment barriers or other restrictions affecting our business. In addition, emerging markets pose other uncertainties, including the difficulty of enforcing agreements, challenges collecting receivables, protection of our intellectual property and other assets, pressure on the pricing of our products, higher business conduct risks, less qualified talent and risks of political instability. We cannot predict the impact such events might have on our business, financial condition and results of operations.

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

In recent fiscal years, we have initiated restructuring, realignment and transformation plans in an effort to optimize our cost structure and improve our operational efficiency and effectiveness. In 2017, we undertook steps to advance a multi-year effort to transform many of our support functions and related technologies, including Finance, Human Resources and Procurement. We may not be able to obtain the cost savings and benefits that were initially anticipated in connection with our restructuring and transformation plans. Additionally, as a result of these plans , we may experience a loss of continuity, loss of accumulated knowledge or inefficiency during transitional periods. Transformation, realignment and restructuring can require a significant amount of management and other employees' time and focus, which may divert attention from operating and growing our business.

The successful implementation and execution of our restructuring, realignment and transformation actions are critical to achieving our expected cost savings as well as effectively competing in the marketplace and positioning us for future growth. Factors that may impede a successful implementation include the retention of key employees, the impact of regulatory matters or matters involving certain third parties selected to assist us, and adverse economic market conditions. If our restructuring actions are not executed successfully, it could have a material adverse effect on our competitive position, business, financial condition and results of operations.

***A material disruption to any of our facilities or operations may adversely affect our business.***

If our facilities or operations were to be disrupted as a result of a significant equipment failure, natural disaster, power outage, fire, explosion, terrorism, cyber-based attack, labor disputes, work stoppages or slowdowns, adverse weather conditions or other reason, our financial performance could be adversely affected as a result of our inability to meet customer demand. Interruptions could increase our costs and reduce our sales. Any interruption in capability could require us to make substantial capital expenditures to remedy the situation, which could negatively affect our profitability and financial condition. Any recovery under our insurance policies may not offset the lost sales or increased costs that may be experienced during the disruption of operations, which could adversely affect our business, financial condition and results of operations.

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

Our business operations rely on information technology and communications networks, and operations that are vulnerable to damage or disturbance from a variety of sources. Regardless of protection measures, essentially all systems are susceptible to disruption due to failure, vandalism, denial-of-service, insider risk, computer viruses, security breaches, natural disasters, power outages and other events. In addition, we have designed products and services that connect to and are part of the “Internet of Things.” While we attempt to provide adequate security measures to safeguard our products from cyber threats, the potential for an attack remains. A successful attack may result in inappropriate access to our or our customers' information or an inability for our products to function properly.

We, and some of our third party vendors, have experienced cybersecurity attacks in the past and may experience them in the future, likely with more frequency and involving a broader range of devices. To date, none have resulted in any material 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 the timing, nature and scope of such disruptions, we could potentially be subject to production downtimes, operational delays, other detrimental impacts on our operations or ability to provide products and services to our customers, the compromising of confidential or otherwise protected information, destruction or corruption of data, security breaches, other manipulation or improper use of our systems or networks, financial losses from remedial actions, loss of business or potential liability, regulatory enforcement actions, and/or damage to our reputation, any of which could have a material adverse effect on our competitive position, results of operations, cash flows or financial condition. We also have or operate through a concentration of operations on certain sites, such as production and shared services centers, where business interruptions could cause material damage and costs. Transport of goods from suppliers, and to customers, could also be hampered for the reasons stated above.

Additionally, to conduct our operations, we regularly move data across national borders, and consequently 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 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, becomes effective in May 2018. And other countries have enacted or are enacting data localization laws that require data to stay within their borders. All of these evolving compliance and operational requirements impose significant costs that are likely to increase over time.

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.

***Our strategy includes acquisitions, and we may not be able to make acquisitions of suitable candidates or integrate acquisitions successfully.***

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

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

***Failure to comply with laws, regulations and policies, including the U.S. Foreign Corrupt Practices Act or other applicable anti-corruption legislation could result in 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 and non-U.S. laws, regulations and policies, including laws related to anti-corruption, trade regulations, including export and import compliance, anti-trust and money laundering, due to our global operations. The U.S. Foreign Corrupt Practices Act (the "FCPA"), the U.K. Bribery Act of 2010 and similar anti-bribery laws in other jurisdictions generally prohibit companies and their intermediaries from making improper payments to government officials or other persons for the purpose of 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, 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. Furthermore, detecting, investigating, and resolving actual or alleged violations is expensive and can consume significant time and attention of our senior management.

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

We conduct approximately 54% of our business in various locations outside the United States. We are exposed to fluctuations in foreign currency transaction exchange rates, particularly with respect to the Euro, Swedish Krona, Polish Zloty, Canadian Dollar, British Pound and Australian Dollar. Any significant change in the value of currencies of the countries in which we do business relative to the value of the U.S. Dollar or Euro could affect our ability to sell products competitively and control our cost structure, which could have a material adverse effect on our business, financial condition and results of operations. Additionally, we are subject 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 translation risk is primarily concentrated in the exchange rate between the U.S. Dollar and the Euro, British Pound, Chinese Yuan, Canadian Dollar, Swedish Krona and Australian Dollar. As the U.S. Dollar fluctuates against other currencies in which we transact business, revenue and income can be impacted. For instance, our 2017 revenue increased by 0.9% due to favorable foreign currency impacts. Strengthening of the U.S. Dollar relative to the Euro and the currencies of the other countries in which we do business, could materially and adversely affect our sales growth in future periods. Refer to Item 7A "Quantitative and Qualitative Disclosures about Market Risk" for additional information on foreign exchange risk.

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

Our success will continue to depend to a significant extent on our ability to retain or attract a significant number of employees in senior management, engineering, sales and other key personnel. The ability to attract or retain employees will depend on our ability to offer competitive compensation, training and cultural benefits. We will need to continue to 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 smooth transitions involving key employees could hinder our strategic planning and execution. A failure to retain or attract highly skilled personnel could adversely affect our operating results or ability to operate or grow our business.

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

Manufacturing or design defects in (including in products or components that we source from third parties), unanticipated use of, or inadequate disclosure of risks relating to the use of our products could create product safety, regulatory or environmental risks, including personal injury, death or property damage. These events could lead to recalls or safety alerts relating to our products, result in the removal of a product from the market and result in product liability claims being brought against us. Although we have liability insurance, we cannot be certain that this insurance coverage will continue to be available to us at a reasonable cost or 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 revenue. Recalls, removals and product liability and quality claims can result in significant costs, as well as negative publicity and damage to our reputation that could reduce demand for our products and have a material adverse effect on our business, financial condition and results of operations.

***Weather conditions and climate changes may adversely affect, or cause 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, can positively or negatively impact portions of our business. Within the dewatering space, pumps provided through our Godwin and Flygt brands are used to remove excess or unwanted water. Heavy flooding due to weather conditions drives increased demand for these applications. On the other hand, drought conditions drive higher demand for pumps used in agricultural and turf irrigation applications, such as those provided by our Goulds Water Technology and Lowara brands. Fluctuations to warmer and cooler temperatures result in varying levels of demand for products used in residential and commercial applications where homes and buildings are heated and cooled with HVAC units such as those provided by our B&G brand. Given the unpredictable nature of weather conditions and climate change, this may result in volatility for certain portions of our business, as well as the operations of certain of our customers and suppliers.

***Our financial results can be difficult to predict.***

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

***Changes in our effective tax rates may adversely affect our financial results.***

We sell our products in approximately 150 countries and 54% of our revenue was generated outside the United States in 2017. Given the global nature of our business, a number of factors may increase our future effective tax rates, including:

- the jurisdictions in which profits are determined to be earned and taxed;
- sustainability of historical income tax rates in the jurisdictions in which we conduct business;
- the resolution of issues arising from tax audits with various tax authorities; and
- changes in the valuation of our deferred tax assets and liabilities, and changes in deferred tax valuation allowances.

For example, compliance with the 2017 United States Tax Cut and Jobs Act (“Tax Act”) may require the collection of information not regularly produced within our Company, the use of provisional estimates in our financial statements, and the exercise of significant judgment in accounting for its provisions. Many aspects of the Tax Act are unclear and may not be clarified for some time. As regulations and guidance evolve with respect to the Tax Act, and as we gather more information and perform more analysis, our results may differ from previous estimates and may materially affect our financial position. Our non-U.S. operations will be subject to alternative tax regimes implemented under the Tax Act. Any significant increase in our future effective tax rates could reduce net income for future periods.

***Our business could be adversely affected by inflation and other manufacturing and operating cost increases.***

Our operating costs are subject to fluctuations, particularly due to changes in commodity prices, raw materials, energy and related utilities, freight, and cost of labor. In order to remain competitive, we may not be able to recuperate all or a portion of these higher costs from our customers through product price increases. Further, in a declining price environment, our operating margins may contract because we account for inventory using the first-in, first- out method. Actions we take to mitigate volatility in manufacturing and operating costs may not be successful and, as a result, our business, financial condition and results of operation could be materially and adversely affected.

***Our business could be adversely affected by the inability of suppliers to meet delivery requirements.***

Our business relies on third-party suppliers, contract manufacturing and commodity markets to secure raw materials, parts and components used in our products, and we expect that reliance to increase. Parts and raw materials commonly used in our products include motors, fabricated parts, castings, bearings, seals, nickel, copper, batteries, aluminum, and plastics. We are exposed to the availability of these materials, which may be 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 tariff regimes, exchange rates and prevailing price levels, ability to meet regulatory requirements, weather emergencies or acts of war or terrorism. Any delay in our suppliers' abilities to provide us with necessary materials could impair our ability to deliver products to our customers and, accordingly, could have a material adverse effect on our business, financial condition or results of operations.

***Our indebtedness may affect our business and may restrict our operational flexibility.***

As of December 31, 2017, our total outstanding indebtedness was $2,200 million as described under "Liquidity and Capital Resources." Our indebtedness could:

- increase our vulnerability to general adverse economic and industry conditions;
- limit our ability to obtain additional financing or borrow additional funds;
- limit our ability to pay future dividends;
- limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate;
- require that a substantial portion of our cash flow from operations be used for the payment of interest on our indebtedness instead of funding working capital, capital expenditures, acquisitions or other general corporate purposes; and
- increase the amount of interest expense that we must pay because some of our borrowings are at variable interest rates, which, as interest rates increase, would result in higher interest expense.

In addition, there can be no assurance that future borrowings or equity financing will be available to us on favorable terms or at all for the payment or refinancing of our indebtedness. If we incur additional debt or raise equity through the issuance of 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 common 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 depend on our future operating performance, which may be affected by factors beyond our control. If we are unable to service our indebtedness, our business, financial condition and results of operations would be materially adversely affected.

***We may be negatively impacted by litigation and regulatory proceedings.***

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

From time to time we are involved in legal proceedings that are incidental to the operation of our businesses. These proceedings may seek remedies relating to environmental matters, acquisitions or divestitures, product liability and personal injury claims, privacy, employment, labor and pension matters, and government contract issues and commercial or contractual disputes. Our acquisition of Sensus and technology focused companies has increased our exposure to intellectual property litigation and we expect that this risk will continue to increase as we execute on our innovation and technology priorities.

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

The global and diverse nature of our operations, coupled with the increase in regulation and enforcement in many regions of the globe, means that legal and compliance risks will continue to exist and additional legal proceedings and other contingencies, the outcome of which cannot be predicted with certainty, will arise from time to time. In addition, subsequent developments in legal proceedings may affect our assessments and estimates of loss contingencies recorded as a reserve and require us to make payments in excess of our reserves, which could have an adverse effect on our results of operations and financial condition.

***If we do not or cannot adequately protect our intellectual property, if third parties infringe our intellectual property rights, or if third parties claim that we are infringing or misappropriating their intellectual property rights, we may suffer competitive injury, expend significant resources enforcing our 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, which in aggregate are important to our business. The intellectual property rights that we obtain, however, may not provide us with a significant competitive advantage because they may not be sufficiently broad or may be challenged, invalidated, 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 rights that convey competitive advantage, adequately protect our intellectual property or detect or prevent circumvention or unauthorized use of such property and the cost of enforcing our intellectual property rights could adversely impact our business, 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 complexity and the uncertainty of intellectual property litigation. Our intellectual property portfolio may not be useful in asserting a counterclaim, or negotiating a license, in response to a claim of infringement or misappropriation. In addition, as a result of such claims of infringement or misappropriation, we could lose our rights to critical technology, be unable to license critical technology or sell critical products and services, be required to pay substantial damages or license fees with respect to the infringed rights or be required to redesign our products at substantial cost, any of which could adversely impact our competitive position, financial condition and results of operations. Even if we successfully defend against claims of infringement or misappropriation, we may incur significant costs and diversion of management attention and resources, which could adversely affect our business, financial condition and results of operations.

***A significant portion of our products and offerings in our Measurement & Control Solutions segment are affected by the availability and regulation of radio spectrum and could be affected by interference with the radio spectrum 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 the extent we introduce new products designed for use in the United States or another country into a new market, such products may require significant modification or redesign in order to meet frequency requirements and other regulatory specifications. In some countries, limitations on frequency availability or the cost of making necessary modifications may preclude us from selling our products in those countries. The regulations that govern our use of the radio spectrum may change and the changes may require us to modify our products or seen new partnerships, either directly or due to interference caused by new consumer products allowed under the regulations. The inability to modify our products to meet such requirements, the possible delays in completing such modifications, and the cost of such modifications all could have a material adverse effect on our business, financial condition, and results of operations. In addition, suitable partners for co-development may not be able to be secured by us.

In the United States, our products are primarily designed to use licensed spectrum in the 900MHz range. If the Federal Communications Commission (“FCC”) did not renew our existing spectrum licenses, our business could be adversely affected. In addition, there may be insufficient available frequencies in some markets to sustain 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. Our advanced and smart metering systems offering typically transmit to (and receive information from, if applicable) handheld, mobile, or fixed network reading devices in licensed bands made available to us through strategic partnerships and are reliant to some extent on the licensed spectrum continuing to be available through our partners or our customers. We may be unable to find partners or customers that have access to sufficient frequencies in some markets to sustain or develop our planned operations or to find partners or customers that have access to sufficient frequencies in the relevant markets at a commercially feasible price or at all.

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

We have a significant amount of goodwill and purchased intangible assets on our balance sheet as a result of acquisitions we have completed. As of December 31, 2017, the net carrying value of our goodwill and other indefinite-lived intangible assets totaled approximately $3 billion. The carrying value of goodwill represents the fair value of an acquired business in excess of identifiable assets and liabilities as of the acquisition date. The carrying value of indefinite-lived intangible assets represents the fair value of trademarks, trade names and FCC licenses as of the acquisition date. We do not amortize goodwill and indefinite-lived intangible assets that we expect to contribute indefinitely to our cash flows, but instead we evaluate these assets for impairment at least annually, or more frequently if interim indicators suggest that a potential impairment could exist. In testing for impairment, we will make a qualitative assessment, and if we believe that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, a goodwill impairment test is required. 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, divestitures and market capitalization declines may impair our goodwill and other indefinite-lived intangible assets. Any charges relating to such impairments could adversely affect our results of operations and financial condition.

***We cannot make assurances that we will pay dividends on our common stock or continue to repurchase our common stock under Board approved share repurchase plans, and likewise our indebtedness could limit our ability 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 depend on many factors, including our financial condition, results of operations and capital requirements, as well as applicable law, regulatory constraints, industry practice and other business considerations that our Board of Directors considers relevant. There can be no assurance that we will pay a dividend in the future or continue to pay dividends.

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

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

***Unforeseen environmental issues could impact our financial position or results of operations.***

Our operations and products and offerings are subject to and affected by many federal, state, local and foreign environmental laws and regulations. In addition, we could be affected by future environmental laws or regulations, including, for example, those imposed in response to climate change concerns. Compliance with current and future environmental laws and regulations currently requires and is expected to continue to require operating and capital expenditures.

Environmental laws and regulations may authorize substantial fines and criminal sanctions as well as facility shutdowns to address violations, and may require the installation of costly pollution control equipment or operational changes to limit emissions or discharges. We also incur, and expect to continue to incur, costs to comply with current environmental laws and regulations.

Developments such as the adoption of new environmental laws and regulations, stricter enforcement of existing laws and regulations, violations by us of such laws and regulations, discovery of previously unknown or more extensive contamination, litigation involving environmental impacts, our inability to recover costs associated with any such developments, or financial insolvency of other responsible parties could in the future have a material adverse effect on our financial position and 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 flows in future periods.***

Certain members of our current and retired employee population are covered by pension and other employee-related defined benefit plans (collectively, postretirement benefit plans). We may experience significant fluctuations in costs related to our postretirement benefit plans as a result of macro-economic factors, such as interest rates, that are beyond our control. The cost of our postretirement plans is incurred over long periods of time and involves factors and uncertainties during those periods which can be volatile and unpredictable, including rates of return on postretirement benefit plan assets, discount rates used to calculate liabilities and expenses and rates of future compensation increases. Management develops each assumption using relevant plan and Company experience and expectations in conjunction with market-related data. Our liquidity, financial position (including shareholders' equity) and results of operations could be materially affected by significant changes in key economic indicators, actuarial experience, financial market volatility, future legislation and other governmental regulatory actions.

We make contributions to fund our postretirement benefit plans when considered necessary or advantageous to do so. The macro-economic factors discussed above, including the return on postretirement benefit plan assets and the minimum funding requirements established by local government funding or taxing authorities, or established by other agreement, may influence future funding requirements. A significant decline in the fair value of our plan assets, or other adverse changes to our overall pension and other employee-related benefit plans, could require us to make significant funding contributions and affect cash flows in future periods.

***The market price of our common stock may fluctuate significantly.***

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

- actual or anticipated fluctuations in our operating results due to factors related to our business;
- success or failure of our business strategy;
- our quarterly or annual earnings, or those of other companies in our industry;
- our ability to obtain financing as needed;
- stock repurchases;
- acquisitions and divestitures;
- announcements by us or our competitors of significant new business awards;
- announcements by us or our competitors of significant acquisitions or dispositions;
- changes in accounting standards, policies, guidance, interpretations or principles;
- changes in earnings estimates by securities analysts or our ability to meet those 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 the budgets of federal, state and local governmental entities around the world;
- results from any material litigation or government investigation;
- changes in laws and regulations affecting our business; and
- general economic conditions and other external factors.

Stock markets in general have experienced volatility that has often been unrelated 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 law could delay or prevent a change in control.***

Certain provisions of our third amended and restated articles of incorporation and our amended and restated by-laws may delay or prevent a merger or acquisition of part or all of our business operations. For example, our articles of incorporation and our by-laws, among other things, require advance notice for shareholder proposals and nominations. In addition, our articles of incorporation authorize our Board of Directors to issue one or more series of preferred stock. These provisions may also discourage acquisition proposals of our business operations or delay or prevent a change in control, which could harm our stock price. Indiana law also imposes some restrictions on mergers and other business combinations between any holder of 10% or more of our outstanding common stock and us.

***In connection with our Spin-off, ITT (now ITT LLC) and Exelis, acquired by Harris Inc., will indemnify us for certain liabilities and we will indemnify ITT (now ITT LLC) or Exelis for certain liabilities. If we are required to indemnify 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 the case of ITT's or Exelis's indemnity, there can be no assurance that those indemnities will be sufficient to insure us against the full amount of such liabilities, or as to ITT's or Exelis's ability to satisfy its indemnification obligations in the future.***

Pursuant to the Distribution Agreement and certain other agreements with ITT (now ITT LLC) and Exelis, ITT (now ITT LLC) and Exelis agreed to indemnify us from certain liabilities, and we agreed to indemnify ITT (now ITT LLC) and Exelis for certain liabilities. Indemnities that we may be required to provide ITT (now ITT LLC) and Exelis may be significant and could negatively impact our business. Third parties could also seek to hold us responsible for any of the liabilities that ITT (now ITT LLC) or Exelis has agreed to retain. Further, there can be no assurance that the indemnities from ITT (now ITT LLC) and Exelis will be sufficient to protect us against the full amount of such liabilities, or that ITT (now ITT LLC) and Exelis will 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 any amounts for which we are held liable, we may be temporarily required to bear these losses ourselves. Each of these risks could negatively affect our business, results of operations and financial condition.

## ITEM 1B. UNRESOLVED STAFF COMMENTS.

None.

## ITEM 2. PROPERTIES

We have approximately 355 locations in more than 51 countries. These properties total approximately 12.2 million square feet, of which more than 315 locations, or approximately 6.1 million square feet, are leased. We consider the offices, plants, warehouses and other properties that we own or lease to be in good condition and generally suitable for the purposes for which they are used. The following table shows our significant locations by segment:

| Location | State or Country | Principal Business Activity | Approx. Square Feet | Owned or Leased |
|---|---|---|---|---|
| | | ***Water Infrastructure*** | | |
| Emmaboda | Sweden | Administration and Manufacturing | 1,197,000 | Owned |
| Stockholm | Sweden | Administration and Research & Development | 172,000 | Leased |
| Bridgeport | NJ | Administration and Manufacturing | 136,000 | Leased |
| Shenyang | China | Manufacturing | 125,000 | Owned |
| Yellow Springs | OH | Administration and Manufacturing | 112,000 | Owned |
| Quenington | UK | Manufacturing | 86,000 | Leased |
| | | ***Applied Water*** | | |
| Morton Grove | IL | Administration and Manufacturing | 530,000 | Owned |
| Montecchio | Italy | Administration and Manufacturing | 379,000 | Owned |
| Nanjing | China | Manufacturing | 363,000 | Owned |
| Auburn | NY | Manufacturing | 273,000 | Owned |
| Stockerau | Austria | Administration | 233,000 | Owned |
| Lubbock | TX | Manufacturing | 229,000 | Owned |
| Strzelin | Poland | Manufacturing | 185,000 | Owned |
| Cheektowaga | NY | Manufacturing | 147,000 | Owned |
| | | ***Measurement & Control Solutions*** | | |
| Ludwigshafen | Germany | Manufacturing | 318,000 | Owned |
| Jiangdu City | China | Manufacturing | 316,000 | Owned |
| Texarkana | AR | Manufacturing | 254,000 | Owned |
| Uniontown | PA | Manufacturing | 240,000 | Leased |
| DuBois | PA | Manufacturing | 197,000 | Owned |
| DuBois | PA | Manufacturing | 137,000 | Leased |
| | | ***Regional Selling Locations*** | | |
| Dubai | United Arab Emirates | Manufacturing | 144,000 | Owned |
| Nottinghamshire | United Kingdom | Sales Office | 139,000 | Leased |
| Nanterre | France | Sales Office | 139,000 | Leased |
| Langenhagen | Germany | Sales Office | 134,000 | Leased |
| | | ***Corporate Headquarters*** | | |
| Rye Brook | NY | Administration | 67,000 | Leased |

## ITEM 3. LEGAL PROCEEDINGS

From time to time we are involved in legal proceedings that are incidental to the operation of our businesses. These proceedings may seek remedies relating to environmental matters, intellectual property matters, acquisitions or divestitures, personal injury claims, employment and pension matters, government contract issues and commercial or contractual disputes. See Note 18, "Commitments and Contingencies", of the consolidated financial statements included in Item 8 of Part II of this 10-K for information regarding certain legal proceedings we are involved in.

## ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

**EXECUTIVE OFFICERS OF THE REGISTRANT**

The following information is provided regarding the executive officers of Xylem as of February 1, 2018:

| NAME | AGE | CURRENT TITLE | OTHER BUSINESS EXPERIENCE DURING PAST 5 YEARS |
|---|---|---|---|
| Patrick K. Decker | 53 | President and Chief Executive Officer (2014) | • President and Chief Executive Officer, Harsco Corp. (diversified, worldwide industrial company) (2012) |
| E. Mark Rajkowski | 59 | Senior VP and Chief Financial Office (2016) | • Senior VP and Chief Financial Officer, MeadWestvaco Corp. (worldwide packaging company) (2004) |
| Tomas Brannemo | 46 | Senior VP and President, Transport and Treatment (2017) | • Senior VP and President, Transport (2014)<br>• VP, Transport (2013) |
| David Flinton | 47 | Senior VP and President, Dewatering (2015) | • VP, Engineering and Marketing, Applied Water Systems (2013) |
| Pak Steven Leung | 61 | Senior VP and President, Emerging Markets (2015) | • VP, Global Sales, Valves and Controls, Pentair Plc (diversified, worldwide industrial manufacturing company) (2013) |
| Kenneth Napolitano | 55 | Senior VP and President, Applied Water Systems and Americas Commercial Team (2017) | • Senior VP and President, Applied Water Systems (2012) |
| Colin R. Sabol | 50 | Senior VP and President, Measurement & Control Solutions (2017) | • Senior VP and President, Analytics and Treatment (2015)<br>• Senior VP and President, Dewatering (2013) |
| Kairus Tarapore | 56 | Senior VP and Chief Human Resources Officer (2015) | • Senior VP and Chief Administrative Officer, Babcock & Wilcox Company (energy and environmental technologies and services) (2013) |

| NAME | AGE | CURRENT TITLE | OTHER BUSINESS EXPERIENCE DURING PAST 5 YEARS |
|---|---|---|---|
| Claudia S. Toussaint | 54 | Senior VP, General Counsel and Corporate Secretary (2014) | • Senior VP, General Counsel and Secretary, Barnes Group Inc. (international industrial and aerospace manufacturing) (2012) |

Note: Date in parentheses indicates the year in which the position was assumed.

**BOARD OF DIRECTORS**

The following information is provided regarding the Board of Directors of Xylem as of February 1, 2018:

| NAME | TITLE |
|---|---|
| Markos I. Tambakeras | Chairman, Xylem Inc., Former Chairman, President and Chief Executive Officer, Kennametal, Inc. |
| Curtis J. Crawford, Ph.D. | President and Chief Executive Officer, XCEO, Inc. |
| Jeanne Beliveau-Dunn | 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 AB |
| Steven R. Loranger | Former Chairman, President and Chief Executive Officer, ITT Corporation |
| Surya N. Mohapatra, Ph.D. | Former Chairman, President and Chief Executive Officer, Quest Diagnostics Incorporated |
| Jerome A. Peribere | Former President and Chief Executive Officer, Sealed Air Corporation |

## PART II

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

*2017 and 2016 Market Price and Dividends*

Our common stock trades publicly on the New York Stock Exchange under the trading symbol “XYL”. The following table shows the high and low prices per share of our common stock as reported by the New York Stock Exchange and the dividends declared per share for the periods indicated.

| | High | Low | Dividend |
|---|---|---|---|
| **Fiscal Year ended December 31, 2017** | | | |
| First Quarter | $ 50.66 | $ 46.67 | $ 0.1800 |
| Second Quarter | 55.68 | 48.81 | 0.1800 |
| Third Quarter | 64.80 | 54.08 | 0.1800 |
| Fourth Quarter | 69.88 | 62.24 | 0.1800 |
| | | | |
| **Fiscal Year ended December 31, 2016** | | | |
| First Quarter | $ 41.33 | $ 31.67 | $ 0.1549 |
| Second Quarter | 46.67 | 40.54 | 0.1549 |
| Third Quarter | 52.71 | 44.44 | 0.1549 |
| Fourth Quarter | 54.99 | 45.60 | 0.1549 |

The closing price of our common stock on the NYSE on January 31, 2018 was $72.26 per share. As of January 31, 2018, there were 11,681 holders of record of our common stock.

Dividends are declared and paid on the common stock at the discretion of our Board of Directors and depend on our profitability, financial condition, capital 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, will be paid in the future. In the first quarter of 2018, we declared a dividend of $0.21 per share to be paid on March 15, 2018 for shareholders of record on February 15, 2018.

There were no unregistered offerings of our common stock during 2017.

*Fourth Quarter 2017 Share Repurchase Activity*

The following table summarizes our purchases of our common stock for the quarter ended December 31, 2017:

(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 Value of Shares That May Yet Be Purchased Under the Plans or Programs (b) |
|---|---|---|---|---|
| 10/1/17 - 10/31/17 | — | — | — | $413 |
| 11/1/17 - 11/30/17 | — | — | — | $413 |
| 12/1/17 - 12/31/17 | — | — | — | $413 |

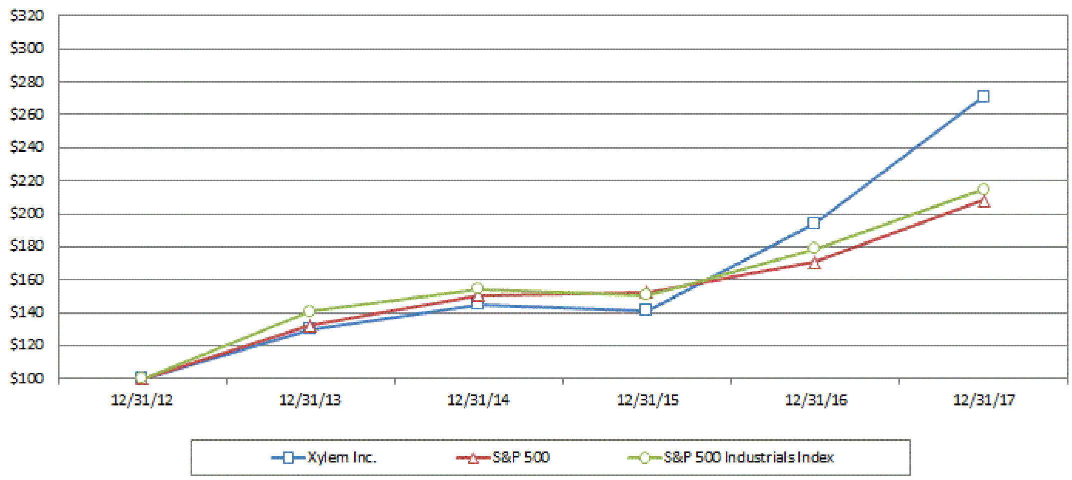
(a) Average price paid per share is calculated on a settlement basis.

(b) On August 24, 2015, our Board of Directors authorized the repurchase of up to $500 million in shares with no expiration date. The program's objective is to deploy our capital in a manner that benefits our shareholders and maintains our focus on growth. There were no shares repurchased under this program during the three months ended December 31, 2017. There are up to $413 million in shares that may still be purchased under this plan as of December 31, 2017.

**PERFORMANCE GRAPH**

**CUMULATIVE TOTAL RETURN**

The following graph compares the relative performance of our common stock, the S&P 500 Index and the S&P 500 Industrials Index. This graph covers the period from December 31, 2012 through December 31, 2017 and assumes that $100 was invested on December 31, 2012 in our common stock, the S&P 500 and the S&P 500 Industrials with the reinvestment of any dividends.




| | XYL | S&P 500 | S&P 500 Industrials Index |
|---|---|---|---|
| December 31, 2012 | 100 | 100 | 100 |
| December 31, 2013 | 130 | 132 | 141 |
| December 31, 2014 | 145 | 150 | 154 |
| December 31, 2015 | 141 | 153 | 150 |
| December 31, 2016 | 194 | 171 | 179 |
| December 31, 2017 | 271 | 208 | 215 |

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

This performance graph shall not be deemed “filed” with the SEC or subject to the liabilities of Section 18 of the Securities Exchange Act of 1934, and should not be deemed incorporated by reference into any of our prior or subsequent filings under the Securities Act of 1933 or the Securities Exchange Act of 1934, except as shall 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 five years ended December 31, 2017. This selected consolidated financial data should be read in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and the consolidated financial statements and the notes thereto included in this Report.

| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| (in millions, except per share data) | **2017** (a) | **2016 (a)** | 2015 | 2014 | 2013 |
| **Results of Operations Data:** | | | | | |
| Revenue | **$ 4,707** | $ 3,771 | $ 3,653 | $ 3,916 | $ 3,837 |
| Gross profit | **1,851** | 1,461 | 1,404 | 1,513 | 1,499 |
| *Gross margin* | ***39.3%*** | *38.7%* | *38.4%* | *38.6%* | *39.1%* |
| Operating income | **556** | 406 | 449 | 463 | 363 |
| *Operating margin* | ***11.8%*** | *10.8%* | *12.3%* | *11.8%* | *9.5%* |
| Net income attributable to Xylem | **331** | 260 | 340 | 337 | 228 |
| **Per Share Data:** | | | | | |
| Earnings per share: | | | | | |
| Basic | **$ 1.84** | $ 1.45 | $ 1.88 | $ 1.84 | $ 1.23 |
| Diluted | **1.83** | 1.45 | 1.87 | 1.83 | 1.22 |
| Basic shares outstanding | **179.6** | 179.1 | 180.9 | 183.1 | 185.2 |
| Diluted shares outstanding | **180.9** | 180.0 | 181.7 | 184.2 | 186.0 |
| Cash dividends per share | **$ 0.7200** | $ 0.6196 | $ 0.5632 | $ 0.5120 | $ 0.4656 |
| **Balance Sheet Data (at period end):** | | | | | |
| Cash and cash equivalents | **$ 414** | $ 308 | $ 680 | $ 663 | $ 533 |
| Working capital* | **873** | 878 | 810 | 882 | 930 |
| Total assets | **6,860** | 6,474 | 4,657 | 4,833 | 4,857 |
| Total debt | **2,200** | 2,368 | 1,274 | 1,284 | 1,235 |

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

(a) The amounts for the years ended December 31, 2017 and December 31, 2016 reflect the acquisition of Sensus. Refer to Notes 3 and 20 to Consolidated Financial Statements for further information regarding Sensus.

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

*The following discussion should be read in conjunction with our consolidated financial statements and the notes thereto. This discussion summarizes the significant factors affecting our results of operations and the financial condition of our business during each of the fiscal years in the three-year period ended December 31, 2017. Except as otherwise indicated or unless the context otherwise requires, "Xylem," "we," "us," "our" and "the Company" refer to Xylem Inc. and its subsidiaries.*

### Overview

Xylem is a leading global water technology company. We design, manufacture and service highly engineered solutions ranging across a wide variety of critical applications. Our broad portfolio of solutions addresses customer needs across the water cycle, from the delivery, measurement and use of drinking water to the collection, test and treatment of wastewater to the return of water to the environment. Our product and service offerings are organized into three reportable segments that are aligned around the critical market applications they provide: Water Infrastructure, Applied Water and Measurement & Control Solutions (formerly Sensus & Analytics).

As previously announced, in the second quarter of 2017 we implemented an organizational redesign by moving Xylem's Analytics business from our Water Infrastructure segment to combine it with our Sensus and Visenti businesses, which were acquired in the fourth quarter of 2016, to form Measurement & Control Solutions. We believe that the combination of these businesses will enhance our focus on advanced sensing technologies and will lead to operating efficiencies by integrating the supply chain process and moving to a leaner functional structure. Accordingly, our reportable segments have changed. Beginning with the second quarter of 2017, the Company now reports the financial position and results of operations of its Analytics, Sensus and Visenti businesses as one new reportable segment, which is called Measurement & Control Solutions. Our Water Infrastructure reportable segment no longer includes the results of our Analytics business. The Company has recast certain historical amounts between the Company's Water Infrastructure and Measurement & Control Solutions reportable segments, however this change had no impact on the Company's historical consolidated financial position or results of operations. The recast financial information does not represent a restatement of previously issued financial statements. Our Applied Water reportable segment remains unchanged.

- *Water Infrastructure* serves the water infrastructure sector with pump systems that transport water from aquifers, lakes, rivers and seas; with filtration, ultraviolet and ozone systems that provide treatment, making the water fit to use; and pumping solutions that move the wastewater to treatment facilities where our mixers, biological treatment, monitoring and control systems provide the primary functions in the treatment process. We also provide sales and rental of specialty dewatering pumps and related equipment and services. In the Water Infrastructure segment, we provide the majority of our sales directly to customers with strong applications expertise, while the remaining amount is through distribution partners.

- *Applied Water* serves the usage applications sector with water pressure boosting systems for heating, ventilation and air conditioning and for fire protection systems to the residential and commercial building services markets. In addition, our pumps, heat exchangers, and controls provide cooling to power plants and manufacturing facilities, as well as circulation for food and beverage processing. We also provide boosting systems for farming irrigation and pumps for dairy operations. In the Applied Water segment, we provide the majority of our sales through long-standing relationships with many of the leading independent distributors in the markets we serve, with the remainder going directly to customers.

- *Measurement & Control Solutions* primarily serves the utility infrastructure solutions and services sector by delivering communications, smart metering, measurement and control technologies and services that allow customers to more effectively use their distribution networks for the delivery of critical resources such as water, electricity and natural gas. In the Measurement & Control Solutions segment, we also provide analytical instrumentation used to measure water quality, flow and level in wastewater, surface water and coastal environments. Additionally, we sell software and services including cloud-based analytics, remote monitoring and data management, leak detection and pressure monitoring solutions. We also sell smart lighting products and solutions that improve efficiency and public safety efforts across communities. In the Measurement & Control Solutions segment, we generate our sales through a combination of long-standing relationships with leading distributors and dedicated channel partners as well as direct sales depending on the regional availability of distribution channels and the type of product.

**Key Performance Indicators and Non-GAAP Measures**

Management reviews key performance indicators including revenue, gross margins, segment operating income and margins, orders growth, working capital and backlog, among others. In addition, we consider certain non-GAAP (or "adjusted") measures to be useful to management and investors evaluating our operating performance for the periods presented, and provide a tool for evaluating our ongoing operations, liquidity and management of assets. This information can assist investors in assessing our financial performance and measures our ability to generate capital for deployment among competing strategic alternatives and initiatives, including, but not limited to, dividends, acquisitions, share repurchases and debt repayment. Excluding revenue, Xylem provides guidance only on a non-GAAP basis due to the inherent difficulty in forecasting certain amounts that would be included in GAAP earnings, such as discrete tax items, without unreasonable effort. These adjusted metrics are consistent with how management views our business and are used to make financial, operating and planning decisions. These metrics, however, are not measures of financial performance under GAAP and should not be considered a substitute for revenue, operating income, net income, earnings per share (basic and diluted) or net cash from operating activities as determined in accordance with GAAP. We consider the following non-GAAP measures, which may not be comparable to similarly titled 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 translation and contributions from acquisitions and divestitures. Divestitures include sales of insignificant portions of our business that did not meet the criteria for classification as a discontinued operation. The period-over-period change resulting from foreign currency translation impacts is determined by translating current period and prior period activity using the same currency conversion rate.

- "constant currency" defined as financial results adjusted for foreign currency translation impacts by translating current period and prior period activity using the same currency conversion rate. This approach is used for countries whose functional currency is not the U.S. dollar.

- "adjusted operating income", "adjusted segment operating Income", "adjusted net income" and “adjusted EPS” defined as operating income, segment operating income, net income and earnings per share, adjusted to exclude restructuring and realignment costs, Sensus acquisition related costs, gain or loss from sale of businesses, special charges and tax-related special items, as applicable. A reconciliation of adjusted net income is provided below.

| (in millions, except per share data) | **2017** | 2016 | 2015 |
|---|---|---|---|
| **Net income attributable to Xylem** | **$ 331** | $ 260 | $ 340 |
| Restructuring and realignment, net of tax of $13, $13 and $5, respectively | **28** | 34 | 15 |
| Sensus acquisition related costs, net of tax of $8 and $15, respectively | **14** | 38 | — |
| Special charges, net of tax of $4, $7 and $0, respectively | **8** | 11 | 5 |
| Tax-related special items | **40** | 21 | (15) |
| Loss (gain) from sale of businesses, net of tax benefit of $2 and net of tax of $0, respectively | **12** | — | (9) |
| **Adjusted net income** | **$ 433** | $ 364 | $ 336 |
| Weighted average number of shares diluted | **180.9** | 180.0 | 181.7 |
| Earnings per share - diluted | **$ 1.83** | $ 1.45 | $ 1.87 |
| **Adjusted earnings per share** | **$ 2.40** | $ 2.03 | $ 1.85 |

- "operating expenses excluding restructuring and realignment costs, Sensus acquisition related costs and special charges" defined as operating expenses, adjusted to exclude restructuring and realignment costs, Sensus acquisition related costs and special charges.

- “realignment costs” defined as costs not included in restructuring costs that are incurred as part of actions taken to reposition our business, including items such as professional fees, severance, relocation, travel, facility set-up and other costs.

- "Sensus acquisition related costs" defined as costs incurred by the Company associated with the acquisition of Sensus that are being reported within operating income. These costs include integration costs, acquisition costs, costs related to the recognition of the backlog intangible asset amortization and inventory step-up recoded in purchase accounting.

- “special charges" defined as costs incurred by the Company, such as non-cash impairment charges, due diligence costs, initial acquisition and integration costs not related to Sensus and other special non-operating items, as well as interest expense related to the early extinguishment of debt and financing costs on the bridge loan entered into for the Sensus acquisition during 2016.

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

- "free cash flow" defined as net cash from operating activities, as reported in the Statement of Cash Flow, less capital expenditures as well as adjustments for other significant items that impact current results which management believes are not related to our ongoing operations and performance. Our definition of free cash flow does not consider certain non-discretionary cash payments, such as debt. The following table provides a reconciliation of free cash flow.

| (in millions) | **2017** | 2016 | 2015 |
|---|---|---|---|
| **Net cash provided by operating activities** | **$ 686** | $ 497 | $ 464 |
| Capital expenditures | **(170)** | (124) | (117) |
| **Free cash flow** | **$ 516** | $ 373 | $ 347 |
| Cash paid for Sensus acquisition related costs | **28** | 13 | — |
| **Free cash flow, excluding Sensus acquisition related costs** | **$ 544** | $ 386 | $ 347 |

- “EBITDA” defined as earnings before interest, taxes, depreciation and amortization expense. “Adjusted EBITDA” reflects adjustments to EBITDA to exclude share-based compensation charges, restructuring and realignment costs, Sensus acquisition related costs, gain or loss from sale of businesses and special charges.

| (in millions) | **2017** | 2016 | 2015 |
|---|---|---|---|
| **Net Income** | **$ 330** | $ 260 | $ 340 |
| Income tax expense | **136** | 80 | 63 |
| Interest expense (Income), net | **79** | 68 | 53 |
| Depreciation | **109** | 87 | 88 |
| Amortization | **125** | 64 | 45 |
| **EBITDA** | **$ 779** | $ 559 | $ 589 |
| Share-based compensation | **21** | 18 | 15 |
| Restructuring and realignment | **41** | 47 | 20 |
| Sensus acquisition related costs | **14** | 46 | — |
| Special charges | **13** | 5 | 5 |
| Loss (gain) from sale of business | **10** | — | (9) |
| **Adjusted EBITDA** | **$ 878** | $ 675 | $ 620 |

**Executive Summary**

Xylem reported revenue of $4,707 million for 2017, an increase of $936 million or 24.8% from $3,771 million reported in 2016. Revenue increased 23.9% on a constant currency basis mostly due to $790 million of revenue related to acquisitions and organic revenue growth of $122 million driven by growth in all end markets.

Operating income for 2017 was $556 million, reflecting an increase of $150 million or 36.9% compared to $406 million in 2016. Operating margin was 11.8% for 2017 versus 10.8% for 2016, an increase of 100 basis points. The increase in operating margin was primarily due to cost reductions resulting from progress in our global procurement and productivity initiatives, a decrease in Sensus acquisition related costs, restructuring savings and a decrease in restructuring and realignment charges. These favorable impacts on operating margin were partially offset by cost inflation increases, Sensus purchase accounting impacts and an increase in special charges.

Adjusted operating income was $630 million, with an adjusted operating margin of 13.4% in 2017 as compared to adjusted operating income of $511 million with an adjusted operating margin of 13.6% in 2016. The decrease in adjusted operating margin was mostly due to cost inflation increases, increased spending on strategic investments and Sensus purchase accounting impacts, which were largely offset by cost savings from our global procurement and productivity initiatives and restructuring savings. The non-cash Sensus purchase accounting impact on adjusted operating margin for the year was 50 basis points, which if excluded would bring the adjusted operating margin to 13.9%, a 30 basis point increase over the prior year.

Additional financial highlights for 2017 include the following:

- Net income attributable to Xylem of $331 million, or $1.83 per diluted share ($433 million or $2.40 per diluted share on an adjusted basis, up 19% from 2016)

- Cash from operating activities of $686 million, and free cash flow, excluding Sensus acquisition related costs, of $544 million up 40.9% from 2016.

- Orders of $4,868 million, up 27.3% from $3,824 million in 2016 (up 6.8% on an organic basis)

- Dividends paid to shareholders increased 16% in 2017.

**2018 Business Outlook**

We anticipate total revenue growth in the range of 8% to 10% in 2018, with the recently announced acquisition of Pure Technologies contributing approximately 2% of that growth. Organic revenue growth is anticipated to be 4% to 6%. The following is a summary of our 2017 organic revenue performance and 2018 organic revenue outlook by end market.

- Public utilities increased approximately 3% for 2017 on an organic basis driven by growth in the United States and Asia Pacific. For 2018, we expect organic growth in the mid-single-digit range driven by solid growth in the U.S. from water and wastewater spending and stable low-single-digit growth in Europe. Additionally, we expect high-single-digit growth from the smart meter market. A healthy infrastructure investment focus in the emerging markets will continue broadly in China and India.

- Industrial increased by roughly 2% for 2017 on an organic basis driven by growth in the emerging markets, specifically in China and Latin America, and a recovery in global oil and gas and mining markets. For 2018, we expect organic growth in the low to mid-single-digits. We believe that market conditions in the U.S. and Europe will continue to improve modestly and oil and gas and mining markets will continue to stabilize in North America. We expect conditions in the emerging markets to be mixed as strength in China and India will be offset by softening conditions in the Middle East and Latin America.

- In the commercial markets, organic growth was around 5% for 2017 primarily driven by strength in the United States. For 2018, we expect continued organic growth in the low to mid-single-digit range. The U.S. market is expected to see low, stable growth while growth in Europe is expected to moderate after strong performance. Strength in the emerging markets will be driven by initiatives in India, the building market in China and large project wins in the Middle East from product localization.

- In residential markets, organic growth increased by about 12% in 2017 primarily driven by strength in Asia Pacific and the United States. For 2018, we expect mid-single-digit growth primarily driven by solid mid-single-digit growth in the U.S. market. Market share gains from an increased selling focus in Europe, along with an increased demand in China and other Asia Pacific countries for a secondary clean water source, are also expected to contribute to this growth.

We will continue to strategically execute restructuring and realignment actions primarily to reposition our European and North American businesses in an effort to optimize our cost structure and improve our operational efficiency and effectiveness. During 2017, we incurred $20 million and $21 million in restructuring and realignment costs, respectively. As a result of these actions in 2017, we realized $6 million of net savings and expect to realize approximately $10 million of incremental net savings in 2018. We expect additional incremental savings to be realized in 2019 and beyond as we complete these actions. During 2018, we currently expect to incur approximately $35 million in restructuring, realignment and integration costs.

We plan to continue to take actions and focus spending in 2018 on actions that allow us to make progress on our top strategic priorities. The priority of accelerating profitable growth encompass our initiatives to drive commercial excellence, grow in emerging markets and strengthen innovation and technology through creation of new centers of excellence, a streamlined approach to product development and smart acquisitions. The priority of driving continuous improvement is an area where we will continue to work to create new opportunities to unlock savings by eliminating waste and increasing efficiencies, which is supported by efforts to expand and further deepen our talent pool. We plan to continue to deploy capital in smart, disciplined ways to develop and acquire solutions to address our customers' challenges. Finally, we continue to work to improve cash performance and generate capital to return to our shareholders.

**Results of Operations**

| (in millions) | **2017** | 2016 | 2015 | 2017 v. 2016 | 2016 v. 2015 |
|---|---|---|---|---|---|
| Revenue | **$ 4,707** | $ 3,771 | $ 3,653 | 24.8 % | 3.2 % |
| Gross profit | **1,851** | 1,461 | 1,404 | 26.7 % | 4.1 % |
| *Gross margin* | **39.3%** | 38.7% | 38.4% | 60bp | 30bp |
| Total operating expenses | **1,295** | 1,055 | 955 | 22.7 % | 10.5 % |
| *Expense to revenue ratio* | **27.5%** | 28.0% | 26.1% | (50)bp | 190bp |
| Restructuring and realignment costs | **(41)** | (47) | (20) | (12.8)% | 135.0 % |
| Sensus acquisition related charges | **(22)** | (53) | — | (58.5)% | NM |
| Special charges | **(11)** | (5) | (5) | 120.0 % | — % |
| Operating expenses excluding restructuring and realignment costs, Sensus acquisition related costs and special charges | **1,221** | 950 | 930 | 28.5 % | 2.2 % |
| *Expense to revenue ratio* | **25.9%** | 25.2% | 25.5% | 70bp | (30)bp |
| Operating income | **556** | 406 | 449 | 36.9 % | (9.6)% |
| *Operating margin* | **11.8%** | 10.8% | 12.3% | 100bp | (150)bp |
| Interest and other non-operating expense (income), net | **80** | 66 | 55 | 21.2 % | 20.0 % |
| (Loss)/gain from sale of businesses | **(10)** | — | 9 | NM | NM |
| Income tax expense | **136** | 80 | 63 | 70.0 % | 27.0 % |
| *Tax rate* | **29.2%** | 23.5% | 15.6% | 570bp | 790bp |
| Net income | $ 330 | $ 260 | $ 340 | 26.9 % | (23.5)% |

NM Not Meaningful

***2017 versus 2016***

***Revenue***

Revenue generated for 2017 was $4,707 million, an increase of $936 million, or 24.8%, compared to $3,771 million in 2016. On a constant currency basis, revenue grew 23.9%. This increase in revenue was primarily driven by additional revenue of $790 million from acquisitions. There was also strong organic growth of $122 million during the year, driven primarily by North America as well as strength in the emerging markets, particularly in China and India. Additionally, to a lesser extent, Europe contributed to this organic growth despite ongoing weakness in the United Kingdom during the year.

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

| | **Water Infrastructure** | | **Applied Water** | | **Measurement & Control Solutions** | | **Total Xylem** | |
|---|---|---|---|---|---|---|---|---|
| (in millions) | $ Change | % Change | $ Change | % Change | $ Change | % Change | $ Change | % Change |
| 2016 Revenue | $ 1,932 | | $ 1,393 | | $ 446 | | $ 3,771 | |
| Organic Growth | 56 | 2.9% | 34 | 2.4 % | 32 | 7.2% | 122 | 3.2% |
| Acquisitions/(Divestitures) | — | —% | (10) | (0.7)% | 790 | 177.1% | 780 | 20.7% |
| Constant Currency | 56 | 2.9% | 24 | 1.7 % | 822 | 184.3% | 902 | 23.9% |
| Foreign currency translation (a) | 16 | 0.8% | 4 | 0.3 % | 14 | 3.1% | 34 | 0.9% |
| Total change in revenue | 72 | 3.7% | 28 | 2.0 % | 836 | 187.4% | 936 | 24.8% |
| **2017 Revenue** | **$ 2,004** | | **$ 1,421** | | **$ 1,282** | | **$ 4,707** | |

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

*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 benefited from $16 million of foreign currency translation for the year and included organic growth of $56 million, or 2.9%.

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

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

*Applied Water*

Applied Water’s revenue increased $28 million, or 2.0%, in 2017 (1.7% increase on a constant currency basis) compared to 2016. Revenue benefited from $4 million of foreign currency translation for the year and the constant currency increase 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 Europe, 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 the timing of promotions and market share gains, and continued strength in Asia Pacific. Commercial building services also grew, primarily in North America, western Europe and Asia Pacific, driven by new product traction and sales channel investments. This growth was partially offset by a decline in industrial applications, 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%, in 2017 (184.3% on a constant currency basis) compared to 2016. The revenue increase for the year was almost entirely from $790 million of revenue related to acquisitions that we did not have in the prior year. Most of the additional revenue contributed by the Sensus business was generated in the United States with additional revenue coming primarily from western Europe and China. The majority of the Sensus business revenue came from water applications with gas and electric applications making up most of the remaining sales for the year. Organic revenue growth in the Measurement & Control Solutions segment was $32 million, or 7.2%, for the year. Organic growth was driven primarily by growth across all applications, except electric which had slight declines. Much of the organic revenue increase was in the water application, which had increased AMI deployments in North America as well as higher demand for iPerl product in eastern Europe and the Middle East. Organic revenue also increased in the gas application, primarily due to AMI deployments in North America, as well as in the software and services application, primarily driven by a couple of major contract upgrades. The test application also contributed to the increase in organic revenue as a result of strength from the environmental monitoring business in the United States.

*Orders/Backlog*

Orders received during 2017 increased by $1,044 million, or 27.3%, to $4,868 million (26.4% increase on a constant currency basis). The order growth on a constant currency basis was primarily driven by additional orders from recent acquisitions, primarily Sensus, of $762 million. Organic order growth was $260 million, or 6.8%, over the prior year.

Water Infrastructure segment orders increased $155 million, or 7.9%, to $2,112 million (7.1% growth on a constant currency basis). Orders benefited from $16 million of foreign currency translation for the year and included organic growth of $139 million, or 7.1%. The majority of the organic order growth for the segment came from the transport application, driven by the public utility sector in the United States, as well as strong project orders in China and India. Additionally, dewatering distributor orders increased driven by storm related activity and the strengthening of the oil and gas markets. Treatment applications also had strong order intake, primarily from projects in the emerging markets, Latin America and North America.

Orders increased in our Applied Water segment by $71 million, or 5.1%, to $1,476 million (4.8% increase on a constant currency basis). The order increase was primarily due to organic order growth of $79 million, or 5.6%, driven by strength in the emerging markets and strong commercial building and industrial performance in North America, which was partially offset by the loss of orders related to divested businesses of $11 million.

Orders increased in our Measurement & Control Solutions segment by $818 million, or 177.1%, to $1,280 million (174% growth on a constant currency basis). This increase included orders from recent acquisitions, primarily Sensus, of $762 million and organic order growth of $42 million, or 9.1%, primarily from Sensus order increases in North America for most applications, as well as increased orders from test application strength in the United States and China.

Backlog includes contractual customer commitments as well as orders on hand as of the end of the period. Delivery schedules vary from customer to customer based upon their requirements. Annual or multi-year contracts are subject to rescheduling and cancellation by customers due to the long-term nature of the contracts. As such, beginning total backlog, plus orders, minus revenues will not equal ending total backlog due to contract adjustments, foreign currency fluctuations and other factors. Typically, large projects require longer lead production cycles and deployment schedules, and delays can occur from time to time. Total backlog was $1,513 million at December 31, 2017 and $1,292 million at December 31, 2016, an increase of 17%. The December 31, 2016 backlog balance has been revised to include contractual agreements that Sensus has with customers that do not have minimum commitments but which we believe will be executed upon over the terms of the contracts. This year over year increase in backlog of $221 million is due to strong order growth in the fourth quarter across all of our segments as well as benefits from currency translation impacts. We anticipate that over 60% of our total backlog at December 31, 2017 will be recognized as revenue during 2018.

***Gross Margin***

Gross margins as a percentage of consolidated revenue increased to 39.3% in 2017 from 38.7% in 2016. The gross margin increase was primarily due to the benefits realized from cost reductions from global procurement and continuous improvement initiatives, as well as a decrease in the inventory step-up charge for Sensus in 2017. These positive impacts on gross margin were partially offset by cost inflation and unfavorable product mix.

***Operating Expenses***

| (in millions) | **2017** | 2016 | Change |
|---|---|---|---|
| Selling, general and administrative expenses ("SG&A") | **$ 1,090** | $ 915 | 19.1 % |
| *SG&A as a % of revenue* | **23.2%** | 24.3% | (110)bp |
| Research and development expenses ("R&D") | **180** | 110 | 63.6 % |
| *R&D as a % of revenue* | **3.8%** | 2.9% | 90bp |
| Restructuring and asset impairment charges | **25** | 30 | (16.7)% |
| Operating expenses | **$ 1,295** | $ 1,055 | 22.7 % |
| *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 23.2% of revenue in 2017, as compared to 24.3% of revenue in 2016. The increase in SG&A expenses includes approximately $160 million of incremental SG&A spending for the Sensus business that we did not have prior to the acquisition in the fourth quarter of 2016. The remaining increases in SG&A expenses were primarily due to inflation, investments in regional sales channels and operational capabilities and foreign currency impacts, which were partially offset by savings from restructuring and other cost actions.

***Research and Development Expenses***

R&D spending increased $70 million or 63.6% to 3.8% of revenue in 2017 as compared to 2.9% of revenue in 2016 primarily due to additional R&D spend from our recent acquisitions and investments in new products and technologies.

***Restructuring Charges and Asset Impairment***

*Restructuring Charges*

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

During 2016, we recognized restructuring costs of $12 million, $10 million, $6 million and $2 million in our Water Infrastructure, Applied Water, Measurement & Control Solutions and Corporate, respectively. These charges were incurred primarily in an effort to realign our organizational structure in Europe and North America to optimize our cost structure. The charges relate to the reduction in structural costs, including a decrease in headcount and consolidation of facilities.

The following table presents expected restructuring spend:

| (in millions) | Water Infrastructure | Applied Water | Measurement & Control Solutions | Corporate | Total |
|---|---|---|---|---|---|
| **Actions Commenced in 2017:** | | | | | |
| Total expected costs | $ 19 | $ 12 | $ 2 | $ 1 | $ 34 |
| Costs incurred during 2017 | 5 | 4 | 2 | — | 11 |
| Total expected costs remaining | **$ 14** | **$ 8** | **$ —** | **$ 1** | **$ 23** |
| | | | | | |
| **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** |
| | | | | | |
| **Actions Commenced in 2015:** | | | | | |
| Total expected costs | $ 4 | $ 1 | $ 1 | $ — | $ 6 |
| Costs incurred during 2015 | 3 | 1 | 1 | — | 5 |
| Costs incurred during 2016 | 1 | — | — | — | 1 |
| Total expected costs remaining | **$ —** | **$ —** | **$ —** | **$ —** | **$ —** |

The Water Infrastructure, Applied Water, Measurement & Control Solutions, and Corporate actions commenced in 2017 consist primarily of severance charges and 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 & Control Solutions actions commenced in 2015 consist primarily of severance charges and are complete. As a result of these actions initiated in 2017, we achieved savings of approximately $4 million in 2017 and estimate annual future net savings beginning in 2018 of approximately $9 million, resulting in $5 million of incremental savings 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 we recognized an impairment charge of $5 million. Refer to Note 10, "Goodwill and Other Intangible Assets," for additional information.

***Operating Income***

We generated operating income of $556 million (operating margin of 11.8%) during 2017, reflecting an increase of $150 million, or 36.9%, when compared to operating income of $406 million (operating margin of 10.8%) during the prior year. This increase in operating income was largely driven by the inclusion of Sensus operating income for the full year in 2017. Sensus acquisition related costs and restructuring and realignment costs decreased $31 million and $6 million, respectively, while special charges increased $6 million when compared to the prior year period. Excluding these costs, adjusted operating income was $630 million (adjusted operating margin of 13.4%) for 2017 as compared to $511 million (adjusted operating margin of 13.6%) for 2016. The decrease in adjusted operating margin was mostly due to cost inflation increases, increased spending on strategic investments and Sensus purchase accounting impacts, which were largely offset by cost savings from our global procurement and productivity initiatives and restructuring savings. The non-cash Sensus purchase accounting impact on adjusted operating margin for the year was 50 basis points.

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

| (In millions) | 2017 | 2016 | Change |
|---|---|---|---|
| **Water Infrastructure** | | | |
| Operating income | **$ 308** | $ 291 | 5.8 % |
| Operating margin | ***15.4%*** | *15.1%* | *30 bp* |
| Restructuring and realignment costs | **16** | 16 | — % |
| Special charges | **—** | 2 | (100.0) % |
| Adjusted operating income | **$ 324** | $ 309 | 4.9 % |
| Adjusted operating margin | ***16.2%*** | *16.0%* | *20 bp* |
| **Applied Water** | | | |
| Operating income | **$ 197** | $ 188 | 4.8 % |
| Operating margin | ***13.9%*** | *13.5%* | *40 bp* |
| Restructuring and realignment costs | **17** | 16 | 6.3 % |
| Special charges | **5** | — | NM |
| Adjusted operating income | **$ 219** | $ 204 | 7.4 % |
| Adjusted operating margin | ***15.4%*** | *14.6%* | *80 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 | **$ (59)** | $ (73) | (19.2) % |
| Restructuring and realignment costs | **—** | 2 | (100.0) % |
| Sensus acquisition related costs | **7** | 28 | (75.0) % |
| Special charges | **6** | — | NM |
| Adjusted operating loss | **$ (46)** | $ (43) | 7.0 % |
| **Total Xylem** | | | |
| Operating income | **$ 556** | $ 406 | 36.9 % |
| Operating margin | ***11.8%*** | *10.8%* | *100 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 | **$ 630** | $ 511 | 23.3 % |
| Adjusted operating margin | ***13.4%*** | *13.6%* | *(20) bp* |

NM Not Meaningful

*Water Infrastructure*

Operating income for our Water Infrastructure segment increased $17 million, or 5.8%, with operating margin also increasing from 15.1% to 15.4%, a 30 basis point increase as compared to the prior year. Operating margin was positively impacted year over year by special charges of $2 million in 2016 that did not recur, while restructuring and realignment costs remained flat. Excluding these items, adjusted operating income increased $15 million, or 4.9%, with adjusted operating margin increasing from 16.0% to 16.2%, a 20 basis point increase as compared to the prior year. The increase in adjusted operating margin was primarily due to cost reductions from global procurement and continuous improvement initiatives as well as restructuring savings and favorable volume. These drivers were partially offset by increases in cost inflation and spending on strategic investments, as well as unfavorable transactional foreign currency impacts.

*Applied Water*

Operating income for our Applied Water segment increased $9 million, or 4.8%, with operating margin also increasing from 13.5% to 13.9%, a 40 basis point increase as compared to the prior year. Operating margin was negatively impacted by higher special charges for a non-cash impairment of $5 million and a $1 million increase in restructuring and realignment costs. Excluding these items, adjusted operating income increased $15 million, or 7.4%, with adjusted operating margin increasing from 14.6% to 15.4%, an 80 basis point increase as compared to the prior year. The increase in adjusted operating margin was primarily due to cost reductions from global procurement and continuous improvement initiatives and restructuring savings, which were partially offset by increases in cost inflation and unfavorable mix.

*Measurement & Control Solutions*

Operating income for our Measurement & Control Solutions segment increased $110 million (operating margin of 8.6%) for the year as compared to operating income and margin of zero in 2016. Operating margin was positively impacted by decreases in Sensus acquisition related costs, restructuring and realignment costs 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 incremental 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 the prior 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 partially offset by the inclusion of Sensus margins, which were negatively impacted by purchase accounting. Non-cash Sensus purchase accounting negatively impacted the segment's full year adjusted operating margin by 200 basis points.

*Corporate and other*

Operating expense for corporate and other decreased $14 million, or 19.2%, compared to the prior year, primarily due to a $21 million decrease in Sensus acquisition related costs and a $2 million decrease in restructuring and realignment costs. This was partially offset by $6 million of special charges incurred during the year which we did not have in the prior year. Excluding these costs, adjusted operating expense increased $3 million compared to the prior year, driven mostly by employee related costs.

***Interest Expense***

Interest expense was $82 million and $70 million for 2017 and 2016, respectively. The increased interest expense for the the year includes additional interest expense in 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 by the reduction in special interest charges incurred in 2016 of $8 million in connection with the early extinguishment of our Senior Notes due in 2016 and $5 million of financing charges on the bridge loan related to the Sensus acquisition, neither of which recurred in 2017, as well as a lower interest rate on the Senior Notes due 2023 which effectively replaced the Senior Notes due in 2016. See Note 13, "Credit Facilities and Debt" of our consolidated financial statements for a description of our 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 of 29.2% compared to $80 million at an effective tax rate of 23.5% in 2016. The 2017 effective tax rate is higher than 2016 due to the provisional one time deemed repatriation transition tax under the newly enacted Tax Cuts and Jobs Act, partially offset by the benefit from the remeasurement of deferred tax assets and liabilities and the release of valuation allowances.

*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 Act"). The Tax Act makes broad and complex changes to the U.S. tax code, including, but not limited to, (1) reducing the U.S. federal corporate tax rate from 35 percent to 21 percent; (2) requiring companies to pay a one-time transition tax on certain unrepatriated foreign earnings of foreign subsidiaries; (3) generally eliminating U.S. federal income taxes on dividends from foreign subsidiaries; (4) requiring a current inclusion in U.S. federal taxable income of certain earnings of controlled foreign corporations; (5) eliminating the corporate alternative minimum tax (AMT) and changing how existing AMT credits can be realized; (6) creating the base erosion anti-abuse tax (BEAT), a new minimum tax; (7) creating a new limitation on deductible interest expense; and (8) changing rules related to uses and limitations of net operating loss carryforwards created in tax years beginning after December 31, 2017.

In connection with our initial analysis of the impact of the Tax Act, we have recorded a provisional tax expense of $46 million as a discrete item. This net income tax expense primarily consists of a tax benefit for the corporate tax rate reduction of $107 million related to the remeasurement of deferred tax assets and liabilities and a tax expense for the repatriation transition tax of $153 million. As permitted under SAB 118, we have not completed our accounting for the income tax effects of certain elements of the Tax Act, and have recorded provisional estimates related to these items. For certain items, a provisional estimate could not be determined, and therefore, we have continued accounting for them in accordance with ASC 740 on the basis of the tax laws in effect before the Tax Act. See Note 6, "Income Taxes" of our consolidated financial statements for further discussion of the Tax Act.

***Other Comprehensive Income***

Other comprehensive income was $108 million in 2017 as compared to an $80 million loss in 2016. This increase was driven primarily by favorable foreign currency translation impacts, primarily due to the strengthening of the Euro, Great British Pound, Chinese Yuan, Polish Zloty, amongst other various currencies, against the U.S. Dollar as compared to the weakening of these same currencies in the prior year. Partially offsetting these favorable movements, was the Euro movement on the Company's net investment hedge as compared to the prior year. The tax impact on the foreign currency translation related to the net investment hedge also contributed to the year over year increase. Finally, year over year movement in foreign currency translation on postretirement benefit plans partially offset the increase in other comprehensive income.

***2016 versus 2015***

***Revenue***

Revenue generated for 2016 was $3,771 million, an increase of $118 million, or 3.2%, compared to $3,653 million in 2015. On a constant currency basis, revenue grew 5.3%. This increase in revenue was primarily driven by additional revenue of $163 million from acquisitions. Additionally, we had strong organic growth, driven by strength within the public utility, industrial and commercial end markets in western Europe, particularly in the United Kingdom, as well as large project deliveries in emerging markets, including India and Asia. Partially offsetting this growth were declines in the United States primarily due to ongoing weakness in the industrial end market.

The following table illustrates the impact on 2016 revenue from organic growth, recent acquisitions/divestitures, and foreign currency translation in relation to revenue.

| | Water Infrastructure | | Applied Water | | Measurement & Control Solutions | | Total Xylem | |
|---|---|---|---|---|---|---|---|---|
| (in millions) | $ Change | % Change | $ Change | % Change | $ Change | % Change | $ Change | % Change |
| 2015 Revenue | $ 1,940 | | $ 1,422 | | $ 291 | | $ 3,653 | |
| Organic Growth | 44 | 2.3 % | (9) | (0.6)% | (6) | (2.1)% | 29 | 0.8 % |
| Acquisitions | — | — % | — | — % | 163 | 56.0 % | 163 | 4.5 % |
| Constant Currency | 44 | 2.3 % | (9) | (0.6)% | 157 | 54.0 % | 192 | 5.3 % |
| Foreign currency translation (a) | (52) | (2.7)% | (20) | (1.4)% | (2) | (0.7)% | (74) | (2.0)% |
| Total change in revenue | (8) | (0.4)% | (29) | (2.0)% | 155 | 53.3 % | 118 | 3.2 % |
| **2016 Revenue** | **$ 1,932** | | **$ 1,393** | | **$ 446** | | **$ 3,771** | |

(a) Foreign currency translation impact primarily due to fluctuations in the value of the British Pound, Chinese Yuan, Argentinian Peso and other various currencies against the U.S. Dollar.

*Water Infrastructure*

Water Infrastructure's revenue decreased $8 million, or 0.4%, in 2016 (2.3% increase on a constant currency basis) compared to 2015. The constant currency increase included organic growth of $44 million, or 2.3%.

Organic growth in our treatment and transport applications primarily reflect increases in the public utility end market where we have been gaining share. Organic growth in the transport application in the public utility end markets in the United States and India was largely offset by declines in the industrial dewatering business in the United States due to continued challenges in the oil and gas market, as well as weakness in the Middle East driven by slower government funding. Organic growth in the treatment application was driven primarily by strong backlog execution and project deliveries in the United States public utility market.

*Applied Water*

Applied Water's revenue decreased $29 million, or 2.0%, in 2016 (0.6% decrease on a constant currency basis) compared to 2015. The decline on a constant currency basis was entirely attributable to organic revenue decline of $9 million, or 0.6%, which was driven by declines in the United States, partially offset by growth in western Europe and, to a lesser extent, the emerging markets.

From an applications perspective, the decrease in organic revenue was predominately due to declines in the United States across all applications, particularly industrial water which saw continued weakness in the oil and gas markets. These declines were partially offset by strength in western Europe due to several large projects combined with strength in commercial building services as well as general industrial applications. Agricultural applications declined in the United States primarily due to market weakness.

*Measurement & Control Solutions*

Measurement & Control Solutions' revenue increased $155 million, or 53.3%, in 2016 (54.0% increase on a constant currency basis) compared to 2015. The constant currency increase included contributions from acquisitions of $163 million which was partially offset by an organic decline of $6 million, or 2.1%, due to weakness from test applications in the United States primarily as a result of lower government agency spending and weakness in the mining and oil and gas markets.

*Orders/Backlog*

Orders received during 2016 increased by $113 million, or 3.0%, to $3,824 million (5.1% increase on a constant currency basis). The order growth on a constant currency basis was primarily made up of orders from recent acquisitions, primarily Sensus, of $179 million and organic order growth of $12 million, or 0.3%, over the prior year.

Water Infrastructure segment orders decreased $52 million, or 2.6%, to $1,957 million (0.1% growth on a constant currency basis). Orders were unfavorably impacted by $55 million from foreign currency translation, while orders were up slightly year over year on an organic basis. Organic orders for the treatment application increased by 5% over the prior year reflecting continued growth in the public utility market with a large ozone project in China and order increases in Europe; however, these orders are largely project based with longer lead times for delivery and recognition of revenue. Largely offsetting the organic order growth in the treatment application were declines in the transport application, primarily due to decreased dewatering orders impacted by the continued weakness in oil and gas, as well as mining, which were partially offset by public utility water and wastewater transport order strength in Europe, particularly in the Nordic region.

Orders decreased in our Applied Water segment by $10 million, or 0.7%, to $1,405 million (0.7% increase on a constant currency basis). The order increase on a constant currency basis was due to organic order growth of 0.7% driven by strength in Europe from new product launches that was partially offset by weakness in the United States.

The Measurement & Control Solutions segment orders increased $175 million, or 61.0%, to $462 (62.0% increase on a constant currency basis). The order growth on a constant currency basis was primarily orders from recent acquisitions of $179 million. Organic orders from test applications were flat versus the prior year.

Backlog includes contractual customer commitments as well as purchase orders on hand as of the end of the period. Delivery schedules vary from customer to customer based upon their requirements. Annual or multi-year contracts are subject to rescheduling and cancellation by customers due to the long-term nature of the contracts. As such, beginning total backlog, plus orders, minus revenues will not equal ending total backlog due to contract adjustments, foreign currency fluctuations and other factors. Typically, large projects require longer lead production cycles, and delays can occur from time to time. Total backlog was $1,292 million at December 31, 2016 and $716 million at December 31, 2015. The December 31, 2016 backlog balance has been revised to include contractual agreements that Sensus has with customers that do not have minimum commitments but which we believe will be executed upon over the terms of the contracts. This increase is primarily attributable to the acquisition of the Sensus business which had a backlog balance of $599 million at December 31, 2016.

***Gross Margin***

Gross margins as a percentage of consolidated revenue increased to 38.7% in 2016 from 38.4% in 2015. The gross margin increase was primarily due to the benefits realized from cost saving initiatives through global sourcing and lean six sigma, partially offset by material and labor inflation headwinds and unfavorable currency impacts and mix.

***Operating Expenses***

| (in millions) | **2016** | 2015 | Change |
|---|---|---|---|
| Selling, general and administrative expenses | **$ 915** | $ 854 | 7.1% |
| *SG&A as a % of revenue* | **24.3%** | 23.4% | 90bp |
| Research and development expenses | **110** | 95 | 15.8% |
| *R&D as a % of revenue* | **2.9%** | 2.6% | 30bp |
| Restructuring charges | **30** | 6 | 400.0% |
| Operating expenses | **$ 1,055** | $ 955 | 10.5% |
| *Expense to revenue ratio* | **28.0%** | 26.1% | 190bp |

***Selling, General and Administrative Expenses***

SG&A increased by $61 million (increase of 7.1%) to 24.3% of revenue in 2016, as compared to 23.4% of revenue in 2015. The increase in SG&A expenses includes $28 million of Sensus acquisition related costs. The remaining increases in SG&A expenses were primarily due to additional operating expenses from recent acquisitions, investments in regional sales channels and operational capabilities and inflation, which were partially offset by savings from restructuring and other cost actions.

***Research and Development Expenses***

R&D spending increased $15 million or 15.8% to 2.9% of revenue in 2016 as compared to 2.6% of revenue in 2015 primarily due to additional R&D spend from our recent acquisitions and investments in new products and technologies.

***Restructuring Charges***

During 2016, we incurred restructuring costs of $12 million, $10 million, $6 million and $2 million in our Water Infrastructure, Applied Water, Measurement & Control Solutions and Corporate and other segments, respectively. These charges were incurred primarily in an effort to realign our organizational structure in Europe and North America to optimize our cost structure. The charges relate to the reduction in structural costs, including a decrease in headcount and consolidation of facilities.

During 2015, we recognized restructuring costs of $4 million, $1 million, and $1 million in our Water Infrastructure, Applied Water, and Monitoring & Control Solutions segments, respectively. These charges were incurred primarily in an effort to realign our organizational structure in Europe and North America to optimize our cost structure. The charges relate to the reduction in structural costs, including a decrease in headcount and consolidation of facilities.

The following table presents expected restructuring spend:

| (in millions) | Water Infrastructure | Applied Water | Measurement & Control Solutions | Corporate | Total |
|---|---|---|---|---|---|
| **Actions Commenced in 2016:** | | | | | |
| Total expected costs | $ 13 | $ 14 | $ 10 | $ 2 | $ 39 |
| Costs incurred during 2016 | 11 | 10 | 6 | 2 | 29 |
| Total expected costs remaining | **$ 2** | **$ 4** | **$ 4** | **$ —** | **$ 10** |
| | | | | | |
| **Actions Commenced in 2015:** | | | | | |
| Total expected costs | $ 4 | $ 1 | $ 1 | $ — | $ 6 |
| Costs incurred during 2015 | 3 | 1 | 1 | — | 5 |
| Costs incurred during 2016 | 1 | — | — | — | 1 |
| Total expected costs remaining | **$ —** | **$ —** | **$ —** | **$ —** | **$ —** |

Approximate total expected costs associated with actions that commenced during 2016 are $13 million for Water Infrastructure, $14 million for Applied Water, $10 million for Measurement & Control Solutions, and $2 million for Corporate. These costs primarily comprise severance charges. The Water Infrastructure and Applied Water actions are expected to continue through the end of 2017. The Measurement & Control Solutions actions are expected to continue through 2018. All of the costs associated with the Corporate actions have been incurred. As a result of these actions initiated in 2016, we achieved savings of approximately $8 million in 2016 and estimate annual future net savings beginning in 2017 of approximately $28 million, resulting in $20 million of incremental savings from the 2016 actions.

***Operating Income***

We generated operating income of $406 million during 2016, reflecting a decrease of $43 million or 9.6% from $449 million during the prior year. Operating income as a percentage of revenue was 10.8% for 2016 versus 12.3% for 2015, a decrease of 150 basis points. This decrease in operating margin was primarily due to Sensus acquisition related costs of $53 million, increases in restructuring and realignment costs of $27 million and increases in special charges of $4 million. Excluding these costs, adjusted operating income was $511 million, with an adjusted operating margin of 13.6%, reflecting an increase of $41 million or 8.7% and 70 basis points, respectively, as compared with 2015 adjusted operating income of $470 million (adjusted operating margin of 12.9%). This increase in adjusted operating income was driven by strong progress in our productivity initiatives and cost saving actions, which more than offset cost inflation, spending on strategic investments in new products and technologies and unfavorable mix.

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

| (In millions) | 2016 | 2015 | Change |
|---|---|---|---|
| **Water Infrastructure** | | | |
| Operating income | **$ 291** | $ 261 | 11.5 % |
| Operating margin | ***15.1%*** | *13.5%* | *160 bp* |
| Restructuring and realignment costs | **16** | 11 | 45.5 % |
| Special charges | **2** | 1 | 100.0 % |
| Adjusted operating income | **$ 309** | $ 273 | 13.2 % |
| Adjusted operating margin | ***16.0%*** | *14.1%* | *190 bp* |
| **Applied Water** | | | |
| Operating income | **$ 188** | $ 190 | (1.1) % |
| Operating margin | ***13.5%*** | *13.4%* | *10 bp* |
| Restructuring and realignment costs | **16** | 7 | 128.6 % |
| Adjusted operating income | **$ 204** | $ 197 | 3.6 % |
| Adjusted operating margin | ***14.6%*** | *13.9%* | *70 bp* |
| **Measurement & Control Solutions** | | | |
| Operating income | **$ —** | $ 42 | NM |
| Operating margin | ***—%*** | *14.4%* | NM |
| Sensus acquisition related costs | **25** | — | NM |
| Restructuring and realignment costs | **13** | 2 | NM |
| Special charges | **3** | $ — | NM |
| Adjusted operating income | **$ 41** | $ 44 | (6.8) % |
| Adjusted operating margin | ***9.2%*** | *15.1%* | *(590) bp* |
| **Corporate and other** | | | |
| Operating loss | **$ (73)** | $ (44) | 65.9 % |
| Restructuring and realignment costs | **2** | — | NM |
| Sensus acquisition related costs | **28** | — | NM |
| Adjusted operating loss | **$ (43)** | $ (44) | (2.3) % |
| **Total Xylem** | | | |
| Operating income | **$ 406** | $ 449 | (9.6) % |
| Operating margin | ***10.8%*** | *12.3%* | *(150) bp* |
| Restructuring and realignment costs | **47** | 20 | 135.0 % |
| Sensus acquisition related costs | **53** | — | 100.0 % |
| Special charges | **5** | 1 | NM |
| Adjusted operating income | **$ 511** | $ 470 | 8.7 % |
| Adjusted operating margin | ***13.6%*** | *12.9%* | *70 bp* |

NM Not Meaningful

*Water Infrastructure*

Operating income for our Water Infrastructure segment increased $30 million or 11.5%, with operating margin also increasing from 13.5% to 15.1%, a 160 basis point increase as compared to the prior year. Operating margin was negatively impacted by a $5 million increase in restructuring and realignment costs and a $1 million increase for special charges. Excluding restructuring and realignment costs and special charges, adjusted operating income increased $36 million or 13.2%, with adjusted operating margin increasing from 14.1% to 16.0%, a 190 basis point increase as compared to the prior year. The increase in adjusted operating margin was due to global procurement and continuous improvement initiatives, which more than offset cost inflation and increased spending in growth initiatives.

*Applied Water*

Operating income for our Applied Water segment decreased $2 million or 1.1%, with operating margin increasing slightly from 13.4% to 13.5%. Operating margin was negatively impacted by increased restructuring and realignment costs of $9 million. Excluding restructuring and realignment costs, adjusted operating income increased $7 million or 3.6%, with adjusted operating margin increasing from 13.9% to 14.6%, a 60 basis point increase as compared to the prior year. The increase in adjusted operating margin was due to global procurement and productivity gains, which more than offset cost inflation, strategic investments and unfavorable mix.

*Measurement & Control Solutions*

Operating income for our Measurement & Control Solutions segment was $0 million, a decrease of $42 million. Operating income was negatively impacted by $25 million of Sensus acquisition related costs in 2016 and increases in restructuring and realignment and special charges of $11 million and $3 million, respectively. Excluding these costs, adjusted operating income decreased $3 million, or 6.8%, with adjusted operating margin decreasing from 15.1% to 9.2%, a 590 basis point decrease as compared to the prior year. The decrease in operating margin was largely due to negative impacts from acquisitions as well as increased spending on strategic investments.

*Corporate and other*

Operating loss for corporate and other increased $29 million or 65.9% (decreased $1 million or 2.3% on an adjusted basis) compared to the prior year, primarily due to $28 million of Sensus acquisition related costs and increased restructuring costs of $2 million.

***Interest Expense***

Interest expense was $70 million and $55 million for 2016 and 2015, respectively, primarily related to interest on our Senior Notes, including a make-whole interest premium of $7 million that was paid in the second quarter of 2016 and fees of $5 million related to the Bridge Facility entered into for the Sensus acquisition. See Note 13, “Credit Facilities and Long-Term Debt,” for further details.

***Income Tax Expense***

The income tax provision for 2016 was $80 million at an effective tax rate of 23.5% compared to $63 million at an effective tax rate of 15.6% in 2015. The 2016 effective tax rate is higher than 2015 due to an increase in valuation allowance and impact of repatriation of foreign earnings offset by a favorable settlement with the tax authorities.

***Other Comprehensive (Loss) Income***

Other comprehensive loss before tax of $57 million in 2016 as compared to $130 million loss in 2015 was primarily due to foreign currency translation loss of $65 million in 2016 compared to a loss of $180 million for 2015. Contributing to this decreased loss was a lower translation loss of $115 million primarily due to less weakening of the Swedish Krona and the Canadian Dollar against the U.S. Dollar, partially offset by the additional weakening of the Euro and the Great British Pound against the U.S. Dollar. Additionally, there were net investment hedges in place that more than offset the weakening of the Euro against the U.S. Dollar, contributing a net Euro gain into comprehensive income in 2016. Other items offsetting the lower translation loss of $115 million were net changes in postretirement benefit plan gains/losses of $43 million.

**Liquidity and Capital Resources**

The following table summarizes our sources and uses of cash:

| | Year Ended December 31, | | |
|---|---|---|---|
| (in millions) | **2017** | 2016 | 2015 |
| Operating activities | **$ 686** | $ 497 | $ 464 |
| Investing activities | **(181)** | (1,886) | (132) |
| Financing activities | **(421)** | 1,034 | (262) |
| Foreign exchange (a) | **22** | (17) | (53) |
| Total | **$ 106** | $ (372) | $ 17 |

(a) 2017 impact is primarily due to the strengthening of the Euro and the Chinese Yuan against the U.S. Dollar. 2016 impact is primarily due to the weakness of the Euro and the Chinese Yuan against the U.S. dollar. 2015 impact is primarily due to the weakness of the Euro against the U.S. Dollar.

*Sources and Uses of Liquidity*

***Operating Activities***

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

During 2016, net cash provided by operating activities was $497 million, compared to $464 million in 2015. The $33 million year-over-year increase was primarily driven by continued improvement in working capital levels. The improvement in working capital includes significant contribution from the acquisition of Sensus during the fourth quarter of 2016 which has positively impacted our working capital efficiency.

***Investing Activities***

Cash used in investing activities was $181 million in 2017, compared to $1,886 million in 2016. This decrease of $1,705 million was primarily driven by the $1,782 million spent on the acquisition of Sensus and two other businesses in 2016 as compared to the $33 million spent for acquisitions in 2017. This impact is partially offset by increased spending of $46 million over the prior year on capital projects, including spending on capitalized software in the Sensus business.

Cash used in investing activities was $1,886 million in 2016 compared to $132 million in 2015. The increase of $1,754 million was primarily due to $1,782 million spent on the acquisition of Sensus and two other businesses in 2016 as compared to $18 million in 2015. Cash provided from other investing activities partially offset the usage.

***Financing Activities***

Cash used by financing activities was $421 million in 2017, compared to cash generated by financing activities of $1,034 in 2016. In 2017, the net decrease in cash provided was primarily due to the issuance of long term and short term debt related to acquisition financing in 2016 versus the net repayment of short-term debt in 2017 (see Note 13, "Credit Facilities and Long-Term Debt" of our consolidated financial statements for a full discussion of debt activities). Also contributing to the decrease in cash generated by financing activities were increased share repurchases and higher dividend payments in 2017.

Cash generated by financing activities was $1,034 million in 2016. In 2015, financing activities used $262 million of cash. In 2016, the net increase in cash provided was due to the issuance of long term and short term debt related to acquisition financing and a reduction in share repurchases. This increase was partially offset by net repayments of short term debt (see Note 13, "Credit Facilities and Long-Term Debt" of our consolidated financial statements for a full discussion of debt activities) and higher dividend payments.

*Funding and Liquidity Strategy*

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

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

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

*Credit Facilities & Long-Term Contractual Commitments*

See Note 13, "Credit Facilities and Long-Term Debt" of our consolidated financial statements for a description of our credit facilities and long-term debt.

*Non-U.S. Operations*

For 2017 and 2016, we generated 54% and 58% of our revenue from non-U.S. operations, respectively. While the addition of Sensus increases our revenue profile in the U.S., we continue to grow our operations in the emerging markets and elsewhere outside of the United States. As such, we expect to continue to generate significant revenue from non-U.S. operations and expect a substantial portion of our cash will be predominately held by our foreign subsidiaries. We expect to manage our worldwide cash requirements considering available funds among the many subsidiaries through which we conduct business and the cost effectiveness with which those funds can be accessed. We may 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 cash generation and investment opportunities and reassess whether there is a need to repatriate funds held internationally to support our U.S. operations. As of December 31, 2017, we have provided a deferred tax liability of $20 million for foreign withholding taxes and state income taxes on $769 million expected to be repatriated to the U.S. parent as deemed necessary.

*Contractual Obligations*

The following table summarizes our contractual commitments as of December 31, 2017:

| (in millions) | 2018 | 2019 - 2020 | 2021 - 2022 | Thereafter | Total |
|---|---|---|---|---|---|
| Debt and capital lease obligations (1) | $ — | $ — | $ 600 | $ 1,622 | $ 2,222 |
| Interest payments (1) (2) | 77 | 153 | 124 | 499 | 853 |
| Operating lease obligations | 65 | 95 | 52 | 45 | 257 |
| Purchase obligations (3) | 141 | 7 | 1 | — | 149 |
| Other long-term obligations reflected on the balance sheet | 12 | 27 | 15 | 32 | 86 |
| Total commitments | $ 295 | $ 282 | $ 792 | $ 2,198 | $ 3,567 |

In addition to the amounts presented in the table above, we have recorded liabilities for net investment hedges of $64 million and employee severance indemnity of $16 million. These amounts have been excluded from the contractual obligations table due to an inability to reasonably estimate the timing or amounts of such payments in individual years. Further, benefit payments which reflect expected future service related to the Company's pension and other postretirement employee benefit obligations are presented in Note 14, “Postretirement Benefit Plans” of the consolidated financial statements and deferred income tax liabilities and uncertain tax positions are presented in Note 6, "Income Taxes" of the consolidated financial statements, and as such, these obligations are not included in the above table. Finally, estimated environmental payments and workers' compensation and general liability reserves are excluded from the table above. We estimate, based on historical experience, that we will spend approximately $2 million to $3 million per year on environmental investigation and remediation and approximately $6 million to

$7 million per year on workers' compensation and general liability. At December 31, 2017, we had estimated and accrued $4 million and $30 million related to environmental matters, and workers' compensation and general liability, respectively.

(1) Refer to Note 13, "Credit Facilities and Long-Term Debt," of the consolidated financial statements for discussion of the use and availability of debt and revolving credit agreements. Amounts represent principal payments of short-term and long-term debt including current maturities and exclude unamortized discounts.

(2) Amounts represent estimates of future interest payments on short-term and long-term debt outstanding as of December 31, 2017.

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

*Off-Balance Sheet Arrangements*

As of December 31, 2017, we have issued guarantees for the debt and other obligations of consolidated subsidiaries in the normal course of business. We have determined that none of these arrangements has a material current effect or is reasonably likely to have a material future effect on our consolidated financial 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 bonds from third-party financial institutions in the ordinary course of business when required under contracts or to satisfy insurance related requirements. As of December 31, 2017, the amount of stand-by letters of credit, bank guarantees and surety bonds was $240 million.

**Critical Accounting Estimates**

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, and the disclosure of contingent liabilities. Management bases its estimates on historical experience and on various other assumptions that it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of 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 Accounting Policies," of the consolidated financial statements. Accounting estimates and assumptions discussed in this section are those that we consider most critical to an understanding of our financial statements because they are inherently uncertain, involve significant judgments, include areas where different estimates reasonably could have been used, and changes in the estimate that are reasonably possible could materially impact the financial statements. Management believes that the accounting estimates employed and the resulting balances are reasonable; however, actual results in these areas could differ from management's estimates under different assumptions or conditions.

***Revenue Recognition.*** We recognize revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collectability of the sales price is reasonably assured. For product sales, delivery does not occur until the products have been shipped, risk of loss has been transferred to the customer and the contractual terms have been fulfilled. In instances where contractual terms include a provision for customer acceptance, revenue is recognized when either (i) we have previously demonstrated that the product meets the specified criteria based on either seller- or customer-specified objective criteria or (ii) upon formal acceptance received from the customer where the product has not been previously demonstrated to meet customer-specified objective criteria. Revenue on service and repair contracts is recognized after services have been agreed to by the customer and rendered.

We enter into contracts to sell our products and services, and while the majority of our sales agreements contain standard terms and conditions, certain agreements contain multiple elements or non-standard terms and conditions. Where sales agreements contain multiple elements or non-standard terms and conditions, judgment is required to determine the appropriate accounting, including whether the deliverables specified in these agreements should be treated as separate units of accounting for revenue recognition purposes, and, if so, how the transaction price should be allocated among the elements and when to recognize revenue for each element. When a sale involves multiple deliverables, the total revenue from the arrangement is allocated to each unit of accounting based on the relative selling price of the deliverable to all other deliverables in the contract. Revenue for multiple element arrangements is recognized when the appropriate revenue recognition criteria for the individual deliverable have been satisfied. Generally, these elements are satisfied within the same reporting period although certain contracts may be completed over 6 months. The allocation of sales price between elements may impact the timing of revenue recognition, but will not change the total revenue recognized on the arrangement. For delivered elements accounted for as separate units of accounting in a multiple element arrangement, revenue is recognized only when the delivered elements have standalone value, there are no uncertainties regarding customer acceptance and there are no customer-negotiated refund or return rights affecting the sales recognized.

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

We record a reduction in revenue at the time of sale for estimated product returns, rebates and other allowances, based on historical experience and known trends.

We adopted the new accounting guidance regarding revenue from contracts with customers January 1, 2018 using the modified retrospective approach (refer to Note 2 “Recently Issued Accounting Pronouncements”). Adoption of the guidance did not have a material impact on our financial statements.

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

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

Due to U.S. Tax Reform, we have recorded provisional amounts of foreign withholding taxes and state income taxes on earnings that are expected to be repatriated to the U.S. parent. The Company intends to distribute a portion of the earnings taxed under the Tax Act. We have not recorded any deferred taxes on the amounts that the Company currently does not intend to distribute as the determination of any deferred taxes 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 our global operations. We recognize potential liabilities and record tax liabilities for anticipated tax audit issues in the U.S. and other tax jurisdictions based on our 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 only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement.

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

***Business Combinations.*** We record acquisitions using the purchase method of accounting. All of the assets acquired, liabilities assumed, contractual contingencies and contingent consideration is recorded at fair value as of the acquisition date. The excess of the purchase price over the estimated fair values of 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 order to properly allocate purchase price consideration between assets that are depreciated and amortized from goodwill. These assumptions and estimates include a market participant’s use of the asset and the appropriate discount rates for a market participant. Our estimates are based on historical experience, information obtained from the management of the acquired companies and, when appropriate, includes assistance from independent third-party appraisal firms. Significant assumptions and estimates include, but are not limited to, the cash flows that an asset is expected to generate in the future, the cost to build/recreate certain technology, the appropriate weighted-average cost of capital, and the cost savings expected to be derived from acquiring an asset. These estimates are inherently uncertain and unpredictable. In addition, unanticipated events and 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 in circumstances indicate the carrying value of an asset may not be recoverable. We also review the carrying value of our finite-lived intangible assets for potential impairment when impairment indicators arise. We conduct our annual impairment test as of the first day of the fourth quarter. For goodwill, the estimated fair value of each reporting unit is compared to the carrying value of the net assets assigned to 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 unit exceeds its estimated fair value, then an impairment charge is recognized for that excess up to the amount of recorded goodwill. We estimate the fair value of our reporting units and intangible assets with indefinite lives using an income approach. Under the income approach, we calculate fair value based on the present value of estimated future cash flows.

Determining the fair value of a reporting unit or an indefinite-lived intangible asset is judgmental in nature and involves the use of significant estimates and assumptions, particularly related to future operating results and cash flows. These estimates and assumptions include, but are not limited to, revenue growth rates and operating margins used to calculate projected future cash flows, risk-adjusted discount rates, assumed royalty rates, future economic and market conditions and identification of appropriate market comparable data. In addition, the identification of reporting units and the allocation of assets and liabilities to the reporting units when determining the carrying value of each reporting unit also require judgment. Goodwill is tested for impairment at either the operating segment identified in Note 20, “Segment and Geographic Data,” of the consolidated financial statements, or one level below. The fair value of our reporting units and indefinite-lived intangible assets is based on estimates and assumptions that are believed to be reasonable. Significant changes to these estimates and assumptions could adversely impact our conclusions. Actual future results may differ from those estimates.

During the fourth quarter of 2017, we performed our annual impairment assessment and determined that the estimated fair values of our goodwill reporting units were substantially in excess of each of their carrying values. However, future goodwill impairment tests could result in a charge to earnings. We will continue to evaluate goodwill on an annual basis as of the beginning of our fourth quarter and whenever events and changes in circumstances indicate there may be a potential impairment. We determined that no impairment of the indefinite-lived intangibles existed as of the measurement date in 2017. However, future indefinite-lived intangible impairment tests could result in a charge to earnings. We will continue to evaluate indefinite-lived intangibles on an annual basis as of the beginning of our fourth quarter and whenever events and changes in circumstances indicate there may be a potential impairment.

***Contingent Liabilities.*** As discussed in Note 18, "Commitments and Contingencies" of the consolidated financial statements, the Company is, from time to time, subject to a variety of litigation, environmental liabilities, product liabilities, and similar contingent liabilities incidental to its business (or the business operations of previously owned entities). The Company recognizes a liability for any contingency that is known or probable of occurrence and reasonably estimable. These assessments require judgments concerning matters such as litigation developments and outcomes, the anticipated outcome of negotiations, the number of future claims and the cost of both pending and future claims. In addition, because most contingencies are resolved over long periods of time, liabilities may change in the future due to various factors, including those discussed in Note 18 of the consolidated financial statements. If the liabilities established by the Company with respect to these contingencies are inadequate, the Company would be required to incur an expense equal to the amount of the loss incurred in excess of the recorded liability, which 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 transactions with customers and are presented net of allowances for doubtful accounts and early payment discounts.

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

Credit risk with respect to accounts receivable is generally diversified due to the large number of entities comprising our customer base and their dispersion across many different geographical regions. We perform ongoing credit evaluations of the financial condition of our third-party distributors, resellers and other customers and require collateral, such as letters of credit and bank guarantees, in certain circumstances. As of December 31, 2017 and 2016 we do not believe we have any significant concentrations of credit risk.

***Postretirement Plans.*** Company employees around the world participate in numerous defined benefit plans. The determination of projected benefit obligations and the recognition of expenses related to these plans are dependent on various assumptions. These major assumptions primarily relate to discount rates, expected long-term rates of return on plan assets, rate of future compensation increases, mortality, health care inflation and years of service (some of which are disclosed in Note 14, “Postretirement Benefit Plans,” of the consolidated financial statements) and other factors. Actual results that differ from our assumptions are accumulated and amortized on a straight-line basis only to the extent they exceed 10% of the higher of the market-related value or projected benefit obligation, over the average remaining service period of active plan participants, or for plans with all or substantially all inactive participants, over the average remaining life expectancy.

*Significant Assumptions*

Management develops each assumption using relevant Company experience, in conjunction with market-related data for each individual country in which such plans exist. All assumptions are reviewed annually with third-party consultants and adjusted as necessary. The table included below provides the weighted average assumptions used to estimate our defined benefit pension obligations and costs as of and for the years ended 2017 and 2016.

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | U.S. | Int’l | U.S. | Int’l |
| Benefit Obligation Assumptions | | | | |
| Discount rate | **3.75%** | **2.43%** | 4.25% | 2.63% |
| Rate of future compensation increase | **NM** | **2.93%** | NM | 2.76% |
| Net Periodic Benefit Cost Assumptions | | | | |
| Discount rate | **4.25%** | **2.63%** | 4.27% | 3.44% |
| Expected long-term return on plan assets | **8.00%** | **7.20%** | 8.00% | 7.25% |
| Rate of future compensation increase | **NM** | **2.76%** | NM | 3.29% |

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

We determine the expected long-term rate of return on plan assets by evaluating both historical returns and estimates of future returns. Specifically, the Company analyzes the estimated future returns based on independent estimates of asset class returns and evaluates historical broad market returns over long-term timeframes based on the strategic asset allocation, which is detailed in Note 14, “Postretirement Benefit Plans,” of the consolidated financial statements.

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

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Expected long-term rate of return on plan assets | **7.30%** | 7.32% | 7.38% |
| Actual rate of return on plan assets | **5.70%** | 12.20% | 3.51% |

For the recognition of net periodic pension cost, the calculation of the expected return on plan assets is generally derived by applying the expected long-term rate of return to the market-related value of plan assets. The market-related value of plan assets is based on average asset values at the measurement date over the 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 net periodic benefit costs for 2018 is estimated at 7.30%. We estimate that every 25 basis point change in the expected return on plan assets impacts the expense by $1 million.

The discount rate reflects our expectation of the present value of expected future cash payments for benefits at the measurement date. A decrease in the discount rate increases the present value of benefit obligations and increases pension expense. We base the discount rate assumption on current investment yields of high-quality fixed income investments during the retirement benefits maturity period. The pension discount rate was determined by considering an interest rate yield curve comprising AAA/AA bonds, with maturities between zero and 30 years, developed by the plan's actuaries. Annual benefit payments are then discounted to present value using this yield curve to develop a single-point discount rate matching the plan's characteristics. Our weighted average discount rate for all pension plans effective January 1, 2018, is 2.58%. We estimate that every 25 basis point change in the discount rate impacts the expense by $1 million.

The rate of future compensation increase assumption reflects our long-term actual experience and future and near-term outlook. Effective January 1, 2018, our expected rate of future compensation is 3.03% for all pension plans. The estimated impact of a 25 basis point change in the expected rate of future compensation is less than $1 million.

The assumed rate of future increases in the per capita cost of health care (the health care trend rate) is 8.72% for 2018, decreasing ratably to 4.50% in 2026. An increase or decrease in the health care trend rates by one percent per year would impact the aggregate annual service and interest components by less than $1 million, and impact the benefit obligation by approximately $4 million.

We currently anticipate making contributions to our pension and postretirement benefit plans in the range of $20 million to $30 million during 2018, of which $6 million is expected to be made in the first quarter.

*Funded Status*

Funded status is derived by subtracting the respective year-end values of the projected benefit obligations from the fair value of plan assets. We estimate that every 25 basis point change in the discount rate impacts the funded status by approximately $31 million.

*Fair Value of Plan Assets*

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

A portion of our pension benefit plan assets portfolio comprises investments in private equity and hedge funds. The private equity and hedge fund investments are generally measured at net asset value. However, in certain instances, the values reported by the asset managers were not current at the measurement date. Accordingly, we made estimate adjustments to the last reported value where necessary to measure the assets at fair value at the measurement date. These adjustments consider information received from the asset managers, as well as general market information. The adjustment recorded at December 31, 2017 and 2016 for these assets represented less than one percent of total plan assets in each respective year. Asset values for other positions were generally measured using market observable prices. We estimate that a 5% change in asset values will impact funded status by approximately $29 million.

**New Accounting Pronouncements**

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

## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

### Foreign Currency Exchange Rate Risk

We conduct approximately 54% of our business in various locations outside the United States.

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

Additionally, we are subject 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 translation risk is primarily concentrated in the exchange rate between the U.S. Dollar and the Euro, British Pound, Chinese Yuan, Canadian Dollar, Swedish Krona and Australian Dollar. As the U.S. Dollar strengthens against other currencies in which we transact business, revenue and income will generally be negatively impacted, and if the U.S. Dollar weakens, revenue and income will generally be positively impacted. We estimate that a hypothetical 10% movement of the U.S. Dollar to the various foreign currency exchange rates we translate from, in the aggregate, could have approximately a 5% and 6% impact on Xylem's consolidated revenue and income, respectively, as reported in U.S. Dollars. We expect to continue to generate significant revenue from non-U.S. operations and we expect our cash will be predominately held by our foreign subsidiaries. We expect to manage our worldwide cash requirements considering available funds among the many subsidiaries through which we conduct business and the cost effectiveness with which those funds can be accessed. We may transfer cash from certain international subsidiaries to the U.S. and other international subsidiaries when it is cost effective to do so, though we continually review our domestic and foreign cash profile, expected future cash generation and investment opportunities and reassess whether there is a need repatriate funds held internationally to support our U.S. operations. Accordingly, we do not expect translation risk to have a material economic impact on our financial position and results of operations.

### Interest Rate Risk

As of December 31, 2017, our long term debt portfolio is primarily comprised of four series of fixed-rate senior notes that total $2.1 billion. The senior notes are not exposed to interest rate risk as the bonds are at a fixed-rate until maturity. Based on current interest rate market we do not anticipate material risk associated with our debt refinancing within the target time-frame of completion.

### Commodity Price Exposures

Portions of our business are exposed to volatility in the prices of certain commodities, such as copper, nickel and aluminum, among others. Our primary exposure to this volatility resides with the use of these materials in purchased component parts. We generally maintain long-term fixed price contracts on raw materials and component parts; however, we are prone to exposure as these contracts expire. We estimate that a hypothetical 10% adverse movement in prices for raw metal commodities would not be material to our financial position and results of operations.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

## INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

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

**Opinion on the Financial Statements**

We have audited the accompanying consolidated balance sheets of Xylem Inc. and subsidiaries (the "Company") as of December 31, 2017 and 2016, the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows, for each of the three years in the period ended December 31, 2017, and the related notes (collectively referred to as the “financial statements”). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2017, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2017, based on the criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 23, 2018, 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 management. Our responsibility is to express an opinion on the Company’s financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those 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 respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Deloitte & Touche LLP

Stamford, Connecticut
February 23, 2018
We have served as the Company's auditor since 2010.

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

| Year Ended December 31, | **2017** | 2016 | 2015 |
|---|---|---|---|
| Revenue | **$ 4,707** | $ 3,771 | $ 3,653 |
| Cost of revenue | **2,856** | 2,310 | 2,249 |
| Gross profit | **1,851** | 1,461 | 1,404 |
| Selling, general and administrative expenses | **1,090** | 915 | 854 |
| Research and development expenses | **180** | 110 | 95 |
| Restructuring and asset impairment charges | **25** | 30 | 6 |
| Operating income | **556** | 406 | 449 |
| Interest expense | **82** | 70 | 55 |
| Other non-operating income, net | **2** | 4 | — |
| (Loss)/gain on sale of businesses | **(10)** | — | 9 |
| Income before taxes | **466** | 340 | 403 |
| Income tax expense | **136** | 80 | 63 |
| Net income | **330** | 260 | 340 |
| Less: Net loss attributable to non-controlling interests | **(1)** | — | — |
| Net income attributable to Xylem | **$ 331** | $ 260 | $ 340 |
| Earnings per share: | | | |
| Basic | **$ 1.84** | $ 1.45 | $ 1.88 |
| Diluted | **$ 1.83** | $ 1.45 | $ 1.87 |
| Weighted average number of shares: | | | |
| Basic | **179.6** | 179.1 | 180.9 |
| Diluted | **180.9** | 180.0 | 181.7 |
| Dividends declared per share | **$ 0.7200** | $ 0.6196 | $ 0.5632 |

See accompanying notes to consolidated financial statements.

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

| Year Ended December 31, | **2017** | 2016 | 2015 |
|---|---|---|---|
| Net income | **$ 330** | $ 260 | $ 340 |
| Other comprehensive income (loss), before tax: | | | |
| Foreign currency translation adjustment | **79** | (65) | (180) |
| Foreign currency gain reclassified into net income | **—** | — | (8) |
| Net change in derivative hedge agreements: | | | |
| Unrealized gain (loss) | **9** | — | (22) |
| Amount of (gain) loss reclassified into net income | **(5)** | (2) | 20 |
| Net change in postretirement benefit plans: | | | |
| Net (loss) gain | **(19)** | (20) | 23 |
| Prior service credit | **1** | 1 | 1 |
| Amortization of prior service credit cost | **(3)** | (3) | (3) |
| Amortization of net actuarial loss into net income | **13** | 13 | 18 |
| Settlement | **1** | — | — |
| Foreign currency translation adjustment | **(18)** | 19 | 21 |
| Other comprehensive income (loss), before tax | **58** | (57) | (130) |
| Income tax (benefit) expense related to other comprehensive loss | **(50)** | 23 | 9 |
| Other comprehensive income (loss), net of tax | **108** | (80) | (139) |
| Comprehensive income | **$ 438** | $ 180 | $ 201 |

See accompanying notes to consolidated financial statements.

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

| December 31, | 2017 | 2016 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | **$ 414** | $ 308 |
| Receivables, less allowances for discounts, returns and doubtful accounts of $35 and $30 in 2017 and 2016, respectively | **956** | 843 |
| Inventories | **524** | 522 |
| Prepaid and other current assets | **177** | 166 |
| Total current assets | **2,071** | 1,839 |
| Property, plant and equipment, net | **643** | 616 |
| Goodwill | **2,768** | 2,632 |
| Other intangible assets, net | **1,168** | 1,201 |
| Other non-current assets | **210** | 186 |
| **Total assets** | **$ 6,860** | $ 6,474 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | **$ 549** | $ 457 |
| Accrued and other current liabilities | **551** | 521 |
| Short-term borrowings and current maturities of long-term debt | **—** | 260 |
| Total current liabilities | **1,100** | 1,238 |
| Long-term debt, net | **2,200** | 2,108 |
| Accrued postretirement benefits | **442** | 408 |
| Deferred income tax liabilities | **252** | 352 |
| Other non-current accrued liabilities | **347** | 161 |
| **Total liabilities** | **4,341** | 4,267 |
| Commitment and Contingencies (Note 18) | | |
| Stockholders' equity: | | |
| Common stock — par value $0.01 per share: | | |
| Authorized 750.0 shares, issued 192.3 and 191.4 shares in 2017 and 2016, respectively | **2** | 2 |
| Capital in excess of par value | **1,912** | 1,876 |
| Retained earnings | **1,227** | 1,033 |
| Treasury stock – at cost 12.4 shares and 11.9 shares in 2017 and 2016, respectively | **(428)** | (403) |
| Accumulated other comprehensive loss | **(210)** | (318) |
| Total stockholders' equity | **2,503** | 2,190 |
| Non-controlling interest | **16** | 17 |
| **Total equity** | **2,519** | 2,207 |
| **Total liabilities and stockholders' equity** | **$ 6,860** | $ 6,474 |

See accompanying notes to consolidated financial statements.

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

| Year Ended December 31, | **2017** | 2016 | 2015 |
|---|---|---|---|
| **Operating Activities** | | | |
| Net income | **$ 330** | $ 260 | $ 340 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation | **109** | 87 | 88 |
| Amortization | **125** | 64 | 45 |
| Deferred income taxes | **(33)** | 14 | (9) |
| Share-based compensation | **21** | 18 | 15 |
| Restructuring and asset impairment charges | **25** | 30 | 6 |
| Loss/(gain) from sale of businesses | **10** | — | (9) |
| Other, net | **19** | 6 | 12 |
| Payments for restructuring | **(28)** | (16) | (14) |
| Contributions to postretirement benefit plans | **(33)** | (27) | (25) |
| Changes in assets and liabilities (net of acquisitions): | | | |
| Changes in receivables | **(79)** | (6) | (24) |
| Changes in inventories | **27** | (15) | 23 |
| Changes in accounts payable | **50** | 61 | 20 |
| Changes in accrued liabilities | **28** | 13 | (11) |
| Changes in accrued taxes | **104** | (13) | (3) |
| Net changes in other assets and liabilities | **11** | 21 | 10 |
| **Net Cash — Operating activities** | **686** | 497 | 464 |
| **Investing Activities** | | | |
| Capital expenditures | **(170)** | (124) | (117) |
| Proceeds from the sale of property, plant and equipment | **1** | 1 | — |
| Acquisitions of businesses and assets, net of cash acquired | **(33)** | (1,782) | (18) |
| Proceeds from sale of businesses | **16** | — | 1 |
| Cash received from investments | **10** | — | — |
| Cash paid for investments | **(11)** | — | — |
| Other, net | **6** | 19 | 2 |
| **Net Cash — Investing activities** | **(181)** | (1,886) | (132) |
| **Financing Activities** | | | |
| Short-term debt issued | **—** | 274 | — |
| Short-term debt repaid, net | **(282)** | (80) | (3) |
| Long-term debt issued, net | **—** | 1,540 | — |
| Long-term debt repaid | **—** | (608) | — |
| Repurchase of common stock | **(25)** | (4) | (179) |
| Proceeds from exercise of employee stock options | **16** | 24 | 21 |
| Excess tax benefit from share based compensation | **—** | — | 2 |
| Dividends paid | **(130)** | (112) | (102) |
| Other, net | **—** | — | (1) |
| **Net Cash — Financing activities** | **(421)** | 1,034 | (262) |
| **Effect of exchange rate changes on cash** | **22** | (17) | (53) |
| Net change in cash and cash equivalents | **106** | (372) | 17 |
| Cash and cash equivalents at beginning of year | **308** | 680 | 663 |
| **Cash and cash equivalents at end of year** | **$ 414** | $ 308 | $ 680 |
| Supplemental disclosure of cash flow information: | | | |
| Cash paid during the year for: | | | |
| Interest | **$ 78** | $ 49 | $ 52 |
| Income taxes (net of refunds received) | **$ 57** | $ 78 | $ 75 |

See accompanying notes to consolidated financial statements.

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

| | Common Stock | Capital in Excess of Par Value | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Treasury Stock | Non-Controlling Interest | **Total** |
|---|---|---|---|---|---|---|---|
| Balance at December 31, 2014 | $ 2 | $ 1,796 | $ 648 | $ (99) | $ (220) | $ — | $ 2,127 |
| Net income | | | 340 | | | | 340 |
| Other comprehensive loss, net | | | | (139) | | | (139) |
| Dividends declared ($0.5632 per share) | | | (103) | | | | (103) |
| Stock incentive plan activity | | 38 | | | | | 38 |
| Repurchase of common stock | | | | | (179) | | (179) |
| Balance at December 31, 2015 | $ 2 | $ 1,834 | $ 885 | $ (238) | $ (399) | $ — | $ 2,084 |
| Net income | | | 260 | | | | 260 |
| Other comprehensive loss, net | | | | (80) | | | (80) |
| Dividends declared ($0.6196 per share) | | | (112) | | | | (112) |
| Stock incentive plan activity | | 42 | | | | | 42 |
| Repurchase of common stock | | | | | (4) | | (4) |
| Acquisition activity | | | | | | **17** | **17** |
| Balance at December 31, 2016 | $ 2 | $ 1,876 | $ 1,033 | $ (318) | $ (403) | $ 17 | $ 2,207 |
| Cumulative effect of change in accounting principle | | | **(7)** | | | | **(7)** |
| Net income | | | **331** | | | **(1)** | **330** |
| Other comprehensive income, net | | | | **108** | | | **108** |
| Dividends declared ($.72 per share) | | | **(130)** | | | | **(130)** |
| Stock incentive plan activity | | **36** | | | **(5)** | | **31** |
| Repurchase of common stock | | | | | **(20)** | | **(20)** |
| **Balance at December 31, 2017** | **$ 2** | **$ 1,912** | **$ 1,227** | **$ (210)** | **$ (428)** | **$ 16** | **$ 2,519** |

See accompanying notes to consolidated financial statements.

## Note 1. Summary of Significant Accounting Policies

Xylem Inc. (“Xylem” or the “Company”) is a leading equipment and service provider for water and wastewater applications with a broad portfolio of products and services addressing the full cycle of water, from collection, distribution and use to the return of water to the environment.

As previously announced, in the second quarter of 2017 we implemented an organizational redesign by moving Xylem’s Analytics business from our Water Infrastructure segment to combine it with our Sensus and Visenti businesses, which were acquired in the fourth quarter of 2016, to form Measurement & Control Solutions. We believe that the combination of these businesses will enhance our focus on advanced sensing technologies and will lead to operating efficiencies by integrating the supply chain process and moving to a leaner functional structure. Accordingly, our reportable segments have changed. Beginning with the second quarter of 2017, the Company now reports the financial position and results of operations of its Analytics, Sensus and Visenti businesses as one new reportable segment, which is called Measurement & Control Solutions. Our Water Infrastructure reportable segment no longer includes the results of our Analytics business. The Company has recast certain historical amounts between the Company's Water Infrastructure and Measurement & Control Solutions reportable segments, however this change had no impact on the Company's historical consolidated financial position or results of operations. The recast financial information does not represent a restatement of previously issued financial statements. Our Applied Water reportable segment remains unchanged.

Xylem operates in three segments, Water Infrastructure, Applied Water and Measurement & Control Solutions. The Water Infrastructure segment focuses on the transportation and treatment of water, offering a range of products including water and wastewater pumps, treatment equipment, and controls and systems. The Applied Water segment serves many of the primary uses of water and focuses on the residential, commercial and industrial markets. The Applied Water segment’s major products include pumps, valves, heat exchangers, controls and dispensing equipment. The Measurement & Control Solutions segment focuses on 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 Solutions segment's major products include smart metering, networked communications, measurement and control technologies, software and services including cloud-based analytics, remote monitoring and data management, leak detection and pressure monitoring solutions and testing equipment.

On October 31, 2011 (the "Distribution Date"), ITT Corporation (“ITT”) completed the Spin-off (the “Spin-off”) of Xylem, formerly ITT’s water equipment and services businesses. The Spin-off was completed pursuant to the Distribution Agreement, dated as of October 25, 2011 (the “Distribution Agreement”), among ITT (now ITT LLC), Exelis Inc., acquired by Harris Inc. on May 29, 2015, (“Exelis”) and Xylem. Xylem Inc. was incorporated in Indiana on May 4, 2011 in connection with the Spin-off.

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

### *Basis of Presentation*

The consolidated financial statements reflect our financial position and results of operations in conformity with accounting principles generally accepted in the United States of America (“GAAP”). All intercompany transactions between our 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 amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the 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, but not limited to, postretirement obligations and assets, revenue recognition, income tax contingency accruals and valuation allowances, valuation of intangible assets, goodwill and indefinite lived intangible impairment testing and contingent liabilities. Actual results could differ from these estimates.

***Consolidation Principles***

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

***Foreign Currency Translation***

The national currencies of our foreign companies are generally the functional currencies. Balance sheet accounts are translated at the exchange rate in effect at the end of each period; income statement accounts are translated at the average 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 currency transactions are reported currently in selling, general and administrative expenses.

***Revenue Recognition***

Revenue is recognized when persuasive evidence of an arrangement exists, the price is fixed or determinable, collectability is reasonably assured and delivery has occurred or services have 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 contracts with customers require delivery, installation, testing, certification or other acceptance provisions to be satisfied before revenue is recognized. We recognize revenue on product sales to channel partners, including resellers, distributors or value-added solution providers at the time of sale when the channel partners have economic substance apart from Xylem and Xylem has completed its obligations related to the sale. Revenue from the rental of equipment is recognized over the rental period. Service revenue is recognized as services are performed.

For agreements that contain multiple deliverables, we recognize revenue based on the relative selling price if the deliverable has stand-alone value to the customer and, in arrangements that include a general right of return relative to the delivered element, performance of the undelivered element is considered probable and substantially in the Company's control. The selling price for a deliverable is based 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 period although certain contracts may be completed over 6 months. We allocate arrangement consideration based on the relative selling prices of the separate units of accounting determined in accordance with the hierarchy described above. For deliverables that are sold separately, we establish VSOE based on the price when the deliverable is sold separately. We establish TPE, generally for services, based on prices similarly situated customers pay for similar services from third-party vendors. For those deliverables for which we are unable to establish VSOE or TPE, we estimate the selling price considering various factors including market and pricing trends, geography, product customization, and profit objectives. Revenue for multiple element arrangements is recognized when the appropriate revenue recognition criteria for the individual deliverable have been satisfied.

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

***Shipping and Handling Costs***

Shipping and handling costs are recorded as a component of cost of revenue.

***Share-Based Compensation***

Share-based awards issued to employees and members of the Board of Directors include non-qualified stock options, restricted stock unit awards and performance share unit awards. Compensation costs resulting from share-based payment transactions are recognized primarily within selling, general and administrative expenses, at fair value over the requisite service period (typically three years) on a straight-line basis. The calculated compensation cost is adjusted based on an estimate of awards ultimately expected to vest. For performance awards, the calculated compensation cost is adjusted based on an estimate of awards ultimately expected to vest and our assessment of the probable outcome of the performance condition.The fair value of a non-qualified stock option is determined on the date of grant using a binomial lattice pricing model incorporating multiple and variable assumptions over time, including assumptions such as employee exercise patterns, stock price volatility and changes in dividends. The fair value of restricted stock unit awards is determined using the closing price of our common 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 price of our common stock on date of grant. The fair value of Total Shareholder Return ("TSR") performance share units is calculated on the date of grant using a Monte Carlo simulation model utilizing several key assumptions, including expected Company and peer company share price volatility, correlation coefficients between peers, the risk-free rate of return, the expected dividend yield and other award design features.

***Research and Development***

We conduct research and development activities, which consist primarily of the development of new products, product applications, and manufacturing processes. These costs are charged to expense as incurred.

***Exit and Disposal Costs***

We periodically initiate management-approved restructuring activities to achieve cost savings through reduced operational redundancies and to position ourselves strategically in the market in response to prevailing economic conditions and associated customer demand. Costs associated with restructuring actions can include severance, infrastructure charges to vacate facilities or consolidate operations, contract termination costs and other related charges. For involuntary 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 termination benefits, such as additional severance pay or benefit payouts, and other exit costs, such as lease termination costs, the liability is measured and recognized initially at fair value in the period in which the liability is incurred, with subsequent changes to the liability recognized as adjustments in the period of change.

***Deferred Financing Costs***

Deferred financing costs represent costs incurred in conjunction with our debt financing activities and are capitalized in long-term debt and amortized over the life 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 retired and are recorded in the results of operations under the caption “interest expense.”

***Income Taxes***

Income taxes are calculated using the asset and liability method. Deferred tax assets and liabilities are determined based on the estimated future tax effects of temporary differences between the financial statement carrying amounts and the tax bases of assets and liabilities, as measured by the current enacted tax rates.

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 intended in part to provide for the uncertainty regarding the ultimate utilization of our U.S. capital loss carryforwards, U.S. foreign tax credit carryovers, and foreign net operating loss carryforwards. In determining whether a valuation allowance is warranted, we consider all positive and negative evidence and all sources of taxable income such as prior earnings history, expected future earnings, carryback and carryforward periods and tax strategies to estimate if sufficient future taxable income will be generated to realize the deferred tax asset. The assessment of the adequacy of our valuation allowance is based on our estimates of taxable income by jurisdiction in which we operate and the period over which our deferred tax assets will be recoverable. In the event that actual results differ from these estimates, or we adjust these estimates in future periods for current trends or expected changes in our estimating assumptions, we may need to modify the level of valuation allowance that could materially impact our business, financial condition and results of operations.

Due to U.S. Tax Reform, we have recorded provisional amounts of foreign withholding taxes and state income taxes on earnings that are expected to be repatriated to the U.S. parent. The Company intends to distribute a portion of the earnings taxed under the Tax Cuts and Jobs Act (the "Tax Act"). We have not recorded any deferred taxes on the amounts that the Company currently does not intend to distribute as the determination of any deferred taxes on this amount is not practicable.

Tax benefits are recognized for an uncertain tax position when, in management’s 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 the largest amount that is judged to have a greater than 50% likelihood of being realized upon ultimate settlement with a taxing authority. The liability associated with unrecognized tax benefits is adjusted periodically due to changing circumstances and when new information becomes available. Such adjustments are recognized in the period in which they are identified. The effective tax rate includes the net impact of changes in the liability for unrecognized tax benefits and subsequent adjustments as considered appropriate by management. While it is often difficult to predict the final outcome or the timing of resolution of any particular tax matter, we believe our liability for unrecognized tax benefits is adequate. We classify interest relating to unrecognized tax benefits as a component of other non-operating (expense) income, net and tax penalties as a component of income tax expense in our Consolidated Income Statements.

***Earnings Per Share***

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

***Cash Equivalents***

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

***Receivables and Allowance for Doubtful Accounts and Discounts***

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

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

Credit risk with respect to accounts receivable is generally diversified due to the large number of entities comprising our customer base and their dispersion across many different geographical regions. We perform ongoing credit evaluations of the financial condition of our third-party distributors, resellers and other customers and require collateral, such as letters of credit and bank guarantees, in certain circumstances. As of December 31, 2017 and 2016 we do not believe we have any significant concentrations of credit risk.

***Inventories***

Inventories, which include the costs of material, labor and overhead, are stated at the lower of cost or net realizable value using the first in, first out ("FIFO") method. Estimated losses from obsolete and slow-moving inventories are recorded to reduce inventory values to their estimated net realizable value. Our manufacturing 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 follows:

| | 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 estimated useful life or the term of the lease. Costs related to maintenance and repairs that do not prolong the assets' useful lives are expensed as incurred.

***Goodwill and Intangible Assets***

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

***Long-Lived Asset Impairment***

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

Goodwill and indefinite-lived intangible assets are not amortized, but rather are tested for impairment annually (or more frequently if impairment indicators arise, such as changes to the reporting unit structure, significant adverse changes in the business climate or an adverse action or assessment by a regulator). We conduct our annual impairment testing on the first day of our fourth quarter. For goodwill, the estimated fair value of each reporting unit is compared to the carrying value of the net assets assigned to 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 unit exceeds its estimated fair value, then an impairment charge is recognized for that excess up to the amount of recorded goodwill. We estimate the fair value of our reporting units and indefinite-lived intangible assets using an income approach. Under the income approach, we estimate fair value based on the present value of estimated future cash flows discounted at an appropriate rate.

***Product Warranties***

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

***Postretirement Benefit Plans***

The determination of defined benefit pension and postretirement plan obligations and their associated costs requires the use of actuarial computations to estimate participant plan benefits to which the employees will be entitled. The significant assumptions primarily relate to discount rates, expected long-term rates of return on plan assets, rate of future compensation increases, mortality, years of service and other factors. We develop each assumption using relevant company experience in conjunction with market-related data for each individual country in which such plans exist. All actuarial assumptions are reviewed annually with third-party consultants and adjusted as necessary. For the recognition of net periodic postretirement cost, the calculation of the expected return on plan assets is generally derived by applying the expected long-term rate of return on the market-related value of plan assets. The market-related value of plan assets is based on average asset values at the measurement date over the last five years. Actual results that differ from our assumptions are accumulated and amortized on a straight-line basis only to the extent they exceed 10% of the higher of the market-related value or the projected benefit obligation, over the average remaining service period of active participants, or for plans with all or substantially all inactive participants, over the average remaining life expectancy. The fair value of plan assets is determined based on market prices or estimated fair value at the measurement date.

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

***Business Combinations***

We allocate the purchase price of acquisitions to the tangible and intangible assets acquired, liabilities assumed, and non-controlling interests in the acquiree based on their estimated fair value at the acquisition date. The excess of the acquisition price over those estimated fair values is recorded as goodwill. Changes to the acquisition date provisional fair values prior to the expiration of the measurement period, a period not to exceed 12 months from date of acquisition, are recorded as 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 for changes in the fair value of derivatives depends on whether we have elected to designate a derivative in a hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. Derivatives designated and qualifying as a hedge of the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk are considered fair value hedges. Derivatives designated and qualifying as a hedge of the exposure to variability in expected future cash flows, including forecasted transactions, are considered cash flow hedges. Derivatives may also be designated as hedges of the foreign currency exposure of a net investment in a foreign operation. Hedge accounting generally provides for the matching of the timing of gain or loss recognition on the hedging instrument with the recognition of the changes in the fair value of the hedged asset 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. We may enter into derivative contracts that are intended to hedge certain risks economically, even though hedge accounting does not apply or we elect not to apply hedge accounting.

The effective portion of changes in the fair value of derivatives designated and that qualify as cash flow hedges of foreign exchange risk is recorded in other comprehensive income ("OCI") and is subsequently reclassified into either revenue or cost of revenue (hedge of sales classified into revenue and hedge of purchases classified into cost of revenue) in the period that the hedged forecasted transaction affects earnings. Any ineffective portion of the change in fair value of the derivative is recognized directly in selling, general and administrative expenses. Our policy is to de-designate cash flow hedges at the time forecasted transactions are recognized as assets or liabilities on a business unit’s balance sheet and report subsequent changes in fair value through selling, general and administrative expenses where the gain or loss due to movements in currency rates on the underlying asset or liability is revalued. If it becomes probable that the originally forecasted transaction will not occur, the gain or loss related to the hedge recorded within accumulated other comprehensive income ("AOCI") is immediately recognized into net income.

The effective portion of changes in the fair value of derivatives designated and that qualify as net investment hedges of foreign exchange risk is recorded in OCI. Amounts in AOCI are reclassified into earnings at the time the hedged net investment is sold or substantially liquidated. Effectiveness of derivatives designated as net investment hedges is assessed using the forward method. Any ineffective portion of the change in fair value of the derivative is recognized directly in selling, general and administrative expenses.

***Commitments and Contingencies***

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

Accruals for environmental matters are recorded on a site-by-site basis when it is probable that a liability has been incurred and the amount of the liability can be 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 such parties are legally responsible and financially capable of paying their respective shares of the relevant costs. These accruals are reviewed quarterly and are adjusted as assessment and remediation efforts progress or as additional technical or legal information becomes available. Actual costs to be incurred at identified sites in future periods may vary from the estimates, given inherent uncertainties in evaluating environmental exposures. Accruals for environmental liabilities are primarily included in other non-current liabilities at undiscounted amounts and exclude claims for recoveries from insurance companies or other third parties.

***Concentrations of Credit Risk***

Financial instruments that potentially subject us to significant concentrations of credit risk consist principally of cash and cash equivalents, and accounts receivable from trade customers. We maintain cash and cash equivalents and derivative contracts with various financial institutions. These financial institutions are located in many different geographical regions, and our policy is designed to limit exposure with any one institution. As part of our cash and risk management processes, we perform periodic evaluations of the relative credit standing of the financial institutions. We have not sustained any material credit losses during the previous three years from instruments held at financial institutions. We may utilize forward contracts to protect against the effects of foreign currency fluctuations. Such contracts involve the risk of non-performance by the counterparty. Credit risk with respect to accounts receivable is generally diversified due to the large number of entities comprising our customer base and their dispersion across many different industries and geographic regions. We perform ongoing credit evaluations of the financial condition of our third-party distributors, resellers and other customers and require collateral, such as letters of credit and bank guarantees, in certain circumstances.

Substantially all of the cash and cash equivalents, including foreign cash balances, at December 31, 2017 and 2016 were uninsured. Foreign cash balances at December 31, 2017 and 2016 were $373 million and $242 million, respectively.

***Fair Value Measurements***

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

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets 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 inputs include quoted prices (in non-active markets or in active markets for similar assets or liabilities), inputs other than quoted prices that are observable, and inputs that 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 inputs and minimizing the use of unobservable inputs when measuring fair value. Classification within the fair value hierarchy is based on the lowest level input that is significant to the fair value measurement.

NAV Practical Expedient is the measurement of fair value using the net asset value ("NAV") per share (or its equivalent) as an alternative to the fair value hierarchy as discussed above.

**Note 2. Recently Issued Accounting Pronouncements**

***Pronouncements Not Yet Adopted***

In February 2018, the Financial Accounting Standards Board (“FASB”) issued amended guidance on the reclassification of certain tax impacts from Accumulated Other Comprehensive Income ("AOCI"). The amendment allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Act. The guidance also requires certain disclosures related to stranded tax effects. This guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those annual periods. Early adoption is permitted. The guidance may be applied either in the period of adoption or retrospectively to each period (or periods) in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Act is recognized. We are evaluating the impact of the guidance on our financial condition and results of operations.

In August 2017, the FASB issued amended guidance on hedging activities. The amendment better aligns a company’s risk management activities and financial reporting for hedging relationships through changes to both the designation and 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 cash flow and net investment hedges

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

(3) Requires a company to present the earnings effect of the hedging instrument in the same income statement line item in which the earnings effect of the hedged item is reported

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

This guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those annual periods. Early adoption is permitted 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 adoption, a cumulative-effect adjustment related to eliminating the separate measurement of ineffectiveness is required. Other presentation and disclosure guidance is required only prospectively. We are evaluating the impact of the guidance on our financial condition and results of operations.

In March 2017, the FASB issued amended guidance on presentation of net periodic benefit costs. The amendment requires that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components are required to be presented in the income statement separately and outside a subtotal of income from operations, if one is presented. The amendment also requires entities to disclose the income statement lines that contain the other components if they are not appropriately described. This guidance is effective retrospectively for periods beginning after December 15, 2017, including interim periods within those annual periods. Early adoption is permitted. The adoption of this guidance is expected to impact the presentation between operating income and other non operating income within Xylem's Consolidated Income Statement but is not expected to have a material impact on our consolidated financial condition or results of operations.

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

In February 2016, the FASB issued guidance amending the accounting for leases. Specifically, the amended guidance requires all lessees to record a lease liability at lease inception, with a corresponding right of use asset, except for short-term leases. Lessor accounting is not fundamentally changed. This amended guidance is effective for interim and annual periods beginning after December 15, 2018 using a modified retrospective approach. Early adoption is permitted. We are evaluating the impact of the guidance on our financial condition and results of operations.

In May 2014, the FASB issued guidance on recognizing revenue from contracts with customers. The guidance outlines a single comprehensive model to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The core principle of the model is that an entity recognizes revenue to portray the 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 those goods or services. The standard also expands disclosure requirements regarding revenue recognition. This guidance is effective for interim and annual reporting periods beginning after December 15, 2017 and may be applied retrospectively to each prior period presented or using a modified retrospective approach with the cumulative effect recognized as of the date of initial application. Early adoption is permitted for interim and annual reporting periods beginning after December 15, 2016. We adopted this guidance effective January 1, 2018 using the modified retrospective approach. The adoption of this guidance did not have a material impact on our financial condition or results of operations.

***Recently Adopted Pronouncements***

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

In January 2017, the FASB issued guidance amending the impairment testing of goodwill. Under current guidance, the testing of goodwill for impairment is performed at least annually using a two-step test. Step one involves comparing the fair value of a “reporting unit” to its carrying amount. If the applicable book value exceeds the reporting unit’s fair value then step two must be performed. Step two involves comparing the fair value of the reporting unit’s goodwill to the applicable carrying amount of the asset and recognizing an impairment charge equal to the amount by which the carrying amount of the goodwill exceeds its implied fair value. The amended guidance eliminates step two of the impairment test and allows an entity to record an impairment charge equal to the amount that the carrying amount 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 annual goodwill impairment tests beginning after December 15, 2019 with early adoption 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 this guidance did not impact our financial condition or results of operations.

In October 2016, the FASB issued guidance amending the accounting for income taxes. Under current guidance the recognition of current and deferred income taxes for an intra-entity asset transfer is prohibited until the asset has been sold to an outside party. The amended guidance eliminates the prohibition against immediate recognition of current and deferred income tax amounts associated with intra-entity transfers of assets other than inventory. This guidance is effective for interim and annual periods beginning after December 15, 2017 with early adoption permitted as of the beginning of an annual reporting period for which financial statements (interim or annual) have not been issued or made available for issuance. The requirements of the amended guidance should be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. We elected to early adopt this guidance effective the first quarter of 2017. As a result of adopting the amended guidance, prepaid tax assets were reduced by $14 million, long-term deferred tax assets increased $3 million, and accrued taxes were reduced by $4 million. The net impact of these adjustments on retained earnings was a decrease of $7 million.

In July 2015, the FASB issued guidance regarding simplifying the measurement of inventory. Under prior guidance, inventory is measured at the lower of cost or 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 margin. The amended guidance requires the measurement of inventory at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. This guidance is effective prospectively for interim and annual periods beginning after December 15, 2016 and early application is 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.

In March 2016, the FASB issued an update on accounting for share-based payments. The guidance simplifies several aspects of the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification of excess tax benefits in the Consolidated Statements of Cash Flows. This standard is effective for annual reporting periods beginning after December 15, 2016. The Company elected to early adopt this standard in the quarter ended June 30, 2016 retroactively to January 1, 2016. The impact of the early adoption resulted in the following:

- The Company recorded tax benefits of $3 million within income tax expense for the year ended December 31, 2016 related to the excess tax benefit on share-based awards. Prior to adoption this amount would have been recorded as an increase of capital in excess of par value. This change could create volatility in the Company's effective tax rate.

- The Company no longer reflects the cash received from the excess tax benefit within cash flows from financing activities but instead now reflects this benefit within cash flows from operating activities in the Consolidated Statements of Cash Flows. The Company elected to apply this change in presentation prospectively and thus prior periods have not been adjusted.

- The Company elected not to change its policy on accounting for forfeitures and continues to estimate the total number of awards for which the requisite service period will not be rendered.

- At this time, the Company has not changed its policy on statutory withholding requirements and will continue to allow the employee to withhold up to the Company's minimum statutory withholding requirements.

- The Company excluded the excess tax benefits from the assumed proceeds available to repurchase shares in the computation of our diluted earnings per share for the year ended December 31, 2016. This increased diluted weighted average common shares outstanding by less than 300,000 shares for the aforementioned period.

In March 2016, the FASB amended the guidance regarding the use of the equity method to record certain investments. Under current guidance, if an investor increases its level of ownership interest in a company and consequently qualifies for the equity method, the investor must retroactively adjust its investment, results of operations and retained earnings to reflect balances that would have arisen if the equity method had been in effect during all previous periods that the investment was held. The amended guidance eliminates the need to retroactively adjust balances and instead allows for the prospective application of the equity method. This guidance is effective prospectively for interim and annual reporting periods beginning after December 15, 2016. We elected to early adopt this guidance effective January 2016. The adoption of this guidance did not impact our financial condition or results of operations.

In March 2016, in response to inconsistency in practice, the FASB issued guidance regarding the ability to maintain hedge accounting for a derivative instruments when one party to the instrument has been replaced by a new party (“a novation”). The new guidance states that a novation does not preclude the continued application of hedge accounting to a derivative assuming all other hedge accounting criteria continue to be met. This guidance is effective using either a prospective or a modified retrospective approach, for interim and annual reporting periods beginning after December 15, 2016. We elected to early adopt this guidance on a prospective basis effective January 2016. The adoption of this guidance did not impact our financial condition or results of operations.

In March 2016, the FASB issued guidance clarifying what steps need to be followed when evaluating if call or put options are not clearly and closely related to their debt hosts, and therefore must be accounted for as separate derivatives. The guidance prescribes a four step process to assess whether an event that triggers the ability to exercise a call or put option is clearly and closely related to the debt host. The four step decision sequence requires an entity to consider whether (1) the payoff is adjusted based on changes in an index; (2) the payoff is indexed to an underlying other than interest rates or credit risk; (3) the debt involves a substantial premium or discount; and (4) the call or put option is contingently exercisable. This guidance is effective using a modified retrospective approach, for interim and annual reporting periods beginning after December 15, 2016. We elected to early adopt this guidance effective January 2016. The adoption of this guidance did not impact our financial condition or results of operations.

**Note 3. Acquisitions and Divestitures**

*Pure Technologies*

On January 31, 2018, we acquired all the issued and outstanding shares of Pure Technologies Ltd. (“Pure”), a leader in intelligent leak detection and condition assessment solutions for water distribution networks. In connection with this acquisition we had cash disbursements of approximately $415 million, net of cash received. Pure, headquartered in Calgary, Canada, has approximately 500 employees and annual revenue in accordance with International Financial Reporting Standards of approximately $100 million. Due to the timing of this transaction, purchase accounting has just commenced and is preliminary.

**2017 Acquisitions and Divestitures**

*Acquisition Activity*

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

*Divestitures*

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

On February 17, 2017, we divested our United Kingdom and Poland based membranes business for approximately $10 million. The sale resulted in a gain of $5 million, which is reflected in gain from sale of business in our Condensed Consolidated Income Statement. The business, which was part of our Applied Water segment, provided membrane filtration products primarily to customers in the municipal water 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 sale treatment. Accordingly an estimated loss of $16 million was recognized.

**2016 Acquisition**

*Sensus Worldwide Limited*

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

Acquisition costs of $19 million were reflected as a component of selling, general 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 segment. Refer to Note 20 "Segment and Geographic Data" for Measurement & Control Solutions segment information.

The Sensus purchase price allocation as of October 31, 2016 is shown in the 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 allocation. The fair values of Sensus assets and liabilities were determined based on estimates and assumptions which management believes are reasonable.

Goodwill arising from the acquisition consists largely of synergies and economies of scale expected from combining the operations of Sensus and Xylem. All of the goodwill was assigned to the Measurement & Control Solutions segment and is not 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 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 significant assumptions inherent in the development of intangible asset values include: the amount and timing of projected future cash flows, the discount rate selected to 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 to the 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 condensed combined results of operations of the Company for the years ended December 31, 2016 and 2015 assuming the acquisition of Sensus was made on January 1, 2015.

| | Year Ended December 31, | |
|---|---|---|
| (in millions) | 2016 | 2015 |
| Revenue | $ 4,528 | $ 4,507 |
| Net income | $ 286 | $ 423 |

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

- Adjustments to revenue resulting from the valuation of the acquired deferred 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 the impact of the calculated fair value of those assets in accordance with purchase accounting
- Amortization of the fair value adjustment for warranty liabilities
- Adjustments to interest expense to remove historical Sensus interest costs and 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 synergies that may be generated or realized due to the acquisition of Sensus. Additionally, the pro forma results for the 2016 and 2015 both include the operating results for the three months ended March 31, 2016 due to the use of Sensus’ annual statement of operations for the fiscal year-ended March 31, 2016 in the twelve months ended December 31, 2015 pro forma numbers. This practice results in the recognition of a $16 million tax valuation release and a $27 million reduction to warranty expense in both the 2016 and 2015 pro forma results. Additionally, the pro forma results for 2015 include a tax valuation release of $64 million.

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

*Visenti Pte. Ltd*

On October 18, 2016, we acquired Visenti Pte. Ltd. ("Visenti"), a smart water analytics company focused on leak detection and pressure monitoring solutions to help water utilities manage their water networks for $8 million. Visenti, a privately-owned company headquartered in Singapore, has approximately 25 employees. Our consolidated financial statements include Visenti's results of operations prospectively from October 18, 2016 within the Measurement & Control Solutions segment.

*Tideland Signal Corporation*

On February 1, 2016, we acquired Tideland Signal Corporation ("Tideland"), a leading producer of analytics solutions in the coastal and ocean management sectors, for $70 million. Tideland, a privately-owned company headquartered in Texas, has approximately 160 employees. Our consolidated financial statements include Tideland's results of operations prospectively from February 1, 2016 within the Water Infrastructure segment.

**2015 Acquisition and Divestitures**

*Hypack*

On October 22, 2015, we acquired substantially all of the assets of Hypack, Inc. ("Hypack"), a leading provider of hydrographic software worldwide, for approximately $18 million. Hypack, a privately-owned company headquartered in Middletown, Connecticut, has approximately 30 employees and annual revenue of approximately $8 million. Our consolidated financial statements include Hypack's results of operations prospectively from October 22, 2015 within the Water Infrastructure segment.

During 2015, we divested two businesses within our Water Infrastructure segment for $1 million, which were not material, individually or in the aggregate, to our results of operations or financial position. The sales resulted in a gain of $9 million, reflected in gain from sale of business in our Consolidated Income Statement.

**Note 4. Restructuring and Asset Impairment Charges**

From time to time, the Company will incur costs related to restructuring actions in order to optimize our cost base and more strategically position ourselves based on the economic environment and customer demand. During 2017, 2016 and 2015, the costs incurred primarily relate to an effort to reposition our European and North American businesses to optimize our cost structure and improve our operational efficiency and effectiveness. The charges included the reduction of headcount and consolidation of facilities within our Applied Water,Water Infrastructure, and Measurement & Control Solutions segments, as well as Corporate headcount reductions. The components of restructuring charges incurred during each of the previous three years ended are presented below.

| | Year Ended December 31, | | |
|---|---|---|---|
| (in millions) | **2017** | 2016 | 2015 |
| By component: | | | |
| Severance and other charges | **$ 20** | $ 28 | $ 7 |
| Lease related charges | **—** | 2 | — |
| Other restructuring charges | **2** | 1 | — |
| Reversal of restructuring accruals | **(2)** | (1) | (1) |
| Total restructuring charges | **20** | 30 | 6 |
| Asset impairment charges | **5** | — | — |
| Total restructuring and asset impairment charges | **25** | 30 | 6 |
| | | | |
| By segment: | | | |
| Water Infrastructure | **$ 7** | $ 12 | $ 4 |
| Applied Water | **13** | 10 | 1 |
| Measurement & Control Solutions | **5** | 6 | 1 |
| Corporate and other | **—** | 2 | — |

*Restructuring*

The following table displays a rollforward of the restructuring accruals, presented on our Consolidated Balance Sheets within accrued and other current liabilities, for the years ended December 31, 2017 and 2016.

| (in millions) | **2017** | 2016 |
|---|---|---|
| Restructuring accruals - January 1 | **$ 15** | $ 3 |
| Restructuring charges | **20** | 30 |
| Cash payments | **(28)** | (16) |
| Foreign currency and other | **—** | (2) |
| Restructuring accruals - December 31 | **$ 7** | $ 15 |
| | | |
| By segment: | | |
| Water Infrastructure | **$ 1** | $ 2 |
| Applied Water | **1** | 5 |
| Measurement & Control Solutions | **2** | 4 |
| Regional selling locations (a) | **3** | 2 |
| Corporate and other | **—** | 2 |

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

The following is a rollforward of employee position eliminations associated with restructuring activities for the years ended December 31, 2017 and 2016.

| | **2017** | 2016 |
|---|---|---|
| Planned reductions - January 1 | **188** | 82 |
| Additional planned reductions | **151** | 612 |
| Actual reductions and reversals | **(292)** | (506) |
| Planned reductions - December 31 | **47** | 188 |

The following table presents expected restructuring spend:

| (in millions) | Water Infrastructure | Applied Water | Measurement & Control Solutions | Corporate | Total |
|---|---|---|---|---|---|
| **Actions Commenced in 2017:** | | | | | |
| Total expected costs | $ 19 | $ 12 | $ 2 | $ 1 | $ 34 |
| Costs incurred during 2017 | 5 | 4 | 2 | — | 11 |
| Total expected costs remaining | **$ 14** | **$ 8** | **$ —** | **$ 1** | **$ 23** |
| **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** |
| **Actions Commenced in 2015:** | | | | | |
| Total expected costs | $ 4 | $ 1 | $ 1 | $ — | $ 6 |
| Costs incurred during 2015 | 3 | 1 | 1 | — | 5 |
| Costs incurred during 2016 | 1 | — | — | — | 1 |
| Total expected costs remaining | **$ —** | **$ —** | **$ —** | **$ —** | **$ —** |

The Water Infrastructure, Applied Water, Measurement & Control Solutions, and Corporate actions commenced in 2017 consist primarily of severance charges and are expected to continue through the end of 2019. 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 & Control Solutions actions commenced in 2015 consist primarily of severance charges and are complete.

*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 we recognized an impairment charge of $5 million. Refer to Note 10, "Goodwill and Other Intangible Assets," for additional information.

**Note 5. Other Non-Operating Income, Net**

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

| | Year Ended December 31, | | |
|---|---|---|---|
| (in millions) | **2017** | 2016 | 2015 |
| Interest income | **$ 3** | $ 2 | $ 2 |
| Income from joint ventures | **3** | 3 | 3 |
| Other expense – net | **(4)** | (1) | (5) |
| Total other non-operating income, net | **$ 2** | $ 4 | $ — |

**Note 6. Income Taxes**

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

| (in millions) | Year Ended December 31, 2017 | 2016 | 2015 |
|---|---|---|---|
| Income components: | | | |
| Domestic | **$ 162** | $ 80 | $ 116 |
| Foreign | **304** | 260 | 287 |
| Total pre-tax income | **$ 466** | $ 340 | $ 403 |
| Income tax expense components: | | | |
| Current: | | | |
| Domestic – federal | **$ 109** | $ 19 | $ 32 |
| Domestic – state and local | **9** | 5 | 6 |
| Foreign | **51** | 42 | 34 |
| Total Current | **169** | 66 | 72 |
| Deferred: | | | |
| Domestic – federal | **$ (29)** | $ 19 | $ 1 |
| Domestic – state and local | **10** | 1 | 1 |
| Foreign | **(14)** | (6) | (11) |
| Total Deferred | **(33)** | 14 | (9) |
| Total income tax provision | **$ 136** | $ 80 | $ 63 |
| Effective income tax rate | **29.2%** | 23.5% | 15.6% |

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

| | Year Ended December 31, 2017 | 2016 | 2015 |
|---|---|---|---|
| Tax provision at U.S. statutory rate | **35.0 %** | 35.0 % | 35.0 % |
| Increase (decrease) in tax rate resulting from: | | | |
| State income taxes | **1.6** | 0.8 | 1.0 |
| Settlements of tax examinations | **1.6** | (6.4) | 0.5 |
| Valuation allowance | **3.3** | 18.5 | 8.6 |
| Tax exempt interest | **(10.6)** | (14.3) | (13.1) |
| Foreign tax rate differential | **(6.7)** | (7.9) | (7.2) |
| Repatriation of foreign earnings, net of foreign tax credits | **37.0** | 5.9 | 0.2 |
| Tax incentives | **(6.6)** | (8.9) | (7.8) |
| Other – net | **(2.5)** | 0.8 | (1.6) |
| Rate change | **(22.9)** | — | — |
| Effective income tax rate | **29.2 %** | 23.5 % | 15.6 % |

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 maintaining certain employment thresholds. The inability to meet the thresholds would have a 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 differences between the financial reporting and tax bases of assets and liabilities, applying enacted tax rates in effect for the year in which we expect the differences will reverse.

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

| (in millions) | December 31, 2017 | December 31, 2016 |
|---|---|---|
| Deferred tax assets: | | |
| Employee benefits | **$ 108** | $ 126 |
| Accrued expenses | **34** | 53 |
| Loss and other tax credit carryforwards | **419** | 387 |
| Inventory | **8** | 6 |
| Other | **24** | — |
| | **593** | 572 |
| Valuation allowance | **(350)** | (311) |
| Net deferred tax asset | **$ 243** | $ 261 |
| Deferred tax liabilities: | | |
| Intangibles | **$ 300** | $ 434 |
| Investment in foreign subsidiaries | **20** | 4 |
| Property, plant, and equipment | **57** | 61 |
| Other | **49** | 48 |
| Total deferred tax liabilities | **$ 426** | $ 547 |

Management assesses the available positive and negative evidence to estimate if sufficient future taxable income will be generated to realize existing deferred tax assets. On the basis of this evaluation, as of December 31, 2017, a valuation allowance of $350 million has been established to reduce the deferred income tax asset related to certain U.S. and foreign net operating losses and U.S. and foreign capital loss carryforwards.

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

| (in millions) | 2017 | 2016 | 2015 |
|---|---|---|---|
| Valuation allowance — January 1 | **$ 311** | $ 248 | $ 427 |
| Change in assessment (a) | **(28)** | 17 | (5) |
| Current year operations | **48** | 38 | 39 |
| Foreign currency and other (b) | **19** | (32) | (213) |
| Acquisitions | **—** | 40 | — |
| Valuation allowance — December 31 | **$ 350** | $ 311 | $ 248 |

(a) Decrease in assessment in 2017 is primarily attributable to Foreign Tax Credit utilization resulting from the Tax Act. Increase in assessment in 2016 is primarily attributable to Foreign Tax Credits resulting from additional indebtedness from the Sensus acquisition.

(b) Included in foreign currency and other in 2015 is the reduction of a net operating loss that was subject to a valuation allowance of $176 million.

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

| (in millions) | December 31, 2017 | December 31, 2016 |
|---|---|---|
| Non-current assets | **$ 69** | $ 66 |
| Non-current liabilities | **(252)** | (352) |
| Total net deferred tax liabilities | **$ (183)** | $ (286) |

Tax attributes available to reduce future taxable income begin to expire as follows:

| (in millions) | December 31, 2017 | First Year of Expiration |
|---|---|---|
| U.S. net operating loss | $ 8 | December 31, 2024 |
| State net operating loss | 124 | December 31, 2017 |
| U.S. tax credits | 12 | December 31, 2024 |
| State tax credits | 2 | Indefinitely |
| Foreign net operating loss | 1,523 | December 31, 2018 |

The Company intends to distribute a portion of the earnings taxed under the Tax Act and, as of December 31, 2017, has provided a provisional deferred tax liability of $20 million for foreign withholding taxes and state income taxes on $769 million of earnings expected to be repatriated to the U.S. parent. The Company currently does not intend to distribute approximately $2 billion taxed under the Tax Act, 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 likely than not that the tax position will be sustained on examination by the taxing authorities, 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% likelihood of being realized upon ultimate settlement. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

| (in millions) | **2017** | 2016 | 2015 |
|---|---|---|---|
| Unrecognized tax benefits — January 1 | **$ 67** | $ 47 | $ 44 |
| Current year tax positions | **56** | 12 | 4 |
| Prior year tax positions | **7** | (22) | 1 |
| Acquisitions | **—** | 30 | — |
| Settlements | **—** | — | (2) |
| Unrecognized tax benefits — December 31 | **$ 130** | $ 67 | $ 47 |

The amount of unrecognized tax benefits at December 31, 2017 which, if ultimately recognized, will reduce our annual effective tax rate is $130 million. We do not believe that the unrecognized tax benefits will significantly change within the next 12 months.

The following table summarizes our earliest open tax years by major jurisdiction:

| Jurisdiction | Earliest Open Year |
|---|---|
| Italy | 2012 |
| Luxembourg | 2014 |
| Sweden | 2012 |
| Germany | 2010 |
| United Kingdom | 2010 |
| United States | 2014 |
| Switzerland | 2012 |

We classify interest relating to unrecognized tax benefits as a component of other non-operating (expense) income, net and tax penalties as a component of income tax expense in our Consolidated Income Statements. The amount of accrued interest relating to unrecognized tax benefits as of December 31, 2017 and 2016 was $4 million.

***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 Act”). The Tax Act makes broad and complex changes to the U.S. tax code, including, but not limited to, (1) reducing the U.S. federal corporate tax rate from 35 percent to 21 percent; (2) requiring companies to pay a one-time transition tax on certain unrepatriated foreign earnings of foreign subsidiaries; (3) generally eliminating U.S. federal income taxes on dividends from foreign subsidiaries; (4) requiring a current inclusion in U.S. federal taxable income of certain earnings of controlled foreign corporations; (5) eliminating the corporate alternative minimum tax (AMT) and changing how existing AMT credits can be realized; (6) creating the base erosion anti-abuse tax (BEAT), a new minimum tax; (7) creating a new limitation on deductible interest expense; and (8) changing rules related to uses and limitations of net operating loss carryforwards created in tax years beginning after December 31, 2017.

The SEC staff issued SAB118, which expresses views of the staff regarding application of ASC740 in the reporting period that includes December 22, 2017. SAB118 provides a measurement period that should not extend beyond one year from the Tax Act enactment date for companies to complete the accounting under ASC 740. In accordance with SAB118, a company must reflect the income tax effects of those aspects of the Act for which the accounting under ASC740 is complete. To the extent that a company's accounting for certain income tax effects of the Tax Act is incomplete but it is able to record a reasonable estimate, it must record a provisional estimate in the financial statements. If a company cannot determine a provisional estimate to be included in the financial statements, it should continue to apply ASC740 on the basis of the provisions of the tax laws that were in effect immediately before the enactment of the Tax Act.

We are still performing our accounting for the tax effects of the Tax Act because all the necessary information is not currently available, prepared, or analyzed. As permitted by SAB118, we have made a reasonable estimate of the effects of the Tax Act on our financial results (see below). As we perform our analysis of the accounting for the tax effects of enactment of the Tax Act, we will recognize additional provisional amounts or adjustments to provisional amounts as discrete items in the periods in which the respective analyses are performed.

In connection with our initial analysis of the impact of the Tax Act, we have recorded a provisional tax expense of $46 million as a discrete item. This net income tax expense primarily consists of a provisional tax benefit for the corporate tax rate reduction of $107 million and a provisional tax expense for the repatriation transition tax of $153 million. For various reasons that are discussed in detail below, we have completed our accounting for the income tax effects of certain elements of the Tax Act, and therefore, have recorded provisional estimates related to these items. For certain items, a provisional estimate could not be determined, and therefore, we have continued accounting for them in accordance with ASC 740 on the basis of the tax laws in effect before the Tax Act.

Our accounting for the following elements of the Tax Act is incomplete. However, we were able to make reasonable estimates for these elements and, therefore, recorded provisional adjustments as follows:

<u>Reduction of U.S. federal corporate tax rate:</u> The Tax Act reduces the corporate tax rate to 21 percent, effective January 1, 2018. Consequently, we have adjusted our deferred taxes to account for the rate change, and have recorded a provisional decrease related to net deferred tax liabilities (DTLs) of $107 million, respectively, with a corresponding net adjustment to deferred tax benefit for the year ended December 31, 2017. Additional work is necessary for a more detailed analysis of our deferred tax assets and liabilities.

<u>Deemed Repatriation Transition Tax</u>: The Deemed Repatriation Transition Tax (Transition Tax) is a tax on previously untaxed accumulated and current earnings and profits (E&P) of certain foreign subsidiaries. To determine the amount of the Transition Tax, we determined in addition to other factors, the amount of post 1986 E&P of the relevant subsidiaries, as well as the amount of the non-U.S. income taxes paid on such earnings. We are able to make a reasonable estimate of the Transition Tax and recorded a provisional Transition Tax liability of $153 million. This provisional amount may materially change due to additional analysis, changes in interpretations and assumptions the Company has made, additional regulatory guidance that may be issued, and actions the Company may take as a result of the Tax Act.

Our accounting for the following elements of the Tax Act is incomplete, and we have not yet been able to make reasonable estimates of the effects. Therefore, no provisional adjustments were recorded as of December 31, 2017.

<u>Global intangible low taxed income (GILTI):</u> The Tax Act creates a new requirement that certain income (i.e., GILTI) earned by controlled foreign corporations (CFCs) must be included currently in the gross income of the CFCs' U.S. shareholder. GILTI is the excess of the shareholder's "net CFC tested income" over the net deemed tangible income return, which is currently defined as the excess of (1) 10 percent of the aggregate of the U.S. shareholder's pro rata share of the qualified business asset investment of each CFC with respect to which it is a U.S. shareholder over (2) the amount of certain interest expense taken into account in the determination of net CFC-tested income.

Because of the complexity of the new GILTI tax rules, we are continuing to evaluate this provision of the Tax Act and the application of ASC740. According to clarifications from FASB, we are allowed to make an accounting policy choice of either (1) treating taxes due on future U.S. inclusions in taxable income related to GILTI as a current period-expense when incurred (the "period cost method") or (2) factoring such amounts into measurement of deferred taxes (the "deferred method"). Our selection of an accounting policy with respect to the new GILTI tax rules will depend, in part, on analyzing our global income to determine any future U.S. inclusions in taxable income related to GILTI and the related impact. Because whether we expect to have future U.S. inclusions in taxable income related to GILTI depends on not only our current structure and estimated future results of global operations but also our intent and ability to modify our structure and/or our business, we are not yet able to reasonably estimate the effects of this provision of the Tax Act. Therefore, as of December 31, 2017, we have not made any adjustments related to potential GILTI tax in our financial statements and have not yet made a policy decision regarding whether to record deferred taxes on GILTI.

**Note 7. Earnings Per Share**

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

| | Year Ended December 31, | | |
|---|---|---|---|
| | **2017** | 2016 | 2015 |
| Net income attributable to Xylem (in millions) | **$ 331** | $ 260 | $ 340 |
| Shares (in thousands): | | | |
| Weighted average common shares outstanding | **179,602** | 179,069 | 180,854 |
| Add: Participating securities (a) | **27** | 37 | 39 |
| Weighted average common shares outstanding — Basic | **179,629** | 179,106 | 180,893 |
| Plus incremental shares from assumed conversions: (b) | | | |
| Dilutive effect of stock options | **712** | 499 | 465 |
| Dilutive effect of restricted stock units and performance share units | **516** | 433 | 379 |
| Weighted average common shares outstanding — Diluted | **180,857** | 180,038 | 181,737 |
| Basic earnings per share | **$ 1.84** | $ 1.45 | $ 1.88 |
| Diluted earnings per share | **$ 1.83** | $ 1.45 | $ 1.87 |

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

(b) Incremental shares from stock options, restricted stock units and performance share units are computed by the treasury stock method. The weighted average shares listed below were not included in the computation of diluted earnings per share because to do so would have been anti-dilutive for the periods presented or were otherwise excluded under the treasury stock method. The treasury stock method calculates dilution assuming the exercise of all in-the-money options and vesting of restricted stock units and performance share units, reduced by the repurchase of shares with the proceeds from the assumed exercises and unrecognized compensation expense for outstanding awards. Performance share units are included in the treasury stock calculation of diluted earnings per share based upon achievement of underlying performance and market conditions at the end of the reporting period, as applicable. See Note 15, "Stock-Based Compensation Plans" for further detail on the performance share units.

| | Year Ended December 31, | | |
|---|---|---|---|
| (in thousands) | **2017** | 2016 | 2015 |
| Stock options | **1,626** | 1,892 | 2,616 |
| Restricted stock units | **379** | 514 | 723 |
| Performance share units | **504** | 373 | 181 |

**Note 8. Inventories**

The components of total inventories are summarized as follows:

| | December 31, | |
|---|---|---|
| (in millions) | **2017** | 2016 |
| Finished goods | **$ 223** | $ 220 |
| Work in process | **42** | 42 |
| Raw materials | **259** | 260 |
| Total inventories | **$ 524** | $ 522 |

## Note 9. Property, Plant and Equipment

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

| (in millions) | December 31, 2017 | December 31, 2016 |
|---|---|---|
| Land, buildings and improvements | **$ 329** | $ 299 |
| Machinery and equipment | **799** | 731 |
| Equipment held for lease or rental | **241** | 218 |
| Furniture and fixtures | **101** | 95 |
| Construction work in progress | **85** | 76 |
| Other | **21** | 19 |
| Total property, plant and equipment, gross | **1,576** | 1,438 |
| Less accumulated depreciation | **933** | 822 |
| Total property, plant and equipment, net | **$ 643** | $ 616 |

Depreciation expense was $109 million, $87 million, and $88 million for 2017, 2016, and 2015, respectively.

## Note 10. Goodwill and Other Intangible Assets

Changes in the carrying value of goodwill by reportable segment during the years ended December 31, 2017 and 2016 are as follows:

| (in millions) | Water Infrastructure | Applied Water | Measurement & Control Solutions | Total |
|---|---|---|---|---|
| Balance as of December 31, 2015 | $ 660 | $ 518 | $ 406 | $ 1,584 |
| *Activity in 2016* | | | | |
| Acquired (a) | — | — | 1,106 | 1,106 |
| Foreign currency and other | (20) | (13) | (25) | (58) |
| 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** |

(a) On February 1, 2016, we acquired Tideland and recorded $38 million of goodwill. On October 18, 2016, we acquired Visenti and recorded $6 million of goodwill. On October 31, 2016, we acquired Sensus and recorded $1,062 million of goodwill. Refer to Note 3, "Acquisitions and Divestitures" for additional information.

During the fourth quarter of 2017, we performed our annual impairment assessment and determined that the estimated fair values of our goodwill reporting units were in excess of each of their carrying values. However, future goodwill impairment tests could result in a charge to earnings. We will continue to evaluate goodwill on an annual basis as of the beginning of our fourth quarter and whenever events and changes in circumstances indicate there may be a potential impairment.

***Other Intangible Assets***

Information regarding our other intangible assets is as follows:

| (in millions) | December 31, 2017 | | | December 31, 2016 | | |
|---|---|---|---|---|---|---|
| | **Carrying Amount** | **Accumulated Amortization** | **Net Intangibles** | Carrying Amount | Accumulated Amortization | Net Intangibles |
| Customer and distributor relationships | **$ 906** | **$ (241)** | **$ 665** | $ 891 | $ (168) | $ 723 |
| Proprietary technology and patents | **163** | **(75)** | **88** | 156 | (61) | 95 |
| Trademarks | **138** | **(37)** | **101** | 139 | (23) | 116 |
| Software | **277** | **(130)** | **147** | 218 | (118) | 100 |
| Other | **26** | **(20)** | **6** | 26 | (13) | 13 |
| Indefinite-lived intangibles | **161** | **—** | **161** | 154 | — | 154 |
| Other intangibles | **$ 1,671** | **$ (503)** | **$ 1,168** | $ 1,584 | $ (383) | $ 1,201 |

We determined that no impairment of the indefinite-lived intangibles existed as of the measurement date of our annual impairment assessment in 2017 or 2016. Future impairment tests could result in a charge to earnings. We will continue to evaluate the indefinite-lived intangible assets on an annual basis as of the beginning of our fourth quarter and whenever events and changes in circumstances indicate there may be a potential impairment.

Customer and distributor relationships, proprietary technology and patents, trademarks, software and other are amortized over weighted average lives of approximately 14 years, 16 years, 12 years, 5 years and 5 years, respectively.

Total amortization expense for intangible assets was $125 million, $64 million, and $45 million for 2017, 2016 and 2015, respectively.

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

| (in millions) | |
|---|---|
| 2018 | $ 121 |
| 2019 | 116 |
| 2020 | 107 |
| 2021 | 91 |
| 2022 | 86 |

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

**Note 11. Derivative Financial Instruments**

***Risk Management Objective of Using Derivatives***

We are exposed to certain risks arising from both our business operations and economic conditions, and principally manage our exposures to these risks through management of our core business activities. Certain of our foreign operations expose us to fluctuations of interest rates and exchange rates that may impact revenue, expenses, cash receipts, cash payments, and the value of our stockholders' equity. We enter into derivative financial instruments to protect the value or fix the amount of certain cash flows in terms of the functional currency of the business unit with that exposure and reduce the volatility in stockholders' equity.

***Cash Flow Hedges of Foreign Exchange Risk***

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

Certain business units with exposure to foreign currency exchange risks have designated certain currency forward agreements as cash flow hedges of forecasted intercompany inventory purchases and sales. Our principal currency exposures relate to the Euro, Swedish Krona, British Pound, Canadian Dollar, Polish Zloty, and Australian Dollar. We had foreign exchange contracts with purchase notional amounts totaling $455 million as of December 31, 2017. As of December 31, 2017, our most significant foreign currency derivatives included contracts to purchase Swedish Krona and sell Euro, sell U.S. Dollar and purchase Euro, sell British Pound and purchase Euro, purchase Polish Zloty and sell Euro, purchase U.S. Dollar and sell Canadian Dollar and to sell Canadian Dollar and purchase Euro. The purchase notional amounts associated with these currency derivatives were $149 million, $147 million, $66 million, $34 million, $28 million and $25 million, respectively. As of December 31, 2016 we did not hold any foreign exchange contracts.

***Hedges of Net Investments in Foreign Operations***

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

*Cross Currency Swaps*

Beginning in 2015, we entered into cross currency swaps to manage our exposure to fluctuations in the Euro-U.S. Dollar exchange rate. The total notional amount of derivative instruments designated as net investment hedges was $446 million and $391 million as of December 31, 2017 and 2016, respectively.

*Foreign Currency Denominated Debt*

On March 11, 2016, we issued 2.250% Senior Notes of €500 million aggregate principal amount due March 2023. We designated the entirety of the outstanding balance, or $592 million and $517 million as of December 31, 2017 and 2016, respectively, net of unamortized discount, as a hedge of a net investment in certain foreign subsidiaries.

*Forward Contracts*

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

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

| | Year Ended December 31, | | |
|---|---|---|---|
| (in millions) | **2017** | 2016 | 2015 |
| **Derivatives in Cash Flow Hedges** | | | |
| **Foreign Exchange Contracts** | | | |
| Amount of (loss) gain recognized in OCI (a) | **$ 9** | $ — | $ (5) |
| Amount of (gain) loss reclassified from OCI into revenue (a) | **(6)** | (2) | 19 |
| Amount of loss reclassified from OCI into cost of revenue (a) | **1** | — | 1 |
| | | | |
| **Derivatives in Net Investment Hedges** | | | |
| **Cross Currency Swaps** | | | |
| Amount of (loss) gain recognized in OCI (a) | **$ (53)** | $ 19 | $ (17) |
| **Foreign Currency Denominated Debt** | | | |
| Amount of (loss) gain recognized in OCI (a) | **$ (74)** | $ 28 | $ — |
| **Forward Contracts** | | | |
| Amount of gain recognized in OCI (a) | **$ —** | $ 9 | $ — |

(a) Effective portion

As of December 31, 2017, $3 million of the net gains on cash flow hedges is expected to be reclassified into earnings in the next 12 months. The ineffective portion of the change in fair value of a cash flow hedge is excluded from effectiveness testing and is recognized immediately in selling, general and administrative expenses in the Consolidated Income Statements and was not material for 2017, 2016, and 2015.

As of December 31, 2017, no gains or losses on the net investment hedges are expected to be reclassified into earnings over the next 12 months. The net investment hedges did not experience any ineffectiveness for 2017.

The fair values of our derivative assets and liabilities are measured on a recurring basis using Level 2 inputs and are determined through the use of models that 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:

| | December 31, | |
|---|---|---|
| (in millions) | **2017** | 2016 |
| **Derivatives designated as hedging instruments** | | |
| **Assets** | | |
| *Cash Flow Hedges* | | |
| Other current assets | **$ 3** | $ — |
| **Liabilities** | | |
| *Cash Flow Hedges* | | |
| Other current liabilities | **(1)** | — |
| *Net Investment Hedges* | | |
| Other non-current liabilities | **(64)** | (6) |

The fair value of our long-term debt, due in 2023, designated as a net investment hedge was $638 million and $555 million as of December 31, 2017 and 2016, respectively.

**Note 12. Accrued and Other Current Liabilities**

| (in millions) | December 31, 2017 | 2016 |
|---|---|---|
| Compensation and other employee-benefits | **$ 203** | $ 182 |
| Customer-related liabilities | **119** | 80 |
| Accrued warranty costs | **55** | 64 |
| Accrued taxes | **75** | 63 |
| Other accrued liabilities | **99** | 132 |
| Total accrued and other current liabilities | **$ 551** | $ 521 |

**Note 13. Credit Facilities and Long-Term Debt**

Total debt outstanding is summarized as follows:

| (in millions) | December 31, 2017 | 2016 |
|---|---|---|
| 4.875% Senior Notes due 2021 (a) | **600** | 600 |
| 2.250% Senior Notes due 2023 (a) | **597** | 522 |
| 3.250% Senior Notes due 2026 (a) | **500** | 500 |
| 4.375% Senior Notes due 2046 (a) | **400** | 400 |
| Commercial paper | **—** | 65 |
| Research and development facility agreement | **—** | 38 |
| Research and development finance contract | **125** | 110 |
| Term loan | **—** | 157 |
| Debt issuance costs and unamortized discount (b) | **(22)** | (24) |
| Total debt | **2,200** | 2,368 |
| Less: short-term borrowings and current maturities of long-term debt | **—** | 260 |
| Total long-term debt | **$ 2,200** | $ 2,108 |

(a) The fair value of our Senior Notes (as defined below) was determined using quoted prices in active markets for identical securities, which are considered Level 1 inputs. The fair value of our Senior Notes due 2021 (as defined below) was $648 million and $651 million as of December 31, 2017 and 2016, respectively. The fair value of our Senior Notes due 2023 (as defined below) was $638 million and $555 million as of December 31, 2017 and 2016, respectively. The fair value of our Senior Notes due 2026 (as defined below) was $498 million and $487 million as of December 31, 2017 and 2016, respectively. The fair value of our Senior Notes due 2046 (as defined below) was $431 million and $397 million as of December 31, 2017 and 2016, respectively.

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

***Senior Notes***

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

The Senior Notes include covenants that restrict our ability, subject to exceptions, to incur debt secured by liens and engage in sale and leaseback transactions, as well as provide for customary events of default (subject, in certain cases, to receipt of notice of default and/or customary grace and cure periods). We may redeem the Senior Notes, as applicable, in whole or in part, at any time at a redemption price 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 other circumstances, as set forth in the applicable Senior Notes indenture.

If a change of control triggering event (as defined in the applicable Senior Notes indenture) occurs, we will be required to make an offer to purchase the Senior Notes at a price equal to 101% of their principal amount plus accrued and unpaid interest to the date of repurchase.

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

We used the net proceeds of the Senior Notes due 2026 and the Senior Notes due 2046, together with cash on hand, proceeds from issuances under our existing commercial paper program and borrowings under the Term Facility (as described below), to fund the acquisition of Sensus (refer to Note 3 for further information on the Sensus acquisition).

***Credit Facilities***

*Five-Year Revolving Credit Facility*

Effective March 27, 2015, Xylem entered into a Five-Year Revolving Credit Facility (the "Credit Facility") with Citibank, N.A., as administrative agent, and a syndicate of lenders. The Credit Facility provides for an aggregate principal amount of up to $600 million of: (i) revolving extensions of credit (the "revolving loans") outstanding at any time and (ii) the issuance of letters of credit in a face amount not in excess of $100 million outstanding at any time. The Credit Facility provides for increases of 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 providing such increased commitments.

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

In accordance with the terms of an amendment to the Credit Facility dated August 30, 2016, we may not exceed a maximum leverage ratio of 4.00 to 1.00 (based on a ratio of total debt to earnings before interest, taxes, depreciation and amortization) for a period of 12-months following the Sensus acquisition and a maximum leverage ratio of 3.50 to 1.00 through the rest of the term. The Credit Facility also contains limitations on, among other things, incurring secured debt, granting liens, entering into sale and leaseback transactions, mergers, consolidations, liquidations, dissolutions and sales of assets. In addition, the Credit Facility contains other terms and conditions such as customary representations and warranties, additional covenants and customary events of default. As of December 31, 2017 the Credit Facility was undrawn and we are in compliance with all covenants.

*European Investment Bank - R&D Finance Contract*

On October 28, 2016, the Company entered into a Finance Contract (the “Finance Contract”) with the European Investment Bank (the “EIB”). The Company's wholly 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 Xylem Inc. is the Guarantor. The Finance Contract provides for up to €105 million (approximately $125 million) to finance research, development and innovation projects in the field of sustainable water and wastewater solutions during the period from 2017 through 2019 in Sweden, Germany, Italy, UK, Hungary and Austria. The Company has unconditionally guaranteed the performance of the borrowers under the Finance Contract. Under the Finance Contract, the borrowers are able to draw loans on or before April 28, 2018, with a maturity of no longer than 11 years.

Both the Finance Contract and the R&D Facility Agreement (described below) are subject to the same leverage ratio as the Credit Facility. Both agreements also contain limitations on, among other things, incurring debt, granting liens, and entering into sale and leaseback transactions, as well as other terms and conditions, such as customary representations and warranties, additional covenants and customary events of default.

Both the Finance Contract and the R&D Facility Agreement provide for fixed rate loans and floating rate loans. Under the Finance Contract, the interest rate per annum applicable to fixed rate loans is at a fixed percentage rate per annum specified by the EIB which includes the applicable margin. The interest rate per annum applicable to floating rate loans is at the rate determined by reference to EURIBOR for loans drawn in Euros and LIBOR for loans drawn in Pounds Sterling or U.S. Dollars, plus an applicable spread specified by the EIB which includes the applicable margin. The applicable margin is 59 basis points (0.59%). As of December 31, 2017 and December 31, 2016, $125 million and $110 million were outstanding under the Finance Contract, respectively.

*European Investment Bank - R&D Facility Agreement*

On December 3, 2015, the Company amended and restated its Risk Sharing Finance Facility Agreement (the "R&D Facility Agreement") with the EIB to amend the maturity date. The Facility provides an aggregate principal amount of up to €120 million (approximately $143 million) to finance research projects and infrastructure development in the European Union. The Company's wholly owned subsidiaries in Luxembourg, Xylem Holdings S.á r.l. and Xylem International S.á r.l., are the borrowers under the R&D Facility Agreement. The obligations of the borrowers under the R&D Facility Agreement are guaranteed by the Company under an Amended and Restated Deed of Guarantee, dated as of December 4, 2013, in favor of the EIB.

Under the R&D Facility Agreement, the borrower was able to draw loans on or before March 31, 2016 with a maturity of no longer than 12 years. As of December 31, 2017 and December 31, 2016 $0 million and $38 million were outstanding, respectively, under the R&D Facility Agreement. On December 15, 2017, the R&D Facility Agreement was settled for $44 million.

***Term Loan Facility***

On October 24, 2016, the Company's subsidiary, Xylem Europe GmbH (the "borrower") entered into a 12-month €150 million term loan facility (the "Term Facility") the terms of which are set forth in a term loan agreement, among the borrower, the Company, as parent guarantor and ING Bank. The Company has entered into a parent guarantee in favor of ING Bank also dated October 24, 2016 to secure all present and future obligations of the borrower under the Term Loan Agreement. The Term Facility was used to partially fund the acquisition of Sensus. As of December 31, 2016, $157 million was outstanding under the Term Loan Facility. The Term Facility matured on October 26, 2017.

***Commercial Paper***

Our commercial paper program generally serves as a means of short-term funding and has a combined outstanding limit of $600 million inclusive of the Five-Year Revolving Credit Facility. As of December 31, 2017, none of the Company's $600 million commercial paper program was outstanding. As of December 31, 2016, $65 million of the Company's $600 million commercial paper program was outstanding at a weighted average interest rate of 1.12%. We will periodically borrow under this program and may borrow under it in future periods.

**Note 14. Postretirement Benefit Plans**

**Defined contribution plans** – Xylem and certain of our subsidiaries maintain various defined contribution savings plans, which allow employees to contribute a 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 employee contributions up to certain limits, generally between 3.0% – 7.0% of employee eligible pay. Xylem's U.S. plan also provides for transition credits for eligible U.S. employees for the first five years after the Spin-off to supplement retirement benefits in the absence of a defined benefit plan. Age plus years of eligible service greater than or equal to 60, entitles an employee to transition credits. The liability for transition credits was approximately $0 million and $1 million at December 31, 2017 and 2016, respectively. Matching obligations, the majority of which were funded in cash in connection with the plans, along with transition credits and other company contributions are as follows:

| (in millions) | Defined Contribution |
|---|---|
| 2017 | **38** |
| 2016 | 35 |
| 2015 | 32 |

The Xylem Stock Fund, an investment option under the defined contribution plan in which Company employees participate is considered an Employee Stock Ownership Plan. As a result, participants in the Xylem Stock Fund may receive dividends in cash or may reinvest such dividends into the Xylem Stock Fund. Company employees held approximately 344 thousand and 391 thousand shares of Xylem Inc. common stock in the Xylem Stock Fund at December 31, 2017 and 2016, respectively.

**Defined benefit pension plans and other postretirement plans** – We historically have maintained qualified and nonqualified defined benefit retirement plans covering certain current and former employees, including hourly and union plans as well as salaried plans, which generally require up to 5 years of service to be 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 2017 and 2016, we made several amendments to plans that had no material impact to the Company's financial statements.

In connection with the Sensus acquisition, the Company acquired one U.S. and three German defined benefit pension plans. The four plans added $96 million in projected benefit obligation and $9 million in assets on October 31, 2016.

Effective December 30, 2016, the Company merged its six U.S. pension plans into one plan to simplify administration and reduce costs. There was no impact to the participants' benefits and no impact to the Company's financial statements.

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

| (in millions) | **December 31, 2017** | | | December 31, 2016 | | |
|---|---|---|---|---|---|---|
| | **Pension** | **Other** | **Total** | Pension | Other | Total |
| Fair value of plan assets | **$ 628** | **$ —** | **$ 628** | $ 562 | $ — | $ 562 |
| Projected benefit obligation | **(950)** | **(55)** | **(1,005)** | (854) | (64) | (918) |
| Funded status | **$ (322)** | **$ (55)** | **$ (377)** | $ (292) | $ (64) | $ (356) |
| **Amounts recognized in the balance sheet** | | | | | | |
| Other non-current assets | **$ 81** | **$ —** | **$ 81** | $ 67 | $ — | $ 67 |
| Accrued and other current liabilities | **(13)** | **(3)** | **(16)** | (11) | (4) | (15) |
| Accrued postretirement benefits | **(390)** | **(52)** | **(442)** | (348) | (60) | (408) |
| Net amount recognized | **$ (322)** | **$ (55)** | **$ (377)** | $ (292) | $ (64) | $ (356) |
| Accumulated other comprehensive income (loss): | | | | | | |
| Net actuarial losses | **$ (251)** | **$ (24)** | **$ (275)** | $ (220) | $ (32) | $ (252) |
| Prior service credit | **(1)** | **12** | **11** | 1 | 12 | 13 |
| Total | **$ (252)** | **$ (12)** | **$ (264)** | $ (219) | $ (20) | $ (239) |

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

The net actuarial loss included in accumulated other comprehensive income at the end of 2017 and expected to be recognized in net periodic benefit cost during 2018 is $14 million ($11 million, net of tax). The prior service credit included in accumulated other comprehensive income to be recognized in 2018 is $4 million ($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 Plans | |
|---|---|---|---|---|
| | December 31, | | December 31, | |
| (in millions) | **2017** | 2016 | **2017** | 2016 |
| **Change in benefit obligation:** | | | | |
| Benefit obligation at beginning of year | **$ 100** | $ 86 | **$ 754** | $ 693 |
| Service cost | **3** | 3 | **12** | 10 |
| Interest cost | **4** | 4 | **21** | 21 |
| Benefits paid | **(5)** | (4) | **(30)** | (26) |
| Actuarial loss (gain) | **5** | (2) | **10** | 52 |
| Plan amendments, settlements and curtailments | **1** | (1) | **(2)** | (1) |
| Acquisitions | **—** | 13 | **—** | 83 |
| Foreign currency translation/Other | **(1)** | 1 | **78** | (78) |
| Benefit obligation at end of year | **$ 107** | $ 100 | **$ 843** | $ 754 |
| **Change in plan assets:** | | | | |
| Fair value of plan assets at beginning of year | **$ 69** | 57 | **$ 493** | $ 502 |
| Employer contributions | **10** | 4 | **20** | 20 |
| Actual return on plan assets | **10** | 4 | **21** | 64 |
| Benefits paid | **(5)** | (4) | **(30)** | (26) |
| Plan amendments, settlements and curtailments | **—** | — | **(3)** | — |
| Acquisitions | **—** | 9 | **—** | — |
| Foreign currency translation/Other | **—** | (1) | **43** | (67) |
| Fair value of plan assets at end of year | **$ 84** | $ 69 | **$ 544** | $ 493 |
| **Unfunded status of the plans** | **$ (23)** | $ (31) | **$ (299)** | $ (261) |

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

| (in millions) | **2017** | 2016 |
|---|---|---|
| **Change in benefit obligation:** | | |
| Benefit obligation at beginning of year | **$ 64** | $ 61 |
| Service cost | **1** | 1 |
| Interest cost | **2** | 3 |
| Benefits paid | **(3)** | (4) |
| Actuarial gain/(loss) | **(5)** | 3 |
| Plan Amendment and other | **(4)** | — |
| Benefit obligation at the end of year | **$ 55** | $ 64 |

The accumulated benefit obligation (“ABO”) for all the defined benefit pension plans was $916 million and $827 million at December 31, 2017 and 2016, respectively.

For defined benefit pension plans in which the ABO was in excess of the fair value of the plans’ assets, the projected benefit obligation, ABO and fair value of the plans’ assets were as follows:

| | December 31, | |
|---|---|---|
| (in millions) | **2017** | 2016 |
| Projected benefit obligation | **$ 528** | $ 474 |
| Accumulated benefit obligation | **499** | 453 |
| Fair value of plan assets | **126** | 116 |

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

| | Year Ended December 31, | | |
|---|---|---|---|
| (in millions) | **2017** | 2016 | 2015 |
| **Domestic defined benefit pension plans:** | | | |
| Service cost | **$ 3** | $ 3 | $ 3 |
| Interest cost | **4** | 4 | 4 |
| Expected return on plan assets | **(6)** | (5) | (5) |
| Amortization of net actuarial loss | **2** | 2 | 2 |
| Net periodic benefit cost | **$ 3** | $ 4 | $ 4 |
| **International defined benefit pension plans:** | | | |
| Service cost | **$ 12** | $ 10 | $ 12 |
| Interest cost | **21** | 21 | 22 |
| Expected return on plan assets | **(34)** | (30) | (32) |
| Amortization of net actuarial loss | **9** | 8 | 13 |
| Settlement | **1** | — | — |
| Net periodic benefit cost | **$ 9** | $ 9 | $ 15 |
| **Total net periodic benefit cost** | **$ 12** | $ 13 | $ 19 |

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

| | Year Ended December 31, | | |
|---|---|---|---|
| (in millions) | **2017** | 2016 | 2015 |
| **Domestic defined benefit pension plans:** | | | |
| Net (gain) loss | **$ 1** | $ (1) | $ 2 |
| Prior service cost | **1** | — | — |
| Amortization of net actuarial loss | **(2)** | (2) | (2) |
| (Gains) losses recognized in other comprehensive loss | **$ —** | $ (3) | $ — |
| **International defined benefit pension plans:** | | | |
| Net (gain) loss | **$ 23** | $ 18 | $ (29) |
| Prior service credit | **1** | (1) | — |
| Amortization of net actuarial loss | **(9)** | (8) | (13) |
| Settlement | **(1)** | — | — |
| Foreign Exchange | **19** | (20) | (21) |
| (Gains) losses recognized in other comprehensive loss | **$ 33** | $ (11) | $ (63) |
| **Total (gains) losses recognized in other comprehensive loss** | **$ 33** | $ (14) | $ (63) |
| **Total (gains) losses recognized in comprehensive income** | **$ 45** | $ (1) | $ (44) |

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

| | Year Ended December 31, | | |
|---|---|---|---|
| (in millions) | **2017** | 2016 | 2015 |
| Service cost | **$ 1** | $ 1 | $ 1 |
| Interest cost | **2** | 3 | 2 |
| Amortization of prior service credit | **(3)** | (3) | (3) |
| Amortization of net actuarial loss | **2** | 3 | 3 |
| Net periodic benefit cost | **$ 2** | $ 4 | $ 3 |

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

| | Year Ended December 31, | | |
|---|---|---|---|
| (in millions) | **2017** | 2016 | 2015 |
| Net loss (gain) | **$ (5)** | $ 3 | $ 4 |
| Prior service credit | **(3)** | — | (1) |
| Amortization of prior service credit | **3** | 3 | 3 |
| Amortization of net actuarial loss | **(2)** | (3) | (3) |
| Foreign Exchange/Other | **(1)** | 1 | — |
| Losses (gains) recognized in other comprehensive loss | **$ (8)** | $ 4 | $ 3 |
| **Total losses (gains) recognized in comprehensive income** | **$ (6)** | $ 8 | $ 6 |

***Assumptions***

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

| | **2017** | | 2016 | | 2015 | |
|---|---|---|---|---|---|---|
| | U.S. | Int'l | U.S. | Int'l | U.S. | Int'l |
| Benefit Obligation Assumptions | | | | | | |
| Discount rate | **3.75%** | **2.43%** | 4.25% | 2.63% | 4.27% | 3.44% |
| Rate of future compensation increase | **NM** | **2.93%** | NM | 2.76% | NM | 3.29% |
| Net Periodic Benefit Cost Assumptions | | | | | | |
| Discount rate | **4.25%** | **2.63%** | 4.27% | 3.44% | 4.01% | 3.14% |
| Expected long-term return on plan assets | **8.00%** | **7.20%** | 8.00% | 7.25% | 8.00% | 7.31% |
| Rate of future compensation increase | **NM** | **2.76%** | NM | 3.29% | NM | 3.34% |

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

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

The expected long-term rate of return on assets reflects the expected returns for each major asset class in which the plans hold investments, the weight of each asset class in the target mix, the correlations among asset classes and their expected volatilities. The assets of the pension plans are held by a number of 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 historical returns and estimates of future returns. Specifically, we analyze the plans' actual historical annual return on assets, net of fees, over the past 15, 20 and 25 years; estimate future returns based on independent estimates of asset class returns; and evaluate historical broad market returns over long-term timeframes based on our asset allocation range. For the U.S. Master Trust which has only existed since 2011, historical returns were estimated using a constructed portfolio that reflects the Company's strategic asset allocation and the historical compound geometric returns of each asset class for the longest time period available. Based on this approach, the weighted average expected long-term rate of return for all of our plan assets to be used in determining net periodic benefit costs for 2018 is estimated at 7.30%.

The table below provides the weighted average actual rate of return generated on all of our plan assets during each of the years presented as compared to the weighted average expected long-term rates of return utilize d in calculating the net periodic benefit costs.

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Expected long-term rate of return on plan assets | **7.30%** | 7.32% | 7.38% |
| Actual rate of return on plan assets | **5.70%** | 12.20% | 3.51% |

The assumed rate of future increases in the per capita cost of health care (the health care trend rate) is 8.72% for 2018, decreasing ratably to 4.50% in 2026. An increase or decrease in the health care trend rates by one percent per year would impact the aggregate annual service and interest components by less than $1 million, and impact the benefit obligation by approximately $4 million.

***Investment Policy***

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

On April 3, 2017 the liquid assets in two UK Plans transitioned into a new fund structure. The restructuring involved transferring a portion of the assets into pooled diversified growth funds, while some investments were sold off and some were kept in place. The pooled funds make up 64% of the assets of the two UK Plans. Liability hedging and illiquid assets remain outside of this arrangement.

The following table provides the actual asset allocations of plan assets as of December 31, 2017 and 2016, and the related asset target allocation ranges by asset category.

| | 2017 | 2016 | Target Allocation Ranges |
|---|---|---|---|
| Equity securities | **35.6%** | 24.2% | 20-50% |
| Fixed income | **23.4%** | 32.7% | 10-40% |
| Hedge funds | **17.0%** | 31.7% | 0-40% |
| Private equity | **1.6%** | 2.4% | 0-30% |
| Insurance contracts and other | **22.4%** | 9.0% | 0-30% |

***Fair Value of Plan Assets***

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

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

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

- Equity securities — Equities (including common and preferred shares, domestic listed and foreign listed, closed end mutual funds and exchange traded funds) are generally valued at the closing price reported on the major market on which the individual securities are traded at the measurement date. Equity securities held by the Company that are publicly traded in active markets are classified within Level 1 of the fair value hierarchy. Those equities that are held in proprietary funds pooled with other investor accounts measured at fair value using the NAV per share practical expedient are not classified in the fair value hierarchy.
- Fixed income — United States government securities are generally valued using quoted prices of securities with similar characteristics. Corporate bonds and notes are generally valued by using pricing models (e.g. discounted cash flows), quoted prices of securities with similar characteristics or broker quotes. Fixed income securities listed on active markets are classified in Level 1. Fixed income held in proprietary funds pooled with other investor accounts measured at fair value using the NAV per share practical expedient are not classified in

the fair value hierarchy. Hedging Instruments are collateralized daily with either cash or government bonds, have daily liquidity and pricing based on observable inputs from over-the-counter markets, and are classified as Level 2.

- Hedge funds — Hedge funds are pooled funds that employ a range of investment strategies including equity and fixed income, credit driven, macro and multi oriented strategies. The valuation of limited partnership interests in hedge funds may require significant management judgment. Generally, hedge funds are valued 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, the timeliness of NAV as reported by the asset manager and changes in general economic and market conditions subsequent to the last NAV reported by the asset manager. All of the hedge funds held have lockups and/or gates. Hedge funds have unfunded commitments of $5 million and $5 million at December 31, 2017 and 2016, respectively.

- Private equity — Private equity includes a diversified range of strategies, including buyout funds, distressed funds, venture and growth equity funds and mezzanine funds with long-term commitments, and redemptions beginning no earlier than 2018. The valuation of limited partnership interests in private equity funds may require significant management judgment. Generally, private equity is valued using the NAV reported by the asset manager, and is 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, the timeliness of NAV as reported by the asset manager and changes in general economic and market conditions subsequent to the last NAV reported by the asset manager. Private equity is not liquid and has unfunded commitments of $4 million and $7 million at December 31, 2017 and 2016, respectively.

- Insurance contracts and other — Primarily comprised of insurance contracts and cash. Insurance contracts are valued at contract value, which approximates fair value, and is calculated using the prior year balance adjusted for investment returns and cash flows and are generally classified as Level 3. Insurance contracts are held by certain foreign pension plans. Cash and cash equivalents are held in accounts with brokers or custodians for liquidity and investment collateral and are classified as Level 1.

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

| | 2017 | | | | | 2016 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| (in millions) | **Level 1** | **Level 2** | **Level 3** | **NAV Practical Expedient** | **Total** | Level 1 | Level 2 | Level 3 | NAV Practical Expedient | Total |
| Equity securities | | | | | | | | | | |
| Global stock funds/securities | **$ 101** | **$ —** | **$ —** | **$ 29** | **$ 130** | $ 87 | $ — | $ — | $ 6 | $ 93 |
| Index funds | **—** | **—** | **—** | **3** | **3** | 4 | — | — | 36 | 40 |
| Emerging market funds | **—** | **—** | **—** | **—** | **—** | 4 | — | — | — | 4 |
| Diversified Growth and Income Funds | **—** | **—** | **—** | **92** | **92** | **—** | **—** | **—** | **—** | **—** |
| Fixed income | | | | | | | | | | |
| Corporate bonds | **24** | **—** | **—** | **8** | **32** | 22 | — | — | 18 | 40 |
| Government bonds | **48** | **—** | **—** | **5** | **53** | 88 | — | — | 11 | 99 |
| Hedging Instruments | **5** | **36** | **—** | **—** | **41** | — | 45 | — | — | 45 |
| Diversified Growth and Income Funds | **—** | **—** | **—** | **20** | **20** | **—** | **—** | **—** | **—** | **—** |
| Hedge funds | **—** | **—** | **—** | **107** | **107** | — | — | — | 178 | 178 |
| Private equity | **—** | **—** | **—** | **10** | **10** | — | — | — | 13 | 13 |
| Insurance contracts and other | **90** | **—** | **17** | **33** | **140** | 26 | — | 24 | — | 50 |
| Total plan assets subject to leveling | **$ 268** | **$ 36** | **$ 17** | **$ 307** | **$ 628** | $ 231 | $ 45 | $ 24 | $ 262 | $ 562 |

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

| (in millions) | **Insurance Contracts and Other** |
|---|---|
| Balance, December 31, 2015 | $ 25 |
| Purchases, sales, settlements | 1 |
| Currency impact | (2) |
| Balance, December 31, 2016 | $ 24 |
| **Purchases, sales, settlements** | **(8)** |
| **Currency impact** | **1** |
| **Balance, December 31, 2017** | **$ 17** |

***Contributions and Estimated Future Benefit Payments***

Funding requirements under governmental regulations are a major consideration in making contributions to our postretirement plans. We made contributions of $33 million and $27 million to our pension and postretirement defined benefit plans during 2017 and 2016, respectively. A discretionary $6 million contribution was made to the U.S. Plan in Q3 2017 to increase the funding ratio and reduce regulatory fees. We currently anticipate making contributions to our pension and postretirement defined benefit plans in the range of $20 million to $30 million during 2018, of which approximately $6 million is expected to be made in the first quarter.

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

| (in millions) | Pension | Other Benefits |
|---|---|---|
| 2018 | $ 36 | $ 3 |
| 2019 | 36 | 3 |
| 2020 | 38 | 4 |
| 2021 | 38 | 4 |
| 2022 | 39 | 4 |
| Years 2023 - 2027 | 212 | 19 |

**Note 15. Stock-Based Compensation Plans**

Our stock-based compensation program is a broad-based program designed to attract and retain employees while also aligning employees' interests with the interests of our shareholders. In addition, members of our Board of Directors participate in our stock-based compensation program in connection with their service on our board. Share-based awards issued to employees include non-qualified stock options, restricted stock unit awards and performance share unit awards. Under the 2011 Omnibus Incentive Plan, the number of shares initially available for awards was 18 million. As of December 31, 2017, there were approximately 7 million shares of common stock available for future grants.

Total share-based compensation costs recognized for 2017, 2016 and 2015 were $21 million, $18 million, and $15 million, respectively. The unamortized compensation expense at December 31, 2017 related to our stock options, restricted share units and performance share units was $6 million, $17 million and $13 million, respectively, and is expected to be recognized over a weighted average period of 1.8, 1.8 and 1.8 years, respectively.

The amount of cash received from the exercise of stock options was $16 million for 2017 with a tax benefit of $10 million realized associated with stock option exercises and vesting of restricted stock units. We classify as an operating activity 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 over a three-year period and are exercisable within the contractual term, except in certain instances of death, retirement or disability. The exercise price per share is the fair market value of the underlying common stock on the date each option is granted. At December 31, 2017, there were options to purchase an aggregate of 2.1 million shares of common stock. The following is a summary of the changes in outstanding stock options for 2017:

| | **Share units** (in thousands) | **Weighted Average Exercise Price / Share** | **Weighted Average Remaining Contractual Term (Years)** | **Aggregate Intrinsic Value** (in millions) |
|---|---|---|---|---|
| Outstanding at January 1, 2017 | 2,126 | $ 33.71 | 6.9 | |
| Granted | 501 | $ 48.43 | | |
| Exercised | (494) | $ 31.95 | | |
| Forfeited and expired | (57) | $ 42.60 | | |
| **Outstanding at December 31, 2017** | **2,076** | **$ 37.44** | **7.0** | **$ 64** |
| **Options exercisable at December 31, 2017** | **1,147** | **$ 33.07** | **5.8** | **$ 40** |
| **Vested and non-vested expected to vest as of December 31, 2017** | **1,997** | **$ 36.52** | **6.8** | **$ 62** |

The amount of non-vested options outstanding was 0.9 million, 1.0 million and 1.0 million at a weighted average grant date fair value of $42.84, $37.10 and $35.65 as of December 31, 2017, 2016 and 2015, respectively. The total intrinsic value of options exercised (which is the amount by which the stock price exceeded the exercise price of the options on the date of exercise) during 2017, 2016 and 2015 was $14 million, $12 million and $9 million, respectively.

The fair value of each option grant was estimated on the date of grant using the binomial lattice pricing model which incorporates multiple and variable assumptions over time, including assumptions such as employee exercise patterns, stock price volatility and changes in dividends. The following are weighted-average assumptions used for 2017, 2016, and 2015:

| | **2017** | 2016 | 2015 |
|---|---|---|---|
| Dividend yield | **1.49%** | 1.63% | 1.57% |
| Volatility | **25.39%** | 28.87% | 27.77% |
| Risk-free interest rate | **2.07%** | 1.41% | 1.64% |
| Expected term (in years) | **5.10** | 5.60 | 5.58 |
| Weighted-average fair value per share | **$ 10.66** | $ 9.05 | $ 8.49 |

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 behavior within the valuation model. Employee groups and option characteristics are considered separately for valuation purposes. The expected term represents an estimate of the period of time options are expected to remain outstanding. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of option grant.

*Restricted Stock Unit Grants*

Restricted shares granted to employees in 2017 vest over a three-year period. Restricted shares granted to employees prior to 2017 generally become fully vested upon the third anniversary of the date of grant. Prior to the time a restricted share becomes fully vested, the awardees cannot transfer, pledge, hypothecate or encumber such shares. Prior to the time a restricted share is fully vested, the awardees do not have certain rights of a stockholder, such as the right to vote and receive dividends; however, dividends accrue during the vesting period and are paid upon vesting. If an employee leaves prior to vesting, whether through resignation or termination for cause, the restricted stock unit and related accrued dividends are forfeited. If an employee retires, a pro rata portion of the restricted stock unit may vest in accordance with the terms of the grant agreements. Restricted stock units granted to Board members become fully vested upon the day prior to the next annual meeting. Our restricted stock units activity was as follows for 2017:

| | **Share Units** (in thousands) | **Weighted Average Grant Date Fair Value / Share** |
|---|---|---|
| Outstanding at January 1, 2017 | 899 | $ 37.67 |
| Granted | 344 | 49.72 |
| Vested | (396) | 38.16 |
| Forfeited | (68) | 41.00 |
| **Outstanding at December 31, 2017** | **779** | **35.39** |

*Performance Share Units*

Performance share units granted under the long-term incentive plan vest based upon performance by the Company over a three-year period against targets approved by the compensation committee of the Company's Board of Directors prior to the grant date. For the performance periods, the performance share units 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 and cumulative adjusted net income performance target for ROIC performance share units and a relative TSR performance for TSR performance share units. The calculated compensation cost for ROIC performance share units is adjusted based on an estimate of awards ultimately expected to vest and our assessment of the probable outcome of the performance condition.

*ROIC Performance Share Unit Grants*

The fair value of the ROIC performance share unit awards at 100% target is determined using the closing price of our common stock on date of grant.

Our ROIC performance share unit activity was as follows for 2017:

| | **Share units** (in thousands) | **Weighted Average Grant Date Fair Value / Share** |
|---|---|---|
| Outstanding at January 1, 2017 | 250 | $ 37.11 |
| Granted | 117 | 49.15 |
| Forfeited | (69) | 38.62 |
| **Outstanding at December 31, 2017** | **298** | **41.48** |

*TSR Performance Share Unit Grants*

The following is a summary of our TSR performance share unit grants for 2017.

| | **Share units** (in thousands) | **Weighted Average Grant Date Fair Value /Share** |
|---|---|---|
| Outstanding at January 1, 2017 | 108 | $ 46.15 |
| Granted | 117 | 47.79 |
| Forfeited | (12) | 44.19 |
| **Outstanding at December 31, 2017** | **213** | **47.04** |

The fair value of TSR performance share units was calculated on the date of grant using a Monte Carlo simulation model utilizing several key assumptions, including expected Company and peer company share price volatility, correlation coefficients between peers, the risk-free rate of return, the expected dividend yield and other award design features. The following are weighted-average assumptions for 2017 grants.

| | |
|---|---|
| Volatility | **30.24 %** |
| Risk-free interest rate | **1.50 %** |

**Note 16. Capital Stock**

The Company has the authority to issue an aggregate of 750 million shares of common stock having a par value of $0.01 per share. The stockholders of Xylem common stock are entitled to receive dividends as declared by the Xylem Board of Directors. Dividends declared were $0.7200, $0.6196 and $0.5632 during 2017, 2016 and 2015, respectively.

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

| (in thousands of shares) | **2017** | 2016 | 2015 |
|---|---|---|---|
| Beginning Balance, January 1 | **179,367** | 178,377 | 182,300 |
| Stock incentive plan net activity | **985** | 1,085 | 1,280 |
| Repurchase of common stock | **(490)** | (95) | (5,203) |
| **Ending Balance, December 31** | **179,862** | 179,367 | 178,377 |

For the year ended December 31, 2017 the Company repurchased 0.5 million shares for $25 million of common stock. Repurchases include both share repurchase programs approved by the Board of Directors and repurchases in relation to settlement of employee withholding obligations due as a result of the vesting of restricted stock units. The detail of repurchases by each program are as follows:

On August 24, 2015, our Board of Directors authorized the repurchase of up to $500 million in shares with no expiration date. The program's objective is to deploy our capital in a manner that benefits our shareholders and maintains our focus on growth. For the year ended December 31, 2017 we repurchased 0.1 million shares for $7 million. There were no shares repurchased under this program during 2016. There are up to $413 million in shares that may still be purchased under this plan as of December 31, 2017.

On August 20, 2013, our Board of Directors authorized the repurchase of up to $250 million in shares with no expiration date. The program's objective was to deploy our capital in a manner that benefited our shareholders and maintain our focus on growth. As of December 31, 2015, we exhausted the authorized amount to repurchase shares under this plan.

On August 18, 2012, the Board of Directors authorized the repurchase of up to 2.0 million shares of common stock with no expiration date. The program's objective is to offset dilution associated with various Xylem employee stock plans by acquiring shares in the open market from time to time. For the year ended December 31, 2017 we repurchased 0.3 million shares for $13 million. There were no shares repurchased under this program during 2016. As of June 2017, we have exhausted the authorized amount to repurchase shares under this plan.

Aside from the aforementioned repurchase programs, we repurchased 0.1 million and 0.1 million shares for $5 million and $4 million during 2017 and 2016, respectively, in relation to settlement of employee 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 table.

**Note 17. Accumulated Other Comprehensive Loss**

The following table provides the components of accumulated other comprehensive loss for 2017, 2016 and 2015:

| (in millions) | Foreign Currency Translation | Postretirement Benefit Plans | Derivative Instruments | Total |
|---|---|---|---|---|
| Balance at January 1, 2015 | $ 145 | $ (231) | $ (13) | $ (99) |
| Foreign currency translation adjustment | (180) | | | (180) |
| Foreign currency gain reclassified into gain on sale of business | (8) | | | (8) |
| Changes in postretirement benefit plans | | 24 | | 24 |
| Income tax expense on changes in postretirement benefit plans | | (10) | | (10) |
| Foreign currency translation adjustment for postretirement benefit plans | | 21 | | 21 |
| Amortization of prior service cost and net actuarial loss on postretirement benefit plans into: | | | | |
| Cost of revenue | | 4 | | 4 |
| Selling, general and administrative expenses | | 9 | | 9 |
| Research and development expenses | | 1 | | 1 |
| Other non-operating income, net | | 1 | | 1 |
| Income tax impact on amortization of postretirement benefit plan items | | (4) | | (4) |
| Unrealized loss on derivative hedge agreements | | | (22) | (22) |
| Income tax benefit on unrealized loss on derivative hedge agreements | | | 6 | 6 |
| Reclassification of unrealized loss on derivative hedge agreements into revenue | | | 19 | 19 |
| Reclassification of unrealized loss on derivative hedge agreements into cost of revenue | | | 1 | 1 |
| Income tax benefit on reclassification of unrealized loss on derivative hedge agreements | | | (1) | (1) |
| Balance at December 31, 2015 | $ (43) | $ (185) | $ (10) | $ (238) |
| Foreign currency translation adjustment | (65) | | | (65) |
| Income tax impact on foreign currency translation adjustment | (21) | | | (21) |
| Changes in postretirement benefit plans | | (19) | | (19) |
| Income tax expense on changes in postretirement benefit plans | | 3 | | 3 |
| Foreign currency translation adjustment for postretirement benefit plans | | 19 | | 19 |
| Amortization of prior service cost and net actuarial loss on postretirement benefit plans into: | | | | |
| Cost of revenue | | 3 | | 3 |
| Selling, general and administrative expenses | | 6 | | 6 |
| Other non-operating income, net | | 1 | | 1 |
| Income tax impact on amortization of postretirement benefit plan items | | (5) | | (5) |
| Reclassification of unrealized gain on derivative hedge agreements into revenue | | | (2) | (2) |

| (in millions) | Foreign Currency Translation | Postretirement Benefit Plans | Derivative Instruments | Total |
|---|---|---|---|---|
| Reclassification of unrealized loss on net investment hedge, net of tax | (11) | | 11 | — |
| Balance at December 31, 2016 | $ (140) | $ (177) | $ (1) | $ (318) |
| Foreign currency translation adjustment | **79** | | | **79** |
| Income tax impact on foreign currency translation adjustment | **46** | | | **46** |
| Changes in postretirement benefit plans | | **(18)** | | **(18)** |
| Foreign currency translation adjustment for postretirement benefit plans | | **(18)** | | **(18)** |
| Income tax expense on changes in postretirement benefit plans | | **7** | | **7** |
| Amortization of prior service cost and net actuarial loss on postretirement benefit plans into: | | | | |
| Cost of revenue | | **2** | | **2** |
| Selling, general and administrative expenses | | **7** | | **7** |
| Other non-operating income, net | | **1** | | **1** |
| Restructuring | | **1** | | **1** |
| Income tax impact on amortization of postretirement benefit plan items | | **(3)** | | **(3)** |
| Unrealized gain on derivative hedge agreements | | | **9** | **9** |
| Reclassification of unrealized (gain) loss on foreign exchange agreements into revenue | | | **(6)** | **(6)** |
| Reclassification of unrealized (gain) loss on foreign exchange agreements into cost of revenue | **—** | | **1** | **1** |
| **Balance at December 31, 2017** | **$ (15)** | **$ (198)** | **$ 3** | **$ (210)** |

**Note 18. Commitments and Contingencies**

***Legal Proceedings***

From time to time we are involved in legal proceedings that are incidental to the operation of our businesses. These proceedings may seek remedies relating to environmental matters, intellectual property matters, acquisitions or divestitures, personal injury claims, employment and pension matters, government contract issues and commercial or contractual disputes.

From time to time claims may be asserted against Xylem alleging injury caused by any of our products resulting from asbestos exposure. We believe there are numerous legal defenses available for such claims and would defend ourselves vigorously. Pursuant to the Distribution Agreement among ITT Corporation (now ITT LLC), Exelis and Xylem, ITT Corporation (now ITT LLC) has an obligation to indemnify, defend and hold Xylem harmless for asbestos product liability matters, including settlements, judgments, and legal defense costs associated with all pending and future claims that may arise from past sales of ITT's legacy products.

Although the ultimate outcome of any legal matter cannot be predicted with certainty, based on present information, including our assessment of the merits of the particular claims, we do not expect that any asserted or unasserted legal claims or proceedings, individually or in aggregate, will have a material adverse effect on our results of operations, or financial condition.

We have estimated and accrued $10 million and $11 million as of December 31, 2017 and 2016, respectively for these general legal matters.

***Indemnifications***

As part of our 2011 spin-off from our former parent, ITT Corporation (now ITT LLC), Exelis Inc. and Xylem will indemnify, defend and hold harmless each of the other parties with respect to such parties' assumed or retained liabilities under the Distribution Agreement and breaches of the Distribution Agreement or related spin agreements. The former parent's indemnification obligations include asserted and unasserted asbestos and silica liability claims that relate to the presence or alleged presence of asbestos or silica in products manufactured, repaired or sold prior to October 31, 2011, the Distribution Date, subject to limited exceptions with respect to certain employee claims, or in the structure or material of any building or facility, subject to exceptions with respect to employee claims relating to Xylem buildings or facilities. The indemnification associated with pending and future asbestos claims does not expire. Xylem has not recorded a liability for material matters for which we expect to be indemnified by the former parent or Exelis Inc. through the Distribution Agreement and we are not aware of any claims or other circumstances that would give rise to material payments from us under such indemnifications. On May 29, 2015, Harris Inc. acquired Exelis. As 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 bonds from third-party financial institutions in the ordinary course of business when required under contracts or to satisfy insurance related requirements. As of December 31, 2017, the amount of stand-by letters of credit, bank guarantees and surety bonds was $240 million.

***Environmental***

In the ordinary course of business, we are subject to federal, state, local, and foreign environmental laws and regulations. We are responsible, or are alleged to be responsible, for ongoing environmental investigation and remediation of sites in 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 Protection Agency, and from similar state and foreign environmental agencies, that a number of sites formerly or currently owned and/or operated by Xylem or for which we are 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 investigation and/or remediation. These sites include instances where we have been identified as a potentially responsible party under federal and state environmental laws and regulations.

Accruals for environmental matters are recorded on a site-by-site basis when it is probable that a liability has been incurred and the amount of the liability can be reasonably estimated, based on current law and existing technologies. Our accrued liabilities for these environmental matters represent the best estimates related to the investigation and remediation of environmental media such as water, soil, soil vapor, air and structures, as well as related legal fees. These estimates, and related accruals, are reviewed quarterly and updated for progress of investigation and remediation efforts and changes in facts and legal circumstances. Liabilities for these environmental expenditures are recorded on an undiscounted basis. We have estimated and accrued $4 million and $4 million as of December 31, 2017 and 2016, respectively, for environmental matters.

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

***Operating Leases***

We lease certain offices, manufacturing buildings, machinery, computers and other equipment. We often pay maintenance, insurance and tax expense related to leased assets. Total rent expense for the three years ended December 31, 2017 was as follows:

| (in millions) | **Total** |
|---|---|
| 2017 | **70** |
| 2016 | 63 |
| 2015 | 59 |

At December 31, 2017, we are obligated to make minimum rental payments under operating leases which are as follows:

| (in millions) | 2018 | 2019 | 2020 | 2021 | 2022 | Thereafter |
|---|---|---|---|---|---|---|
| Minimum rental payments | $ 65 | $ 53 | $ 42 | $ 29 | $ 23 | $ 45 |

***Warranties***

We warrant numerous products, the terms of which vary widely. In general, we warrant products against defect and specific non-performance. Warranty expense was $28 million, $32 million, and $32 million for 2017, 2016 and 2015, respectively. The table below provides changes in the combined current and non-current product warranty accruals over each period.

| (in millions) | 2017 | 2016 |
|---|---|---|
| Warranty accrual – January 1 | **$ 99** | $ 33 |
| Net charges for product warranties in the period | **28** | 32 |
| Settlement of warranty claims | **(48)** | (31) |
| Warranty accrual acquired | **—** | 66 |
| Foreign currency and other | **3** | (1) |
| Warranty accrual – December 31 | **$ 82** | $ 99 |

**Note 19. Related Party Transactions**

Sales to and purchases from unconsolidated joint ventures for 2017, 2016 and 2015 are as follows:

| (in millions) | 2017 | 2016 | 2015 |
|---|---|---|---|
| Sales to unconsolidated affiliates | **$ 12** | $ 11 | $ 11 |
| Purchases from unconsolidated affiliates | **17** | 22 | 19 |

**Note 20. Segment and Geographic Data**

Our business has three reportable segments: Water Infrastructure, Applied Water and Measurement & Control Solutions. When determining the reportable segments, the Company aggregated operating segments based on their similar economic and operating characteristics. The Water Infrastructure segment focuses on the transportation and treatment of water, offering a range of products including water and wastewater pumps, treatment equipment, and controls and systems. The Applied Water segment serves many of the primary uses of water and focuses on the residential, commercial and industrial markets. The Applied Water segment's major products include pumps, valves, heat exchangers, controls and dispensing equipment. The Measurement & Control Solutions segment focuses on 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 Solutions segment's major products include smart metering, networked communications, measurement and control technologies, software and services including cloud-based analytics, remote monitoring and data management, leak detection and pressure monitoring solutions and testing equipment.

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

| | Year Ended December 31, | | |
|---|---|---|---|
| (in millions) | **2017** | 2016 | 2015 |
| **Revenue:** | | | |
| Water Infrastructure | **$ 2,004** | $ 1,932 | $ 1,940 |
| Applied Water | **1,421** | 1,393 | 1,422 |
| Measurement & Control Solutions | **1,282** | 446 | 291 |
| Total | **$ 4,707** | $ 3,771 | $ 3,653 |
| **Operating income:** | | | |
| Water Infrastructure | **$ 308** | $ 291 | $ 261 |
| Applied Water | **197** | 188 | 190 |
| Measurement & Control Solutions | **110** | — | 42 |
| Corporate and other | **(59)** | (73) | (44) |
| Total operating income | **556** | 406 | 449 |
| Interest expense | **82** | 70 | 55 |
| Other non-operating income (expense) | **2** | 4 | — |
| (Loss)/gain from sale of businesses | **(10)** | — | 9 |
| Income before taxes | **$ 466** | $ 340 | $ 403 |
| **Depreciation and amortization:** | | | |
| Water Infrastructure | **$ 64** | $ 66 | $ 71 |
| Applied Water | **23** | 24 | 26 |
| Measurement & Control Solutions | **122** | 41 | 17 |
| Regional selling locations (a) | **17** | 11 | 11 |
| Corporate and other | **8** | 9 | 8 |
| Total | **$ 234** | $ 151 | $ 133 |
| **Capital expenditures:** | | | |
| Water Infrastructure | **$ 58** | $ 62 | $ 62 |
| Applied Water | **20** | 21 | 22 |
| Measurement & Control Solutions | **69** | 13 | 5 |
| Regional selling locations (b) | **18** | 24 | 23 |
| Corporate and other | **5** | 4 | 5 |
| Total | **$ 170** | $ 124 | $ 117 |

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

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

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

| | Year Ended December 31, | | |
|---|---|---|---|
| (in millions) | **2017** | 2016 | 2015 |
| Pumps, accessories, parts and service | **$ 2,998** | $ 2,888 | $ 2,917 |
| Other (a) | **1,709** | 883 | 736 |
| Total | **$ 4,707** | $ 3,771 | $ 3,653 |

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

The following table contains the total assets for each reportable segment as of December 31, 2017, 2016 and 2015.

| | Total Assets | | |
|---|---|---|---|
| (in millions) | **2017** | 2016 | 2015 |
| Water Infrastructure | **$ 1,232** | $ 1,179 | $ 1,265 |
| Applied Water | **1,002** | 990 | 1,054 |
| Measurement & Control Solutions | **3,198** | 3,102 | 759 |
| Regional selling locations (a) | **1,119** | 965 | 905 |
| Corporate and other (b) | **309** | 238 | 674 |
| Total | **$ 6,860** | $ 6,474 | $ 4,657 |

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

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

***Geographical Information***

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

| | Revenue | | |
|---|---|---|---|
| | Year Ended December 31, | | |
| (in millions) | **2017** | 2016 | 2015 |
| United States | **$ 2,161** | $ 1,574 | $ 1,490 |
| Europe | **1,335** | 1,195 | 1,179 |
| Asia Pacific | **611** | 518 | 482 |
| Other | **600** | 484 | 502 |
| Total | **$ 4,707** | $ 3,771 | $ 3,653 |

| | Property, Plant & Equipment | | |
|---|---|---|---|
| | December 31, | | |
| (in millions) | **2017** | 2016 | 2015 |
| United States | **$ 258** | $ 255 | $ 168 |
| Europe | **259** | 237 | 189 |
| Asia Pacific | **85** | 87 | 56 |
| Other | **41** | 37 | 26 |
| Total | **$ 643** | $ 616 | $ 439 |

**Note 21. Valuation and Qualifying Accounts**

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

| (in millions) | **2017** | 2016 | 2015 |
|---|---|---|---|
| Balance at beginning of year | **$ 21** | $ 22 | $ 24 |
| Additions charged to expense | **5** | 4 | 4 |
| Deductions/other | **(1)** | (5) | (6) |
| Balance at end of year | **$ 25** | $ 21 | $ 22 |

**Note 22. Quarterly Financial Data (Unaudited)**

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

| | **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 | **509** | **471** | **459** | **412** |
| Operating income | **179** | **152** | **139** | **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** |

| | 2016 Quarter Ended | | | |
|---|---|---|---|---|
| (in millions, except per share amounts) | Dec. 31 | Sept. 30 | June 30 | Mar. 31 |
| Revenue | $ 1,095 | $ 897 | $ 932 | $ 847 |
| Gross profit | 406 | 357 | 369 | 329 |
| Operating income | 109 | 109 | 109 | 79 |
| Net income | $ 50 | $ 73 | $ 71 | $ 66 |
| Earnings per share: | | | | |
| Basic | $ 0.28 | $ 0.41 | $ 0.39 | $ 0.37 |
| Diluted | $ 0.28 | $ 0.41 | $ 0.39 | $ 0.37 |

**Note 23. Subsequent Events**

***Pure Technologies***

On January 31, 2018, we acquired all the issued and outstanding shares of Pure Technologies Ltd. ("Pure"), a leader in intelligent leak detection and condition assessment solutions for water distribution networks. See Note 3, "Acquisitions and Divestitures", for further detail.

**Term *Loan***

On January 26, 2018, the Company's subsidiary, Xylem Europe GmbH (the "borrower") entered into a 12-month €225 million (approximately $280 million) term loan facility (the "Term Facility") the terms of which are set forth in a term loan agreement, among the borrower, the Company, as parent guarantor and ING Bank. The Company has entered into a parent guarantee in favor of ING Bank also dated January 26, 2018 to secure all present and future obligations of the borrower under the Term Loan Agreement. The Term Facility was used to partially fund the acquisition of Pure.

## ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON 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 Financial Officer ("CFO") of the Company, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the year ended December 31, 2017 pursuant to Rule 13a-15(b) and 15d-15(e) of the Securities Exchange Act of 1934 (“the Exchange Act”). Based upon that evaluation, our CEO and our CFO concluded that our disclosure controls and procedures as of the year ended December 31, 2017 were effective, in all material respects, and designed to provide reasonable assurance that the information required to be 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 specified in the SEC's rules and forms and (2) accumulated and communicated to our management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosures.

### Management's Annual Report on Internal Control Over Financial Reporting

As required by the SEC's rules and regulations for the implementation of Section 404 of the Sarbanes-Oxley Act, the Company's management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. The Company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of 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 reporting as of December 31, 2017 based on the framework established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organization of the Treadway Commission (2013). This assessment included an evaluation of the design of our internal control over financial reporting and testing of the operational effectiveness of those controls. Based on our assessment, the Company's management has concluded that our internal control over financial reporting was effective as of December 31, 2017.

The effectiveness of the Company's internal control over financial reporting as of December 31, 2017 has been audited by Deloitte & Touche LLP, an independent registered public accounting firm, as stated in their report which appears following 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 reporting that occurred during the quarter ended December 31, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## ITEM 9B. OTHER INFORMATION

None

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders 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. and subsidiaries (the "Company") as of December 31, 2017, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by COSO.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated financial statements as of and for the year ended December 31, 2017, and the related notes (collectively referred to as the “financial statements”), of the Company and our report dated February 23, 2018, expressed an unqualified opinion on those financial statements.

**Basis of Opinion**

The Company’s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of 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 over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit 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 to provide reasonable assurance regarding the reliability of financial reporting and the 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 the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Deloitte & Touche LLP

Stamford, Connecticut
February 23, 2018

## PART III

### ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this Item is incorporated herein by reference to the information in our Definitive Proxy Statement to be filed with the SEC in connection with our 2018 Annual Meeting of Shareholders (the “2018 Proxy Statement”) under the captions “Proposal 1 - Election of Directors,” "Identifying and Evaluating Director Nominees," "Board Committees - Audit Committee" and “Section 16(a) Beneficial Ownership Reporting Compliance.”

The information called for by Item 10 with respect to executive officers is set forth in Part I of this Report under the caption “Executive Officers of the Registrant” and is incorporated by reference in this section.

We have adopted corporate governance principles and charters for each of our board committees. The principles address director qualification standards, responsibilities, access to management and independent advisors, compensation, 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 and board committee charters are also available to any shareholder who requests a copy from the Company’s Corporate Secretary at our Principal Executive Offices.

We have also adopted a written code of conduct which is applicable to all our directors, officers and employees, including the Company’s Chief Executive Officer and Chief Financial Officer and other executive officers identified pursuant to this Item 10. In accordance with the SEC’s rules and regulations, a copy of the Code of Conduct has been posted to our website and it is also available to any shareholder who requests a copy from our Corporate Secretary. We intend to disclose any changes in our Code of Conduct and waivers of the Code of Conduct on our website at *www.xyleminc.com* within four business days following the date of the amendment or waiver.

### ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item is incorporated herein by reference to the information in our 2018 Proxy Statement set forth under captions “Executive Compensation," "Director Compensation", "Board Committees - Leadership Development and Compensation Committee" and “Leadership Development and Compensation Committee Report.”

### ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this Item is incorporated herein by reference to the information in our 2018 Proxy Statement set forth under the captions “Stock Ownership of Directors, Executive Officers and Certain Beneficial Owners” and "Equity Compensation Plan Information."

### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this Item is incorporated herein by reference to the information in our 2018 Proxy Statement set forth under the captions "Governance - 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 the information in our 2018 Proxy Statement set forth under the captions “Fees of Audit and Other Services Fees” and "Pre-Approval of Audit and Non-Audit Services."

## PART IV

### ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) (1) The Index to Consolidated Financial Statements of the Registrant under 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 have been omitted because they are not applicable or the required information is shown 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 to Exhibit 10.1 of ITT Corporation's Form 10-Q Quarterly Report filed on October 28, 2011 (CIK No. 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 to Exhibit 2.1 to Xylem Inc.'s Current Report on Form 8-K filed on August 15, 2016 (CIK No. 1524472, File No. 1-35229). |
| 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 to Exhibit 2.2 to Xylem Inc.'s Current Report on Form 8-K filed on October 31, 2016 (CIK No. 1524472, File No. 1-35229). |
| 2.4 | Arrangement Agreement, dated as of December 8, 2017, by and between Xylem Inc. and Pure Technologies Ltd. | Incorporated by reference to Exhibit 2.1 to Xylem Inc.'s Current Report on Form 8-K filed on December 11, 2017 (CIK No. 1524472, File No. 1-35229) |
| 3.1 | Fourth Amended and Restated Articles of Incorporation of Xylem Inc. | Incorporated by reference to Exhibit 3.1 of Xylem Inc.'s Form 8-K filed on May 15, 2017 (CIK No. 1524472, File No. 1-35229). |
| 3.2 | Fourth Amended and Restated By-laws of Xylem Inc. | Incorporated by reference to Exhibit 3.1 of Xylem Inc.'s Form 8-K filed on May 15, 2017 (CIK No. 1524472, File No. 1-35229). |
| 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 to Exhibit 4.2 of ITT Corporation's Form 8-K Current Report filed on September 21, 2011 (CIK No. 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 to Exhibit 4.1 of Xylem Inc.'s Form 8-K filed on March 11, 2016 (CIK No. 1524472, File No. 1-35229). |
| 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 to Exhibit 4.1 of Xylem Inc.'s Form 8-K filed on March 11, 2016 (CIK No. 1524472, File No. 1-35229) |
| 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 to Exhibit 4.1 of Xylem Inc.'s Form 8-K filed on March 11, 2016 (CIK No. 1524472, File No. 1-35229). |
| 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 to Exhibit 4.1 of Xylem Inc.'s Form 8-K filed on October 11, 2016 (CIK No. 1524472, File No. 1-35229). |

| Exhibit Number | | Description | Location |
|---|---|---|---|
| 4.6 | | Form of Xylem Inc. 4.875% Senior Notes due 2021. | Incorporated by reference to Exhibit 4.6 of Xylem Inc.'s Form S-4 Registration Statement filed on May 24, 2012 (CIK No. 1524472, File No. 333-181643). |
| 4.7 | | Form of Xylem Inc. 2.250% Senior Notes due 2023. | Incorporated by reference to Exhibit 4.3 of Xylem Inc.'s Current Report on Form 8-K dated March 11, 2016 (CIK No. 1524472, File No. 1-35229). |
| 4.8 | | Form of Xylem Inc. 3.250% Senior Notes due 2026. | Incorporated by reference to Exhibit 4.1 of Xylem Inc.'s Form 8-K filed on October 11, 2016 (CIK No. 1524472, File No. 1-35229). |
| 4.9 | | Form of Xylem Inc. 4.375% Senior Notes due 2046. | Incorporated by reference to Exhibit 4.1 of Xylem Inc.'s Form 8-K filed on October 11, 2016 (CIK No. 1524472, File No. 1-35229). |
| 10.1 | # | Form of Xylem 2011 Omnibus Incentive Plan Non-Qualified Stock Option Award Agreement (2015). | Incorporated by reference to Exhibit 10.1 of Xylem Inc.'s Form 10-K Annual Report filed on February 26, 2015 (CIK No. 1524472, File No. 1-35229). |
| 10.2 | # | Benefits and Compensation Matters Agreement, dated as of October 25, 2011, among ITT Corporation, Exelis Inc. and Xylem Inc. | Incorporated by reference to Exhibit 10.2 of ITT Corporation's Form 10-Q Quarterly Report filed on October 28, 2011 (CIK No. 216228, File No. 1-5672). |
| 10.3 | | Tax Matters Agreement, dated as of October 25, 2011, among ITT Corporation, Exelis Inc. and Xylem Inc. | Incorporated by reference to Exhibit 10.3 of ITT Corporation's Form 10-Q Quarterly Report filed on October 28, 2011 (CIK No. 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 reference to Exhibit 10.1 of Xylem Inc.'s Form 8-K filed on March 31, 2015 (CIK No. 1524472, File No. 1-35229). |
| 10.6 | # | Xylem 2011 Omnibus Incentive Plan (Amended as of February 24, 2016). | Incorporated by reference to Exhibit 10.6 of Xylem Inc.'s Form 10-K filed on February 26, 2016 (CIK No. 1524472, File No. 1-35229). |
| 10.7 | # | Form of Xylem Non-Qualified Stock Option Award Agreement (Amended as of February 24, 2016). | Incorporated by reference to Exhibit 10.7 of Xylem Inc.'s Form 10-K filed on February 26, 2016 (CIK No. 1524472, File No. 1-35229). |
| 10.8 | # | Form of Xylem Restricted Stock Unit Agreement (Amended as of February 24, 2016). | Incorporated by reference to Exhibit 10.8 of Xylem Inc.'s Form 10-K filed on February 26, 2016 (CIK No. 1524472, File No. 1-35229). |
| 10.9 | # | Form of Xylem Performance Share Unit Agreement (Amended as of February 24, 2016). | Incorporated by reference to Exhibit 10.9 of Xylem Inc.'s Form 10-K filed on February 26, 2016 (CIK No. 1524472, File No. 1-35229). |
| 10.10 | # | Xylem Retirement Savings Plan. | Incorporated by reference to Exhibit 10.1 of Xylem Inc.'s Form 10-Q filed on July 30, 2013 (CIK No. 1524472, File No. 1-35229). |
| 10.11 | # | Xylem Supplemental Retirement Savings Plan. | Incorporated by reference to Exhibit 10.11 of Xylem Inc.'s Form 10-Q Quarterly Report filed on November 21, 2011 (CIK No. 1524472, File No. 1-35229). |
| 10.12 | # | Xylem Deferred Compensation Plan. | Incorporated by reference to Exhibit 10.12 of Xylem Inc.'s Form 10-K Annual Report filed on February 23, 2017 (CIK No. 1524472, File No. 1-35229). |
| 10.13 | # | Xylem Deferred Compensation Plan for Non-Employee Directors. | Incorporated by reference to Exhibit 10.13 of Xylem Inc.'s Form 10-Q Quarterly Report filed on November 21, 2011 (CIK No. 1524472, File No. 1-35229). |
| 10.14 | # | Form of Non-Employee Director Restricted Stock Unit Award Agreement. | Incorporated by reference to Exhibit 10.1 of Xylem Inc.'s Form 10-Q Quarterly Report filed on July 30, 2015 (CIK No. 1524472, File No. 1-35229). |

| Exhibit Number | | Description | Location |
|---|---|---|---|
| 10.15 | # | Xylem Special Senior Executive Severance Pay Plan (Amended as of February 24, 2016). | Incorporated by reference to Exhibit 10.15 of Xylem Inc.'s Form 10-K filed on February 26, 2016 (CIK No. 1524472, File No. 1-35229). |
| 10.16 | # | Xylem Senior Executive Severance Pay Plan (Amended as of May 10, 2017). | Incorporated by reference to Exhibit 10.1 of Xylem Inc.'s Form 10-Q filed on August 1, 2017 (CIK No. 1524472, File No. 1-35229). |
| 10.17 | # | Form of Xylem 2011 Omnibus Incentive Plan 2011 Non-Qualified Stock Option Award Agreement — Founders Grant. | Incorporated by reference to Exhibit 10.17 of Xylem Inc.'s Form 10-Q Quarterly Report filed on November 21, 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 Exhibit 10.18 of Xylem Inc.'s Form 10-Q Quarterly Report filed on November 21, 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 Exhibit 10.16 of Xylem Inc.'s Form 10-K filed on February 26, 2016 (CIK No. 1524472, File No. 1-35229). |
| 10.20 | # | Form of Director's Indemnification Agreement. | Incorporated by reference to Exhibit 10.16 of Xylem Inc.'s Form 10-K filed on February 26, 2016 (CIK No. 1524472, File No. 1-35229). |
| 10.21 | # | Form of Xylem 2011 Omnibus Incentive Plan Non-Qualified Stock Option Award Agreement (2013). | Incorporated by reference to Exhibit 10.1 of Xylem Inc.'s Form 10-Q Quarterly Report filed on April 30, 2013 (CIK No. 1524472, File No. 1-35229). |
| 10.22 | # | Letter Agreement between Xylem Inc. and Patrick K. Decker. | Incorporated by reference to Exhibit 10.1 of Xylem Inc.'s Form 10-Q Quarterly Report filed on April 29, 2014 (CIK No. 1524472, File No. 1-35229). |
| 10.23 | # | Restricted Stock Unit Grant Agreement between Xylem Inc. and Patrick K. Decker. | Incorporated by reference to Exhibit 10.1 of Xylem Inc.'s Form 8-K Current Report filed on March 20, 2014 (CIK No. 1524472, File No. 1-35229). |
| 10.24 | | Research and Development Facility Agreement - Xylem Water Technologies Risk-Sharing Financing Facility First Amended and Restated Finance Contract, dated December 4, 2013, among the European Investment Bank, Xylem Holdings S.a.r.l. and Xylem International S.a.r.l., as borrowers, and Xylem Inc., as guarantor. | Incorporated by reference to Exhibit 10.30 of Xylem Inc.'s Form 10-K Annual Report filed on February 27, 2014 (CIK No. 1524472, File No. 1-35229). |
| 10.25 | | Agreement dated May 4, 2015, Amending the Research and Development Facility Agreement - Xylem Water Technologies Risk-Sharing Financing Facility First Amended and Restated Finance Contract, dated June 28, 2014, among the European Investment Bank, Xylem Holdings S.á r.l. and Xylem International S.á r.l., as borrowers, and Xylem Inc., as guarantor. | Incorporated by reference to Exhibit 10.2 of Xylem Inc.'s Form 10-Q Quarterly Report filed on July 30, 2015 (CIK No. 1524472, File No. 1-35229). |
| 10.26 | | Agreement dated December 3, 2015, Amending the Research and Development Facility Agreement - Xylem Water Technologies Risk-Sharing Financing Facility First Amended and Restated Finance Contract, dated June 28, 2014, among the European Investment Bank, Xylem Holdings S.á r.l. and Xylem International S.á r.l., as borrowers, and Xylem Inc., as guarantor. | Incorporated by reference to Exhibit 10.16 of Xylem Inc.'s Form 10-K filed on February 26, 2016 (CIK No. 1524472, File No. 1-35229). |

| Exhibit Number | | Description | Location |
|---|---|---|---|
| 10.27 | | Amendment No.1, dated as of August 30, 2016, to the Five-Year Revolving Credit Facility, dated as of March 27, 2015, among Xylem Inc., the lenders named therein and Citibank N.A. as Administrative Agent. | Incorporated by reference to Exhibit 10.1 of Xylem Inc.'s Form 10-Q filed on November 1, 2016 (CIK No. 1524472, File No. 1-35229). |
| 10.28 | | Finance Contract, dated October 28, 2016, between Xylem Holdings S.a.r.l. and Xylem International S.a.r.l., as borrowers, Xylem Inc., as guarantor and the European Investment Bank. | Incorporated by reference to Exhibit 10.2 of Xylem Inc.'s Form 10-Q filed on November 1, 2016 (CIK No. 1524472, File No. 1-35229). |
| 10.29 | | Term Loan Agreement, dated as of October 24, 2016 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 Exhibit 10.1 of Xylem Inc.'s Form 8-K filed on October 28, 2016 (CIK No. 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). | Filed herewith. |
| 10.31 | # | Form of Xylem Restricted Stock Unit Agreement (Amended as of February 21, 2018). | Filed herewith. |
| 10.32 | # | Form of Xylem Performance Share Unit Agreement (Amended as of February 21, 2018). | Filed herewith. |
| 11.0 | | Statement re computation of per share earnings. | Information required to be presented in Exhibit 11 is provided under "Earnings Per Share" in Note 7 of the consolidated financial statements in Part II, Item 8. "Financial Statements and Supplementary Data" of this Annual Report on Form 10-K in accordance with the provisions of Financial Accounting Standards Board Accounting Standards Codification 260, *Earnings Per Share*. |
| 12.0 | | Statements re computation of ratios. | 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 furnished in accordance with Regulation S-K Item 601(b) (32) (ii) and shall not be deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934 or incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except as shall be expressly set forth by specific reference. |

| 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 be furnished in accordance with Regulation S-K Item 601(b) (32) (ii) and shall not be deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934 or incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except as shall be expressly set forth by specific reference. |
| (101) | The following materials from Xylem Inc.'s Annual Report on Form 10-K for the year ended December 31, 2016, formatted in XBRL (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 does not appear in the interactive data file because its XBRL tags are embedded within the Inline XBRL document. |

#Management contract or compensatory plan or arrangement

## ITEM 16. FORM 10-K SUMMARY

None

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

**XYLEM INC.**
**(Registrant)**

/s/ Paul A. Stellato
Paul A. Stellato
Vice President, Controller and Chief Accounting Officer

February 23, 2018

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated:

| | |
|---|---|
| February 23, 2018 | /s/ Patrick K. Decker<br>Patrick K. Decker<br>President and Chief Executive Officer<br>(Principal Executive Officer) |
| February 23, 2018 | /s/ Markos I. Tambakeras<br>Markos I. Tambakeras, Chairman |
| February 23, 2018 | /s/ Jeanne Beliveau-Dunn<br>Jeanne Beliveau-Dunn, Director |
| February 23, 2018 | /s/ Curtis J. Crawford<br>Curtis J. Crawford, Director |
| February 23, 2018 | /s/ Robert F. Friel<br>Robert F. Friel, Director |
| February 23, 2018 | /s/ Victoria D. Harker<br>Victoria D. Harker, Director |
| February 23, 2018 | /s/ Sten E. Jakobsson<br>Sten E. Jakobsson, Director |
| February 23, 2018 | /s/ Steven R. Loranger<br>Steven R. Loranger, Director |
| February 23, 2018 | /s/ Surya N. Mohapatra<br>Surya N. Mohapatra, Director |
| February 23, 2018 | /s/ Jerome A. Peribere<br>Jerome A. Peribere, Director |

# EUR 225,000,000 TERM LOAN AGREEMENT



This Agreement is dated 26 January 2018 and is made between:

**(1)** **Xylem Europe GmbH**, a company incorporated under the laws of Switzerland, having its registered address at Bleicheplatz 6, 8200 Schaffhausen, Switzerland, registration number CH-287.650.247 (**the Borrower**);

**(2)** **Xylem Inc.**, an Indiana company incorporated under the laws of United States of America, having its registered address at 1 International Drive, Rye Brook, NY 10573, United States of America, registration number 201 105 050 0560 (**the Parent Guarantor**); and

**(3)** **ING Bank, a branch of ING-DiBa AG**, a company incorporated under the laws of Germany, having its registered address at Hamburger Allee 1, 60486 Frankfurt am Main (**the Bank**).

IT IS AGREED AS FOLLOWS:

## 1. DEFINITIONS

Terms used in this Agreement have the following meaning:

**Affiliate** means in relation to any Person, a Subsidiary of that Person, or a Holding Company of that Person or any other Subsidiary of that Holding Company.

**Agreement** means this agreement (including the attached schedules) as amended from time to time.

**Authorisation** means an authorisation, consent, approval, resolution, licence, exemption, filing, notarisation or registration.

**Availability Period** means the period from and including the date of this Agreement to and including the date falling one month after the date of this Agreement.

**Base Rate** means for any Loan or Unpaid Sum in EUR the EURIBOR Screen Rate as at 11.00 a.m. (Frankfurt time), on the relevant Rate Fixing Day for such currency for a period equal in length to the Interest Period of that Loan or Unpaid Sum and, if any such rate is below zero, the Base Rate will be deemed to be zero.

**Break Funding Costs** means the amount reasonably determined by the Bank to be the costs incurred as a result of the Borrower repaying a Loan on another date than the last day of an Interest Period.

**Business Day** means a day (other than a Saturday or a Sunday) on which banks are open for general business in Frankfurt am Main, Germany.

**Change of Control** means (i) the current parent or controlling shareholder ceasing to Control the Borrower or (ii) the obtaining of Control over the Borrower and/or Parent Guarantor by a Person or a group of Persons who acted jointly on the basis of an arrangement or understanding between themselves or (iii) if any Person or group of Persons shall have acquired beneficial ownership of more than 30% of the outstanding shares of the Parent Guarantor.

**Commitment** means the amount specified in Clause 2 **Facility** to the extent not cancelled, increased or reduced under this Agreement.

**Compliance Certificate** means a Compliance Certificate in accordance with Section 5.03 (c) (ii) of the Revolving Facility.

**Control** means (i) the direct or indirect ownership of more than 50% of the shares, voting capital or similar rights of ownership of a Person, or (ii) the power to directly or indirectly, on the basis of an agreement, through the exercise of voting rights or otherwise, appoint or dismiss the majority of the members of the board of directors or supervisory board or give instructions regarding the policy of the Person with which such members are obliged to comply.

**Cost of Funds** means the interest rate per annum which the Bank determines in its reasonable discretion (*nach billigem Ermessen*) pursuant to Section 315 German Civil Code is the cost it will incur in order to fund a Loan in the public or private markets.

**Default** means an Event of Default or any event or circumstance which would become an Event of Default with the lapse of time, giving of notice, expiry of a grace period or the making of any determination of an Event of Default.

**Euro**, **euro, €** and **EUR** means the currency that, at the date of this Agreement, has been adopted by some of the member

states of the European Community as their lawful currency in accordance with legislation of the European Community relating to Economic and Monetary Union.

**Event of Default** means an event or circumstance specified as such in Clause 12 **Events of Default. Facility** means the term loan facility made available

pursuant to this Agreement.

**Finance Document** means this Agreement, any Compliance Certificate, Parent Guarantee, Utilisation Request, Revolving Facility (only for the purpose of calculation of the Financial Covenants and Compliance Certificate), and any other document designated as such by the Bank and the Borrower, all as may be amended from time to time.

**Financial Covenants** means the financial covenants set out in Clause 9 **Financial Covenants.**

**Financial Indebtedness** means any indebtedness for or in respect of:

a) moneys borrowed;

b) any acceptance credit;

c) any bond, note, debenture or other similar instrument;

d) any agreement treated as a 'financial lease' in accordance with IFRS, (local) GAAP (General Accepted Accounting Principles) or (other) local accounting standards;

e) receivables sold or discounted (otherwise than on a non-recourse basis);

f) any derivative transaction entered into to protect against or benefit from fluctuations in any interest, rate or price (and the then marked to market value of the derivative transaction will be used to calculate its amount);

g) any other transaction which has the commercial effect of a borrowing;

h) any counter-indemnity obligation or other recourse commitment in respect of any guarantee, indemnity, bond, letter of credit, or other similar instrument issued by a bank or financial institution; or

i) any guarantee, indemnity, surety-ship or similar assurance against financial loss in respect of any liability referred to in the above paragraphs (a) up to and including (h).

**Group** means the Borrower, the Parent Guarantor and its Subsidiaries from time to time.

**Holding Company** means, in relation to a Person, any other Person in respect of which it is a Subsidiary.

**Increased Cost** means:

(a) an additional or increased cost (including, but not limited to, any cost incurred by the Bank or any of its Affiliates as a result of the compliance with the minimum reserve requirements or other requirements imposed by any relevant central bank, by law or regulation);

(b) a reduction in the rate of return from the Facility or on the Bank's or any of its Affiliates invested overall capital; or

(c) a reduction of an amount due and payable under any Finance Document,

which is incurred or suffered by the Bank or any of its Affiliates to the extent attributable (directly or indirectly) to the Bank having entered into any Finance Document or funding or performing its obligations under any Finance Document.

**Interest Period** means, in relation to a Loan or Unpaid Sum, the period determined in accordance with Clause 5 **Interest and Fees**.

**Loan** means a loan made or to be made available under the Facility or the principal amount outstanding for the time being of that loan.

**Long Term Credit Rating**" means the credit rating or ratings (as the case may be) from time to time assigned by Moody's and/or Standard & Poor's to the long term senior unsecured debt of the Parent Guarantor.

**Margin** means the rate set out in Clause 5.3 **Margin**.

**Market Disruption Event** means:

(a) at or about 11:00 a.m. (Frankfurt time) on a Rate Fixing Day the relevant Screen Rate or Interpolated Screen Rate is not available for the relevant Interest Period; or

(b) before close of business in Frankfurt a.M. (Germany) on a Rate Fixing Day, the cost to the Bank of funding the Loan in the European interbank market for the relevant Interest Period would be in excess of the Base Rate.

**Material Adverse Effect** means any material adverse effect on:

(a) the financial condition, business or assets of the Borrower or the Parent Guarantor;

(b) the ability of the Borrower to perform its obligations under any Finance Document; or

(c) the validity, enforceability, effectiveness or ranking of any Finance Document or of a right of the Bank thereunder.

**Original Financial Statements** means the audited financial statements of the Borrower and the audited consolidated financial statements of the Parent Guarantor for the financial year ended 31st December 2017 (or, if unavailable, for the year ended 31st December 2016 each).

**Party** means a party to this Agreement.



**Person** means any natural person, legal entity, firm, company, corporation, government, state or agency of a state or any association, trust, joint venture, consortium or partnership (whether or not having separate legal personality).

**Rate Fixing Day** means, for any period for which an interest rate is to be determined, two Business Days before the first day of that period.

**Repayment Instalment** means each repayment instalment as specified in Clause 6 **Repayment.**

**Screen Rate** means the percentage rate per annum administered by the European Money Markets Institute (in respect of EURIBOR), or any other Person which takes over the administration of that rate, for the relevant period displayed on the appropriate page of the Reuters screen. If the relevant page is replaced or the service ceases to be available, the Bank (after consultation with the Borrower) may specify another page or service displaying the appropriate rate.

**Parent Guarantee** means the document set out in Schedule **Parent Guarantee**

**Revolving Facility** means the five-year revolving credit facility agreement dated as of March 27th 2015 with Xylem Inc as amended on 30th August 2016 and may be amended from time to time.

**Security Interest** means (the creation of) a pledge, charge, hypothecation, mortgage, lien or any other security interest securing any obligation of any Person or any other agreement or arrangement having a similar effect in the relevant jurisdiction.

**Subsidiary** means in relation to a specified Person any Person over which it has Control.

**Unpaid Sum** means any sum due and payable but unpaid by the Borrower under the Finance Documents. **Utilisation Date** means the date on which a Loan

is made or to be made.

**Utilisation Request** means a request for a Loan in writing substantially in the form of Schedule **Utilisation Request** or in any other manner or form as accepted by the Bank.

## 2.FACILITY

### 2 . 1 Availability

Subject to the terms of this Agreement, the Bank makes available to the Borrower a committed term loan facility in an aggregate amount of EUR 225,000,000.

The aggregate amount of the outstanding Loans may not exceed the Commitment at any moment in time.

## 3.PURPOSE

The Borrower shall apply all amounts borrowed by it under the Facility towards the payment of the partial acquisition price of Pure Technologies Ltd, located in Calgary, Alberta, Canada. The Bank is not bound to monitor or verify the application of any amount borrowed pursuant to this Agreement.

## 4.CONDITIONS

### 4 . 1 Conditions precedent

The first Loan may be requested by the Borrower only after the Bank has received all of the documents and evidence set out in Schedule **Conditions Precedent** in form and substance satisfactory to the Bank.

### 4.2 Utilisation Request

The Borrower may request a Loan by giving the Bank, via a method as approved by the Bank, a duly completed and duly executed Utilisation Request substantially in the form of Schedule **Utilisation Request**. A Utilisation Request must be given to the Bank no later than 15:30 Central European Time on the first Business Day after the Rate Fixing Day of the relevant Loan. A Utilisation Request is irrevocable.

### 4.3 Utilisation

The Bank is not obliged to make a Loan available if:

(a) on the date of the Utilisation Request or on the Utilisation Date an Event of Default or Default is continuing or would result from that Loan;

(b) the Borrower has issued a notice pursuant to Clause 8.5 **Notification of Default**;

(c) the Utilisation Date is not a Business Day within the Availability Period;

(d) the amount of the Loan is not at least EUR 225,000,000 and the currency of the Loan does not comply with Clause 2 **Facility**;

(e) the Interest Period does not comply with Clause 5.1 **Interest Periods**;

(f)as a result of the proposed utilisation more than one (1) Loan would be outstanding; and



(g)as a result of the proposed utilisation the aggregate amount of the outstanding Loans would exceed the Commitment.

**4.4 Security**

For the purpose of securing all present and future obligations at any time due, owing or incurred by the Borrower to the Bank under the Finance Documents, the Parent Guarantor shall create in favour of the Bank a Parent Guarantee. For the avoidance of doubt, this shall not prejudice the right of the Bank to proceed in accordance with Clause 13 **Acceleration.**

**4.5 Cancellation of Commitment**

The Commitment which, at that time, is unutilised shall be cancelled immediately at the end of the Availability Period.

## 5. INTEREST AND FEES

**5.1 Interest Periods**

(a) Each Loan has successive Interest Periods. The Borrower selects an Interest Period of six (6) months in the Utilisation Request for that Loan and for each subsequent Interest Period in an irrevocable notice received by the Bank not later than 15:30 Central European Time on the last Business Day before the start of that Interest Period. Each Interest Period for a Loan will start on its Utilisation Date or (if applicable) on the first day after the expiry of its preceding Interest Period. The Bank will determine the appropriate Interest Period for any Unpaid Sum.

(b) No Loans may be outstanding after the date on which the final Repayment Instalment must be repaid.

**5.2 Obligation to pay interest**

(a) The Borrower must pay interest on each Loan made available to it and on any Unpaid Sum on the last day of each Interest Period.

(b) Except where it is provided to the contrary in this Agreement, the rate of interest for each Loan is the percentage rate per annum equal to the aggregate of the applicable Base Rate and Margin.

**5.3 Margin**

The Margin shall be the percentage rate per annum adjusted from time to time in accordance with the Long Term Credit Rating as set out in the table below:

| **Long Term Credit Rating** | **Margin (per cent. per annum)** |
|---|---|
| Baa2/BBB (or higher) | 0.45 |
| Baa3/BBB- (or lower) | 0.65 |

provided that:

(i) the initial Margin as at the date of this Agreement is 0.45 per cent. per annum;

(ii) in the event that the Long Term Credit Ratings of Moody's and Standard & Poor's differ by one notch the margin will be the one associated with the higher rating. In the event that the Long Term Credit Ratings of Moody’s and Standard & Poor’s will differ by more than one notch the margin will be the one associated with the lower rating;

(iii) in the event that only one of the two above Long Term Credit Ratings is available the remaining one shall determine the Margin;

(iv) if both Long Term Credit Ratings are withdrawn or no Long Term Credit Rating is assigned, the Margin shall be the highest percentage rate per annum set out above; and

(v) a change in the Margin will take effect from and including the fifth Business Day following the publication of the relevant assignment of or change in the Long Term Credit Rating or other event set out in sub-paragraph (iv) above with respect to all Advances then outstanding or made after that date.

### 5.4 Default interest

Upon the occurrence of an Event of Default, the rate of interest referred to in Clause 5.2 **Obligation to pay interest** will be equal to the aggregate of:

(a)the Base Rate for whatever Interest Period the Bank may deem appropriate;

(b)the Margin; and

(c)2.00% per annum.

### 5.5 Market disruption

If a Market Disruption Event occurs in relation to a Loan for any Interest Period, then the rate of interest for the Interest Period shall be the percentage rate per annum which is the sum of the Margin and the Cost of Funds.

### 5.6 Debiting of interest, costs and fees

Unless otherwise agreed in this Agreement, principal, interest, costs and fees payable by the Borrower may and will be debited by the Bank from any account of the Borrower with the Bank. In case an account will be designated by the Borrower in this respect, the Bank will debit the designated account if possible.

## 6. REPAYMENT



(a)The Borrower must repay the Loan made to it in one amount 12 (twelve) months after the Utilisation Date.

(b)No amount of a Loan repaid may subsequently be re-borrowed.

## 7. PREPAYMENT AND CANCELLATION

### 7.1 Mandatory prepayment – Illegality, Change of Control

(a) If it becomes unlawful for the Bank or any of its Affiliates to perform any of its obligations, to fund, issue or maintain any Loan or to receive interest under any Finance Document, the Bank may immediately cancel the Commitment and/or declare all outstanding Loans, together with accrued interest and all other amounts accrued under the Finance

Documents, to be immediately due and payable.

(b) The Borrower must promptly notify the Bank if it becomes aware of any Change of Control or intended Change of

Control. After a Change of Control, the Bank may by not less than 5 days' notice to the Borrower cancel the Commitment and/or declare all outstanding Loans, together with accrued interest and all other amounts accrued under the Finance Documents, to be immediately due and payable.

### 7.2 Voluntary prepayment

(a) Without prejudice to Clause 17.6 **Break Funding Costs**, the Borrower may, by giving not less than 10 Business Days prior notice to the Bank, prepay the Loan in whole or in part. Each prepayment notice is irrevocable and must specify the relevant date(s) and the amount of the Loan to be prepaid.

(b) No amount of a Loan prepaid under this Agreement may subsequently be re-borrowed.

## 8. INFORMATION COVENANTS

### 8.1 Financial statements

(a) The Borrower must supply to the Bank:

(i) its audited financial statements prepared in accordance with IFRS and/or local GAAP for each financial year;

(b) The Borrower shall supply the financial statements specified above as soon as the same become available but in any

event:

(i) in case of the annual audited financial statements of the Borrower, within 180 days after the end of each relevant

financial period;

(c) The Parent Guarantor must supply to the Bank:

(i)its audited consolidated financial statements prepared in accordance with local GAAP for each financial year; and

(ii)its interim consolidated financial statements for each quarter of each financial year.

(d) The Parent Guarantor shall supply the financial statements specified above as soon as the same become available but in

any event:

(i) in case of the annual audited consolidated financial statements of the Parent Guarantor, within 180 days after the end of each relevant financial period; and

(ii) in case of the quarterly interim consolidated financial statements of the Parent Guarantor, within 45 days after the end of each relevant financial period.

(e) The Borrower and the Parent Guarantor must inform the Bank as soon as reasonably possible in case its auditor does not issue an audit report for the Borrower in respect of the financial statements.

**8.2 Changes of financial year or in the method of financial reporting**

(a) The Borrower and the Parent Guarantor must notify the Bank of any proposed change of its financial year or to the manner in which its financial statements are prepared.

(b) If requested by the Bank, the Borrower and the Parent Guarantor must supply to the Bank:

(i) a full description of any change notified under paragraph (a) above;

(ii) sufficient information to enable the Bank to make a proper comparison between the financial position shown by the set of financial statements prepared on the changed basis and its most recent audited consolidated financial statements delivered to the Bank under this Agreement prior to the implementation of the change; and

(iii) positive sign -off by the Borrower’s auditor regarding the change.

Any reference in this Agreement to those financial statements shall be construed as a reference to those financial statements as adjusted to reflect the basis upon which the Original Financial Statements were prepared.

**8.3 Compliance Certificate**

Together with each set of its financial statements the Parent Guarantor must supply to the Bank a Compliance Certificate in accordance with Section 5.03 (c) (ii) of the Revolving Facility and a specification of the financial covenants' calculation. The Compliance Certificate must be duly signed by two authorised signatories, of whom one must be the Parent Guarantor’s chief financial officer. A Compliance Certificate supplied with the Parent Guarantor’s audited financial statements, must also be signed by its auditor.

### 8.4 Information - miscellaneous



The Borrower must supply to the Bank:

(a) copies of all material documents dispatched by the Borrower to its shareholders (or any class of them) and/or its creditors generally or any class of them, at the same time as they are dispatched to such shareholders and/or creditors by the Borrower;

(b) all information on changes in the legal or organisational structure of the Borrower, its constitutional documents, the Persons that are authorised to sign on behalf of the Borrowers documents and notices in connection with this Agreement and/or Persons that are authorised to sign payment orders on behalf of the Borrowers, promptly following the relevant change;

(c) promptly on request of the Bank, such information as the Bank requires to fulfil its know your customer requirements; and

(d) promptly on request of the Bank, any further information regarding the financial condition and operations of the Borrower as the Bank may reasonably request.

### 8.5 Notification of Default

The Borrower must notify the Bank of the occurrence of any Default (and the steps being taken to remedy it) promptly upon becoming aware of its occurrence. The Parent Guarantor must promptly upon becoming aware thereof, notify the Bank of the expectation that the Parent Guarantor will not be able to comply with its obligations under Clause 9 **Financial Covenants**.

## 9.FINANCIAL COVENANTS

The Parent Guarantor agrees to be bound by and that it shall comply with the Leverage Ratio 3.5x as stipulated and defined in Section 6.05 of the Revolving Facility and a specification of the financial covenants' calculation. The Parent Guarantor shall comply with the above mentioned Leverage Ratio 3.5x also in case the Revolving Facility is cancelled or otherwise ceases to be valid. The Compliance Certificate must be duly signed by two authorised signatories, of whom one must be the Parent Guarantor’s chief financial officer. A Compliance Certificate supplied with the Parent Guarantor’s audited financial statements, must also be signed by its auditor.

## 10.GENERAL COVENANTS

### 10.1 General

The Borrower agrees to be bound by the covenants set out in this Clause 10 **General Covenants** relating to it.

### 10.2 Borrowing for own account/no trustee

The Borrower declares that all Loans will be drawn by the Borrower for use in connection with funding of the Acquisition.

For the purpose of this Clause 10, “Acquisition” means the purchase, directly or indirectly, by Xylem Inc of the shares in Pure Technologies Ltd., 705 – 11th Avenue S.W., Calgary, Alberta, Canada T2R 0E3 and each of its direct and indirect subsidiaries.

### 10.3 Compliance with laws, constitutional documents and agreements

The Borrower must comply in all material respects with all relevant provisions of all laws and regulations, any court or administrative order, its constitutional documents and any agreement and other document to which it is a party or pursuant to which it or any of its assets is subject.

### 10.4 Negative pledge

(a) Except as provided in paragraph (b) below, the Borrower may not create or allow to exist any Security Interest on any of its present or future assets.

(b) Paragraph (a) does not apply to:

(i) any Security Interest constituted by or entered into pursuant to a Finance Document;

(ii) any Security Interest comprising a netting or set-off arrangement (including cash pooling) entered into by the Borrower in the ordinary course of its banking arrangements;

(iii) any Security Interest or other lien arising by operation of law and in the ordinary course of trading of the Borrower; or

(iv) any Security Interest securing indebtedness the amount of which (when aggregated with the amounts of any other indebtedness which has the benefit of a Security Interest given by the Borrower, other than any permitted security under (i), (ii) or (iii), does not exceed 10% of the total assets (or its equivalent in any other currency) of the Borrower at any time.

**10.5 Disposals**

(a) Except as provided below in paragraph (b), the Borrower may not, either in a single transaction or in a series of transactions whether related or not, dispose of all or any material part of its assets.

(b) Paragraph (a) does not apply to any disposal:

(i) from a member of the Group (including the Borrower) to another member of the Group (other than the Borrower);

(ii) made in the ordinary course of business of the disposing entity; or

(iii) other than under (i) or (ii) where the aggregate amount of those disposals does not exceed €50,000,000 (or its equivalent in any other currency) at any time in any financial year of the Borrower.

**10.6 Financial Indebtedness**



(a)Except as provided below in paragraph (b), the Borrower may not incur any Financial Indebtedness.

(b)Paragraph (a) does not apply to any Financial Indebtedness:

(i) incurred by the Borrower from another member of the Group;

(ii) incurred under or in relation to the Finance Documents and/or incurred under any other finance document as agreed between a member of the Group and (an Affiliate of) the Bank;

(iii) subordinated to the satisfaction of the Bank; or

(iv) other than under (i), (ii) or (iii) which in aggregate does not exceed €300,000,000 (or its equivalent in any other currency) at any time.

**10.7 Loans out**

(a) Except as provided in paragraph (b) below, the Borrower may not extend loans or be a creditor in respect of any Financial Indebtedness.

(b) Paragraph (a) does not apply to any loan or trade credit:

(i) from a member of the Group (including the Borrower) to another member of the Group (other than the Borrower);

(ii) extended on arm's length terms and in the ordinary course of business of the relevant member of the Group; or

(iii) other than under (i) or (ii), provided that the aggregate amount thereof does not exceed €50,000,000 (or its equivalent in any other currency) at any time.

**10.8 No Guarantees or indemnities**

(a) Except as provided in paragraph (b) below, the Borrower may not guarantee the obligations of any other Person or assume joint and several liability for or commit itself as surety for those obligations.

(b) Paragraph (a) does not apply to:

(i) guarantees on arm's length terms and given in the ordinary course of business of the relevant member of the Group;

(ii) any obligation under the Finance Documents or under any other finance document as agreed between a member of the Group and (an Affiliate of) the Bank; or

(iii) other guarantees than under (i) or (ii), provided that the aggregate amount thereof does not exceed €50,000,000 (or its equivalent in any other currency) at any time.

**10.9 Acquisitions**

The Borrower may not make any acquisition to the extent that the consideration (when aggregated with the consideration of all other acquisitions by members of the Group (excluding the Acquisition) in any financial year of the Borrower) exceeds €200,000,000 (or its equivalent in any other currency) at any time.

**10.10 Pari Passu**

The Borrower shall ensure that at all times any unsecured and unsubordinated claims of the Bank against it under the Finance Documents rank at least pari passu with the claims of all its other unsecured and unsubordinated creditors except those creditors whose claims are mandatorily preferred by laws of general application to companies.

## 11. REPRESENTATIONS

The Borrower makes the representations and warranties set out in this Clause 11 **Representations** to the Bank on the date of this Agreement. The representations are deemed to be made by the Borrower by reference to the facts and circumstances then existing on the date of each Utilisation Request and the first day of each Interest Period.

**11.1 Status**

It is a corporation, duly incorporated and validly existing under the law of its jurisdiction of incorporation. It has the power to own its assets and carry on its business as it is being conducted.

**11.2 Binding obligations**

Subject to applicable insolvency and other laws generally affecting the rights or remedies of creditors the obligations expressed to be assumed by it in each Finance Document are legal, valid, binding and enforceable obligations.

**11.3 Non-conflict with other obligations**

The entry into and performance by it of, and the transaction contemplated by, the Finance Documents do not and will not conflict in any material respect with (i) any law or regulation applicable to it, (ii) any constitutional documents of the Borrower or (iii) any agreement or instrument binding upon it or any member of the Group or any of its or any member of the Group assets.

**11.4 Power and authority**

It has the power to enter into, perform and deliver, and has taken all necessary action to authorise its entry into, performance and delivery of, the Finance Documents and the transactions contemplated by those Finance Documents.

**11.5 Validity and admissibility in evidence**

All Authorisations required (i) to enable it lawfully to enter into, exercise its rights and comply with its obligations in the Finance Documents, and (ii) to make the Finance Documents admissible in evidence in its jurisdiction of incorporation, have been obtained or effected and are in full force and effect.





**11.6 Governing law and enforcement**

The choice of governing law of the Finance Documents will be recognised and enforced in its jurisdiction of incorporation. Any judgment obtained in relation to a Finance Document in the jurisdiction of the governing law of that Finance Document will be recognised and enforced in its jurisdiction of incorporation.

**11.7 No Default**

No Event of Default is continuing or is reasonably likely to result from the utilisation of the Facility or the entry into, the performance of, or any transaction contemplated by, any Finance Document.

**11.8 No Misleading Information**

All the information supplied to the Bank were and continue to be true and accurate in any material respect; in particular, the financial statements furnished to the Bank fairly and completely reflect the financial status of the Borrower as on the date of and for the period to which they refer and are not affected by any material change since the date these accounts were drawn up.

**11.9 No Litigation**

No litigation, attachment, arbitration, administrative procedure, which has or might have an adverse effect on the financial condition of the Borrower or on the ability of the Borrower to perform its obligations under the Finance Documents, or a reorganization or bankruptcy procedure, is pending or resolved save for those disclosed upon the signing of this Agreement.

## 12. EVENTS OF DEFAULT

Each of the events set out in this Clause 12 **Events of Default** is an Event of Default.

**12.1 Non-payment**

The Borrower does not pay on the due date any amount payable by it under the Finance Documents in the manner required under the Finance Documents, unless the non-payment is caused by a technical or administrative error and is remedied within three (3) Business Days of the due date.

**12.2 Breach of other obligations**

(a) The Parent Guarantor does not comply with any term of Clause 9 **Financial Covenants**;

(b) The Borrower does not comply with any term of Clause 10 **General Covenants**; or

(c) The Borrower does not comply with any term of the Finance Documents (other than those referred to in Clause 12.1 **Non–payment** or under paragraph (b) above) provided that no Event of Default under this paragraph (c) will occur if the non-compliance is capable of remedy and is remedied within 14 days of the earlier of (i) the Bank giving notice or (ii) the Borrower becoming aware of the non-compliance.

**12.3 Misrepresentation**

Any representation or statement made or deemed to be made by the Borrower in the Finance Documents or any other document delivered by or on behalf of the Borrower under or in connection with any Finance Document is or proves to have been incorrect or misleading when made or deemed to be made.

**12.4 Cross-default**

(a) Any Financial Indebtedness of a member of the Group is not paid when due (after the expiry of any originally applicable grace period);

(b) Any Financial Indebtedness of a member of the Group is declared to be or otherwise becomes due and payable prior to its specified maturity as a result of an event of default (however described);

(c) Any commitment for any Financial Indebtedness to a member of the Group is reduced, cancelled or suspended as a result of the occurrence of an event of default (however described), or

(d) Any creditor of a member of the Group becomes entitled to declare any Financial Indebtedness of any member of the Group due and payable prior to its specified maturity as a result of an event of default (however described); unless the

aggregate amount of Financial Indebtedness indicated in paragraphs (a), (b), (c) and (d) above is less than EUR 50,000,000 (or its equivalent in any other currency)

(e) Any event of default (however described) under any agreement or document entered into or issued by a Person to secure the obligations of the Borrower under this Agreement.

**12.5 Insolvency, dissolution or attachment**

(a) Any member of the Group or any of its creditors applies for moratorium or files for bankruptcy or any other equivalent that

materially qualifies as insolvency of that member, or any member of the Group is declared bankrupt or insolvent by a competent authority, a petition is presented for its winding-up or liquidation, is subject to a moratorium or any other equivalent that materially qualifies as insolvency, is unable or admits its inability to pay its debts as they fall due, suspends making payments on any of its debts (or announces an intention to do so), begins negotiations with its creditors for the rescheduling of any of its indebtedness, offers a composition, compromise, concordat, assignment or arrangement to its creditors, is being dissolved or decides (or another corporate body of such Person decides or consents to such a decision) to carry out any of the above mentioned actions. If a moratorium occurs, the ending of the



moratorium will not remedy any Event of Default caused by that moratorium.

(b) The appointment of a liquidator, receiver, administrator or other similar officer in respect of any member of the Group or any of its assets.

(c) The enforcement of any Security Interest over any assets of one or more members of the Group.

(d) Any asset(s) of one or more members of the Group is affected by an expropriation, executorial attachment, sequestration, distress or execution or a provisional attachment which is not discharged or set aside within 30 days.

(e) A member of the Group acts or decides, or is the subject of an act or decision, in a foreign jurisdiction which is comparable with an act or decision described in the paragraphs (a), (b), (c) or (d) above.

**12.6 Changes within the Borrower**

The Borrower’s articles of association or internal rules or regulations are, in the opinion of the Bank, materially amended or the corporate structure of the Group is, in the opinion of the Bank, changed significantly, by a merger, demerger, winding up, conversion, takeover or otherwise,other than with the prior written consent of the Bank.

**12.7 Cessation of business**

The Borrower ceases, or threatens to cease, to carry on all, or a material part of its business.

**12.8 Qualified audit report**

The Borrower’s auditor issues a qualified audit report in respect of the audited financial statements which the Bank considers material (acting reasonably).

**12.9 Material adverse change**

Any (series of) event(s) (which specifically includes a change in law or regulation) which have or, in the opinion of the Bank, are reasonably likely to have a Material Adverse Effect.

**12.10 Invalidity and unenforceability of the Finance Documents**

(a) It is or becomes unlawful for the Borrower to perform any of its obligations under the Finance Documents.

(b) Any Finance Document is not effective or enforceable in accordance with its terms or is alleged by the Borrower to be ineffective and/or unenforceable in accordance with its terms for any reason.

(c) The Borrower repudiates or rescinds a Finance Document or evidences an intention to repudiate or rescind a Finance Document.

## 13. ACCELERATION

Without prejudice to any other rights it may have under this Agreement, if an Event of Default occurs or is continuing, the Bank may, by notice to the Borrower:

(a)cancel the Commitment in whole or in part;

(b)declare that any and all amounts outstanding under the Finance Documents are:

i) immediately (without a default notice being required) due and payable (as a result of which all outstanding Loans including accrued interest and any other amounts due by the Borrowers under the Finance Documents (including Break Funding Costs) are immediately due and payable), or

ii) payable on first demand by the Bank (as a result of which all outstanding Loans including accrued interest and any other amounts due by the Borrowers under the Finance Documents (including Break Funding Costs) will become payable on first demand by the Bank;

## 14. PAYMENTS AND SET-OFF

### 14.1 Currency of account

(a) Each (re)payment in respect of Loans, Unpaid Sums, interest, costs, expenses or taxes shall be made in the currency in which such amounts are denominated or, if applicable, incurred.

(b) Any amount expressed to be payable in a specific currency shall be paid in that currency.

### 14.2 Place of payment

Without prejudice to Clause 5.6 **Debiting of Interest, Cost and Fees**, all payments to the Bank under the Finance Documents shall be made into the account specified by the Bank.

### 14.3 No set-off

All payments made by the Borrower under the Finance Documents must be made without set-off or counterclaim with the exception of counterclaims which are not in dispute between the Borrower and the Bank or have been legally established.

### 14.4 Set-off by the Bank

The Bank is at all times entitled to set off any debt receivable by it from the Borrower under or in connection with the Finance Documents (each a **claim**) against any debt owed by the Bank to the Borrower (each a **debt**) regardless of the currency in which the relevant claim and the relevant debt are denominated.

### 14.5 Business Days



If a payment under a Finance Document is due on a day which is not a Business Day, the due date for that payment will instead be the next Business Day in the same calendar month or if there is no such day in that calendar month the preceding Business Day.

### 14.6 Priority of payments

If the funds provided by the Borrower for the payment of amounts due under the Finance Documents are insufficient, the priority of payments shall be determined by the Bank irrespective of the due date of the particular amounts or any instruction of the Borrower.

## 15. INCREASED COST

The Borrower shall, within three Business Days of a written demand from the Bank, pay to the Bank the amount equal to any Increased Cost incurred by the Bank or any of its Affiliates as a result of:

(a) the introduction of or any change in (or in the interpretation, administration or application of) any law or regulation (with or without having the force of law) made after the date of this Agreement;

(b) compliance with any law or regulation (with or without having the force of law) made after the date of this Agreement; or

(c) the implementation or application of or compliance with Basel III or any law or regulation that implements, applies or amends Basel III.

For this Clause Basel III means:

**(a)** Directive 2013/36/EU of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directive 2006/48/EC and 2006/49/EC (*CRD IV*);

(b) Regulation (EU) no. 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending regulation (EU) No. 648/2012 (*CRR*); and

(c) any and all other agreements, rules, guidance, regulations and/or standards published by the Basel Committee on Banking Supervision relating to "*Basel III*".

## 16. EVIDENCE AND CALCULATIONS

### 16.1 Evidence

In the absence of manifest error:

(a) accounts maintained by the Bank will be conclusive evidence of the existence and the amount of the obligations of the Borrower under any Finance Document; and

(b) a determination by the Bank of a fee, an interest rate or amount under any Finance Document will be conclusive

evidence.

### 16.2 Calculations

Any interest or fee accruing under this Agreement accrues from day to day and is calculated on the basis of the actual number of days elapsed and a year of 360 days.

## 17. INDEMNITY AND GROSS UP

### 17.1 Indemnity

The Borrower must indemnify the Bank promptly upon demand against any costs, loss or expenses (including notarial and legal fees) which the Bank incurs in connection with (i) the occurrence of, or investigating any event or circumstances which the Bank reasonably believes to be a Default or an Event of Default, (ii) the enforcement of the performance by the **Borrower** of its obligations, or the preservation of any rights, under or in connection with the Finance Documents and (iii) the creation, execution, modification and termination of or the Parent Guarantee.

### 17.2 Currency indemnity

If any sum due from the Borrower under the Finance Documents has to be converted into another currency, that Borrower shall as an independent obligation within 3 Business Days of a written demand: (i) indemnify the Bank against any loss, cost or liability; and (ii) make such additional payment to the Bank necessary to enable it to exchange the sum received against the exchange rate available to it at the time it is received, into the sum and currency originally expressed to be due under the Finance Documents. The Borrower waives any right it may have in any jurisdiction to pay any amount under the Finance Documents in a currency other than the currency in which it is expressed to be payable.

**17.3 Gross up**

The Borrower must make all payments to be made under the Finance Documents without any tax deduction, unless a tax deduction is required by law. If a tax deduction is required by law to be made by the Borrower or the Bank, the amount of the payment due from the Borrower will be increased to an amount which (after making the tax payment) leaves an amount equal to the payment which would have been due if no tax payment had been required.

**17.4 Stamp duty**

The Borrower shall pay and indemnify the Bank against any cost, loss or liability that the Bank incurs in relation to all stamp duty, registration and other similar taxes payable in respect of any Finance Document.



**17.5 Value added tax**

All amounts payable under a Finance Document to the Bank shall be deemed to be exclusive of any value added tax (VAT). If VAT is chargeable, the Borrower shall, pay to the Bank (in addition to and at the same time as paying the original amount) an amount equal to the amount of the VAT. Where a Finance Document requires the Borrower to reimburse or indemnify the Bank for any costs or expenses, the Borrower shall, at the same time reimburse and indemnify the Bank against all VAT incurred by the Bank in respect of the costs or expenses save to the extent that the Bank is entitled to repayment or credit in respect of such VAT.

**17.6 Break Funding Costs**

If a Loan is repaid prior to the end of its Interest Period, the relevant Borrower must pay to the Bank the Break Funding Costs attributable to that Loan.

## 18.CHANGES TO THE DOCUMENTS AND PARTIES

**18.1 Amendments, waivers and consents**

Any waiver, amendment and consent in relation to or under the Finance Documents must be agreed upon in writing (*Schriftform* according to Section 126 German Civil Code).

**18.2 Transfers by the Borrower**

The Borrower may not assign or transfer any of its rights or obligations under any Finance Document without the prior written consent of the Bank.

**18.3 Transfers by the Bank**

The Bank may freely assign, transfer or otherwise create a Security Interest over any or all of its rights and/or any or all of its obligations under any Finance Document. To the extent necessary, the Borrower hereby unconditionally and irrevocably agrees in advance to cooperate with and in advance approves any assignment, transfer or the creation of any Security Interest in accordance with this Clause.

## 19.NOTICES

**19.1 Manner of giving notices**

(a) Any communication in connection with a Finance Document must be in writing, or, if agreed or indicated by the Bank, electronically (including, but not limited to, e-mail), and must be duly signed and, unless stated otherwise, may be made by letter, sent by post, attached to an e-mail or by fax.

(b) The Bank may rely on the literal wording of any notice (purporting to be) from the Borrower and is not obliged to verify the contents thereof. Incompleteness or distortion of a notice is for the risk of the sender thereof.

(c) The Bank will not be liable for any loss and/or damage resulting from the use of fax or electronic means of communication, including, but not limited to, loss or damage resulting from failure or delay in delivery, interception or manipulation by third parties or computer programs used for electronic communications and transmission of viruses (other than in the case of gross negligence and/or wilful misconduct).

**19.2 Contact details**

(a) Subject to the provisions of this Clause and unless expressly agreed otherwise in writing between the Bank and the Borrower, the contact details of each Party for all communications are those notified by that Party on or before the date it becomes a Party to this Agreement.

(b) The contact details of the Borrower are: Xylem Europe GmbH

attn: Mr. Thomas Joakim Brannemo Bleicheplatz 6

8200 Schaffhausen, Switzerland

(c) The contact details of the Bank are: ING Bank, a branch of ING-DiBa AG attn. Corporate and FI Lending (CFIL) Hamburger Allee 1,

60486 Frankfurt am Main, Germany

E-mail: Ingo.Steen@ing.de and SPCB-DE-ING-LOAN-ADMINISTRATION@ing.de

(d) A Party may change its contact details by giving 5 Business Days' notice to the Bank (or in the case of the Bank, to the other Parties). Any communication or document to be made or delivered to the Bank will only be effective if and when actually received by the Bank. Where a Party nominates a particular department or officer to receive a communication, a communication will not be effective if it fails to specify that department or officer.

## 20. GENERAL TERMS AND CONDITIONS



The general terms and conditions of the Bank attached hereto as Schedule **General Terms and Conditions** shall be applicable. By the execution of the Agreement each Obligor acknowledges receipt of a copy of these conditions and agrees to the terms. In the event of a conflict between these conditions and the terms of the Agreement, the terms of the Agreement shall prevail.

## 21. DISCLOSURE OF CONFIDENTIAL INFORMATION

The Borrower irrevocably consents to the disclosure by the Bank, to the extent allowed by applicable law, of any (confidential) information, including personal data, regarding the Borrower and the Finance Documents including information which is, if applicable, subject to bank secrecy rules, to:

(a) the Bank's Affiliates, professional advisers, auditors, representatives and service providers;

(b) any Person to whom the Bank (intends to) assign(s) or transfer(s) or create(s) a Security Interest over all or a part of its rights or obligations under the Finance Documents, and to any of that entity's Affiliates and other entities, including professional advisers, to the extent necessary or desired to conclude and perform such assignment, transfer or Security Interest; and

(c) any Person to whom information is required or requested to be disclosed by any court of competent jurisdiction or any governmental, banking, taxation or other regulatory authority, the rules of any stock exchange or pursuant to any applicable law or regulation.

## 22. MISCELLANEOUS

(a) No failure or delay by the Bank in exercising any right or remedy under the Finance Documents shall operate as a waiver thereof, no single or partial exercise of any such right or remedy shall prevent any other or further exercise thereof or the exercise of any other right or remedy, and the rights and remedies provided in the Finance Documents are cumulative and not exclusive of any rights or remedies provided by law.

(b) If, at any time, any provision of the Finance Documents is or becomes illegal, invalid or unenforceable, it shall not affect or impair the legality, validity or enforceability of any other provisions of the Finance Documents.

(c) The Agreement may be executed in any number of counterparts, and this has the same effect as if the signatures on the counterparts were on a single copy of this Agreement.

## 23. GOVERNING LAW AND JURISDICTION

(a) This Agreement and any non-contractual obligations arising out of or in connection with it are governed by the laws of Germany.

(b) The courts of Frankfurt a.M. in Germany, in first instance, have jurisdiction to settle any dispute in connection with this Agreement. This submission shall not limit the rights of the Bank to take proceedings in any other court which may exercise jurisdiction over the Borrower or any of its assets.

## SCHEDULE 1
## CONDITIONS PRECEDENT
## PART 1
## TO BE DELIVERED BEFORE THE FIRST UTILISATION



(1) A certified copy of the articles of association or constitutional documents of the Borrower and the Parent Guarantor.

(2) Certified copies of up to date excerpts from the commercial register, a signature-card with a specimen of the signature, copies of the identity cards/passports and, if applicable, all additional documentation evidencing that the Person(s) executing a document or notice on behalf of the Borrower are entitled to represent the Borrower and the Parent Guarantor.

(3) All information that the Bank needs to fulfil its know your customer requirements and comply with applicable anti money-laundering legislation.

(4) A copy of the Group structure chart, including the ultimate parent of the Borrower.

(5) A copy of the most recent audited financial statements of the Borrower.

(6) A copy of the most recent audited consolidated financial statements of the Parent Guarantor.

(7) Legal opinions: legal opinion on the executed Parent Guarantee (to be prepared by ING's lawyer in the US) and capacity opinion done by ING legal in Switzerland

(8) A copy of the duly executed Parent Guarantee and relevant Finance Documents.

(9) A copy of the resolution of the board of directors of the Borrower and the Parent Guarantor approving the transaction and the execution of the Finance Documents.

(10) A copy of the resolution/letter of the shareholder(s) of the Borrower.

(11) A certified confirmation of the regulatory approval of the acquisition finance of Pure Technologies Ltd.

## SCHEDULE 2

## PARENT GUARANTEE



**Xylem Inc. Parent Guarantee dated January , 2018**

The undersigned, Xylem Inc., incorporated in Indiana, U.S.A. and having its registered office and principal place of business at 1 International Drive, Rye Brook, NY 10573 U.S.A., hereinafter referred to as the "**Guarantor**",

**hereby unconditionally and irrevocably guarantees** as an independent obligation to and in favor of ING Bank, a Branch of ING-DiBa AG, for itself, its branches and all of its direct and indirect holding companies, subsidiaries and/or any of its or their affiliates, branches and offices (hereinafter collectively referred to as the "**Bank**"), the correct and prompt fulfilment of any and all debt and liabilities, actual or contingent, present or future of Xylem Europe GmbH, incorporated in Switzerland and having its registered address at Schaffhausen, Switzerland (hereinafter referred to as the "**Borrower**") under or in connection with the Euro 225,000,000 Term Loan Agreement dated January ___, 2018, entered into with the Bank, as amended and supplemented from time to time (hereinafter referred to as the "**Agreement**") including without limitation any debts or liabilities under the Agreement (hereinafter collectively referred to as the "**Obligations**").

Capitalized terms used herein and not otherwise defined herein shall have the same meaning as given those terms in the Agreement, unless the context requires otherwise.

The Guarantor represents and warrants to the Bank that:

(a) it is duly organized and validly existing under the laws of the state of its incorporation and is in good standing under the aforesaid laws and it has full corporate power and authority to enter into this Guarantee;

(b) the execution, delivery and performance of this Guarantee and the performance of the obligations of the Guarantor hereunder have been duly authorized by all necessary corporate action and other actions required on the part of the Guarantor

(c) this Guarantee constitutes legal, valid and binding obligations of the Guarantor, subject to the laws of bankruptcy and other laws affecting the rights of creditors generally;

(d) neither the execution, delivery and performance by the Guarantor of this Guarantee nor the payment of any or all amounts due hereunder nor the compliance with the terms and conditions hereof will:

(i)violate any law, administrative regulation or court judgement or decree; or

(ii)conflict with the certificate of incorporation of the Guarantor;

(e) all provisions of the Agreement are, and all provisions of the Transactions are or will be, fully known to and approved by the Guarantor.

The Guarantor therefore undertakes upon first written demand of the Bank to pay – without set-off or counterclaim – as its own debt to the Bank the amount of the Obligations demanded by the Bank within ten (10) Business Days following the day on which the demand is received by the Guarantor. The determination by the Bank of the amount shall, in the absence of manifest error, be conclusive and binding on the Guarantor.

The Bank shall be entitled to make more than one demand against the Guarantor, and each written demand of the Bank shall contain a declaration that the Borrower has failed to fulfil its Obligations in whole or in part.

All sums payable by the Guarantor under this Guarantee, whether in respect of principal, interest, fees or otherwise, shall be paid free and clear of and without any deduction or withholding or payment for or on account of any present or future tax (other than any income tax on overall net income of the Bank) levied or imposed. If any such deduction or withholding shall be required to be made by any competent authority, the Guarantor shall forthwith pay to the Bank such additional sums as shall result in the Bank receiving the same net amount as it would have received in the absence of such deduction or withholding.

The Guarantor's liability under this Guarantee is irrevocable, absolute and unconditional, and shall not be impaired, affected or discharged by reason of (and the Guarantor hereby irrevocably waives any defenses it may now have or hereafter acquire in any way relating to):

(a) any variation in the terms or provisions of the Agreement or the Transactions;

(b) any time or other indulgence granted by the Bank to the Borrower or any other person or any forbearance (whether as to payment, time, performance or otherwise howsoever) or absence of any action to enforce the Agreement or the Transactions which might but for this provision have any such effect;

(c) unenforceability, invalidity or termination of, or any irregularity in the Agreement or the Transactions or the execution of either by the Borrower or any other person or any deficiency in the power of the Borrower or any other person to enter into and perform its obligations under the Agreement or the Transactions (whether or not known to the Bank);



(d) the recovery of any judgment against the Borrower or any action to enforce the same, or any other circumstances which may otherwise constitute a legal or equitable discharge or defense of a guarantor, except in each case for satisfaction in full of the Obligations.

The Guarantor hereby expressly waives diligence, presentment, demand of payment, protest and notice of dishonor.

The Guarantor's liability shall include an obligation to compensate the Bank for any reasonable out-of-pocket costs and expenses, including without limitation reasonable legal fees, incurred in enforcing this Guarantee (collectively, "**Bank Expenses**").

This Guarantee shall be binding upon and shall inure to the benefit of the Bank and its respective successors and assigns and references in this Guarantee shall be construed accordingly.

This Guarantee is a continuing guarantee and shall remain in full force and effect and be binding upon Guarantor until the Borrower is no longer entitled to incur additional Obligations and all Obligations have been satisfied in full, at which time this Guarantee shall automatically be cancelled; provided that this Guaranty shall continue to be effective or be reinstated (as the case may be) in the event the payment or collateralization of any of the Obligations or any part thereof is rescinded or must be otherwise restored or returned by the Bank upon a bankruptcy of the Borrower or otherwise.

This Guarantee and all rights and obligations hereunder or in connection herewith shall be governed by and construed in accordance with the laws of the State of New York. The Guarantor hereby irrevocably and unconditionally consents to submit to the jurisdiction of the courts of the State of New York and of the United States of America located in the borough of Manhattan or in the United States District Court for the Southern District of New York for any action, suit, or proceeding arising out of or relating to this Guarantee and the transactions contemplated hereby. The Guarantor hereby irrevocably and unconditionally waives any objection to the laying of venue of any action, suit, or proceeding arising out of this letter agreement in the courts of the State of New York or the United States of America located in the borough of Manhattan or the United States District Court located in the Southern District of New York, and hereby further irrevocably and unconditionally waives and agrees not to plead or claim in any such court that any such action, suit, or proceeding brought in any such court has been brought in an inconvenient forum.

Each of Guarantor and Bank hereby waives its respective rights to a jury trial of any claim or cause of action based upon or arising out of this guarantee, including contract claims, tort claims, breach of duty claims, and all other common law or statutory claims. Each of Guarantor and Bank hereby states that it knowingly and voluntarily waives its rights to a jury trial. In the event of litigation, a copy of this guarantee may be filed as a written consent to a trial by the court.

Notwithstanding anything to the contrary contained herein, in no event shall Guarantor's payment obligations under this Guarantee exceed the sum of (a) any unpaid Obligations and (b) Bank Expenses.

IN WITNESS WHEREOF, the undersigned has executed this Guarantee as of the date first above written.

XYLEM INC.

By:

Name:

Title:

Acknowledged

ING BANK, a Branch of ING-DiBa AG

By:

Name:

Title:

By:

Name:

Title:

## SCHEDULE 3
## UTILISATION REQUEST



To: [ING ENTITY]

From: [BORROWER] Date: [DATE]

**[NAME COMPANY] – EUR [•] Term Loan Agreement dated [DATE] (**the **"Agreement")**

1. We refer to the Agreement. This is a Utilisation Request. Capitalised terms used herein have the meaning given to those terms in the Agreement unless defined otherwise herein.

2. We wish to borrow a Loan on the following terms:

   (a)Utilisation Date: [•];

   (b)Amount [and currency]: €[•];

   (c)Interest Period: [•] months.

3. The bank account to which the Loan should be paid is: bank account [•] in the name of [•] held at [•].

4. We confirm that each condition precedent under Clause 4.1 **Conditions precedent** of the Agreement which must be satisfied on the date of this Utilisation Request is so satisfied and that there are no circumstances as described in Clause 4.3 **Utilisation** of the Agreement on the basis of which the Bank would not be obliged to extend the Loan.

5. This Utilisation Request is irrevocable.

[BORROWER] By: [•]

Title: [•]

SIGNATORIES

**XYLEM EUROPE GMBH**

By: /s/ Christian Blanc
By: Christian Blanc
Title: SVP & President, Europe CT

**XYLEM INC.**

By: /s/ Samir Patel
By: Samir Patel
Title: Vice President & Treasurer

**ING BANK, a branch of ING-DiBa AG**

By: /s/ Stefanie Flora
By: Stefanie Flora
Title: VP

By: /s/ Ingo Steen
By: Ingo Steen
Title: VP

**XYLEM**
**2011 OMNIBUS INCENTIVE PLAN**

**[YEAR] RESTRICTED STOCK UNIT AGREEMENT**

This Agreement (the "**Agreement**") between Xylem Inc. (the "**Company**") and **[Participant Name]** (the "**Participant**") is effective as of **[Grant Date]**. Capitalized terms that are not defined in this Agreement are defined in the Company's 2011 Omnibus Incentive Plan (the "**Plan**"). This Agreement is only being provided in English. The Participant is an employee of the Company or an Affiliate. In recognition of the Participant's valued services, the Company, through the Leadership Development and Compensation Committee of its Board of Directors (the "**Committee**"), is providing the Participant an inducement to remain employed and an incentive for increased efforts while employed. In consideration of the terms and conditions in this Agreement, the parties agree as follows:

1. **Grant of Restricted Stock Units**. The Company hereby confirms the grant on [**Grant date**] (the "**Grant Date**") to the Participant of **[#,###]** Restricted Stock Units ("**RSUs**"). The RSUs are notional units of measurement denominated in shares of common stock (*i.e*., one Restricted Stock Unit is equivalent in value to one share of common stock of the Company).

   The RSUs represent an unfunded, unsecured right to receive shares and dividend equivalent payments under subsection 2(b) in the future if the conditions in the Plan and this Agreement are satisfied.

   **Nature of the Grant:**

   (a) The grant of the RSUs is voluntary and occasional and does not create any contractual or other right to receive future grants of RSUs, or benefits in lieu of RSUs, even if RSUs have been granted in the past. All decisions with respect to future RSUs or other grants, if any, will be at the sole discretion of the Company;

   (b) The Participant is voluntarily participating in the Plan;

   (c) The RSUs and the shares subject to the RSUs, are not part of normal or expected compensation for any purpose, including for purposes of calculating any severance, resignation, termination, redundancy, dismissal, end-of-service payments, bonuses, pension or retirement or welfare benefits or similar payments;

   (d) Future value of the underlying shares is unknown, indeterminable and cannot be predicted with certainty;

   (e) No claim or entitlement to compensation or damages will arise from forfeiture of the RSUs resulting from the termination of the Participant's employment; and

   (f) The Company will not be liable for any foreign exchange rate fluctuation between the Participant's local currency and the United States Dollar that may affect the value of the RSUs or of any amounts due to the Participant pursuant to the settlement of the RSUs or the subsequent sale of any shares acquired upon settlement.

2. **Terms and Conditions**. It is understood and agreed that the RSUs are subject to the following terms and conditions:

   (a) **Restrictions**. Except as otherwise provided in the Plan and this Agreement, neither this Award nor any RSUs subject to this Award may be sold, assigned, pledged, exchanged, transferred, hypothecated or encumbered, other than to the Company as a result of forfeiture of the RSUs.

   (b) **Voting and Dividend Equivalent Rights.** The Participant will not have any privileges of a stockholder of the Company with respect to the RSUs or any shares that may be delivered under this Agreement, including without limitation any right to vote the shares or to receive dividends, unless and until the shares are delivered on vesting of the RSUs. Dividend equivalents will be earned with respect to each Restricted Stock Unit that vests and the amount will be equal to the total dividends declared on a share, where the record date of the dividend is between the Grant Date of this Award and the date a share is issued on vesting of the RSU. Any dividend equivalents earned will be paid in cash to the Participant when the shares subject to the vested RSUs are issued. No dividend equivalents will be earned or paid with respect to any RSUs that do not vest. Dividend equivalents will not accrue interest.

   (c) **Vesting and Payment**. RSUs will vest if the Participant has been actively employed by the Company or an Affiliate from the Grant Date through the vesting date. Active employment does not include any potential severance period. The RSUs will vest in 3 installments as follows:

   - 1/3rd of the RSUs will vest 1 year after the **Grant Date,**
   - 1/3rd of the RSUs will vest 2 years after the **Grant Date**, and
   - 1/3rd of the RSUs will vest 3 years after the **Grant Date**.

   **[Grant Date]**, **[Grant Date + 1 year], and [Grant Date + 2 years]** are the respective **"Vest Period Start Date"** for each of the 3 installments.

   Except as provided in subsection 2(i), on vesting of the RSUs, including vesting pursuant to subsections 2(d) or 2(e), the Company will deliver to the Participant (i) one share for each vested RSU, with any fractional shares resulting from proration pursuant to subsection 2(e), if applicable, to be rounded to the nearest whole share, and (ii) an amount in cash attributable to dividend equivalents earned in accordance with subsection 2(b), less shares withheld in accordance with subsection 2(f).

   (d) **Effect of Change in control.** If the acquiring or surviving company in the transaction assumes or continues outstanding RSUs under the Plan, any unvested RSUs will continue to vest based on the RSUs' service-based vesting criteria, if any.

   If the Participant's active employment with the Company or an Affiliate is terminated by the Company or an Affiliate without Cause or by the Participant for Good Reason (for applicable Participants only) within 2 years of a Change in Control, any assumed unvested RSUs will become 100% vested on the termination date.

   If the acquiring or surviving company in the transaction does not assume or continue outstanding awards under the Plan, immediately prior to the Change in Control any unvested RSUs will become 100% vested.

   "**Cause**" means (i) the Participant's willful and continued failure to substantially perform his or her duties with the Company (other than any such failure resulting from the Participant's incapacity due to physical or mental illness) or (ii) the Participant willfully engaging in conduct that demonstrably and materially injures the Company or its Affiliates, monetarily or otherwise. "Willful" means the action is done or omitted in bad faith or without reasonable belief that the action or omission was in the best interests of the Company.

"**Good Reason**" means, without the Participant's express written consent (i) a reduction in annual target total cash compensation (base salary and target bonus), (ii) the assignment of any duties inconsistent in any material adverse respect with the Participant's position, authority, duties or responsibilities, (iii) any other action by the Company or an Affiliate which results in a material diminution in such position, authority, duties or responsibilities; or (iv) the Company or an Affiliate requiring the Participant to relocate to a work location 50 miles or more from the location where the Participant was principally working immediately prior to the Change in Control. The Participant must give notice within 90 days of any Good Reason event.

Good Reason only applies to Company employees who are at the time of termination of employment, or were at any time during the 2 year period immediately preceding the Change in Control, covered by the Xylem Special Senior Executive Pay Plan or the Xylem Enhanced Severance Pay Plan and will exclude an isolated, insubstantial and inadvertent action not taken in bad faith that is resolved by the Company or an Affiliate within 30 days of receiving notice.

(e) **Effect of Termination of Employment.** RSUs will only vest while the Participant is actively employed by the Company or an Affiliate. If the Participant's active employment with the Company or an Affiliate is terminated for any reason, and the termination constitutes a "separation from service" within the meaning of Section 409A of the Code and any related regulations or other effective guidance promulgated thereunder ("**Section 409A**"), subject to subsection 2(d), the following would apply to any unvested RSUs on the date of the Participant's termination of employment:

(i) Termination due to Death or Disability. Any unvested RSUs will immediately become 100% vested.

(ii) Termination due to Retirement. A prorated portion (as described below) of unvested RSUs with vesting date within 12 months of termination shall immediately vest. All other unvested RSUs will automatically be forfeited.

(iii) Termination other than Death, Disability and Retirement. Any unvested RSUs will automatically be forfeited.

"**Disability**" means the complete and permanent inability of the Participant to perform all duties under the terms of his or her employment, as determined by the Committee upon the basis of such evidence, including independent medical reports and data, as the Committee deems appropriate or necessary.

"**Retirement**" means the termination of the Participant's employment (either by the Company or the Participant), if, at the time of such termination, the Participant is at least age 55 and has completed 10 years of service with the Company or the Participant is age 65 or older.

**Prorated Vesting Upon Retirement.** The prorated portion of the RSUs that vests upon the Participant's termination of employment due to the Participant's Retirement will be determined by multiplying the total number of unvested RSUs with vesting date within 12 months of termination by a fraction, of which the numerator is the number of full months the Participant has been continually employed since the most recent Vest Period Start Date and the denominator is 12. For this purpose, full months of employment shall be based on monthly anniversaries of the Vest Period Start Date, not calendar months.

(f) **Tax Withholding.** The Company may make such provisions and take such actions as it may deem necessary for the withholding of all applicable taxes attributable to the RSUs and any related dividend equivalents. Unless the Committee determines otherwise, the minimum statutory tax withholding required to be withheld upon delivery of the shares (or such other amount that will not cause an adverse accounting consequence or cost) and payment of dividend equivalents will be satisfied by withholding a number of shares having an aggregate Fair Market Value equal to the minimum statutory tax required to be withheld (or such other amount that will not cause an adverse accounting consequence or cost). If this withholding would result in a fractional share being withheld, the number of shares withheld will be rounded up to the nearest whole share. Notwithstanding the foregoing, the Participant may elect to satisfy these tax withholding requirements by timely remitting this amount by cash or check or any other method that is acceptable to the Company, rather than by withholding of shares. This election must be made in accordance with any conditions and restrictions the Company may establish. If FICA taxes are required to be withheld while the RSUs are outstanding, the withholding will be made in a manner determined by the Company.

(g) **Participant Acknowledgements.** The Participant acknowledges and agrees that:

1. Participant Obligations. In partial consideration for the award of these RSUs, if at any time during the period between the Grant Date and the 12-month period following the Participant's termination of Employment (the "Obligation Period"), the Participant: (i) directly or indirectly, hires or solicits or arranges for the hiring or solicitation of any employee or customer of the Company or its Affiliates, or encourages any employee to leave the Company; (ii) directly or indirectly, assist in soliciting in competition with the Company the business of any current customer, distributor or dealer or other sales or distribution channel partners of the Company; (iii) uses, discloses, misappropriates or transfers confidential or proprietary information concerning the Company or its Affiliates (except as required by the Participant's work responsibilities with the Company or its Affiliates); or (iv) engages in any activity in violation of Company policies, including the Company's Code of Conduct, or engages in conduct materially adverse to the best interests of the Company or its Affiliates; the RSUs, whether previously vested or not, may be cancelled in full, and the Participant may be required to return to the Company any shares received on settlement of vested RSUs or the net after-tax income from the disposition of any shares received upon settlement of vested RSUs, unless the Committee, in its sole discretion, elects not to cancel the RSUs and/or elects not to recover any income from settled RSUs or unless applicable law prohibits such action.

   The obligations in this subsection are in addition to any other agreements related to non-solicitation and preservation of Company confidential and proprietary information entered into between the Participant and the Company, or otherwise applicable to the Participant, and nothing in this Agreement is intended to waive, modify, alter or amend the terms of any such other agreement. THE PARTICIPANT UNDERSTANDS THAT THIS SUBSECTION IS NOT INTENDED TO AND DOES NOT PROHIBIT THE CONDUCT DESCRIBED, BUT PROVIDES FOR THE CANCELLATION OF THE AWARDS IN FULL AND A RETURN TO THE COMPANY OF ANY SHARES RECEIVED UPON SETTLEMENT OF VESTED RSUS OR THE NET AFTER-TAX INCOME FROM THE DISPOSITION OF ANY SHARES RECEIVED UPON SETTLEMENT OF VESTED RSUS IF THE PARTICIPANT SHOULD CHOOSE TO VIOLATE THIS SUBSECTION DURING THE OBLIGATION PERIOD. Nothing in this Agreement prohibits the Participant from voluntarily communicating, without notice to or approval by the Company, with any federal government agency about a potential violation of a federal law or regulation.

2. Electronic Delivery and Acceptance. The Participant consents to electronic delivery of any Plan documents. The Participant consents to any and all procedures that the Company has established or may establish for an electronic signature system for delivery and acceptance of Plan related documents. The Participant agrees that his or her electronic signature is the same as, and will have the same force and effect as, his or her manual signature. Participant agrees that these procedures and delivery may be effected by a third party engaged by the Company to provide administrative services related to the Plan.

3. Right of Set-Off. If the Company in its reasonable judgment determines that the Participant owes the Company any amount due to any loan, obligation or indebtedness, including amounts owed under the Company's tax equalization program or the Company's policies with respect to travel and business expenses, and the Participant has not satisfied these obligation(s), the Company may instruct the plan administrator to withhold and/or sell shares acquired by the Participant on settlement of the RSUs (to the extent such RSUs are not subject to Code Section 409A), or the Company may deduct funds equal to the amount of the obligation from other funds due to the Participant from the Company to the maximum extent permitted by Code Section 409A.

i. Data Privacy. Participant acknowledges and consents to the collection, use, processing and transfer of personal data. Participant is not obliged to consent to such collection, use, processing and transfer of personal data. However, failure to provide the consent may affect Participant's ability to participate in the Plan. The Company holds certain personal information about Participant, that may include his/her name, home address and telephone number, date of birth, social security number or other employee identification number, salary grade, hire data, salary, nationality, job title, or details of all options or performance stock units or any other entitlement to shares of stock awarded, canceled, purchased, vested, or unvested, for the purpose of managing and administering the Plan ("**Data**"). The Company and its Affiliates will transfer Data amongst themselves as necessary for the purpose of implementation, administration and management of Participant's participation in the Plan, and the Company or its Affiliates may each further transfer Data to any third parties assisting the Company with the implementation, administration and management of the Plan. These recipients may be located throughout the world, including the United States. The Participant authorizes them to receive, possess, use, retain and transfer the Data, in electronic or other form, for the purposes of implementing, administering and managing participation in the Plan, including any transfer of Data that may be required for the administration of the Plan and/or the subsequent holding of shares of stock on Participant's behalf to a broker or other third party with whom Participant may elect to deposit any shares of stock acquired pursuant to the Plan. Participant may, at any time, review Data, require any necessary amendments to it or withdraw this consent in writing by contacting the Company; however, withdrawing consent may affect Participant's ability to participate in the Plan.

1. Stock Ownership Guidelines. If the Participant is or becomes subject to the Company's Stock Ownership Guidelines and applicable retention requirements, the Participant may be limited in selling shares obtained upon settlement of the RSUs.

2. Clawback Policy. If the Participant is covered by the Company's Clawback Policy, the Participant agrees that the RSUs are subject to the Policy and may be subject to recovery (in whole or in part) by the Company. The Participant agrees that the Clawback Policy may be amended from time to time by the Committee, including amendments to comply with applicable laws, regulations or stock exchange listing requirements.

(h) **Section 409A Compliance.** It is intended that the Plan and this Agreement comply with the requirements of Section 409A to the extent applicable, and the Plan and this Agreement shall be interpreted accordingly.

i. If it is determined that all or a portion of the Award constitutes deferred compensation for the purposes of Section 409A, and if the Participant is a "specified employee," as defined in Section 409A(a)(2)(B)(i) of the Code, at the time of the Participant 's separation from service, then, to the extent required under Section 409A, any shares that would otherwise be distributed (along with the cash value of all dividend equivalents that would be payable) upon the Participant 's separation from service, shall instead be delivered (and, in the case of the dividend equivalents, paid) on the earlier of (x) the first business day of the seventh month following the date of the Participant 's separation from service or (y) the Participant 's death.

ii. If it is determined that all or a portion of the Award constitutes deferred compensation for the purposes of Section 409A, upon an Change in Control that does not constitute a "change in the ownership" or a "change in the effective control" of the Company or a "change in the ownership of a substantial portion of a corporation's assets" (as those terms are used in Section 409A), the RSUs will vest at the time of the Change in Control, but distribution of any RSUs (or related dividend equivalents) that constitute deferred compensation for the purposes of Section 409A will not be accelerated (*i.e.*, distribution will occur when it would have occurred absent the Change in Control).

(i) **Governing Law.** This Agreement is issued and the RSUs are granted in Rye Brook, New York, and will be governed and construed in accordance with the laws of the State of New York, excluding any conflicts or choice of law rule or principle that might otherwise refer construction or interpretation of this Agreement to the substantive law of another jurisdiction.

*By signing a copy of this Agreement, the Participant acknowledges that s/he has received a copy of the Plan and that s/he has read and understands the Plan and this Agreement and agrees to their terms and conditions.*

Agreed to: **XYLEM INC.**

______________________________ ______________________________

Participant **[Name of Xylem Signatory]**

(Online Acceptance Constitutes Agreement)

Dated: _________________ Dated: **[Date]**

Enclosures

**XYLEM**
**2011 OMNIBUS INCENTIVE PLAN**

**[YEAR] PERFORMANCE SHARE UNIT AGREEMENT**

This Agreement (the "**Agreement**") between Xylem Inc. (the "**Company**") and **[Participant Name]** (the "**Participant**") is effective as of **[Grant Date]**. Capitalized terms that are not defined in this Agreement are defined in the Company's 2011 Omnibus Incentive Plan (the " **Plan**"). This Agreement is only being provided in English. The Participant is an employee of the Company or an Affiliate. In recognition of the Participant's valued services, the Company, through the Leadership Development and Compensation Committee of its Board of Directors (the "**Committee**"), is providing the Participant an inducement to remain employed and an incentive for increased efforts while employed. In consideration of the terms and conditions in this Agreement, the parties agree as follows:

**1.** **Grant of Performance Share Units**. The Company confirms the grant on **[Grant Date]** (the "**Grant Date**") to the Participant, the target number of **[#,###]** Performance Share Units ("**PSUs**"). All PSUs granted under this agreement are intended to be Performance Based Awards. The PSUs are notional units of measurement denominated in shares of common stock (*i.e*., one Performance Share Unit is equivalent in value to one share of common stock of the Company).

The PSUs represent an unfunded, unsecured right to receive shares and dividend equivalent payments under subsection 2(b) in the future if the conditions in the Plan and this Agreement are satisfied.

**Nature of the Grant:**

(a) The grant of the PSUs is voluntary and occasional and does not create any contractual or other right to receive future grants of PSUs, or benefits in lieu of PSUs, even if PSUs have been granted in the past. All decisions with respect to future PSUs or other grants, if any, will be at the sole discretion of the Company;

(b) The Participant is voluntarily participating in the Plan;

(c) The PSUs and the shares subject to the PSUs, are not part of normal or expected compensation for any purpose, including for purposes of calculating any severance, resignation, termination, redundancy, dismissal, end-of-service payments, bonuses, pension or retirement or welfare benefits or similar payments;

(d) Future value of the underlying shares is unknown, indeterminable and cannot be predicted with certainty;

(e) No claim or entitlement to compensation or damages will arise from forfeiture of the PSUs resulting from the termination of the Participant's employment; and

(f) The Company will not be liable for any foreign exchange rate fluctuation between the Participant's local currency and the United States Dollar that may affect the value of the PSUs or of any amounts due to the Participant pursuant to the settlement of the PSUs or the subsequent sale of any shares acquired upon settlement.

**2.** **Terms and Conditions.** The PSUs are subject to the following additional terms and conditions:

(a) **Restrictions**. Except as otherwise provided in the Plan and this Agreement, the PSUs cannot be sold, assigned, pledged, exchanged, transferred, hypothecated or encumbered, other than to the Company as a result of forfeiture.

(b) **Voting and Dividend Equivalent Rights**. The Participant will not have any privileges of a stockholder of the Company with respect to the PSUs, including without limitation any right to vote such shares or to receive dividends, unless and until shares are delivered to the Participant on the vesting of the PSUs. Dividend equivalents will be earned for each Performance Share Unit that vests and the amount will equal the total dividends declared on a share, where the record date of the dividend is between the Grant Date of this Award and the date a share is issued on vesting of the PSU. Any dividend equivalents earned will be paid in cash to the Participant when the shares subject to the vested PSUs are issued. No dividend equivalents will be earned or paid for any PSUs that do not vest. Dividend equivalents will not accrue interest.

(c) **Earning of PSUs.** The Participant can earn between 0% and 175% of the target number of PSUs granted under this Agreement, based on the achievement of a 3-year average Xylem adjusted Return on Invested Capital ("**ROIC**") performance target and 3-year Xylem Total Shareholder Return ("**TSR**") relative to companies in the S&P 500 index (excluding Financial Services companies) pursuant to the performance scales set forth on Exhibit A. The Committee will determine and certify the results of the level of achievement of such targets and the associated number of PSUs earned.

**Vesting and Payment**. Earned PSUs will vest on **[Grant Date + 3 years]** (the **"Vesting Date"**) if the Participant has been actively employed by the Company or an Affiliate from the Grant Date through the vesting date. Active employment does not include any potential severance period.

Except as provided in subsection 2(h), on vesting of the PSUs, including vesting pursuant to subsections 2(d) or 2(e), the Company will deliver to the Participant (i) one share for each vested Performance Share Unit, with any fractional shares resulting from proration pursuant to subsection 2(d) and 2(e) to be rounded to the nearest whole share, and (ii) an amount in cash attributable to dividend equivalents earned in accordance with subsection 2(b), less shares withheld in accordance with subsection 2(f).

(d) **Effect of Change in Control.** If the acquiring or surviving company in the transaction assumes or continues the outstanding PSUs, any unvested PSUs will be deemed to have satisfied all applicable performance targets at the target level, and will be converted to restricted stock units, which will continue to vest based on the PSUs' service-based vesting criteria, if any.

If the Participant's active employment with the Company or an Affiliate is terminated by the Company or an Affiliate without Cause or by the Participant for Good Reason (for applicable Participants only) within 2 years of a Change in Control, any converted and any unvested PSUs will become 100% vested at the target level on the termination date.

If the acquiring or surviving company in the transaction does not assume or continue outstanding awards under the Plan, immediately prior to the Change in Control, any unvested PSUs will become 100% vested based on deemed performance at the target level.

"**Cause**" means (i) the Participant's willful and continued failure to substantially perform his or her duties with the Company (other than any such failure resulting from the Participant's incapacity due to physical or mental illness) or (ii) the Participant willfully engaging in conduct that demonstrably and materially injures the Company or its Affiliates, monetarily or otherwise. "Willful" means the action is done or omitted in bad faith or without reasonable belief that the action or omission was in the best interests of the Company.

"**Good Reason**" means, without the Participant's express written consent (i) a reduction in annual target total cash compensation (base salary and target bonus), (ii) the assignment of any duties inconsistent in any material adverse respect with the Participant's position, authority, duties or responsibilities, (iii) any other action by the Company or an Affiliate which results in a material diminution in such position, authority, duties or responsibilities; or (iv) the Company or an Affiliate requiring the Participant to relocate to a work location 50 miles or more from the location where the Participant was principally working immediately prior to the Change in Control. The Participant must give notice within 90 days of any Good Reason event.

Good Reason only applies to Company employees who are at the time of termination of employment, or were at any time during the 2 year period immediately preceding the Change in Control, covered by the Xylem Special Senior Executive Pay Plan or the Xylem Enhanced Severance Pay Plan and will exclude an isolated, insubstantial and inadvertent action not taken in bad faith that is resolved by the Company or an Affiliate within 30 days of receiving notice.

**(e)** **Effect of Termination of Employment.** PSUs will only vest while the Participant is actively employed by the Company or an Affiliate. If the Participant's active employment is terminated for any reason, and the termination constitutes a "separation from service" within the meaning of Section 409A of the Code and any related regulations or other effective guidance promulgated thereunder ("**Section 409A**"), subject to subsection 2(d), the following would apply to any unvested PSUs:

(i) Termination due to Death, Disability, or Retirement. Any unvested PSUs continue to vest. A prorated portion (as described below) of the unvested PSUs will be paid out on Vesting Date.

(ii) Termination other than Death, Disability, or Retirement. Any unvested PSUs will automatically be forfeited.

"**Disability**" means the complete and permanent inability of the Participant to perform all duties under the terms of his or her employment, as determined by the Committee upon the basis of such evidence, including independent medical reports and data, as the Committee deems appropriate or necessary.

"**Retirement**" means the termination of the Participant's employment (either by the Company or the Participant), if, at the time of such termination, the Participant is at least age 55 and has completed 10 years of service with the Company or the Participant is age 65 or older.

**Prorated Vesting**. The prorated portion of the PSUs that vests on the Vesting Date following the Participant's Death, Disability or Retirement (or while Retirement Eligible) will be determined by multiplying the total number of PSUs the Participant would have earned based on actual performance by a fraction, of which the numerator is the number of months the Participant had been continually employed since the beginning of the performance cycle under his or her Death, Disability or Retirement and the denominator is 36.

(f) **Tax Withholding.** The Company may make such provisions and take such actions as necessary for the withholding of all applicable taxes attributable to the PSUs and any related dividend equivalents. Unless the Committee determines otherwise, the minimum statutory tax withholding required to be withheld on delivery of the shares (or such other amount that will not cause an adverse accounting consequence or cost) and payment of dividend equivalents will be satisfied by withholding a number of shares having an aggregate Fair Market Value equal to the minimum statutory tax required to be withheld (or such other amount that will not cause an adverse accounting consequence or cost). If this withholding would result in a fractional share being withheld, the number of shares withheld will be rounded up to the nearest whole share. Notwithstanding the foregoing, the Participant may elect to satisfy these tax withholding requirements by timely remitting this amount by cash or check or any other method that is acceptable to the Company, rather than by withholding of shares. This election must be made in accordance with any conditions and restrictions the Company may establish. If FICA taxes are required to be withheld while the PSUs are outstanding, the withholding will be made in a manner determined by the Company.

(g) **Participant Acknowledgements.** The Participant acknowledges and agrees that:

i. Participant Obligations. In partial consideration for the award of these PSUs, if at any time during the period between the Grant Date and the 12-month period following the Participant's termination of Employment (the "Obligation Period"), the Participant: (i) directly or indirectly, hires or solicits or arranges for the hiring or solicitation of any employee of the Company or its Affiliates, or encourages any employee to leave the Company; (ii) directly or indirectly, assist in soliciting in competition with the Company the business of any current customer, distributor or dealer or other sales or distribution channel partners of the Company; (iii) uses, discloses, misappropriates or transfers confidential or proprietary information concerning the Company or its Affiliates (except as required by the Participant's work responsibilities with the Company or its Affiliates); or (iv) engages in any activity in violation of Company policies, including the Company's Code of Conduct, or engages in conduct materially adverse to the best interests of the Company or its Affiliates; the PSUs, whether previously vested or not, may be cancelled in full, and the Participant may be required to return to the Company any shares received on settlement of vested PSUs or the net after-tax income from any disposition of any shares received upon settlement of vested PSUs, unless the Committee, in its sole discretion, elects not to cancel the PSUs and/or elects not to recover any income from settled and vested PSUs or unless applicable law prohibits such action.

The obligations in this subsection are in addition to any other agreements related to non-solicitation and preservation of Company confidential and proprietary information entered into between the Participant and the Company, or otherwise applicable to the Participant, and nothing in this Agreement is intended to waive, modify, alter or amend the terms of any such other agreement. THE PARTICIPANT UNDERSTANDS THAT THIS SUBSECTION IS NOT INTENDED TO AND DOES NOT PROHIBIT THE CONDUCT DESCRIBED, BUT PROVIDES FOR THE CANCELLATION OF THE AWARD IN FULL AND A RETURN TO THE COMPANY OF ANY SHARES RECEIVED ON SETTLEMENT OF VESTED PSUS OR THE NET AFTER-TAX INCOME FROM THE DISPOSITION OF ANY SHARES

RECEIVED UPON SETTLEMENT OF VESTED PSUS IF THE PARTICIPANT SHOULD CHOOSE TO VIOLATE THIS PARAGRAPH DURING THE OBLIGATION PERIOD. Nothing in this Agreement prohibits the Participant from voluntarily communicating, without notice to or approval by the Company, with any federal government agency about a potential violation of a federal law or regulation.

ii. Electronic Delivery and Acceptance. The Participant consents to electronic delivery of any Plan documents. The Participant consents to any and all procedures that the Company has established or may establish for an electronic signature system for delivery and acceptance of Plan related documents. The Participant agrees that his or her electronic signature is the same as, and will have the same force and effect as, his or her manual signature. Participant agrees that these procedures and delivery may be effected by a third party engaged by the Company to provide administrative services related to the Plan.

iii. Right of Set-Off. If the Company in its reasonable judgment determines that the Participant owes the Company any amount due to any loan, obligation or indebtedness, including amounts owed under the Company's tax equalization program or the Company's policies with respect to travel and business expenses, and the Participant has not satisfied these obligation(s), the Company may instruct the plan administrator to withhold and/or sell shares acquired by the Participant on settlement of the PSUs (to the extent such PSUs are not subject to Code Section 409A), or the Company may deduct funds equal to the amount of the obligation from other funds due to the Participant from the Company to the maximum extent permitted by Code Section 409A.

iv. Data Privacy. Participant acknowledges and consents to the collection, use, processing and transfer of personal data. Participant is not obliged to consent to such collection, use, processing and transfer of personal data. However, failure to provide the consent may affect Participant's ability to participate in the Plan. The Company holds certain personal information about Participant, that may include his/her name, home address and telephone number, date of birth, social security number or other employee identification number, salary grade, hire data, salary, nationality, job title, or details of all options or performance stock units or any other entitlement to shares of stock awarded, canceled, purchased, vested, or unvested, for the purpose of managing and administering the Plan ("**Data**"). The Company and its Affiliates will transfer Data amongst themselves as necessary for the purpose of implementation, administration and management of Participant's participation in the Plan, and the Company or its Affiliates may each further transfer Data to any third parties assisting the Company with the implementation, administration and management of the Plan. These recipients may be located throughout the world, including the United States. The Participant authorizes them to receive, possess, use, retain and transfer the Data, in electronic or other form, for the purposes of implementing, administering and managing participation in the Plan, including any transfer of Data that may be required for the administration of the Plan and/or the subsequent holding of shares of stock on Participant's behalf to a broker or other third party with whom Participant may elect to deposit any shares of stock acquired pursuant to the Plan. Participant may, at any time, review Data, require any necessary amendments to it or withdraw this consent in writing by contacting the Company; however, withdrawing consent may affect Participant's ability to participate in the Plan.

v. Stock Ownership Guidelines. If the Participant is or becomes subject to the Company's Stock Ownership Guidelines and applicable retention requirements, the Participant may be limited in selling shares obtained upon settlement of the PSUs.

vi. Clawback Policy. If the Participant is covered by the Company's Clawback Policy, the Participant agrees that the PSUs are subject to the Policy and may be subject to recovery (in whole or in part) by the Company. The Participant agrees that the Clawback Policy may be amended from time to time by the Committee, including amendments to comply with applicable laws, regulations or stock exchange listing requirements.

(h) **Section 409A Compliance.** It is intended that the Plan and this Agreement comply with the requirements of Section 409A to the extent applicable and the Plan and this Agreement will be interpreted accordingly.

(i) If it is determined that all or a portion of the Award constitutes deferred compensation for the purposes of Section 409A, and if the Participant is a "specified employee," as defined in Section 409A(a)(2)(B)(i) of the Code, at the time of the Participant's separation from service, then, to the extent required under

Section 409A, any shares that would otherwise be distributed (along with the cash value of all dividend equivalents that would be payable) on the Participant's separation from service, will instead be delivered (and, in the case of the dividend equivalents, paid) on the earlier of (x) the first business day of the seventh month following the date of the Participant's separation from service or (y) the Participant's death.

(ii) If it is determined that all or a portion of the Award constitutes deferred compensation for the purposes of Section 409A, upon an Change in Control that does not constitute a "change in the ownership" or a "change in the effective control" of the Company or a "change in the ownership of a substantial portion of a corporation's assets" (as those terms are used in Section 409A), the PSUs will vest at the time of the Change in Control, but distribution of any PSUs (or related dividend equivalents) that constitute deferred compensation for the purposes of Section 409A will not be accelerated (i.e., distribution will occur when it would have occurred absent the Change in Control).

(i) **Governing Law.** This Agreement is issued, and the PSUs are granted, in Rye Brook, New York, and will be governed and construed in accordance with the laws of the State of New York, excluding any conflicts or choice of law rule or principle that might otherwise refer construction or interpretation of this Agreement to the substantive law of another jurisdiction.

*By signing a copy of this Agreement, the Participant acknowledges that s/he has received a copy of the Plan and that s/he has read and understands the Plan and this Agreement and agrees to their terms and conditions.*

Agreed to: **XYLEM INC.**

______________________________ ______________________________

Participant **[Name of Xylem Signatory]**

(Online Acceptance Constitutes Agreement)

Dated: _________________ Dated: **[Date]**

Enclosures

**Exhibit A**

**[Year]-[Year+3] Performance Targets and Payout Scale**

The payout scale for performance metrics below provides for PSUs to be earned above 100% for above target performance and below 100% for below target performance.

**Adjusted ROIC (50%)** **Relative TSR* (50%)**

| | TSR 3-Year %ile Rank | Payout% | | ROIC 3-Year Average % | Payout% |
|---|---|---|---|---|---|
| **Maximum Payout** | **xth** | **x%** | **Maximum Payout** | **x%** | **x%** |
| | xth | x% | | x% | x% |
| Above Plan | xth | x% | Above Plan | x% | x% |
| | xth | x% | | x% | x% |
| | xth | x% | | x% | x% |
| **Plan/Target** | **xth** | **x%** | **Plan/Target** | **x%** | **x%** |
| | xth | x% | | x% | x% |
| | xth | x% | | x% | x% |
| Below Plan | xth | x% | Below Plan | x% | x% |
| | xth | x% | | x% | x% |
| **Threshold** | **xth** | **x%** | | x% | x% |
| **Below Threshold** | **<xth** | **0%** | **Minimum** | x% | 0% |

*Results are interpolated between threshold/minimum to target and between target to maximum.*

**Measured against S&P 500 less Financial Services companies. Payout capped at target if Xylem's 3-year TSR is negative.*

**EXHIBIT 12**

## Ratio of Earnings to Fixed Charges

| (In Millions Except Ratios) | Years Ended December 31, 2017 | 2016 | 2015 | 2014 | 2013 |
|---|---|---|---|---|---|
| Fixed Charges: | | | | | |
| Interest Expense | **$ 82** | $ 70 | $ 55 | $ 54 | $ 55 |
| Interest Portion of Rental Expense (a) | **23** | 21 | 19 | 24 | 25 |
| Total Fixed Charges | **105** | 91 | 74 | 78 | 80 |
| Earnings Before Income Taxes, Discontinued Operations and Fixed Charges: | | | | | |
| Pre-tax income (before income or loss from equity investees) | **463** | 337 | 403 | 421 | 298 |
| Fixed Charges | **105** | 91 | 74 | 78 | 80 |
| Total Earnings Available For Fixed Charges | **$ 568** | $ 428 | $ 477 | $ 499 | $ 378 |
| Ratio of Earnings to Fixed Charges: | **5.4** | 4.7 | 6.4 | 6.4 | 4.7 |

(a) Calculated as 33% of rent expense, which is a reasonable approximation of the interest factor.

EXHIBIT 21

**SUBSIDIARIES OF THE REGISTRANT***

| Name | Jurisdiction of Organization | Name Under Which Doing Business |
|---|---|---|
| Aanderaa Data Instruments AS | Norway | |
| Beijing United Gas Meters Co. Ltd. | China | |
| Bellingham & Stanley Ltd. | England & Wales | |
| Bombas Flygt de Venezuela S.A. | Venezuela | |
| CMS Research Corporation | Alabama | |
| EmNet, LLC | Indiana | |
| Faradyne Motors (Suzhou) Co. Ltd. | China | |
| Faradyne Motors LLC | Delaware | |
| Flow Control LLC | Delaware | |
| Flowtronex PSI, LLC | Nevada | |
| Fluid Handling, LLC | Delaware | |
| Godwin Holdings Ltd. | England & Wales | |
| Goulds Water Technology Philippines, Inc | Philippines | |
| Grindex AB | Sweden | |
| Grindex Pumps LLC | Delaware | |
| IMT B.V. | Netherlands | |
| Jabsco Marine Italia s.r.l. | Italy | |
| Jabsco S. de R.L. De C.V. | Mexico | |
| Lowara s.r.l. | Italy | Lowara |
| Lowara UK Ltd | England & Wales | |
| Lowara Vogel Polska SP ZOO | Poland | |
| MJK Automation ApS | Denmark | |
| MultiTrode Inc. | Florida | |
| Multitrode Pty Ltd | Australia | |
| Nova Analytics Europe LLC | Delaware | |
| O.I. Corporation | Oklahoma | OI Analytical |
| PCI Membrane Systems, Inc. | Delaware | |
| Pension Trustee Management Ltd | England & Wales | |
| Portacel Inc. | Pennsylvania | |
| Safe Sea Services FZC | UAE | |
| SELC Group Ltd. | Ireland | |
| SELC Electronics Ltd | England & Wales | |
| SELC Ireland Ltd | Ireland | |
| Sensus (UK Holdings) Ltd. | England & Wales | |
| Sensus Australia Pty Ltd | Australia | |
| Sensus Canada Inc. | Canada | |
| Sensus Česká republika spol. s r.o. | Czech Republic | |
| Sensus Chile SA | Chile | |
| Sensus de Mexico S. de R.L. de C.V. | Mexico | |
| Sensus España SA | Spain | |
| Sensus France Holdings SAS | France | |

*Each of the named subsidiaries is not necessarily a “significant subsidiary” as defined in Rule 1-02(w) of Regulation S-X, and the Company has several additional subsidiaries not named above. The unnamed subsidiaries, considered in the aggregate as a single subsidiary, would not constitute a “significant subsidiary” at the end of the year covered by this report.

| Name | Jurisdiction of Organization | Name Under Which Doing Business |
|---|---|---|
| Sensus France SAS | France | |
| Sensus GmbH Hannover | Germany | |
| Sensus GmbH Ludwigshafen | Germany | |
| Sensus Italia SRL | Italy | |
| Sensus Japan Kabushiki Kaisha | Japan | |
| Sensus Manufacturing (Shanghai) Co., Ltd. | China | |
| Sensus Maroc S.A.. | Morocco | |
| Sensus Metering Systems (Fuzhou) Co., Ltd. | China | |
| Sensus Metering Systems (LuxCo 1) S.A R.L. | Luxemborg | |
| Sensus Metering Systems (LuxCo 2) S.A R.L. | Luxemborg | |
| Sensus Metering Systems (LuxCo 3) S.A R.L. | Luxemborg | |
| Sensus Metering Systems (LuxCo 4) S.A R.L. | Luxemborg | |
| Sensus Metering Systems (LuxCo 5) S.A R.L | Luxemborg | |
| Sensus Metering Systems IP Holdings, Inc. | Delaware | |
| Sensus metrologicke sluzby s.r.o._Slovakia | Slovak Republic | |
| Sensus Polska sp. zoo | Poland | |
| Sensus Precision Die Casting (Yangzhou) Co., Ltd. | China | |
| Sensus Services Deutschland GmbH | Germany | |
| Sensus Slovensko a.s. | Slovakia | |
| Sensus South Africa (Proprietary) Ltd. | South Africa | |
| Sensus SPA | Algeria | |
| Sensus Spectrum LLC | Delaware | |
| Sensus UK Systems Limited | England & Wales | |
| Sensus USA Inc. | Delaware | |
| Sentec Limited | England & Wales | |
| Smith-Blair, Inc. | Delaware | |
| Texas Turbine LLC | Delaware | Xylem Texas Turbine LLC |
| Tideland Signal EMEA B.V. | Netherlands | |
| Tideland Signal Corporation | Texas | |
| Tideland Signal Limited | England and Wales | |
| Tideland Signal, LLC | Delaware | |
| Tirinstal Investments Ltd | Ireland | |
| UGI Global Limited | England & Wales | |
| Visenti Pte. Ltd | Singapore | |
| Water Asset Management, Inc. | Delaware | |
| Watercompany | England & Wales | |
| Water Process Limited | England & Wales | |
| Xylem (China) Company Limited | China | |
| Xylem (Hong Kong) Limited | Hong Kong | |
| Xylem (Nanjing) Co., Ltd | China | |
| Xylem Analytics Australia Pty Ltd. | Australia | |
| Xylem Analytics (Beijing) Co. Ltd | China | |
| Xylem Analytics France S.A.S. | France | |
| Xylem Analytics Germany GmbH | Germany | |

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| Name | Jurisdiction of Organization | Name Under Which Doing Business |
|---|---|---|
| Xylem Analytics Germany Sales GmbH& Co. KG | Germany | |
| Xylem Analytics IP Management GmbH | Germany | |
| Xylem Analytics IP Management SCS | Luxembourg | |
| Xylem Analytics LLC | Delaware | |
| Xylem Analytics UK LTD | England & Wales | |
| Xylem Australia Holdings PTY LTD | New South Wales | |
| Xylem Brasil Soluções para Água Ltda | Brazil | |
| Xylem Canada Company | Nova Scotia | |
| Xylem Delaware, Inc. | Delaware | |
| Xylem Denmark Holdings ApS | Denmark | |
| Xylem Dewatering Solutions UK Ltd | England & Wales | |
| Xylem Dewatering Solutions, Inc. | New Jersey | Godwin Pumps of America |
| Xylem Europe GmbH | Switzerland | |
| Xylem Financing S.a.r.l | Luxembourg | |
| Xylem Germany GmbH | Frankfurt am Main | |
| Xylem Global S.a.r.l | Luxembourg | |
| Xylem Holdings S.a.r.l. | Luxembourg | |
| Xylem Industriebeteiligungen GmbH | Germany | |
| Xylem Industries S.a.r.l. | Luxembourg | |
| Xylem International S.a.r.l. | Luxembourg | |
| Xylem IP Holdings LLC | Delaware | |
| Xylem IP Management S.a.r.l | Luxembourg | |
| Xylem IP UK S.a.r.l. | Luxembourg | |
| Xylem Lowara Limited | England & Wales | |
| Xylem Luxembourg S.a r.l. | Luxembourg | |
| Xylem Management GmbH | Germany | |
| Xylem Manufacturing Austria GmbH | Austria | |
| Xylem Manufacturing Middle East Region FZCO | UAE | |
| Xylem Middle East Water Equipment Trading & Rental LLC | UAE | |
| Xylem Russia LLC | Russia | |
| Xylem Saudi Arabia Limited | Saudi Arabia | |
| Xylem Service Hungary Kft | Hungary | |
| Xylem Service Italia Srl | Italy | |
| Xylem Services Austria GmbH | Austria | |
| Xylem Services GmbH | Germany | |
| Xylem Shared Services Sp. Z.o.o. | Poland | |
| Xylem Technologies & Partners S.C.S | Luxembourg | |
| Xylem Technologies GmbH | Frankfurt am Main | |
| Xylem Water Holdings Limited | England & Wales | |
| Xylem Water Limited | England & Wales | |
| Xylem Water Services Limited | England & Wales | |
| Xylem Water Solutions (Hong Kong) Limited | Hong Kong | |
| Xylem Water Solutions Argentina S.R.L. | Argentina | |
| Xylem Water Solutions Australia Limited | New South Wales | |

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| Name | Jurisdiction of Organization | Name Under Which Doing Business |
|---|---|---|
| Xylem Water Solutions Austria GmbH | Austria | |
| Xylem Water Solutions Belgium | Belgium | |
| Xylem Water Solutions Chile S.A. | Chile | |
| Xylem Water Solutions Colombia SAS | Colombia | |
| Xylem Water Solutions Denmark ApS | Denmark | |
| Xylem Water Solutions Deutschland GmbH | Germany | Flygt |
| Xylem Water Solutions España, S.A. | Spain | |
| Xylem Water Solutions Florida LLC | Delaware | |
| Xylem Water Solutions France SAS | France | |
| Xylem Water Solutions Global Services AB | Sweden | |
| Xylem Water Solutions Herford GmbH | Germany | |
| Xylem Water Solutions Holdings France SAS | France | |
| Xylem Water Solutions India Private Limited | India | |
| Xylem Water Solutions Ireland Ltd. | Ireland | |
| Xylem Water Solutions Italia S.R.L | Italy | Flygt |
| Xylem Water Solutions Korea Co., Ltd. | Korea | |
| Xylem Water Solutions Magyarorszag KRT | Hungary | |
| Xylem Water Solutions Malaysia SDN. BHD. | Malaysia | |
| Xylem Water Solutions Manufacturing AB | Sweden | |
| Xylem Water Solutions Metz SAS | France | |
| Xylem Water Solutions Mexico S.de R.L. de C.V. | Mexico | |
| Xylem Water Solutions Middle East Region FZCO | UAE | |
| Xylem Water Solutions Muscat LLC | Oman | |
| Xylem Water Solutions Nederland BV | Netherlands | Flygt |
| Xylem Water Solutions New Zealand Limited | New Zealand | |
| Xylem Water Solutions Norge AS | Norway | |
| Xylem Water Solutions Panama s.r.l. | Panama | |
| Xylem Water Solutions Peru S.A. | Peru | |
| Xylem Water Solutions Polska Sp.z.o.o. | Poland | |
| Xylem Water Solutions Portugal Unipessoal Lda. | Portugal | |
| Xylem Water Solutions Rugby Limited | England & Wales | |
| Xylem Water Solutions Singapore PTE Ltd. | Singapore | |
| Xylem Water Solutions South Africa (Pty) Ltd. | South Africa | |
| Xylem Water Solutions South Africa Holdings LLC | Delaware | |
| Xylem Water Solutions Suomi Oy | Finland | |
| Xylem Water Solutions Sweden AB | Sweden | |
| Xylem Water Solutions U.S.A., Inc. | Delaware | |
| Xylem Water Solutions UK Holdings Limited | England & Wales | |
| Xylem Water Solutions UK Limited | England & Wales | |
| Xylem Water Solutions Zelienople LLC | Delaware | |
| Xylem Water Solutions(Shenyang) CO., Ltd | China | |
| Xylem Water Systems (California), Inc. | California | |
| Xylem Water Systems Hungary KFT | Hungary | |
| Xylem Water Systems International, Inc. | Delaware | |

*Each of the named subsidiaries is not necessarily a “significant subsidiary” as defined in Rule 1-02(w) of Regulation S-X, and the Company has several additional subsidiaries not named above. The unnamed subsidiaries, considered in the aggregate as a single subsidiary, would not constitute a “significant subsidiary” at the end of the year covered by this report.

| Name | Jurisdiction of Organization Name Under Which Doing Business |
|---|---|
| Xylem Water Systems Japan Corporation | Japan |
| Xylem Water Systems Philippines Holding, Inc. | Delaware |
| Xylem Water Systems Texas Holdings LLC | Delaware |
| Xylem Water Systems U.S.A., LLC | Delaware |
| YSI (China) Ltd. | Hong Kong |
| YSI (Hong Kong) Ltd. | Hong Kong |
| YSI (UK) Ltd. | England & Wales |
| YSI Incorporated | Ohio |
| YSI Instrumentos E Servicos Ambientais Ltda. | Brazil |
| YSI International, Inc. | Ohio |
| YSI Nanotech Limited | Japan |

*Each of the named subsidiaries is not necessarily a “significant subsidiary” as defined in Rule 1-02(w) of Regulation S-X, and the Company has several additional subsidiaries not named above. The unnamed subsidiaries, considered in the aggregate as a single subsidiary, would not constitute a “significant subsidiary” at the end of the year covered by this report.

**EXHIBIT 23.1**

## CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statement No. 333-207672 on Form S-3 and Registration Statement No. 333-177607 on Form S-8 of our reports dated February 23, 2018, relating to the consolidated financial statements of Xylem Inc. and subsidiaries (the "Company"), and the effectiveness of the Company's internal control over financial reporting, appearing in this Annual Report on Form 10-K of the Company for the year ended December 31, 2017.

/s/ Deloitte & Touche LLP

Stamford, Connecticut
February 23, 2018

**EXHIBIT 31.1**

**CERTIFICATION PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Patrick K. Decker, certify that:

1. I have reviewed this Annual Report on Form 10-K of Xylem Inc. for the period ended December 31, 2017;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
   a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   c) evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   d) disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and
5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):
   a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and
   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: February 23, 2018

/s/ Patrick K. Decker

Patrick K. Decker

President and Chief Executive Officer

**EXHIBIT 31.2**

**CERTIFICATION PURSUANT TO**
**SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, E. Mark Rajkowski, certify that:

1. I have reviewed this Annual Report on Form 10-K of Xylem Inc. for the period ended December 31, 2017;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
   a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
   a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 23, 2018

/s/ E. Mark Rajkowski

E. Mark Rajkowski

Senior Vice President and Chief Financial Officer

**EXHIBIT 32.1**

**CERTIFICATION PURSUANT TO**
**18 U.S.C. SECTION 1350,**
**AS ADOPTED PURSUANT TO**
**SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report on Form 10-K of Xylem Inc. (the "Company") for the period ended December 31, 2017 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Patrick K. Decker, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to 906 of the Sarbanes-Oxley Act of 2002, to my knowledge, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Patrick K. Decker

Patrick K. Decker

President and Chief Executive Officer

February 23, 2018

A signed original of this written statement required by Section 906 has been provided to Xylem Inc. and will be retained by Xylem Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

**EXHIBIT 32.2**

**CERTIFICATION PURSUANT TO**
**18 U.S.C. SECTION 1350,**
**AS ADOPTED PURSUANT TO**
**SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report on Form 10-K of Xylem Inc. (the “Company”) for the period ended December 31, 2017 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, E. Mark Rajkowski, Senior Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to 906 of the Sarbanes-Oxley Act of 2002, to my knowledge, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ E. Mark Rajkowski

E. Mark Rajkowski

Senior Vice President and Chief Financial Officer

February 23, 2018

A signed original of this written statement required by Section 906 has been provided to Xylem Inc. and will be retained by Xylem Inc. and furnished to the Securities and Exchange Commission or its staff upon request.