Xylem Inc.
Form 10-K
February 26, 2015

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K
(Mark One)

þ	ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the fiscal year ended December 31, 2014 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

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 þ 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 þ
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (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 þ 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 þ 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," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):
Large Accelerated Filer þ Accelerated Filer ¨ Non-Accelerated Filer ¨ Smaller reporting company ¨
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ¨ No þ
The aggregate market value of the common stock of the registrant held by non-affiliates of the registrant as of June 30, 2014 was approximately $7.1 billion. As of January 31, 2015, there were 182,309,721 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 2015 Annual Meeting of Shareowners, to be held in May of 2015, 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, 2014
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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 and its consolidated subsidiaries (other than Xylem Inc.).

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,” “ “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: economic, 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 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 herein 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 2014 revenue of $3.9 billion and approximately 12,500 employees, is a world leader in the design, manufacturing, and application of highly engineered technologies for the water industry. We are 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. We have leading market positions among equipment and service providers in the core application areas of the water equipment industry: transport, treatment, test, building services, industrial processing and irrigation. Our Company’s brands, such as Bell & Gossett and Flygt, are well known throughout the industry and have served the water market for many years.

We serve a global customer base across diverse end markets while offering localized expertise. We sell our products in more than 150 countries through a balanced distribution network consisting of our direct sales force and independent channel partners. In 2014, 62% of our revenue was generated outside the United States, with 21% of revenue generated in emerging markets.

In 2014, we began implementing an organizational redesign to integrate our commercial teams within geographical regions. The integration of our commercial teams creates a cross-Xylem sales and marketing organization, shifting from a dedicated product line organizational structure. This sales structure is largely in place in the Company's Europe, Middle East, Africa and Asia regions and to a lesser extent in our other regions. While this organizational redesign did not change the Company's reportable segments, it had implications on how the Company manages the business, the most significant of which was the shift of certain responsibilities, namely customer and market-related activities, into the regional selling organizations.

Our Industry

Our planet faces a serious water challenge. Less than 1% of the total water available on earth is fresh water, and this percentage is declining due to factors such as the draining of aquifers, increased pollution and climate change. In addition, 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, degrading pipe systems leak one out of every six gallons of water, on average, on its way from a treatment plant to the customer. These challenges are driving opportunities for growth in the global water industry, which we estimate to have a total market size of approximately $550 billion.

We view these challenges through the lens of 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. The Company's customers often face all three of these challenges, ranging from inefficient 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”). Delivering value in these areas creates significant opportunity for the Company.

The water industry supply chain is comprised of Equipment and Services companies, Design and Build service providers, and Utilities. Equipment and Service providers serve distinct customer types. The Utilities supply water through an infrastructure network. Supply chain companies provide single, or sometimes combined, functions from equipment manufacturing and services to facility design (engineering, procurement and construction, or “EPC” firms) to plant operations (Utilities), as depicted below in Figure 1. The 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. The end users of water consist of a wide array of entities, including farms, mines, power plants, industrial facilities and residential homes. These customers are predominately served through specialized distributors and original equipment manufacturers (“OEMs”).

Figure 1: Water Industry Supply Chain

Our business focuses on the beginning of the supply chain by providing technology-intensive equipment and services. We sell our equipment and services via direct and indirect channels that serve the needs of each customer type. On the utility side, we provide the majority of our sales direct to customers with strong application expertise, with the remaining amount going through distribution partners. To end users of water, we provide the majority of our sales through long-standing relationships with the world's leading distributors, with the remainder going direct to customers. The Equipment and Services market addresses the key processes of the water industry, which are best illustrated through the cycle of water, as depicted in Figure 2, below. We believe this industry has two distinct sectors within the cycle of water: Water Infrastructure and Usage Applications. The key processes of this cycle begin when raw water is extracted by pumps, which provide the necessary pressure and flow, to move or transport, this water from natural sources, such as oceans, groundwater, lakes and rivers, through pipes to treatment facilities. Treatment facilities can provide many forms of treatment, such as filtration, disinfection and desalination, to remove solids, bacteria, and salt, respectively. Throughout each of these stages, analytical instruments test the water to ensure regulatory requirements are met so that it can be utilized by end-use customers. A network of pipes and pumps again transports this clean water to where it is needed, such as to crops for irrigation, to power plants to provide cooling in industrial water, or to an apartment building as drinking water in residential and commercial buildings. After usage, the wastewater is collected by a separate network of pipes and pumps and transported to a wastewater treatment facility, where processes such as digestion deactivate and reduce the volume of solids, and disinfection purifies effluent water. Once treated, analytical instruments test the water to ensure regulatory requirements are met so that it can be discharged back to the environment, thereby completing the cycle.

Figure 2: Cycle of Water

In the Water Infrastructure sector, two primary end markets exist: public utility and industrial. The public utility market comprises public, private and public-private institutions that handle water and wastewater for mostly residential and commercial purposes. The industrial market involves the supply of water and removal of wastewater for industrial facilities. We view the main macro drivers of this sector to be water quality, the desire for energy-efficient products, water scarcity, regulatory requirements and infrastructure needs, for both the repair of aging systems in developed countries as well as new installations in emerging markets.

In the Usage Applications sector, end-use customers fall into four main markets: residential, commercial, industrial and agricultural. Homeowners represent the end users in the residential market. 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 is wide ranging, involving OEMs, exploration and production firms, and developers and managers of facilities operated by electrical power generators, chemical manufacturers, machine shops, clothing manufacturers, beverage dispensing and food processing firms, and car washes. The agricultural market end users are owners and operators of businesses such as crop and livestock farms, aquaculture, golf courses, and other turf applications. We believe population growth, urbanization and regulatory requirements are the primary macro drivers of these markets, as these trends drive the need for housing, food, community services and retail goods within growing city centers. Water reuse and conservation are driving the need for new technologies.

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 achieve our goal of accelerating growth, we have identified the following five priorities:
- Emerging Market Growth - We seek to accelerate our growth in priority emerging markets through increased focus on product localization and channel development.

Innovation - We seek to enhance the Company’s innovation efforts with increased focus on disruptive technologies that can significantly improve customers’ water productivity, quality and resilience.

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- Industry vertical marketing - We are strengthening vertical marketing capabilities for key end markets to bring the full breadth of the Company’s portfolio to bear on critical customer challenges.

- Commercial team effectiveness - We continue to strengthen our regional commercial teams, including through the global adoption of improved commercial information technology tools, such as customer relationship management software.

- Mergers and acquisitions - We continue to evaluate and, where appropriate, will act upon attractive acquisition candidates to accelerate our growth, including into new markets.

- Build a Continuous Improvement Culture. We seek to embed continuous improvement into our culture and simplify our organizational structure to make the Company more agile, more profitable, and create room to re-invest in growth. To accomplish this, we will continue to strengthen our lean six sigma and global strategic sourcing capabilities, and continue to optimize our cost structure by eliminating unnecessary costs and inefficient overhead.
- Build Superior 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 to the objectives of the Company and its shareholders.
- Build a Culture of 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

We have two reportable business segments that are aligned with the cycle of water and the key strategic market applications they provide: Water Infrastructure (collection, distribution, return) and Applied Water (usage). See Note 21, “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	2014 Revenue (in millions)	% Revenue	Major Products	Primary Brands
Water Infrastructure	Transport	$1,779	73 %	• Water and wastewater pumps • Filtration, disinfection and biological treatment equipment • Test equipment • Controls	• Flygt • WEDECO • Godwin • WTW • Sanitaire • YSI • Leopold
	Treatment	348	14 %		
	Test	315	13 %		
		$2,442	100 %		
Applied Water	Building Services	$781	53 %	• Pumps • Valves • Heat exchangers • Controls • Dispensing equipment systems	• Goulds Water Technology • Bell & Gossett • A-C Fire Pump • Standard Xchange • Lowara • Jabsco • Flojet • Flowtronex
	Industrial Water	592	40 %		
	Irrigation	101	7 %		
		$1,474	100 %		

Water Infrastructure
Water Infrastructure involves the process that collects water from a source and distributes it to users, and then returns the wastewater responsibly to the environment. Within the Water Infrastructure segment, our pump systems transport water from oceans, groundwater, aquifers, lakes, rivers and seas. From there, our filtration, ultraviolet ("UV") and ozone systems provide treatment, making the water fit for use. After consumption, our pump lift stations move the wastewater to treatment facilities where our mixers, biological treatment, monitoring, and control systems provide the primary functions in the treatment process. Throughout each of these stages, our analytical systems test to ensure quality of water for consumption as well as for its return to nature. Water Infrastructure serves its customers, public utilities and industrial applications, through three closely linked applications: Transport, Treatment and Test of water and wastewater. We estimate our served market size in this sector to be approximately $20 billion.
Transport
The Transport application includes all of the equipment and services involved in the safe and efficient movement of water from sources such as oceans, groundwater, aquifers, lakes, rivers and seas to treatment facilities, and then to users. It also includes the movement of wastewater from the point of use to a treatment facility and then back into the environment. Finally, the Transport application also includes dewatering pumps, equipment and services which provide the safe removal or draining of groundwater and surface water from a riverbed, construction site or mine shaft. We offer a wide range of highly engineered products such as water and wastewater submersible pumps, monitoring controls, and application solutions; we do not serve the market for lower-value equipment such as pipes and fittings. We primarily employ configure-to-order capabilities to maximize manufacturing and logistics efficiencies by producing high volumes of basic product configurations. When we provide a configure-to-order solution, we configure a standard product to our customers' specifications. To a lesser extent, we provide engineer-to-order products to meet the customization requirements of our customers. This process requires that we apply our technical expertise and production capabilities to provide a non-standard solution to the customer. We believe our business is one of the largest players in this served market based on management estimates. With operations on six continents, we also have one of the world's largest dewatering rental fleets, serviced with our Flygt and Godwin brands. In our Water Infrastructure Segment, Transport accounted for approximately 73% of our segment revenue in 2014, 74% in 2013 and 73% in 2012.
Flygt — Flygt is a world-leader in the design and manufacture of dry and submersible pumps and related intelligent controls systems. Under the Flygt banner, customers have access to a complete range of products and solutions for moving water, wastewater, and advanced monitoring and control equipment to optimize their use. Founded in Sweden in 1901, Flygt is the originator of the reliable, energy-efficient electrical submersible pump. Flygt products have applications in various markets, including wastewater lift stations, water and wastewater treatment facilities, pressurized sewage systems, oil and gas, steel, mining and leisure markets. Customers include public utility and industrial water and wastewater systems operators. In 2012, Xylem successfully launched Flygt Experior which brings together advanced controls, hydraulics and energy-efficient motor technology to deliver substantial energy savings. During 2014, we won a large contract to provide large custom-made Flygt pumps for the Xayaburi run-of-river hydropower dam in Laos. The construction of the dam allows water to be kept within the river's course and minimally raises the water level to allow fish migration between the Upper and Lower Mekong Rivers, while providing electricity to about 1 million people in Laos and 3 million people in Thailand.
Godwin — With more than 35 years as a leader in pump manufacturing and applications, Godwin has established itself as a well-recognized, market leading brand in the global portable pump market. Godwin manufactures, sells, rents and services its products. Its quick response and 24/7 capabilities allow it to provide customized pumping solutions to meet the specific needs of its customers. Founded in Quenington, England, Godwin is currently headquartered in Bridgeport, New Jersey. Godwin's products include fully automatic self-priming Dri-Prime® pumps, a full range of Flygt electric submersible pumps, Heidra hydraulic submersible pumps, Wet-Prime gasoline-powered contractor pumps and a broad line of generators and portable light towers, as well as a multitude of pumping accessories and pipe. Godwin products are primarily used in construction, water & wastewater transport, oil & gas markets, hydraulic fracturing, industrial, mining, and municipal, as well as government, temporary fire protection, environmental, agriculture, and marine. Godwin products are also instrumental in disaster relief efforts. After Superstorm Sandy hit the United States in October 2012, Godwin's pumps were instrumental in minimizing or preventing flood damage in

various flooded regions throughout the Northeast. Godwin's fleet of equipment is rented through 45 U.S. branches and a global network of distributors and Xylem rental and sales facilities.

Treatment
The Treatment application includes equipment and services that treat both water for consumption and wastewater to be returned responsibly to the environment. Primary served markets include public utilities and industrial operations. While there are several treatment solutions in the market today, we focus on three basic treatment types: (i) filtration, (ii) disinfection systems and (iii) biological treatment systems. Filtration uses gravity-based media filters and clarifiers to clean both water and wastewater. Leopold, with more than 90 years of experience, is our leading filtration brand. Disinfection systems, both UV and ozone oxidation, treat both public utility drinking water and wastewater, as well as industrial process water, and are provided through our WEDECO brand. Biological treatment systems are key to the treatment and mixing of solids in wastewater plants, which are provided through our Sanitaire and Flygt brands. We believe our business is one of the largest players in this served market based on management estimates. In our Water Infrastructure Segment, Treatment accounted for approximately 14% of our segment revenue in both 2014 and 2013, and 15% in 2012.
Leopold — Founded in 1924 in Pittsburgh, Pennsylvania, Leopold is a leader in rapid gravity media filtration and clarification solutions for the water and wastewater industry. In potable drinking water treatment plants, the Clari-DAF system is used to clarify raw water to remove contaminants such as turbidity, algae, color, iron/manganese, organics, and taste and odor compounds. Several years ago, we augmented our filtration products with membrane technology. Our filtration products include the rapid gravity media, membranes and reverse osmosis/ultrafine filtration. Leopold gravity media filtration is used in potable water treatment plants to remove particulate in the final filtration step. In public utility wastewater treatment plants, the ClariVAC system is used in final clarifiers to remove the sludge solids. For those areas where nitrogen and phosphorus nutrient removal is required, we provide elimi-NITE systems which convert the filters to become biologically active so that the effluent meets the mandated nitrate and phosphorus levels. In desalination systems, Leopold Clari-DAF® systems and Filterworx systems are provided to remove contaminants that will harm reverse osmosis membranes, so that salt can be removed from the seawater to make it potable. Primary customers are public utility water and wastewater systems, as well as desalination plant facilities. During 2014, Leopold launched Oxelia, which is a cutting-edge, ozone-enhanced biologically active filtration system and multi-barrier solution for municipal wastewater treatment. Oxelia combines ozone, filtration and analytical instrumentation to deliver optimal wastewater treatment for water reuse, as well as discharge into sensitive water.
WEDECO — WEDECO was founded in 1975 in Herford, Germany to develop chemical-free and environmentally-friendly water treatment technologies, including UV light and ozone systems. There are more than 250,000 installed WEDECO systems for UV disinfection and ozone oxidation globally in private, public utility and industrial locations. WEDECO introduced ozone technology in 1988 and has been expanding internationally ever since. UV disinfection systems have a number of applications including water treatment and aquaculture. Ozone disinfection systems have applications in drinking water, wastewater, process water, product polishing, bleaching, ozonolysis/synthesis and deodorization. Customers include public utility wastewater and clean water treatment facilities, power plants, pulp and paper mills, food product manufacturers and aquaculture facilities. During 2014, we won a large contract with Bahrain’s Ministry of Works to upgrade a wastewater treatment facility in Manama, the capital city of Bahrain. The Company will design, install and commission an expansion and upgrade of the existing Wedeco ozone systems at the Tubli Water Pollution Control Centre which will increase the capacity of the wastewater treatment facility from 200,000 to 240,000 cubic meters per day. The enhanced wastewater reuse capacity is necessary for irrigation purposes in the area and will benefit the local agriculture and horticulture sectors in particular.
Sanitaire — Launched in 1967, the Sanitaire brand provides complete biological wastewater treatment solutions for public utility and industrial applications. Sanitaire’s comprehensive offering includes diffused aeration, sequencing batch reactors, drum filters and state-of-the-art controls that drive efficient operations. Sanitaire is regarded as a leading brand in diffused aeration, which is a process that introduces air into a liquid, providing an aerobic environment for degradation of organic matter. Fine-pore diffusion of air is highly competitive due to its high oxygen transfer efficiency and lower energy costs. Sanitaire wide-band aeration systems are used in applications such as grit chambers and sludge that require non-clogging, maintenance-free systems. Principal Sanitaire customers are public utility and industrial wastewater treatment facilities. In 2013, Xylem launched the Sanitaire OSCAR process performance optimization system. When combined with Sanitaire’s advanced aeration system, Xylem was able to

deliver 65 percent energy savings to the operators of the Sterno, Sweden wastewater treatment plant.

Flygt — Flygt is also a world-leader in the design and manufacturing of submersible, jet and top-entry mixers. Flygt has over 30 years of expertise in the area of wastewater treatment mixing, as well as over 100,000 applications globally. Submersible mixers are often used in sewage treatment plants to keep solids in suspension in the various process tanks and/or sludge holding tanks. In 2013, Xylem won an order to provide Flygt submersible mixers for the

Panama Canal. The project includes four anti-sedimentation mixers at each lock gate of a new Panama Canal channel, as well as local electrical panels and accessories.

Test

Analytical instrumentation is used across most industries to ensure regulatory requirements are met. Growth in this market is primarily driven by increasing regulation of water and wastewater in North America, Europe and Asia. Our served market is predominately focused on water and the environment for quality levels throughout the water infrastructure loop. Analytical systems are applied in three primary ways: in the field, in a facility laboratory, or real time, online monitoring in a treatment facility process. We believe we have a leading position in this served market based on management estimates. In our Water Infrastructure Segment, Test accounted for approximately 13% of our segment revenue in 2014 and 12% in both 2013 and 2012.

WTW — In wastewater treatment facilities, WTW-branded systems monitor parameters such as dissolved oxygen, pH, and turbidity throughout the water process to ensure regulatory standards are met before water is discharged back into the environment. Founded in 1945, as a major brand in Europe, WTW has strong market penetration in the environmental, water and wastewater segments. WTW holds leading market positions in on-line instrumentation and manufactures premium positioned robust and reliable analysis products for the measurement of pH, dissolved oxygen, conductivity, total dissolved solids, turbidity, specific ions and biological oxygen demand. WTW’s product offering includes meters, sensors, data-loggers, photometers and software providing customer solutions for even the most challenging applications. WTW instruments have been placed in major monitoring stations around the globe to monitor water quality. One of our largest installations is in the Yangtze river station in China.

YSI — Yellow Springs Instrument Company ("YSI"), founded in 1948, develops and manufactures sensors, instruments, software and data collection platforms for environmental and coastal water quality monitoring and testing. YSI holds a leading market position in surface water monitoring and sampling which includes equipment that allows users to measure multiple parameters simultaneously, including conductivity, dissolved oxygen, temperature, turbidity, depth or level, chlorophyll, blue green algae and pH, among others, in a variety of applications. YSI's SonTek Division designs and manufactures acoustic Doppler instruments which provide water velocity measurements for oceans, rivers, lakes, harbors, canals, estuaries and laboratories. YSI also offers Life Sciences products including biochemical analyzers for bioprocess monitoring, food and beverage processing, and sports physiology. YSI instruments have become integral across Xylem as the technologies have enabled customers such as water treatment plants to meet their critical water and wastewater testing requirements while lowering energy costs and improving process efficiencies. The main market areas are water quality, environmental monitoring, aquaculture, life sciences and ocean research. YSI sensors played a critical role in monitoring water levels and providing other real-time data that helped track Superstorm Sandy which hit the Mid-Atlantic and Northeast United States in October of 2012.

Applied Water

Applied Water encompasses the uses of water. Since water is used to some degree in almost every aspect of human, economic and environmental activity, this segment has a significant number of potential applications and we participate in all major areas of water demand. Irrigation applications constitute the majority of all water usage globally. Examples of what we provide include: boosting systems for farming irrigation, pumps for dairy operations, and rainwater reuse systems for small scale crop and turf irrigation. Industrial Water applications account for the next largest amount of global water consumption. Our pumps, heat exchangers, valves and controls provide cooling to power plants and manufacturing facilities, as well as circulation for food and beverage processing. The remaining portion of global water use resides in human and building consumption, where we deliver water boosting systems for drinking, heating, ventilation and air conditioning ("HVAC") and fire protection systems to Residential and Commercial Building Services. We estimate our served market size in this sector to be approximately $15 billion.

Residential & Commercial Building Services

This business is defined by four main uses of water in building services applications, such as in residential homes and commercial buildings, including offices, hotels, hospitals, schools, restaurants and malls. The first application is in HVAC, where Bell & Gossett and Lowara specialize in pumps and valves that are used in water-driven heating and cooling systems, along with heat exchangers, valves, and monitoring and control products that augment the system. The second is the supply of potable water for consumption, such as for drinking and hygiene. The Goulds Water Technology and Lowara brands provides pumps and boosting systems utilized within buildings, sourcing water from distribution networks or from wells. The third application is wastewater removal with sump and sewage pumps, provided by Bell & Gossett, Goulds Water Technology and Lowara. The fourth water-related building service area is fire protection, where our AC Fire brand supplies full pump systems for emergency fire suppression. Bell & Gossett, Goulds Water Technology and Lowara have continued to innovate, focusing on providing industry-leading energy-efficient and intelligent pumps for the building services market; many of these products are more efficient than competitive devices. We believe our business is one of the largest players in this served market based on management estimates. In our Applied Water Segment, Building Services accounted for approximately 53% of our segment revenue in 2014, 50% in 2013 and 53% in 2012.

Industrial Water

Water is used in most industrial facilities to provide processing steps such as cooling, heating, cleaning and mixing. Our Goulds Water Technology and Lowara brands supply vertical multistage pumps to bring in source water or to boost pressure for purposes such as circulating water through a manufacturing facility to cool machine tools. Our Standard Xchange brand delivers heat exchangers for combined heat and power applications within power generation plants. We also service niche applications such as flexible impeller pumps for wine processing facilities served by our Jabsco brand, and water-based detergent dispensing and water circulation within car washes served by Flojet and Goulds Water Technology air-operated diaphragm and end suction pumps. Our boosting pumps are also increasingly being used in hydraulic fracturing applications. Across all these various end applications, we believe our business is the second largest player in this served market based on management estimates. In our Applied Water Segment, Industrial Water accounted for approximately 40% of our segment revenue in 2014, 43% in 2013 and 40% in 2012.

Irrigation

The irrigation business consists of irrigation-related equipment and services associated with bringing water from a source to the plant or livestock need, including hoses, sprinklers, center pivot and drip irrigation. We focus on the pumps and boosting systems that supply this ancillary equipment with water. Our Goulds Water Technology brand brings mixed flow pumps, and our Flowtronex group specializes in equipment "packaged solutions" incorporating monitoring and controls to optimize energy efficiency in irrigation delivery. Our Lowara brand also produces pumps for agriculture applications and irrigation of gardens and parks. We believe we have a leading position in this served market based on management estimates. In our Applied Water Segment, Irrigation accounted for approximately 7% of our segment revenue in each of 2014, 2013 and 2012.

As described above, the following brands and products are used across the applications in our Applied Water segment:

Goulds Water Technology — With origins dating back more than 150 years, Goulds Water Technology is a leading brand of centrifugal and turbine pumps, controllers, variable frequency drives and accessories for residential and commercial water supply and wastewater applications. Goulds Water Technology is a leader in the water technologies market with its line of residential water well pumps. The Goulds Water Technology product portfolio includes submersible and line shaft turbine, 4” submersible, jet, sump, effluent, sewage and centrifugal pumps for residential, agriculture and irrigation, sewage and drainage, commercial and light industrial use. Goulds Water Technology has various vertical configuration high pressure centrifugal pumps which are utilized for water boost, filtration and boiler feed applications in industrial environments. Goulds Water Technology submersible, deepwell or other pumps can be found in more than a quarter of the existing 15 million household wells and more than 380,000 public and community wells in the United States. Products for commercial wastewater include sewage, effluent and grinder pumps and packages. Agriculture products include pump and control products for irrigation, stockwater, wash systems, cooling systems and waste management, with turf irrigation products, including submersible and surface pumps for landscape and turf irrigation systems. We serve the building trades market with filtration, chilling, pressure boost, wash system, water supply, wastewater and boiler feed applications. We also have a range of standard cast iron and bronze end-suction and multistage pumps for various commercial applications. In 2014, the Company won a large project with a mining customer at the Kinross Fort Knox gold mine in Fairbanks, Alaska, which will address the customer’s water productivity needs. The project includes Goulds Water Technology turbine pump assemblies with motors for the mine’s barren booster pump supply, a process in which previously mined and processed ore is reprocessed through a leach field to pull more gold from the tailings.

Lowara — Founded in 1968 in Vicenza, Italy, Lowara is a leader in stainless steel pump manufacturing technology for water technology applications. The Lowara range of products includes submersible, sump, effluent, sewage, centrifugal pumps and booster packages for water supply and water pumping needs in the residential, agriculture, industrial, public utility, building service and commercial markets worldwide, with particular strength in Europe.

Residential applications include pumps for pressurization, conditioning, fire-fighting systems, lifting stations and dewatering. Agriculture applications include pumps for irrigation of gardens and parks. Industrial applications include drinking water, industrial washing equipment and machine tool cooling. The German water services company Erftverband implemented a comprehensive system of Lowara pumps and a Hydrovar speed control smart system to address complex water management needs in Korschenbroich and Kaarst, Germany during 2013.

Bell & Gossett — Founded in 1916 in Chicago, Illinois, Bell & Gossett ("B&G") is a leader in plumbing and water-based heating and air conditioning markets. Products are used in residential applications where single- or multi-family homes are heated with hot water or steam. Key products include circulating pumps, valves, and specialty products used in these systems. B&G also sells wastewater pumps for commercial and residential applications. In commercial applications, B&G provides a broad range of products, including a wide variety of pumps, heat exchangers, valves and controls for heating and air-conditioning systems, sump pumps for wastewater systems, condensate pumping systems for steam heating systems and a comprehensive line of energy-saving variable speed controls. Training is provided for building system design engineers at B&G’s industry renowned Little Red Schoolhouse in Morton Grove, Illinois which has educated more than 60,000 engineers. Key commercial building types include hospitals, schools, institutional buildings and data centers. B&G products are sold globally by independent manufacturer representatives and distributed locally by HVAC wholesalers. During 2014, the B&G brand Series e-1510 single stage end suction centrifugal pump won the Consulting-Specifying Engineer’s Product of the Year award, the premier award for new products in the HVAC, fire/life safety, electrical and plumbing systems engineering markets.

A-C Fire Pump — Allis-Chalmers Company ("A-C Fire Pump") was founded in the 1840s in Milwaukee, Wisconsin. It offers turnkey fire pump systems for commercial, residential and industrial applications. A-C Fire Pump designs and custom-builds a wide range of fire pump systems, including prefabricated packages and house units that meet every fire protection need. A-C Fire Pump products include In-Line Pumps, Vertical Turbine, Package Systems, Split Case (various series) and 13D Home Defender for residential fire pump service. The 13D Home Defender is designed to boost water pressure for automatic residential sprinkler systems. In addition to residential applications, turnkey fire pumping systems from A-C Fire Pump protect an increasing number of petrochemical facilities, commercial buildings and factories around the world. During 2014, we secured a large project in Bolivia to meet an energy customer’s water resilience needs by providing customized diesel-driven split case A-C Fire Pumps that will protect gas treatment plants, connecting pipelines and the base camp where workers reside.

Flowtronex — Flowtronex, founded in 1974 as Pumping Systems, Inc., began by producing some of the golf industry’s first prefabricated water pumping systems. The Silent Storm package and Pace Integrated Pump Controller are our two primary products sold into the golf market. In landscape, Flowtronex products, primarily the Floboy system, are sold to customers such as cities and nurseries. In golf, Flowtronex products are sold to golf course superintendents through our Toro Distribution partnership. Retrofit sales of golf pumping systems are sold through our FlowNet Service Network, a group of factory authorized service technicians that provide set up and start up, and service and repair of Flowtronex pump stations. During 2014, we launched the Oasis EX, a new pump controller which delivers modern features, such as remote monitoring, Web-enabled controls and advanced water measurements, to maximize water and energy efficiency in pump stations, while also reducing operating costs and increasing productivity.

Standard Xchange — Since 1917, Standard Xchange has been the leader in the design and manufacture of shell and tube heat exchangers. Standard Xchange is the brand of our complete line of heat transfer products used in industrial and process applications such as heating or cooling liquids or gases, heat recovery in chemical processing, power and co-generation, paper and pulp, OEMs and commercial marine markets. Products include basic shell-and-tube heat exchangers, air coolers, heat transfer coils, compact brazed, welded, gasketed plate units and packaged steam condensers. Standard Xchange heat exchangers provide cooling for many of the major turbine manufacturers in electrical power generation plants around the world.

Jabsco — The Jabsco brand is known for its marine, industrial, and hygienic/sanitary pumps and systems that are used in many industries, including marine, industrial, healthcare and food processing. It was founded in 1938 by the inventors of the flexible impeller pump. Jabsco is a leader in the leisure marine market, with a broad range of products including water system, engine cooling pumps, searchlights and marine waste systems. Jabsco also offers industrial pumps for hygienic applications, fluid transfer in chemical processing, laboratory, paint processing, plating, and construction. Jabsco rotary lobe pumps offer outstanding performance with unique capabilities. Jabsco Hy-line and Ultima rotary lobe pumps support food and dairy product production, healthcare, chemical, pharmaceutical and biotech applications, whether the product is thin, viscous or fragile. Jabsco also offers multi-purpose and specialized flexible impeller, diaphragm and sliding vane pumps for chemical and general transfer applications. Jabsco marine products can be found under the decks of millions of pleasure boats around the world.

Flojet — Established in 1975, the Flojet brand encompasses a broad range of small pumps, motors and dispensing pumps for the beverage, industrial, recreational vehicle, marine and food processing markets. Flojet is a leader in the small pump market, offering a versatile range of products serving the beverage market, including both air- and motor-operated diaphragm pumps and centrifugal chilling pumps, as well as booster systems and accumulator tanks. Flojet’s beverage pumps can be found in applications such as beer dispensing, syrup mixing for carbonated drinks, re-circulation in vending machines and refrigerators, bottled water dispensers, icemakers and coffee machines. In addition to significant beverage applications, Flojet’s electric and air-operated diaphragm pumps are utilized in street sweepers, car washes, carpet cleaners, parts washers, agricultural spraying and road rollers. Flojet’s positive displacement diaphragm pumps can be driven by air, electric motor or solenoid. The positive displacement diaphragm design of Flojet pumps makes them ideal for use in conditions that require self-priming and dry running capability for short periods of time. Additionally, the compact size of these pumps makes them very useful in tight spaces where one cannot ensure a flooded suction. Flojet pumps are designed to be more efficient and are often the choice of customers for applications where low power consumption is critical. Xylem services many of the world's leading beverage producers. During 2014, the Company launched Filtration by Flojet, which is a system that uses integrated membrane pre-activated carbon technology to improve water taste and appearance, better protect dispense equipment and mitigate health concerns in food-service applications.

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, 2014.

	Revenue								
(in millions)	2014			2013			2012		
	$ Amount	% of Total		$ Amount	% of Total		$ Amount	% of Total	
United States	$1,477	38	%	$1,434	38	%	$1,400	37	%
Europe	1,379	35	%	1,387	36	%	1,338	35	%
Asia Pacific	478	12	%	467	12	%	469	12	%
Other	582	15	%	549	14	%	584	16	%
Total	$3,916			$3,837			$3,791		

In addition to the traditional markets of the United States and Europe, opportunities in emerging markets within Asia Pacific, Eastern Europe, Latin America and other countries are growing. Revenue derived from emerging markets comprised 21%, 19% and 20% of our revenue in 2014, 2013 and 2012, respectively.

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, 2014.

	Property, Plant & Equipment								
(in millions)	2014			2013			2012		
	$ Amount	% of Total		$ Amount	% of Total		$ Amount	% of Total	
United States	$180	39	%	$186	38	%	$183	38	%
Europe	206	45	%	225	46	%	219	45	%
Asia Pacific	53	11	%	45	9	%	65	13	%
Other	22	5	%	32	7	%	20	4	%
Total	$461			$488			$487		

Distribution, Training and End Use

Water Infrastructure provides the majority of its sales through direct channels with remaining sales through indirect channels and service capabilities. Both public 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 the need for this application expertise: (i) the increase in type and amount of contaminants in water supply, (ii) increasing environmental regulations, (iii) the need to increase system efficiencies to optimize energy costs, and (iv) the retirement of a largely aging water industry workforce not systematically replaced at utilities.

In the Applied Water segment, many end-use areas are widely different, so specialized distribution partners are often preferred. Our commercial teams have built long-standing relationships around our brands in many of these industries through which we can continue to leverage new product and service applications. Revenue opportunities are balanced between OEMs and after-market customers. Our products in the Applied Water segment are sold through our global direct sales and strong indirect channels with the majority of revenue going through indirect 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.

Aftermarket Parts and Service

During their lifecycle, installed products require maintenance, repair services and parts due to the harsh environments in which they operate. We have many service centers around the world, which employ service employees to provide aftermarket parts and services to our large installed base of customers. Service centers offer an array of integrated service solutions for the industry including: preventive monitoring, contract maintenance, emergency field service, engineered upgrades, inventory management, and overhauls for pumps and other rotating equipment.

Depending on the type of product, median lifecycles range from five years to over 50 years, at which time they must be replaced. Many of our products are precisely selected and applied within a larger network of equipment driving a strong preference by customers and installers to replace them with the same exact brand and model when they reach the end of their lifecycle. This dynamic establishes a large recurring revenue stream for our business.

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, aluminum, and plastics. While we may recover some cost increases through operational improvements, we are still exposed to some pricing risk. We attempt to control costs through fixed-priced contracts with suppliers and various other programs, such as our global strategic sourcing 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 most 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 that have had a significant adverse impact on our business as a whole.

Our Water Infrastructure and Applied Water segments experience some modest level of seasonality in its 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 Water Infrastructure or Applied Water segments or on the Company as a whole. No individual customer accounted for more than 10% of our consolidated 2014, 2013 or 2012 revenue.

Backlog

Delivery schedules vary from customer to customer based upon their requirements. Typically, large projects require longer lead production cycles and delays can occur from time to time. Total backlog was $740 million at December 31, 2014 and $707 million at December 31, 2013. We anticipate that more than 85% of the backlog at

December 31, 2014 will be recognized as revenue during 2015.

Competition

Given the highly fragmented nature of the water industry, the Water Infrastructure segment competes with a large number of businesses. Competition in the water transport and treatment technologies markets focuses 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 of products and services, we benefit from our large installed base of pumps and complementary products, which require maintenance, repair and replacement parts due to the 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 (formerly Siemens AG) and Danaher Corporation.

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 allowed 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.

Research and Development

Research and development (“R&D”) is a key element of our engineering culture and is generally focused 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 and improvement of existing products. Our businesses invest substantial resources for 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 invested $104 million, $104 million, and $106 million for the years ended December 31, 2014, 2013 and 2012, respectively, in R&D.

We have engineering and research employees in technology centers 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 development process. We have a Center of Excellence in Stockholm, Sweden, with research, development and engineering employees. We have Centers of Excellence in India and China, where we are accelerating the customization of our application expertise to local needs. In the scale-up process, our R&D activities are conducted at our piloting and testing facilities or at strategic customer sites. These piloting and testing facilities enable us to serve our strategic markets in each region of the world.

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. We cannot make assurances that other sites, or new details about sites known to us, that could give rise to environmental liabilities with such material adverse effects on us will not be identified in the future. At December 31, 2014, we had estimated and accrued $5 million related to environmental matters.

Employees

As of December 31, 2014, Xylem had approximately 12,500 employees worldwide. We have more than 3,700 employees in the United States, of whom approximately 17% are represented by labor unions, and in certain foreign countries, some of 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.

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 ("WaterCo"). The Spin-off was completed pursuant to the Distribution Agreement, dated as of October 25, 2011 (the “Distribution Agreement”), among ITT, Exelis Inc. (“Exelis”) and Xylem.

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 provide products and services into 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 continued investment by us in manufacturing, research and development, engineering, marketing, customer service and support, and our distribution networks. We may not be successful in maintaining our competitive position. Our competitors may develop 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. Pricing pressures also could cause us to adjust the prices of certain products to stay competitive. We may not be able to compete successfully with our existing or new competitors. 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 2014, 38%, 35% and 21% of our total revenue was from customers located in the United States, 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 spending; the strength of the residential and commercial real estate markets; interest rates; availability of commercial financing for our customers and end-users; and unemployment rates. A slowdown or downturn in these financial or macro-economic conditions could have a significant 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 2014, 62% of our total revenue was from customers outside the United States, with 21% of total revenue generated in emerging markets. We expect our international operations sales 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:

- possibility of unfavorable circumstances arising from host country laws or regulations;
- currency exchange rate fluctuations and restrictions on currency repatriation;
- potential negative consequences from changes to taxation policies;
- disruption of operations from labor and political disturbances;
- changes in tariff and trade barriers and import and export licensing requirements; and
- insurrection 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, we now conduct more of our operations in emerging markets than we have in the past, which 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 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 future, largely unforeseeable events might have on our business, financial condition and 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, 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. There has been an increase in anti-bribery law enforcement activity in recent years, with more frequent and aggressive investigations and enforcement proceedings by both the Department of Justice ("DOJ") and the SEC, increased enforcement activity by non-U.S. regulators, and increases in criminal and civil proceedings brought against companies and individuals. 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 agents 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 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 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. Parts and raw materials commonly used in our products include motors, fabricated parts, castings, bearings, seals, nickel, copper, 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 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 business could be adversely affected by significant movements in foreign currency exchange rates.

We conduct approximately 62% 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, British Pound, Australian Dollar, Canadian Dollar, Polish Zloty, and Hungarian Forint. 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, Swedish Krona and Canadian Dollar. As the U.S. dollar fluctuates against other currencies in which we transact business, revenue and income can be impacted. Refer to Item 7A "Quantitative and Qualitative Disclosures about Market Risk" for additional information on foreign exchange risk.

Weather conditions may adversely affect our financial results.
Weather conditions, including heavy flooding, droughts and fluctuations in temperatures, can positively or negatively impact portions of our business. Within the dewatering space, our 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, Flowtronex 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, 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 an increasing 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.
Our strategy includes acquisitions, and we may not be able to make acquisitions of suitable candidates or integrate acquisitions successfully.
Our historical growth has included acquisitions. 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 cannot make assurances, however, that we will 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 have acquired substantial undisclosed liabilities; and the loss of key employees of the acquired businesses.
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, 2014, the net carrying value of our goodwill and other indefinite-lived intangible assets totaled approximately $2 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 and trade names 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, the quantitative two-step 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 in the periods recognized.

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Our ability to successfully execute our organizational redesign as well as other restructuring and realignment actions could impact our business results.

We initiated an organizational redesign during the fourth quarter of 2013, shifting from individually managed businesses to an integrated approach within geographical regions. We expect that this will enable us to leverage the breadth of the Company’s product and services portfolio to better serve our customers and address market opportunities as well as effectively utilize internal support organizations to realize economies of scale and efficient use of resources. The successful implementation and execution of this redesign as well as our other restructuring and realignment actions, is critical to achieving our expected cost savings as well as effectively competing in the marketplace. Other factors that may impede a successful implementation is retention of key employees, the impact of regulatory matters, and adverse economic market conditions. If the organizational redesign or restructuring and realignment actions are not executed successfully, the Company’s financial results could be adversely impacted.

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

We sell our products in more than 150 countries and 62% of our revenue was generated outside the United States in 2014. Given the global nature of our business, a number of factors may increase our future effective tax rates, including:

- our decision to repatriate non-U.S. earnings for which we have not previously provided for U.S. taxes;
- 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.

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, our ability to realize financial benefits from lean six sigma projects may not be able to mitigate fully or in part these manufacturing and operating cost increases and, as a result, could negatively impact our profitability.

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 products that we make or sell can lead to 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. Recalls, removals and product liability claims can result in significant costs, as well as negative publicity and damage to our reputation that could reduce demand for our products.

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

As of December 31, 2014, our total outstanding indebtedness was $1,288 million, including our 3.55% Senior Notes of $600 million aggregate principal amount due September 2016 and 4.875% Senior Notes of $600 million aggregate principal amount due October 2021. We have an existing Four Year Competitive Advance and Revolving Credit Facility (the “Credit Facility”), which provides for an aggregate principal amount of up to $600 million. We have a Risk Sharing Finance Facility Agreement (the "R&D Facility Agreement") with The European Investment Bank ("EIB") in an aggregate principal amount of up to €120 million (approximately $146 million).

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 laws, regulations and potential liability relating to claims, complaints and proceedings, including those related to antitrust, environmental, product, and other matters.

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, including acquisitions and divestitures. Some of these proceedings seek remedies relating to environmental matters, intellectual property matters, product liability and personal injury claims, employment, labor and pension matters, and government and commercial or contract issues, sometimes related to acquisitions or divestitures. We may become subject to significant claims of which we are currently unaware, or the claims of which we are aware may result in our incurring a significantly greater liability than we anticipate or can estimate. Additionally, we may receive fines or penalties or 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.

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

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, computer viruses, security breaches, natural disasters, power outages and other events. In addition, cybersecurity threats are evolving and include, among others, malicious software, attempts to gain unauthorized access to data, and other electronic security breaches that could lead to disruptions in our systems or our third party vendors’ systems and applications, unauthorized release of confidential or otherwise protected information and corruption of data. We also have a concentration of operations on certain sites, e.g. 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. Although we continue to assess these risks, implement controls, and perform business continuity planning, we cannot be sure that interruptions with material adverse effects will not occur.

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.

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 and financial statements. 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.
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 continue to 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.

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.

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

Our operations 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 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;
- 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 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 part or all of our business operations. For example, the third amended and restated articles of incorporation and the amended and restated by-laws, among other things, require advance notice for shareholder proposals and nominations and do not permit action by written consent of the shareholders, unless unanimous. In addition, the amended and restated 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.

Risks Related to our 2011 Spin-off from ITT Corporation

The Spin-off may expose us to potential liabilities arising out of state and federal fraudulent conveyance laws and legal distribution requirements.

The Spin-off could be challenged under various state and federal fraudulent conveyance laws. An unpaid creditor or an entity vested with the power of such creditor (such as a trustee or debtor-in-possession in a bankruptcy) could claim that the Spin-off left us, ITT and/or Exelis insolvent or with unreasonably small capital or that we, ITT and/or Exelis intended or believed it would incur debts beyond its ability to pay as they mature and that ITT did not receive fair consideration or reasonably equivalent value in the Spin-off. If a court were to agree with such a plaintiff, then such court could void the Spin-off as a fraudulent transfer and could impose a number of different remedies, which could adversely affect our financial condition and our results of operations.

In connection with our Spin-off, ITT and Exelis will indemnify us for certain liabilities and we will indemnify ITT or Exelis for certain liabilities. If we are required to indemnify ITT 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 and Exelis, ITT and Exelis agreed to indemnify us from certain liabilities, and we agreed to indemnify ITT and Exelis for certain liabilities. Indemnities that we may be required to provide ITT and Exelis may be significant and could negatively impact our business, particularly indemnities relating to our actions that could impact the tax-free nature of the Spin-off. Third parties could also seek to hold us responsible for any of the liabilities that ITT or Exelis has agreed to retain. Further, there can be no assurance that the indemnities from ITT and Exelis will be sufficient to protect us against the full amount of such liabilities, or that ITT and Exelis will be able to fully satisfy their indemnification obligations. Moreover, even if we ultimately were to succeed in recovering from ITT 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 more than 350 locations in more than 40 countries. These properties total approximately 10.4 million square feet, of which more than 300 locations, or approximately 6.0 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 the significant locations by segment:

Location	State or Country	Principal Business Activity	Approx. Square Feet	Owned or Expiration Date of Lease
Water Infrastructure				
Emmaboda	Sweden	Administration and Manufacturing	1,194,000	Owned
Stockholm	Sweden	Administration and Research & Development	172,000	2019
Shenyang	China	Manufacturing	125,000	Owned
Bridgeport	NJ	Administration and Manufacturing	136,000	2015
Yellow Springs	OH	Administration and Manufacturing	112,000	Owned
Quenington	UK	Manufacturing	86,000	2015
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
Lubbock	TX	Manufacturing	229,000	Owned
Cheektowaga	NY	Manufacturing	145,000	Owned
Corporate Headquarters				
Rye Brook	NY	Administration	67,000	2023

ITEM 3. LEGAL PROCEEDINGS

From time to time, we are involved in legal proceedings that are incidental to the operation of our businesses, including acquisitions and divestitures, environmental matters, intellectual property matters, anti-trust and anti-corruption matters, product liability and personal injury claims, employment and pension matters, government and commercial contract disputes. Although we cannot predict the outcome of these and other proceedings, including the cases below, with certainty, we believe that they will not have a material adverse effect on our consolidated financial position and results of operations.

On December 17, 2014, the Korea Fair Trade Commission ("KFTC") issued a written decision regarding an investigation into bid-rigging allegations against Xylem Water Solutions South Korea Co., Ltd. ("Xylem South Korea"), a subsidiary of Xylem Inc. The KFTC found that certain employees of Xylem South Korea had participated in activities that violated Korea's antitrust laws. Xylem South Korea was assessed a fine of approximately $1.6 million and the matter was referred for criminal prosecution. In January 2015, Xylem South Korea paid the fine and filed an appeal of the KFTC's decision with the Seoul High Court.

In connection with the KFTC matter, the Company commenced an internal investigation relating to the allegations against Xylem South Korea. In late 2014, the Company broadened this internal investigation to assess related allegations made by certain employees of Xylem South Korea during the investigation into the KFTC matter. The broadened investigation includes a review of compliance by Xylem South Korea and its employees with the requirements of the Foreign Corrupt Practices Act. The Company engaged independent outside counsel to assist with its investigation and an independent professional services firm to provide forensic accounting assistance. In late January 2015, the Company voluntarily contacted the Securities and Exchange Commission and the Department of Justice to advise both agencies of this internal investigation. The Company will fully cooperate with any government investigation. Xylem South Korea's revenue is less than one percent of the Company's total revenue. Although the Company currently cannot reasonably estimate the potential liability, if any, related to the

investigation, we currently believe that these matters will not have a material adverse effect on the Company’s business, financial condition or results of operations.
On or about February 17, 2009, following a statement submitted to the Spanish Competition Authority (Comision Nacional de la Competencia, "CNC") by Grupo Industrial Ercole Marelli, S.A. regarding an anti-competitive agreement in which it said it had been participating, the CNC conducted an investigation at ITT Water & Wastewater España S.A. (now named Xylem Water Solutions España S.A.), at the Spanish Association of Fluid Pump Manufacturers (the "Association"), and at the offices of other members of the Association. On September 16, 2009, the Directorate of Investigation of the CNC commenced formal proceedings for alleged restrictive practices, such as several exchanges of information and a recommendation on general terms and conditions of sale, allegedly prohibited under applicable law. Following the conclusion of the formal proceedings, the CNC Council imposed fines on the Association and nineteen Spanish manufacturers and distributors of fluid pumps, including a fine of Euro 2,373,675 applied to ITT Water & Wastewater España S.A. and ITT Corporation. In March 2012, the Company appealed the CNC's decision to the Audiencia Nacional (the "High Court"), and vigorously defended the case. In March 2013, the High Court upheld the determination of the CNC and the fine previously assessed. In June 2013, the Company filed an appeal with the Tribunal Supremo, the Supreme Court of Spain. Xylem is awaiting the decision of the Supreme Court.

ITEM 4. MINE SAFETY DISCLOSURES

None.

EXECUTIVE OFFICERS OF THE REGISTRANT

The following information is provided regarding the executive officers of Xylem:

NAME	AGE	CURRENT TITLE	OTHER BUSINESS EXPERIENCE DURING PAST 5 YEARS
Patrick K. Decker	50	President and Chief Executive Officer (2014)	• President and Chief Executive Officer, Harsco Corp. (diversified, worldwide industrial company) (2012) • President, Flow Control Segment, Tyco International Ltd. (industrial products and services company) (2003)
Michael T. Speetzen	45	Senior VP and Chief Financial Officer (2011)	• VP of Finance, Fluid and Motion Control, ITT Corporation (global manufacturing company) (2009)
Tomas Brannemo	43	Senior VP and President, Transport (2014)	• VP, Transport (2013) • VP Strategy and Aftermarket and Service (2010) • VP and Director of Business Unit Aftermarket and Service (2010) • VP Marketing and Sales, Customer Support, Volvo Construction Equipment, AB Volvo (multinational manufacturing company) (2008)
Christopher R. McIntire	51	Senior VP and President, Analytics and Treatment (2013)	• Senior VP and President, Analytics (2011) • President and Chief Operating Officer, Nova Analytics (manufacturing and analytical instruments) (2006)
Robyn T. Mingle	49	Senior VP and Chief Human Resources Officer (2011)	• Senior VP of Human Resources, Hovnanian Enterprises, Inc. (real estate company) (2003)
Kenneth Napolitano	53	Senior VP and President, Applied Water Systems (2012)	• Senior VP and President, Residential and Commercial Water (2011) • President, Residential and Commercial Water (2009)
Colin R. Sabol	47	Senior VP and President, Dewatering (2013)	• Senior VP and Chief Strategy and Growth Officer (2011) • VP of Marketing and Business Development, Fluid and Motion Control, ITT Corporation (global manufacturing company)(2009)

NAME	AGE	CURRENT TITLE	OTHER BUSINESS EXPERIENCE DURING PAST 5 YEARS
Claudia S. Toussaint	51	Senior VP, General Counsel and Corporate Secretary (2014)	• Senior VP, General Counsel and Secretary, Barnes Group Inc. (international industrial and aerospace manufacturing) (2012) • General Counsel, Flow Control Segment, Tyco International Ltd. (industrial products and services company) (2012) • Senior VP, General Counsel and Secretary, Barnes Group Inc. (international industrial and aerospace manufacturing) (2010) • Senior VP, General Counsel and Secretary, Embarq (multinational communications company) (2009)

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:

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.
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, Gannett Co., Inc.
Sten E. Jakobsson	Former President and Chief Executive Officer, ABB AB
Steven R. Loranger	Former Chairman, President and Chief Executive Officer, ITT Corporation
Edward J. Ludwig	Former Chairman, President and Chief Executive Officer, Becton, Dickinson and Company
Surya N. Mohapatra, Ph.D.	Former Chairman, President and Chief Executive Officer, Quest Diagnostics Incorporated
Jerome A. Peribere	President and Chief Executive Officer, Sealed Air Corporation
James P. Rogers	Former Chairman, Chief Executive Officer, Eastman Chemical Company

PART II

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

2014 and 2013 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, 2014			
First Quarter	$39.79	$32.62	$0.1280
Second Quarter	40.00	34.50	0.1280
Third Quarter	39.43	34.77	0.1280
Fourth Quarter	39.23	31.80	0.1280
Fiscal Year ended December 31, 2013			
First Quarter	$29.49	$26.39	$0.1164
Second Quarter	29.19	25.56	0.1164
Third Quarter	29.79	23.61	0.1164
Fourth Quarter	34.93	26.99	0.1164

The closing price of our common stock on the NYSE on January 30, 2015 was $34.10 per share. As of January 30, 2015, there were 14,700 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 2015, we declared a dividend of $0.1408 per share to be paid on March 18, 2015 for shareholders of record on February 18, 2015.

There have been no unregistered offerings of our common stock during 2014.

Fourth Quarter 2014 Share Repurchase Activity

The following table summarizes our purchases of our common stock for the quarter ended December 31, 2014:

(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)
10/1/14 - 10/31/14	—	—	—	$108.2
11/1/14 - 11/30/14	—	—	—	$110.2
12/1/14 - 12/31/14	—	—	—	$110.0

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

(b) On August 18, 2012, the Board of Directors authorized the repurchase of up to two 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. There were no shares purchased under this program during the three months ended December 31, 2014 and there are 1.0 million shares (approximately $40 million based on the closing share price on December 31, 2014) that may still be purchased under this plan.

On August 20, 2013, the Board of Directors authorized the repurchase of shares up to $250 million 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. During the three months ended December 31, 2014, there were no shares repurchased under this program. There are up to $70 million in shares that may still be purchased under this plan.

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 October 13, 2011 (the first day our common stock began "when-issued" trading on the NYSE) through December 31, 2014. Our common stock began "regular-way" trading following the Spin-off on November 1, 2011.

	XYL	S&P 500	S&P 1500 Industrials Index
October 13, 2011	$100	$100	$100
October 31, 2011	110	104	106
December 31, 2011	106	105	108
December 31, 2012	114	121	124
December 31, 2013	148	161	175
December 31, 2014	165	183	192

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, 2014. 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.

On and prior to the Distribution Date, our financial position and results of operations consisted of WaterCo, the water equipment and services businesses of ITT Corporation. The Spin-off was completed pursuant to the Distribution Agreement among ITT, Exelis Inc. and Xylem. Xylem's financial position and results of operations have been derived from ITT's historical accounting records and are presented on a carve-out basis through the Distribution Date, while our financial results for Xylem post Spin-off are prepared on a stand-alone basis. Further, financial information for the twelve months ended December 31, 2011 consists of the consolidated results of Xylem on a stand-alone basis for the two months of November and December and the combined results of operations of WaterCo for the first ten months on a carve-out basis.

	Year Ended December 31,				
(in millions, except per share data)	2014	2013	2012	2011 (b)	2010 (c)
Results of Operations Data:					
Revenue	$3,916	$3,837	$3,791	$3,803	$3,202
Gross profit	1,513	1,499	1,502	1,461	1,214
Gross margin	38.6 %	39.1 %	39.6 %	38.4 %	37.9 %
Operating income	463	363	443	395	388
Operating margin	11.8 %	9.5 %	11.7 %	10.4 %	12.1 %
Net income	337	228	297	279	329
Per Share Data:					
Earnings per share:					
Basic	$1.84	$1.23	$1.60	$1.51	$1.78
Diluted	1.83	1.22	1.59	1.50	1.78
Basic shares outstanding (a)	183.1	185.2	185.8	185.1	184.6
Diluted shares outstanding (a)	184.2	186.0	186.2	185.3	184.6
Cash dividends per share	$0.5120	$0.4656	$0.4048	$0.1012	$—
Balance Sheet Data (at period end):					
Cash and cash equivalents	$663	$533	$504	$318	$131
Working capital*	882	930	859	834	759
Total assets	4,864	4,896	4,679	4,400	3,742
Total debt	1,288	1,241	1,205	1,206	4

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

(a) On October 31, 2011, the Spin-off from ITT was completed through a tax-free stock dividend to ITT's shareholders. ITT shareholders received one share of Xylem common stock for each share of ITT common stock. As a result on October 31, 2011, we had 184.6 million shares of common stock outstanding and this share amount is being utilized to calculate earnings per share and diluted earnings per share for all prior periods presented.

(b) In 2011, we acquired YSI Incorporated, which contributed revenue of $35 million in 2011 and $371 million of total assets on date of acquisition.

(c) In 2010, we acquired Godwin Pumps of America, Inc. and Nova Analytics Corporation. These businesses in the aggregate contributed revenue of $247 million in 2010 and $1,070 million of total assets on date of acquisition.

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, 2014. Except as otherwise indicated or unless the context otherwise requires, “Xylem,” “we,” “us,” “our” and “the Company” refer to Xylem In and its subsidiaries. References in the consolidated financial statements to "ITT" or the "former parent" refer to ITT Corporation and its consolidated subsidiaries (other than Xylem Inc.).

Overview

Xylem 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. Our business focuses on providing technology-intensive equipment and services. Our product and service offerings are organized into two segments: Water Infrastructure and Applied Water. Our segments are aligned with each of the sectors in the cycle of water, water infrastructure and usage applications. The Water Infrastructure segment focuses on the transportation, treatment and testing of water, offering a range of products including water and wastewater pumps, treatment and testing equipment, and controls and systems. The Applied Water segment serves many of the primary uses of water and focuses on the residential, commercial, industrial and agricultural markets. The segment’s major products include pumps, valves, heat exchangers, controls and dispensing equipment.

- Water Infrastructure serves the water infrastructure sector with pump systems that transport water from oceans, groundwater, 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 provide analytical instrumentation used to measure water quality, flow, and level in wastewater, surface water, and coastal environments.
- 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, valves 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, pumps for dairy operations, and rainwater reuse systems for small scale crop and turf irrigation.

We sell our equipment and services through direct and indirect channels that serve the needs of each customer type. In the Water Infrastructure segment, we provide the majority of our sales direct to customers with strong application expertise, while the remaining amount was through distribution partners. In the Applied Water segment, we provide the majority of our sales through long-standing relationships with the world’s leading distributors, with the remainder going direct to customers.

Key Performance Indicators and Non-GAAP Measures

Management reviews key performance indicators including revenue, gross margin, segment operating income and margins, earnings per share, orders growth, working capital, free cash flow and backlog, among others. In addition, we consider certain 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. These metrics, however, are not measures of financial performance under accounting principles generally accepted in the United States of America (“GAAP”) and should not be considered a substitute for revenue, operating income, net income, earnings per share (basic and diluted) or net cash from operations 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 foreign currency fluctuations 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 fluctuations assumes no change in exchange rates from the prior period.

- "constant currency" defined as financial results adjusted for 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 net income" and "adjusted earnings per share" defined as net income and earnings per share, respectively, adjusted to exclude non-recurring separation costs from the Spin-off (not excluded after 2012), restructuring and realignment costs, gain on sale of business, special charges and tax-related special items. A reconciliation of adjusted net income is provided below.

(in millions, except per share data)	2014	2013	2012
Net income	$337	$228	$297
Separation costs, net of tax (a)	—	—	16
Restructuring and realignment, net of tax	31	46	17
Special charges, net of tax	—	23	—
Tax-related special items	5	14	—
Gain on sale of business, net of tax	(11)	—	—
Adjusted net income	$362	$311	$330
Weighted average number of shares - Diluted	184.2	186.0	186.2
Adjusted earnings per share	$1.97	$1.67	$1.77

(a) Costs of $4 million ($2 million, net of tax) during 2013, associated with non-recurring separation activities are not excluded from adjusted net income.

- "operating expenses excluding separation, restructuring and realignment costs and special charges" defined as operating expenses, adjusted to exclude non-recurring separation costs from the Spin-off (not excluded after 2012), restructuring and realignment costs and special charges.
- "adjusted segment operating income" defined as segment operating income, adjusted to exclude non-recurring separation costs from the Spin-off (not excluded after 2012), restructuring and realignment costs, and "adjusted segment operating margin" defined as adjusted segment operating income divided by total segment revenue.
- “realignment costs” defined as non-recurring costs not included in restructuring costs that are incurred as part of actions taken to reposition our business, including items such as professional fees, relocation, travel and other costs.
- “special charges" defined as costs incurred by the Company associated with the settlement of legal proceedings with Xylem Group LLC and certain costs incurred for the change in chief executive officer made during the third quarter of 2013, as well as costs incurred in the fourth quarter of 2013 for the contractual indemnification of federal tax obligations to ITT and costs associated with a legal judgment arising from a historical acquisition matter.
- "free cash flow" defined as net cash provided by operating activities less capital expenditures, as well as adjustments for other significant items that impact current results that 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)	2014	2013	2012
Net cash provided by operating activities	$416	$324	$396
Capital expenditures	(119)	(126)	(112)
Separation cash payments (a)	—	—	28
Free cash flow	$297	$198	$312

(a) Separation cash payments associated with non-recurring separation activities are included in the 2013 free cash flow. Separation cash payments are excluded from free cash flow in 2012 and include capital expenditures associated with the Spin-off of $4 million.

Executive Summary

Xylem reported revenue for 2014 of $3,916 million, an increase of 2.1% from $3,837 million reported in 2013. Significant growth in the industrial and public utility end markets combined with strength in the emerging markets, most notably in China, drove the increase. Continued challenging market conditions limited growth in other regions, Europe, for example, was flat organically year-over-year, while Japan and Australia declined. Operating income for 2014 was $463 million, reflecting an increase of $100 million or 27.5% compared to $363 million in 2013, which was primarily due to savings from lean six sigma activities, global sourcing initiatives and restructuring actions as well as lapping $24 million in non-recurring special charges in 2013, which more than offset headwinds from cost inflation and unfavorable sales mix. Additionally, restructuring and realignment cost actions taken to improve the overall cost base of the business were $43 million in 2014 as compared to $64 million in the prior year.

Additional financial highlights for 2014 include the following:

- Net income of $337 million, or $1.83 per diluted share ($362 million or $1.97 per diluted share on an adjusted basis)
- Free cash flow of $297 million, and net cash from operating activities of $416 million
- Orders of $4,021 million (a 3.9% increase from 2013 on a constant currency basis)
- We repurchased $130 million in shares under the $250 million share repurchase program approved by our Board of Directors in 2013 as part of our strategy to enhance shareholder return
- Dividends paid to shareholders increased 10.0% in 2014.

2015 Business Outlook

In 2015, we are anticipating organic revenue growth of low single digits. The projected organic growth excludes an expected negative foreign exchange translation impact on growth of high single digits, primarily driven by a weaker Euro to U.S. dollar. We expect continued strength in the United States industrial markets, but a modest deceleration in emerging market growth and weakness in the oil and gas markets to result in low single digit growth overall for the industrial end market. We expect public utilities to also increase at low single digits where emerging market infrastructure investments continue to bolster growth and we see improving market conditions in the United States. In the commercial market, we anticipate growth of low to mid-single digits as the United States appears to continue to slowly recover and emerging markets continue to be strong, which we expect will be partially offset by soft European markets. We believe the residential markets will be flat to down low single digits as the United States markets moderate and Europe continues to be negative. Finally, the agriculture markets, which is our smallest end market, we expect will likely be relatively flat compared to 2014 as we are expecting slower growth in the United States from lapping of a strong 2014 combined with stabilization in Europe and continued strength in emerging markets.

We will continue to execute restructuring and realignment actions to reposition our European and North American business to optimize our cost structure and improve our operational efficiency and effectiveness. During 2014, we incurred $26 million and $17 million in restructuring and realignment costs, respectively. As a result of the restructuring actions in 2014, we realized $13 million of net savings. In 2015, we expect to incur approximately $20 million in restructuring and realignment costs. We expect to realize approximately $16 million of incremental net savings in 2015 from actions initiated in 2014, and an additional $2 million of net savings from our 2015 actions. Additional strategic actions we are taking include strategic initiatives to drive above-market growth, advance continuous improvement activities to increase productivity, focus on improving cash performance and drive a disciplined capital deployment strategy.

Results of Operations

(in millions)	2014		2013		2012		2014 v. 2013		2013 v. 2012	
Revenue	$3,916		$3,837		$3,791		2.1	%	1.2	%
Gross profit	1,513		1,499		1,502		0.9	%	(0.2	)%
Gross margin	38.6	%	39.1	%	39.6	%	(50	)bp	(50	)bp
Operating expenses excluding separation, restructuring and realignment costs and special charges (a)	1,007		1,048		1,013		(3.9	)%	3.5	%
Expense to revenue ratio	25.7	%	27.3	%	26.7	%	(160	)bp	60	bp
Restructuring and realignment costs	43		64		24		(32.8	)%	166.7	%
Separation costs (a)	—		—		22		—	%	NM	
Special charges	—		24		—		NM		NM	
Total operating expenses	1,050		1,136		1,059		(7.6	)%	7.3	%
Operating income	463		363		443		27.5	%	(18.1	)%
Operating margin	11.8	%	9.5	%	11.7	%	230	bp	(220	)bp
Interest and other non-operating expense (income), net	53		65		55		(18.5	)%	18.2	%
Gain on sale of business	11		—		—		NM		—	%
Income tax expense	84		70		91		20.0	%	(23.1	)%
Tax rate	19.8	%	23.5	%	23.4	%	(370	)bp	10	bp
Net income	$337		$228		$297		47.8	%	(23.2	)%

(a) Separation costs of $4 million ($2 million, net of tax) during 2013 are included within the $1,048 million of operating expenses.

NM Not Meaningful

2014 versus 2013

Revenue

Revenue generated for 2014 was $3,916 million, an increase of $79 million, or 2.1%, compared to $3,837 million in 2013. On a constant currency basis, revenue grew 3.3%. The following table illustrates the impact on 2014 revenue from organic growth, recent acquisitions, and fluctuations in foreign currency.

(in millions)	$ Change		% Change	
2013 Revenue	$3,837			
Organic Growth	134		3.5	%
Acquisitions/(Divestitures)	(6	)	(0.2	)%
Constant Currency	128		3.3	%
Foreign currency translation (a)	(49	)	(1.3	)%
Total change in revenue	79		2.1	%
2014 Revenue	$3,916			

(a) Foreign currency impact primarily due to weakness in the value of the Canadian Dollar, Australian Dollar, Argentine Peso, Swedish Krona and Norwegian Krone against the U.S. Dollar, partially offset by strength in the value of the British Pound against the U.S. Dollar.

The following table summarizes revenue by segment for 2014 and 2013:

(in millions)	2014	2013	As Reported Change	Constant Currency Change
Water Infrastructure	$2,442	$2,384	2.4 %	4.4 %
Applied Water	1,474	1,453	1.4 %	1.6 %
Total	$3,916	$3,837	2.1 %	3.3 %

Water Infrastructure

Water Infrastructure's revenue increased $58 million, or 2.4% in 2014 (4.4% on a constant currency basis). The 4.4% constant currency increase reflects growth within the industrial water and public utility end markets and $6 million of incremental revenue from our 2013 acquisitions.

Organic revenue increased $99 million or 4.2% during the year, which was substantially due to higher volumes in transport, test and treatment applications. Revenue from transport applications grew primarily from increased industrial dewatering applications in the United States from oil and gas market-related rental activities. Transport also grew organically from public utility pump and aftermarket demand. Revenue from test applications increased due to significant strength in the United States from increased government spending coupled with the continued success of new products and cross-selling of our European technologies. Revenue from treatment applications grew from the delivery of several large projects in the emerging markets, particularly in Latin America, partially offset by lower deliverable project backlog in the United States and European markets.

Applied Water

Applied Water's revenue increased $21 million, or 1.4% in 2014 (a 1.6% increase on a constant currency basis). The growth on a constant currency basis is driven primarily by organic revenue growth of $35 million, or 2.4% versus the prior year due to strength in the commercial building services, industrial water and agriculture end markets, which more than offset declines in the residential building services. The increase in the current year was partially offset by the absence of revenue from our Wolverhampton valves business following its divestiture in the third quarter of 2014 as compared to $12 million of revenue for the comparative period in 2013.

Organic revenue increased $35 million or 2.4% for the year due primarily to commercial building recovery in the United States institutional building market, including distributor restocking and promotional activity. Also contributing to the organic growth was industrial water application strength across all regions, particularly from projects in the Middle East and Latin America. Irrigation application revenue also grew, driven by the timing of project shipments and increased demand for vertical turbines. A decline in European demand for residential applications partially offset organic growth.

Orders/Backlog

Orders received during 2014 increased by $109 million, or 2.8% to $4,021 million (a 3.9% increase on a constant currency basis). Organic order growth increased $153 million or 3.9% for the year.

Water Infrastructure segment orders increased $68 million, or 2.8% to $2,511 million (4.4% growth on a constant currency basis), including $8 million from acquisitions. Organic order growth of 4.1% was primarily due to higher industrial demand within transport for wastewater pumps in the United States and Europe as well as strength within the dewatering business for rental and equipment sales into oil and gas markets. Orders for test applications also bolstered the growth for the segment from large orders in the United States. The strength in transport and test offset declines in treatment from project delays in the United States and Europe.

Orders increased in our Applied Water segment $41 million, or 2.8% to $1,510 million (3.0% growth on a constant currency basis). Organic growth of 3.6% was driven by strong performance in the commercial building services and industrial water markets in the United States, as well as continued strength in China. The growth was partially offset by weakness in the residential markets of Europe.

Delivery schedules vary from customer to customer based upon their requirements. Typically, large projects require longer lead production cycles, and delays can occur from time to time. Total backlog was $740 million at December 31, 2014 and $707 million at December 31, 2013. We anticipate that more than 85% of the backlog at December 31, 2014 will be recognized as revenue during 2015.

Gross Margin

Gross margins as a percentage of consolidated revenue declined to 38.6% in 2014 from 39.1% in 2013. The decrease is primarily attributable to lower margin sales within the Water Infrastructure segment caused by higher mix sold to emerging markets, which have lower margins, in conjunction with foreign exchange headwinds as well as unfavorable product sales mix. These negative impacts were partially mitigated by benefits from restructuring savings and cost-saving initiatives through lean six sigma and global sourcing across both segments.

Operating Expenses

(in millions)	2014		2013		Change	
Selling, General and Administrative (SG&A)	$920		$986		(6.7	)%
SG&A as a % of revenue	23.5	%	25.7	%	(220	)bp
Research and Development (R&D)	104		104		—	%
R&D as a % of revenue	2.7	%	2.7	%	—	
Restructuring and asset impairment charges	26		42		(38.1	)%
Separation Costs	—		4		NM	
Operating expenses	$1,050		$1,136		(7.6	)%
Expense to revenue ratio	26.8	%	29.6	%	(280	)bp

NM Not meaningful percentage change

Selling, General and Administrative Expenses

SG&A decreased by $66 million or 6.7% to $920 million, or 23.5% of revenue in 2014, as compared to $986 million or 25.7% of revenue in 2013. The decrease in SG&A expenses as a percentage of revenue is due primarily to savings from restructuring actions combined with lapping the impacts from non-recurring special charges in 2013 of $24 million, which comprise the legal settlement with Xylem Group LLC, costs incurred for the change in our chief executive officer, costs incurred for the contractual indemnification of federal tax obligations to ITT and costs associated with a legal judgment arising from a historical acquisition matter. The decrease was also driven by $7 million less realignment costs in 2014, which were costs incurred by the Company to reposition our European business in an effort to optimize our cost structure and improve our operational efficiency and effectiveness as well as implement our new organizational structure.

Research and Development Expenses

R&D spending was flat at $104 million or 2.7% of revenue in both 2014 and 2013.

Restructuring and Asset Impairment Charges

During 2014, we incurred restructuring costs of $19 million, $6 million and $1 million in our Water Infrastructure and Applied Water segments, and Corporate and other, 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 2013, we recognized restructuring costs of $31 million and $9 million in our Water Infrastructure and Applied Water segments, respectively. These charges were incurred primarily in an effort to realign our organizational structure in Europe and North America to address declines in sales volumes and optimize our cost structure. The charges relate to the reduction in structural costs, including a decrease in headcount and consolidation of facilities.

Total expected costs associated with actions that commenced during 2014 are approximately $22 million for Water Infrastructure, approximately $10 million for Applied Water and approximately $1 million for Corporate and other. These costs primarily comprise severance charges. The Water Infrastructure and Applied Water actions are expected to continue through 2015. The Corporate and other actions are complete. As a result of these actions initiated in 2014, we achieved savings of approximately $13 million in 2014 and estimate annual future net savings beginning in 2015 of approximately $29 million.

Additionally, in the fourth quarter of 2013, we recorded a $2 million impairment charge related to three trade names in our Water Infrastructure segment associated with acquired businesses within our Analytics operating unit, reflecting a decline in their value since being acquired. Refer to Note 11, “Goodwill and Other Intangible Assets,” for additional information.

Operating Income

We generated operating income of $463 million during 2014, a $100 million or 27.5% increase from the prior year operating income of $363 million, primarily reflecting cost-saving initiatives and savings from restructuring actions. These benefits were partially offset by cost inflation combined with unfavorable impacts from our geographic and product sales mix described above. Another driving factor in the year-over-year improvement was the absence of the aforementioned special charges in 2013 within SG&A, which did not recur as well as lower restructuring and realignment costs. The following table illustrates operating income results by business segments for 2014 and 2013.

(in millions)	2014		2013		Change	
Water Infrastructure	$321		$263		22.1	%
Applied Water	193		175		10.3	%
Segment operating income	514		438		17.4	%
Corporate and other	(51	)	(75	)	(32.0	)%
Total operating income	$463		$363		27.5	%
Operating margin						
Water Infrastructure	13.1	%	11.0	%	210	bp
Applied Water	13.1	%	11.6	%	150	bp
Total Xylem	11.8	%	9.5	%	230	bp

The table included below provides a reconciliation from segment operating income to adjusted operating income, and a calculation of the corresponding adjusted operating margin.

(in millions)	2014		2013		Change	
Water Infrastructure						
Operating income	$321		$263		22.1	%
Restructuring and realignment costs	29		48		(39.6	)%
Special charges	—		4		NM	
Adjusted operating income	$350		$315		11.1	%
Adjusted operating margin	14.3	%	13.2	%	110	bp
Applied Water						
Operating income	193		175		10.3	%
Restructuring and realignment costs	13		16		(18.8	)%
Adjusted operating income	$206		$191		7.9	%
Adjusted operating margin	14.0	%	13.1	%	90	bp
Total Xylem						
Operating income	$463		$363		27.5	%
Restructuring and realignment costs	43		64		(32.8	)%
Special charges	—		24		NM	
Adjusted operating income	$506		$451		12.2	%
Adjusted operating margin	12.9	%	11.8	%	110	bp

NM Not meaningful percentage change

Water Infrastructure

Operating income for our Water Infrastructure segment increased $58 million or 22.1% (increased $35 million or 11.1% on an adjusted basis) compared with the prior year. The 11.1% increase was primarily driven by higher volume, restructuring savings and cost reduction initiatives, such as global sourcing and lean six sigma. The increase was partially offset by cost inflation, unfavorable sales mix and price.

Applied Water

Operating income for our Applied Water segment increased $18 million or 10.3% (increased $15 million or 7.9% on an adjusted basis) compared to the prior year. The 7.9% increase was driven by lean six sigma initiatives, global sourcing and restructuring savings combined with modest price realization. The increase was partially offset by cost inflation and unfavorable foreign exchange headwinds.

Interest Expense

Interest expense was $54 million and $55 million for 2014 and 2013, respectively, primarily related to interest expense on $1.2 billion aggregate principal amount of our senior notes. Refer to Note 14, “Credit Facilities and Long-Term Debt,” for further details.

Income Tax Expense

The income tax provision for 2014 was $84 million at an effective tax rate of 19.8% compared to $70 million at an effective tax rate of 23.5% in 2013. The 2014 effective tax rate is lower than 2013 due primarily to geographic mix of earnings.

Other Comprehensive Income/(Loss)

Other comprehensive loss before tax of $284 million in 2014 as compared to income of $74 million in 2013 was primarily due to a $221 million foreign currency translation impact due to a weakening of the Euro, British Pound and Swedish Krona against the U.S. dollar. Further contributing to the year-over-year decline was a $110 million net loss in postretirement benefit plans in 2014 as compared to a net gain of $34 million in 2013 due to a decrease in discount rates, partially mitigated by actual gains on plan assets in excess of the assumed long-term rate of return. The effective tax rate on other comprehensive income decreased as compared to 2013 due primarily to the shift in comprehensive earnings from foreign currency translation, which is not taxable, as well as from a change in the jurisdictional mix of net gains and losses from postretirement benefit plans.

2013 versus 2012

Revenue

Revenue generated for 2013 was $3,837 million, an increase of $46 million, or 1.2%, compared to $3,791 million in 2012. On a constant currency basis, revenue grew 1.1%. The following table illustrates the impact from organic growth, recent acquisitions, and fluctuations in foreign currency, in relation to revenue during 2013.

(in millions)	$ Change	% Change
2012 Revenue	$3,791	
Organic Growth	(39)	(1.0)%
Acquisitions	82	2.2%
Constant Currency	43	1.1%
Foreign currency translation (a)	3	0.1%
Total change in revenue	46	1.2%
2013 Revenue	$3,837	

(a) Foreign currency impact primarily due to strength in the value of the Euro and Swedish Krona against the U.S. Dollar, partially offset by weakness in the value of the Australian Dollar, South African Rand, Canadian Dollar and British Pound against the U.S. Dollar.

The following table summarizes revenue by segment for 2013 and 2012:

(in millions)	2013	2012	As Reported Change	Constant Currency Change
Water Infrastructure	$2,384	$2,349	1.5%	1.7%
Applied Water	1,453	1,442	0.8%	0.3%
Total	$3,837	$3,791	1.2%	1.1%

Water Infrastructure

Water Infrastructure’s revenue increased $35 million, or 1.5% in 2013 (1.7% on a constant currency basis). Our 2012 and 2013 acquisitions contributed $82 million of incremental revenue in 2013.

Organic revenue decreased $43 million or 1.8% during the year, which was due substantially to lower volumes across the transport, treatment and test applications. The significant declines were caused primarily by weakness in the Europe, Middle East and Africa treatment markets and declines in transport in the Asia Pacific markets from less mining activity. Organic revenue performance improved year-over-year in the third and fourth quarters of 2013 driven by increases in transport revenue, which reflected modest market recovery in northern and central Europe as well as the United States. Treatment negatively impacted organic growth for the year as revenue decreased from 2012 due substantially to non-recurring large custom projects shipped in the prior year as well as project delays from government funding uncertainties. Additionally, test applications, which had flat organic revenue in 2013, experienced lower revenue for the year from delays in orders and the government sequestration in the United States during the first half of 2013, which were offset by revenue growth in the second half of the year, specifically in Europe, as well as incremental revenue from price increases, new products and cross-branding initiatives.

Applied Water

Applied Water’s revenue increased $11 million, or 0.8% in 2013 (a 0.3% increase on a constant currency basis). The growth on a constant currency basis was driven by organic revenue growth predominately due to irrigation and industrial water applications.

Organic revenue increased $4 million or 0.3% for the year due primarily to irrigation application revenue caused by drought conditions in the United States. Strength in the industrial water application also bolstered revenue, particularly within China from large fire pump projects as well as in northern Europe from increased industrial multistage pump revenue. These revenue increases were partially offset by weakness in Europe, particularly within the residential and commercial building services markets of southern Europe, combined with sluggish industrial and commercial building service markets in the United States and Latin America.

Orders/Backlog

Orders received during 2013 increased by $130 million, or 3.4% to $3,912 million (a 3.4% increase on a constant currency basis). These amounts include a benefit of $87 million from acquisitions. Organic order growth was $43 million for the year.

The Water Infrastructure segment orders increased $79 million, or 3.3% to $2,443 million (3.6% growth on a constant currency basis), including $87 million from acquisitions. Orders increased slightly on a constant currency basis due primarily to a strong second half of 2013 driven by higher transport volume from Europe public utilities and the dewatering business, combined with healthy growth in emerging markets. Orders increased in our Applied Water segment $51 million, or 3.6% to $1,469 million (3.2% growth on a constant currency basis), driven by strong performance in the commercial building services and industrial water markets in China as well as orders within the residential building services and agriculture markets in the United States during 2013, partially offset by weakness in Southern Europe across all end markets.

Delivery schedules vary from customer to customer based upon their requirements. Typically, large projects require longer lead production cycles and delays can occur from time to time. Total backlog was $707 million at December 31, 2013 and $647 million at December 31, 2012.

Gross Margin

Gross margins as a percentage of consolidated revenue declined to 39.1% in 2013 from 39.6% in 2012. The decrease is attributable to negative price realization, geographic sales mix and additional costs associated with recent acquisitions. These negative impacts were partially mitigated by benefits from restructuring savings and cost saving initiatives such as lean six sigma and global sourcing.

Operating Expenses

(in millions)	2013		2012		Change	
Selling, General and Administrative (SG&A)	$986		$914		7.9	%
SG&A as a % of revenue	25.7	%	24.1	%	160bp	
Research and Development (R&D)	104		106		(1.9	)%
R&D as a % of revenue	2.7	%	2.8	%	(10)bp	
Restructuring and asset impairment charges	42		17		147.1	%
Separation Costs	4		22		(81.8	)%
Operating expenses	$1,136		$1,059		7.3	%
Expense to revenue ratio	29.6	%	27.9	%	170bp	

Selling, General and Administrative Expenses

SG&A increased by $72 million or 7.9% to $986 million or 25.7% of revenue in 2013, as compared to $914 million or 24.1% of revenue in 2012. The increase in SG&A expenses as a percentage of revenue is primarily due to the combined impacts from the legal settlement with Xylem Group LLC and costs incurred for the change in our chief executive officer of $20 million. The increase was also driven by realignment costs of $17 million during 2013 incurred by the Company to reposition our European business in an effort to optimize our cost structure and improve our operational efficiency and effectiveness. Acquisitions, increased pension costs and investments in growth platforms also contributed to the increase.

Research and Development Expenses

R&D spending decreased $2 million or 1.9% to $104 million or 2.7% of revenue for 2013 as compared to $106 million or 2.8% of revenue in 2012.

Restructuring and Asset Impairment Charges

During 2013, we incurred restructuring costs of $31 million and $9 million in our Water Infrastructure and Applied Water segments, respectively. These charges were incurred primarily in an effort to realign our organizational structure in Europe and North America to address declines in sales volumes and optimize our cost structure. The charges relate to the reduction in structural costs, including a decrease in headcount and consolidation of facilities. During 2012, we recognized restructuring charges of $17 million related to restructuring related severance payments for manufacturing reduction in force initiatives primarily within our Water Infrastructure segment.

Total expected costs associated with actions that commenced during 2013 are approximately $32 million for Water Infrastructure and approximately $8 million for Applied Water. These costs primarily comprise severance charges. These actions are substantially complete. As a result of actions initiated during 2013, we achieved net savings of approximately $13 million in 2013 and annual future net savings beginning in 2014 of approximately $36 million.

Additionally, in the fourth quarter of 2013 we recorded a $2 million impairment charge related to three trade names in our Water Infrastructure segment associated with acquired businesses within our Analytics operating unit, reflecting a decline in their value since being acquired. Refer to Note 11, “Goodwill and Other Intangible Assets,” for additional information.

Separation Costs

We had non-recurring separation costs related to our Spin-off from ITT as presented below.

(in millions)	2013	2012
Rebranding and marketing costs	$—	$8
Advisory and professional fees	—	7
Information and technology costs	2	3
Employee retention and hiring costs	—	1
Lease termination and other real estate costs	2	1
Other	—	2
Total separation costs in operating income	4	22
Income tax benefit	(2)	(6)
Total separation costs, net of tax	$2	$16

Operating Income

We generated operating income of $363 million during 2013, an $80 million or 18.1% decrease from the prior year operating income of $443 million, primarily reflecting higher operating expenses as increased SG&A, and restructuring and asset impairment charges more than offset reductions from lower separation costs and savings from restructuring activities. The following table illustrates operating income results by business segments for 2013 and 2012.

(in millions)	2013	2012	Change
Water Infrastructure	$263	$334	(21.3)%
Applied Water	175	178	(1.7)%
Segment operating income	438	512	(14.5)%
Corporate and other	(75)	(69)	8.7%
Total operating income	$363	$443	(18.1)%
Operating margin			
Water Infrastructure	11.0%	14.2%	(320)bp
Applied Water	12.0%	12.3%	(30)bp
Total Xylem	9.5%	11.7%	(220)bp

The table included below provides a reconciliation from segment operating income to adjusted operating income, and a calculation of the corresponding adjusted operating margin.

(in millions)	2013	2012	Change
Water Infrastructure			
Operating income	$263	$334	(21.3)%
Separation costs	—	4	NM
Restructuring and realignment costs	48	19	152.6 %
Special charges	4	—	NM
Adjusted operating income	$315	$357	(11.8)%
Adjusted operating margin	13.2 %	15.2 %	(200)bp
Applied Water			
Operating income	175	178	(1.7)%
Separation costs	—	2	NM
Restructuring and realignment costs	16	5	220.0 %
Adjusted operating income	$191	$185	3.2 %
Adjusted operating margin	13.1 %	12.8 %	30bp
Total Xylem			
Operating income	$363	$443	(18.1)%
Separation costs*	—	22	NM
Restructuring and realignment costs	64	24	166.7 %
Special charges	24	—	NM
Adjusted operating income*	$451	$489	(7.8)%
Adjusted operating margin*	11.8 %	12.9 %	(110)bp

NM Not meaningful percentage change

* Costs associated with non-recurring separation activities of $4 million ($2 million, net of tax) during 2013 are not excluded from adjusted operating income.

Water Infrastructure

Operating income for our Water Infrastructure segment decreased $71 million or 21.3% (decreased $42 million or 11.8% on an adjusted basis) compared with the prior year. The 11.8% decrease was driven by lower volume, inflation, unfavorable foreign exchange impacts, costs associated with the establishment of our European headquarters and investments in growth platforms, specifically acquisitions and new product launches. The decrease was partially offset by restructuring savings and cost reduction initiatives, such as global sourcing and lean six sigma.

Applied Water

Operating income for our Applied Water segment decreased $3 million or 1.7% (increased $6 million or 3.2% on an adjusted basis) compared to the prior year. The 3.2% increase was driven by lean initiatives, global sourcing and price realization partially offset by inflation and new product development.

Interest Expense

Interest expense was $55 million for both 2013 and 2012, reflecting the same full year of interest expense related to the issuance of $1.2 billion aggregate principal amount of our senior notes. Refer to Note 14, “Credit Facilities and Long-Term Debt,” for further details.

Income Tax Expense

The income tax provision for 2013 was $70 million at an effective tax rate of 23.5% compared to $91 million at an effective tax rate of 23.4% in 2012. The 2013 effective tax rate is higher than 2012 due to an increase in foreign repatriations partially offset by mix of earnings.

Other Comprehensive Income/(Loss)

Other comprehensive income before tax of $74 million in 2013 compared to a loss of $30 million in 2012, an improvement of $104 million, was primarily due to a $34 million net gain in 2013 as compared to a net loss of $84 million in 2012 related to postretirement benefit plans. The net gain in 2013 was due to an increase in discount rates as well as actual gains on plan assets in excess of the assumed long-term rate of return as compared to the net loss in 2012 which was due to a reduction in discount rates, partially mitigated by actual gains on plan assets in excess of the assumed long-term rate of return. This year-over-year improvement was partially offset by a $33 million reduction in foreign currency translation benefit primarily due to the Euro, Swedish Krona and British Pound strengthening against the U.S. dollar. The effective tax rate on other comprehensive income decreased as compared to 2012 due primarily to the shift in comprehensive earnings from foreign currency translation, which is not taxable, as well as from a change in the jurisdictional mix of net gains and losses from postretirement benefit plans.

Liquidity and Capital Resources

The following table summarizes our sources and uses of cash:

	Year Ended December 31,		
(in millions)	2014	2013	2012
Operating activities	$416	$324	$396
Investing activities	(86)	(199)	(147)
Financing activities	(147)	(100)	(74)
Foreign exchange (a)	(53)	4	11
Total	$130	$29	$186

(a) 2014 impact is primarily due to the weakness of the Euro against the US Dollar.

Sources and Uses of Liquidity

Operating Activities

During 2014, net cash provided by operating activities was $416 million, compared to $324 million in 2013. The $92 million year-over-year increase was driven by an increase in income, as well as a modest improvement in working capital performance. Reductions in payments made for restructuring and postretirement plan contributions in 2014 were largely offset by an increase in tax payments. Also contributing to the increase was a refund of value-added tax in the current year that had been paid during 2013.

During 2013, net cash provided by operating activities was $324 million, compared to $396 million in 2012. The $72 million year-over-year decrease was driven by an increase in the use of working capital in both segments, due to increased accounts receivable primarily from longer collection times in Europe, and increased inventories to support a higher backlog as well as to be able to support shorter lead times. Additionally, revenue volume declines during the first half of 2013 reduced cash inflow from income. Payments made for restructuring and realignment activities in 2013 also contributed to the decline, largely offset by lower tax payments.

Investing Activities

Cash used in investing activities was $86 million for 2014, compared to $199 million in 2013. The decrease of $113 million was primarily driven by a decrease in acquisition activity as there were no acquisitions in 2014, whereas we spent $81 million for the acquisitions during 2013. Also contributing to the decrease was the receipt of $30 million in 2014 for the sale of a business. Capital expenditures were also lower in 2014, with a $7 million reduction primarily due to a decrease in the spending on post Spin-off information technology investments and the relocation of our corporate headquarters.

Cash used in investing activities was $199 million in 2013 compared to $147 million in 2012. The changes in investing activities are driven almost entirely by acquisitions activity and, to a lesser extent, from changes in spending on capital expenditures. Cash used for acquisitions was $81 million in 2013 compared to $41 million during 2012. Capital expenditures were $126 million in 2013 and $112 million in 2012. The increase in capital expenditures were primarily due to information technology investments within both the Applied Water segment and Corporate as a result of system requirements subsequent to the Spin-off in addition to capital expenditures required for the relocation of our corporate headquarters as required by the Spin-off from ITT.

Financing Activities

Cash used by financing activities was $147 million, $100 million and $74 million during 2014, 2013 and 2012, respectively. The increases in cash used for financing activities was primarily driven by an increase in share repurchase activity and dividend payments. In 2014, share repurchase activity increased $61 million and dividend payments increased $7 million compared to 2013. Additionally, there was an increase in short-term debt for borrowings under the European Investment Bank facility of $50 million in 2014 versus $38 million in 2013. In 2013, increases in share repurchase activity and dividend payments were $60 million and $12 million, respectively, compared to 2012. The 2013 share repurchase activity was impacted by $50 million of repurchases under a new share repurchase program approved on August 20, 2013 by the Board of Directors to repurchase up to $250 million in shares.

Funding and Liquidity Strategy

Our ability to fund our capital needs depends on our ongoing ability to generate cash from operations, and access to the bank and capital markets.

Our global funding requirements are continually monitored with appropriate strategies executed to ensure liquidity needs are met cost effectively. 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.

Historically, we have generated operating cash flow sufficient to fund our primary cash needs centered on operating activities, working capital, capital expenditures, and strategic investments. 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 we will continue to have access to the capital markets on terms acceptable to us or that financing will be available at all.

We anticipate that our present sources of funds, including funds from operations, will provide us with sufficient liquidity and capital resources to meet our global liquidity and capital needs over the next twelve months.

Senior Notes

On September 20, 2011, we issued 3.550% Senior Notes of $600 million aggregate principal amount due September 2016 (the "Senior Notes due 2016") and 4.875% Senior Notes of $600 million aggregate principal amount due October 2021 (the "Senior Notes due 2021" and together with the Senior Notes due 2016, the "Senior Notes").

The Senior Notes include covenants which 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. If a change of control triggering event (as defined in the Senior Notes) 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. As of December 31, 2014, we were in compliance with all covenants.

Interest on the Senior Notes due 2016 is payable on March 20 and September 20 of each year. Interest on the Senior Notes due 2021 is payable on April 1 and October 1 of each year.

Four Year Competitive Advance and Revolving Credit Facility
Effective October 31, 2011, Xylem and its subsidiaries entered into a Four Year Competitive Advance and Revolving Credit Facility (the "Credit Facility") with JPMorgan Chase Bank, 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) a competitive advance borrowing option which will be provided on an uncommitted competitive advance basis through an auction mechanism (the "competitive loans"), (ii) revolving extensions of credit (the "revolving loans") outstanding at any time and (iii) the issuance of letters of credit in a face amount not in excess of $100 million outstanding at any time.
At our election, the interest rate per annum applicable to the competitive advances will be based on either (i) a Eurodollar rate determined by reference to LIBOR, plus an applicable margin offered by the lender making such loans and accepted by us or (ii) a fixed percentage rate per annum specified by the lender making such loans. At our election, 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 JPMorgan Chase Bank, 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, we may not exceed a maximum leverage ratio of 3.50 (based on a ratio of total debt to earnings before interest, taxes, depreciation and amortization) throughout the term. The Credit Facility also contains limitations on, among other things, incurring debt, granting liens, and entering sale and leaseback transactions. 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, 2014, we were in compliance with all covenants.
As of December 31, 2014, this credit facility remains undrawn. Our intention is to renew the Credit Facility in 2015.
Research and Development Facility Agreement
On December 4, 2013, the Company amended and restated its Risk Sharing Finance Facility Agreement (the "R&D Facility Agreement") with The European Investment Bank (the "EIB") to add an additional borrower under the facility. The facility provides an aggregate principal amount of up to €120 million (approximately $146 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. The funds are available to finance research and development projects during the period from 2013 through 2016 at the Company's R&D facilities in Sweden, Germany, Italy, the United Kingdom, Austria, Norway and Hungary.
Under the R&D Facility Agreement, the borrower can draw loans on or before June 14, 2015 with a maturity of no longer than 12 years. The R&D Facility Agreement provides for Fixed Rate loans and Floating Rate loans. The interest rate per annum applicable to Fixed Rate loans will be 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 will be 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 for both Fixed Rate loans and Floating Rate loans shall be determined by reference to the credit rating of the Company.
In accordance with the terms of the R&D Facility Agreement, we may not exceed a maximum leverage ratio of 3.50 (based on a ratio of total debt to earnings before interest, taxes, depreciation and amortization) throughout the term. The R&D Facility Agreement also contains limitations on, among other things, incurring debt, granting liens, and entering into sale and leaseback transactions. In addition, the R&D Facility Agreement contains other terms and conditions such as customary representations and warranties, additional covenants and customary events of default. As of December 31, 2014, we were in compliance with all covenants.
As of December 31, 2014, $84 million was outstanding under the R&D Facility Agreement. Although the borrowing term for this arrangement is for five years, we have classified it as short-term debt on our Consolidated Balance Sheet since we intend to repay this obligation in less than one year.

Non-U.S. Operations

For both 2014 and 2013, we generated 62% of our revenue from non-U.S. operations. As we continue to grow our operations in the emerging markets and elsewhere outside of the United States, 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. Our intent is to indefinitely reinvest all but $65 million of these funds outside of the United States. However, we continually review our domestic and foreign cash profile, expected future cash generation and investment opportunities that support our current designation of these funds as being indefinitely reinvested and reassess whether there is a demonstrated need to repatriate funds held internationally to support our U.S. operations. If, as a result of our review, it is determined that all or a portion of the funds may be needed for our operations in the United States, we would be required to accrue U.S. taxes related to future tax payments associated with the repatriation of these funds. As of December 31, 2014, our foreign subsidiaries were holding $537 million in cash or marketable securities.

As of December 31, 2014, our excess of financial reporting over the tax basis of investments in certain foreign subsidiaries totaled $1.9 billion. We have not asserted that $65 million of our excess basis difference will be indefinitely reinvested and have therefore provided for United States or additional foreign withholding taxes for that portion. Generally, such amounts become subject to U.S. taxation upon the remittance of dividends and under certain other circumstances.

Contractual Obligations

The following table summarizes our contractual commitments as of December 31, 2014:

(in millions)	2015	2016 - 2017	2018 - 2019	Thereafter	Total
Debt and capital lease obligations (1)	$89	$600	$—	$600	$1,289
Interest payments (2)	51	80	59	58	248
Operating lease obligations	63	81	37	25	206
Purchase obligations (3)	54	7	—	—	61
Other long-term obligations reflected on the balance sheet	1	2	2	21	26
Total commitments	$258	$770	$98	$704	$1,830

In addition to the amounts presented in the table above, we have recorded liabilities for uncertain tax positions of $44 million. These amounts have been excluded from the contractual obligations table due to an inability to reasonably estimate the timing 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 15, “Postretirement Benefit Plans” and not included in the above table. Finally, estimated environmental payments are excluded from the table above. We estimate, based on historical experience, that we will spend approximately $1 million to $2 million per year on environmental investigation and remediation. At December 31, 2014, we had estimated and accrued $5 million related to environmental matters.

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

(2) Amounts represent estimate of future interest payments on long-term debt outstanding as of December 31, 2014.

(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 cancellable without penalty have been excluded.

Off-Balance Sheet Arrangements

As of December 31, 2014, 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, liquidity, capital expenditures or capital resources.

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," in the notes to 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. 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.

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.

Warranty Accrual. Accruals for estimated expenses related to warranties are made at the time products are sold or services are rendered and are recorded as a component of cost of revenue. These accruals are established using historical information on the nature, frequency and average cost of warranty claims and consider any factors that may cause differences in expected future warranty costs as compared to historical claim experience. While we engage in extensive product quality programs and processes, we base our estimated warranty obligation on product warranty terms offered to customers, ongoing product failure rates, material usage and service delivery costs incurred in correcting a product failure, as well as specific product class failures outside of our baseline experience. We also record a warranty liability for specific matters. We assess the adequacy of our recorded warranty liabilities quarterly and adjust amounts as necessary.

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.

Our effective tax rate reflects the impact of certain undistributed foreign earnings for which we have not provided U.S. taxes because we plan to reinvest such earnings indefinitely outside the United States. We plan foreign earnings remittance amounts based on projected cash flow needs, as well as the working capital and long-term investment requirements of our foreign subsidiaries and our domestic operations. Based on these assumptions, we estimate the amount we will distribute to the United States and provide the U.S. federal taxes due on these amounts. Material changes in our estimates of cash, working capital and long-term investment requirements in the various jurisdictions in which we do business could impact our effective tax rate.

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.

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. We perform a two-step impairment test for goodwill. In the first step, we compare the estimated fair value of each reporting unit to its carrying value. If the estimated fair value of the reporting unit exceeds the carrying value of the net assets assigned to that reporting unit, goodwill is not impaired and we are not required to perform further testing. If the carrying value of the net assets assigned to the reporting unit exceeds its fair value, then we must perform the second step of the impairment test in order to measure the impairment loss to be recorded, if any. If the carrying value of a reporting unit's goodwill exceeds its implied fair value, then we record an impairment loss equal to the difference. In our annual impairment test for indefinite-lived intangible assets, we compare the fair value of those assets to their carrying value. We recognize an impairment loss when the estimated fair value of the indefinite-lived intangible asset is less than its carrying value. 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 21, "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 2014, 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 2014. During the fourth quarter of 2013 we performed our annual impairment test of our indefinite-lived intangibles assets which resulted in an impairment charge of $2 million related to trade names within our Water Infrastructure segment. Refer to Note 11, “Goodwill and Other Intangible Assets,” for additional information.

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 15, “Postretirement Benefit Plans,” in the notes to 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 2014 and 2013.

	2014				2013			
	U.S.		Int'l		U.S.		Int'l	
Benefit Obligation Assumptions								
Discount rate	4.01	%	3.14	%	4.79	%	4.23	%
Rate of future compensation increase	NM		3.34	%	NM		3.48	%
Net Periodic Benefit Cost Assumptions								
Discount rate	4.79	%	4.23	%	4.13	%	4.04	%
Expected long-term return on plan assets	8.00	%	7.30	%	8.00	%	7.33	%
Rate of future compensation increase	NM		3.48	%	4.50	%	3.50	%

NM Not meaningful. During 2013, an amendment to one of the Company's U.S business unit's pension plans modified the benefit formula. Similar to all other U.S. pension plans, pension benefits for future service was changed to be based on years of service and not be 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 15, “Postretirement Benefit Plans,” in the notes to 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.

	2014		2013		2012	
Expected long-term rate of return on plan assets	7.38	%	7.40	%	7.42	%
Actual rate of return on plan assets	18.13	%	10.17	%	10.09	%

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. Our weighted average expected long-term rate of return on plan assets for all pension plans, effective January 1, 2015 is 7.38%. 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, 2015, is 3.23%. 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, 2015, our expected rate of future compensation is 3.34% 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 6.88% for 2015, decreasing ratably to 5.00% in 2020. 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 $24 million to $34 million during 2015, of which $7 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 $30 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, 2014 and 2013 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 $27 million.

New Accounting Pronouncements

See Note 2, "Recently Issued Accounting Pronouncements," in the notes to 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 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 62% 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. In January 2012, we began to 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, British Pound, Canadian Dollar, Polish Zloty, Australian Dollar and Hungarian Forint. 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, Swedish Krona and Canadian 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 7% impact on Xylem's consolidated revenue and income 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 our intent is to indefinitely reinvest most of these funds outside of the U.S. As such, 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, 2014, we do not have a material exposure to interest rate risk as our debt portfolio primarily comprises long-term, fixed-rate instruments. We do not account for our long-term debt using the fair value option.

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

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the accompanying consolidated balance sheets of Xylem Inc. and subsidiaries (the "Company") as of December 31, 2014 and 2013, and 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, 2014. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Xylem Inc. and subsidiaries as of December 31, 2014 and 2013, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2014, 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), the Company's internal control over financial reporting as of December 31, 2014, 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 26, 2015 expressed an unqualified opinion on the Company's internal control over financial reporting.

/s/ Deloitte & Touche LLP
Stamford, Connecticut
February 26, 2015

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

Year Ended December 31,	2014	2013	2012
Revenue	$3,916	$3,837	$3,791
Cost of revenue	2,403	2,338	2,289
Gross profit	1,513	1,499	1,502
Selling, general and administrative expenses	920	986	914
Research and development expenses	104	104	106
Separation costs	—	4	22
Restructuring and asset impairment charges	26	42	17
Operating income	463	363	443
Interest expense	54	55	55
Other non-operating income (expense), net	1	(10)	—
Gain from sale of business	11	—	—
Income before taxes	421	298	388
Income tax expense	84	70	91
Net income	$337	$228	$297
Earnings per share:			
Basic	$1.84	$1.23	$1.60
Diluted	$1.83	$1.22	$1.59
Weighted average number of shares:			
Basic	183.1	185.2	185.8
Diluted	184.2	186.0	186.2
Dividends declared per share	$0.5120	$0.4656	$0.4048

See accompanying notes to consolidated financial statements.

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

Year Ended December 31,	2014	2013	2012
Net income	$337	$228	$297
Other comprehensive income, before tax:			
Foreign currency translation adjustment	(206)	15	48
Net change in cash flow hedges:			
Unrealized (losses) gains	(22)	1	4
Amount of loss (gain) reclassified into net income	6	—	(3)
Net change in postretirement benefit plans:			
Net (loss) gain	(110)	34	(84)
Prior service credit (cost)	17	4	(1)
Amortization of prior service (credit) cost	(1)	1	1
Amortization of net actuarial loss	11	17	11
Settlement	1	—	2
Foreign exchange	20	2	(8)
Other comprehensive (loss) income, before tax	(284)	74	(30)
Income tax (benefits) expense related to other comprehensive (loss) income	(18)	22	(23)
Other comprehensive (loss) income, net of tax	(266)	52	(7)
Comprehensive income	$71	$280	$290

See accompanying notes to consolidated financial statements.

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

December 31,	2014	2013
ASSETS		
Current assets:		
Cash and cash equivalents	$663	$533
Receivables, less allowances for discounts and doubtful accounts of $34 and $31 in 2014 and 2013, respectively	771	817
Inventories	486	475
Prepaid and other current assets	144	143
Deferred income tax assets	38	41
Total current assets	2,102	2,009
Property, plant and equipment, net	461	488
Goodwill	1,635	1,718
Other intangible assets, net	431	488
Other non-current assets	235	193
Total assets	$4,864	$4,896
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$338	$332
Accrued and other current liabilities	481	479
Short-term borrowings and current maturities of long-term debt	89	42
Total current liabilities	908	853
Long-term debt	1,199	1,199
Accrued postretirement benefits	388	348
Deferred income tax liabilities	158	191
Other non-current accrued liabilities	84	64
Total liabilities	2,737	2,655
Commitment and Contingencies (Note 19)		
Stockholders' equity:		
Common Stock — par value $0.01 per share:		
Authorized 750.0 shares, issued 188.9 and 187.6 shares in 2014 and 2013, respectively	2	2
Capital in excess of par value	1,796	1,753
Retained earnings	648	405
Treasury stock – at cost 6.6 shares and 3.0 shares in 2014 and 2013, respectively	(220)	(86)
Accumulated other comprehensive income	(99)	167
Total stockholders' equity	2,127	2,241
Total liabilities and stockholders' equity	$4,864	$4,896

See accompanying notes to consolidated financial statements.

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

Year Ended December 31,	2014	2013	2012
Operating Activities			
Net income	$337	$228	$297
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	95	99	94
Amortization	47	51	48
Deferred income taxes	(29)	(14)	1
Share-based compensation	18	27	22
Restructuring and asset impairment charges, net	26	42	17
Gain from sale of business	(11)	—	—
Other, net	2	15	2
Payments of restructuring	(26)	(35)	(9)
Contributions to postretirement benefit plans	(35)	(43)	(46)
Changes in assets and liabilities (net of acquisitions):			
Changes in receivables	(37)	(47)	2
Changes in inventories	(49)	(39)	5
Changes in accounts payable	17	4	(4)
Changes in accrued liabilities	3	18	(28)
Changes in accrued taxes	25	20	(17)
Net changes in other assets and liabilities	33	(2)	12
Net Cash — Operating activities	416	324	396
Investing Activities			
Capital expenditures	(119)	(126)	(112)
Proceeds from the sale of property, plant and equipment	2	6	5
Acquisitions of businesses and assets, net of cash acquired	—	(81)	(41)
Proceeds from sale of business	30	—	—
Other, net	1	2	1
Net Cash — Investing activities	(86)	(199)	(147)
Financing Activities			
Net transfer to former parent	—		