Xylem Inc.
Form 10-K
February 27, 2014

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, 2013
	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, 2013 was approximately $5.0 billion. As of January 31, 2014, there were 184,681,473 outstanding shares of the registrant's common stock, par value $0.01 per share.

DOCUMENTS INCORPORATED BY REFERENCE

The information required by Part III of this Report is incorporated herein by reference from the registrant's definitive proxy statement relating to its annual meeting of shareholders to be held in May 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 and combined 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 and combined financial statements to “ITT” or “parent” refers to ITT Corporation and its consolidated subsidiaries (other than Xylem Inc.), former parent of Xylem.

Forward-Looking Statements

This Report contains “forward-looking statements” within the meaning of the Private Securities Litigation Act of 1995 that are based on our current expectations and assumptions. Forward-looking statements by their nature address matters that are, to different degrees, uncertain. Generally, the words “anticipate,” “estimate,” “expect,” “project,” “intend,” “p “strategy,” “may,” “will,” “believe,” “target” 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.

Forward-looking statements include, but are not limited to, statements about the capitalization of the Company, the Company's restructuring and realignment, our future strategic plans and other statements that describe the Company’s business strategy, outlook, objectives, plans, intentions or goals, and any discussion of future operating or financial performance. All statements that address performance, events or developments that we expect or anticipate will occur in the future - including statements relating to orders, sales, operating margins and earnings per share growth, cash flows, and statements expressing general views about future operating results - are forward-looking statements. Caution should be taken not to place undue reliance on any such forward-looking statements because they involve risks, uncertainties and other factors that could cause actual results to differ materially from those expressed or implied in, or reasonably inferred from, such statements. 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. In addition, forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from the Company’s historical experience and its present expectations or projections. These risks and uncertainties include, but are not limited to, those set forth below under “Item 1A. Risk Factors” and those described from time to time in subsequent filings with the U.S. Securities and Exchange Commission ("SEC").

ITEM 1. BUSINESS

Business Overview

Xylem, with 2013 revenue of $3.8 billion and more than 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 2013, 62% of our revenue was generated outside the United States, with 36% of revenue generated in Europe.

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. This organizational redesign has implications on how we will manage the business and the

related measurement system by which we will hold our management team accountable. We are in the process of changing our measurement system, including our underlying accounting system, which we expect to complete by the middle of 2014.

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 supply, existing infrastructure for water supply is relatively underfunded and aging. 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.

The water industry supply chain is comprised of Equipment and Services companies, Design and Build service providers, and Water Utilities. Equipment and Service providers serve distinct customer types. The utilities type supply water through an infrastructure network. Companies that operate on this side of the supply chain 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 utility and EPC customers are looking for technology and application expertise from their Equipment and Services providers, due to trends such as rising pollution, stricter regulations, and the increased outsourcing of process knowledge. The customer type serves the end users of water and comprises 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, ground water, 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 treated 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 treated 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, restaurants, hospitals, and hotels are examples of end users in the commercial market. The industrial market is wide ranging, involving developers and managers of facilities operated by electrical power generators, chemical manufacturers, machine shops, clothing manufacturers, beverage production and dispensing 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 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:

- Advance our High Performance Organization. We plan to continue to operate with an emphasis on speed, simplicity and accountability. We focus on attracting, developing and managing talent within the Company. Further, we align individual performance to the objectives of the Company in order to ensure accountability, standardization and alignment of all key business processes, and to ensure a seamless transition from strategy to execution.
- Drive Profitable Growth. To achieve our goal of accelerating growth, we have identified the following four priorities:

Leverage Integrated Front End Resources - We plan to drive more sales growth through our regionally integrated sales organization. We will enhance our marketing and sales capabilities with the assistance of digital marketing and automation. We will implement technologies we believe will accelerate our growth, including a customer relationship management system that will enable us to have a view of all customer touch points and to share leads and expertise.

Accelerate Innovation and Product Renewal - We plan to focus our research and development on products designed to offer specialized advantages to customers; multi-product packages; and integrated offers that leverage Xylem's intelligent analytics and monitoring and control technologies.

Accelerate International Expansion - We plan to target fast-growing markets for additional investment and resource allocation, including the expansion of distribution and sales channels. We plan to customize product offerings based upon local needs.

Expand Industrial End-Market Presence - We plan to build upon our current capabilities to serve industrial end-markets through the development of key vertical strategies, including channel development and market-specific offerings.

- Improve Operational Excellence. We will focus on growth in our operating margins to make the Company more profitable. To accomplish this, we will build on our global strategic sourcing capability to maximize leverage from global spend and reinvigorate lean capabilities. We are committed to optimizing our cost structure by eliminating unnecessary costs and inefficient overhead, as well as by simplifying the business by streamlining product relationships across our businesses. We have been executing our plan to simplify our business through restructuring and realignment actions which we believe will better position the Company for the future and enable us to re-prioritize investments to high-priority areas. We will also continue to align the Company to leverage our existing cost structure and broad product portfolio into a greater competitive advantage. We will implement additional cost reductions in an effort to further reduce manufacturing, selling and general and administrative costs.
- Optimize Capital Deployment. We plan to continue to allocate capital strategically in an effort to drive strong returns for shareholders, taking decisive action to pivot our portfolio composition and future growth investments in order to create the greatest value. These investments include share repurchases, dividend payments and acquisitions. We intend to continue to execute on our share repurchase programs. We recently announced a 10% increase in our quarterly dividend to shareholders. Finally, although we announced a slow down in acquisitions during 2013 as we focused on growth and operational efficiency, we will continue to selectively evaluate and pursue acquisitions that will broaden our core product portfolio, expand our geographic footprint and enhance our position in strategic markets.

Business Segments

We operate in two 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, “Industry Segment and Geographic Data,” in our consolidated and combined financial statements for financial information about segments and geographic areas.

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

	Market Applications	2013 Revenue	% Revenue		Major Products	Primary Brands
Water Infrastructure	Transport	$1,812	74	%	• Water and wastewater pumps • Filtration, disinfection and biological treatment equipment • Test equipment • Controls	• Flygt • WEDECO • Godwin Pumps • WTW • Sanitaire • YSI • Leopold
	Treatment	329	14	%		
	Test	298	12	%		
		$2,439	100	%		
Applied Water	Building Services	$696	50	%	• Pumps • Valves • Heat exchangers • Controls • Dispensing equipment systems	• Goulds Water Technology • Bell & Gossett • AC Fire • Standard • Lowara • Jabsco • Flojet • Flowtronex
	Industrial Water	600	43	%		
	Irrigation	102	7	%		
		$1,398	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, lakes and rivers. From there, our filtration, ultraviolet 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, lakes, rivers and ground water, 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 ground water and surface water from a riverbed, construction site or mine shaft. We serve the higher-value equipment markets, 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 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 74% of our segment revenue 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

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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. For example, energy consumption at London's Heathrow Airport cargo center pump station was reduced by 50% following installation of the new Flygt Experior pumps.

Godwin Pumps — With more than 35 years as a leader in pump manufacturing and applications, Godwin Pumps ("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 eliminating 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 and (iii) biological treatment systems. Filtration uses gravity-based media filters and clarifiers to clean both water and wastewater. Leopold, with more than 80 years of experience, is our leading filtration brand. Disinfection systems, both ultraviolet ("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 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. Leopold won an order in the fourth quarter of 2013 to provide a new pre-treatment DAF system to help ensure an uninterrupted potable water supply to Abu Dhabi Emirate and the east coast of the United Arab Emirates. The source water in the Arabian Gulf is subject to harmful algal blooms also known as "red-tides." Xylem's Leopold Clari-DAF® system is proven to be over 95 percent effective in removing these microorganisms prior to desalination, ensuring the production of clean, fresh, drinking water.

WEDECO — WEDECO was founded in 1975 in Herford, Germany to develop chemical-free and environmentally friendly water treatment technologies, including ultraviolet 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. In the fourth quarter of 2013, a WEDECO LBX 1000 UV system was installed in a hospital in the German city of Warstein to combat an outbreak of Legionnaire's disease, a potentially fatal form of pneumonia which had contaminated a municipal wastewater treatment plant.

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 a 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. During the fourth quarter of 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 12% of our segment revenue 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 particularly strong market penetration in the environmental, water and wastewater segments. WTW holds leading market positions in both field and 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 also offers Life Sciences products including biochemical analyzers for bioprocess monitoring, food and beverage processing, and sports physiology. 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.

OI Analytical — Oceanography International Corporation ("OIC"), founded in 1969, provides innovative products used for chemical analysis. Data from our analytical instruments serve as the basis for informed decisions affecting human health and safety, environmental protection, industrial operations and product quality. OIC was originally focused on oceanography equipment moving to production of water-quality measurement instrumentation, as oceanography equipment sales declined. OIC developed the Company’s first total organic carbon analyzer. Since that time, the

Company has become recognized worldwide as a provider of quality analytical instrumentation. OIC developed a Total Organic Carbon Analyzer in cooperation with National Aeronautics and Space Administration specifically for use on the International Space Station. Without this validation that the drinking water has been purified for human consumption, the Space Station would not be suitable for astronaut habitation.

Aanderaa Data Instruments AS — ("Aandera") was founded in 1966 in Bergen, Norway, and offers sensors, instruments and systems for measuring and monitoring in the most demanding environments such as rivers, oceans and the polar regions through fully networked systems using wireless technology that monitors temperature, salinity, oxygen, turbidity, current and waves for ecosystem health. The main market areas are marine transportation, environmental and ocean research, oil and gas, aquaculture, road and traffic, and construction. Aanderaa's new technologies underlie the most advanced distributed instrumentation for underwater and atmospheric measurements. Hydro-acoustic, electro-optical, electro-chemical, pressure, temperature and meteorological data are captured by observing networks and self-contained instrumentation using real-time communication. Key customers include many oceanographic institutes, universities, geophysical surveyors, navies, offshore oil and gas companies, drilling companies, port and harbor authorities, government agencies, water authorities and international electric power utilities. Key installations include our new on-line tide and salinity station at Palmer Station in the Antarctic and coastal ocean wave and water quality monitoring station for United States Geological Survey alongside a National Oceanic and Atmospheric Administration Sentinel site in Galveston, Texas.

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 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 50% of our segment revenue 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 brand supplies 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 Lowara brand focuses on industrial washing equipment and machine tool cooling. 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 43% of our segment revenue 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 2013 and 7% in 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. During 2012, Goulds Water Technology products were installed to help protect the Ancient Sphinx and Pyramids in Giza, Egypt from rising ground water that was causing erosion to the soft limestone structures.
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, and data centers. B&G products are sold globally by independent manufacturer representatives and distributed locally by HVAC wholesalers. One of the most interesting installations of B&G products is at McMurdo Station in Antarctica. McMurdo is operated by the United States through the United States Antarctica Program, a branch of the National Science Foundation. This station includes more than 200 B&G pumps in various applications throughout the facility.

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 2013, A-C Fire Pump provided fire pump packages to CNOOC (Chinese National Offshore Oil Company) as part of a large project in China.

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. Flowtronex has pumping systems operating in more than seventy countries around the world. In the United States alone, 78 of the Top 100 golf courses use Flowtronex golf irrigation pumping systems.

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, OEM 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 and during 2013 secured a large contract that will require 22 Flojet beverage pumps per store for a large national restaurant chain.

Geographic Profile

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.

The table below illustrates the annual revenue and percentage of revenue by geographic area for each of the three years ended December 31, 2013.

	Revenue					
(in millions)	2013		2012		2011	
	$ Amount	% of Total	$ Amount	% of Total	$ Amount	% of Total
United States	$1,434	38 %	$1,400	37 %	$1,363	36 %
Europe	1,387	36 %	1,338	35 %	1,422	37 %
Asia Pacific	467	12 %	469	12 %	426	11 %
Other	549	14 %	584	16 %	592	16 %
Total	$3,837		$3,791		$3,803	

Revenue derived from emerging markets comprised 19%, 20% and 19% of our revenue in 2013, 2012 and 2011, 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, 2013.

	Property, Plant & Equipment					
(in millions)	2013		2012		2011	
	$ Amount	% of Total	$ Amount	% of Total	$ Amount	% of Total
United States	$186	38 %	$183	38 %	$178	38 %
Europe	225	46 %	219	45 %	209	45 %
Asia Pacific	45	9 %	65	13 %	57	12 %
Other	32	7 %	20	4 %	19	5 %
Total	$488		$487		$463	

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 due to rising 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 OEM 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 the leading independent distributors in the markets we serve, and we provide incentives to distributors, such as specialized training programs, to sell our products exclusively.

Aftermarket Parts and Service
We have many service centers around the world which employ service employees to provide aftermarket parts and services to our customers. During their lifecycle, installed products require maintenance, repair services and parts due to the harsh environments in which they operate.
In addition, depending on the type of product, median lifecycles range from 5 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. In addition, we maintain a global network of service centers providing after-market customer care. 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.
We offer a wide range of highly engineered products. 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.
Our inventory management and distribution practices seek to minimize inventory holding periods by taking delivery of the inventory and manufacturing immediately prior 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 the applicable market or on the Company as a whole. No individual customer accounted for more than 10% of our consolidated 2013, 2012 or 2011 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 $707 million at

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December 31, 2013 and $647 million at December 31, 2012. We anticipate that more than 90% of the backlog at December 31, 2013 will be recognized as revenue during 2014.

Competition

Given the highly fragmented nature of the water industry, Water Infrastructure competes with a large number of businesses. Competition in the water transport and treatment technologies markets focuses on product performance, application expertise, design, quality, delivery, 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 Siemans AG) and Danaher Corporation.

Competition in the Applied Water segment focuses on brand names, 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, $106 million, and $100 million for the years ended December 31, 2013, 2012 and 2011, respectively, towards 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 wastewater 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.

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 and combined 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, 2013, we had estimated and accrued $8 million related to environmental matters.

Employees

As of December 31, 2013, Xylem had more than 12,500 employees worldwide. We have over 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.

Available Information

Xylem’s website address is www.xyleminc.com. We make available free of charge on or through www.investors.xyleminc.com our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with or furnished to the SEC. Information contained on our website is not incorporated by reference unless specifically stated therein.

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 2013, 38% and 36% of our total revenue was from customers located in the United States and Europe, 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 2013, 62% of our total revenue was from customers outside the United States. We expect our international operations and export sales to continue to be a significant portion of our revenue. 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.

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 are exposed to fluctuations in foreign currency 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.

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 brand 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, 2013, 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.

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, which is still in the process of being implemented, 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 2013. 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 Six Sigma and Lean 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, 2013, our total outstanding indebtedness was $1,241 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 $165 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. Also, regardless of the terms of our debt or equity financing, the amount of our stock that we can issue may be limited because the issuance of our stock may cause the distribution to be a taxable event for ITT under Section 355(e) of the Internal Revenue Code of 1986, as amended (the “Code”), and under the Tax Matters Agreement entered into by ITT in connection with the Spin-off (the “Tax Matters Agreement”), we could be required to indemnify ITT for that tax.

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.

Failure to comply with 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 operate in a number of countries throughout the world, including countries considered to have a high risk of corruption. We are committed to doing business in accordance with applicable anti-corruption laws. We are subject, however, to the risk that we or our affiliated entities or our representatives or their respective officers, directors, employees and agents, may take action determined to be in violation of such anti-corruption laws or regulations, including the U.S. Foreign Corrupt Practices Act of 1977, the U.K. Bribery Act of 2010 and others. 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.

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.

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, 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 or protected. 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'

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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;
- 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 second 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 second amended and restated articles of incorporation and the amended and restated by-laws, among other things, require advance notice for shareholder proposals and nominations, do not permit shareholders to convene special meetings 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 Separation from ITT Corporation

If the Spin-off were to fail to qualify as a tax-free transaction under the Internal Revenue Code, then we and/or our former parent and our stockholders could be subject to significant tax liability.

In connection with the Spin-off, we and our former parent, ITT Corporation, received an IRS ruling (the "IRS Ruling") stating that ITT and its shareholders will not recognize any taxable income, gain or loss for U.S. Federal income tax purposes as a result of the Spin-off. In addition, ITT received an opinion of tax counsel as to the satisfaction of certain requirements necessary for the Spin-off to receive tax-free treatment upon which the IRS did not rule. The IRS Ruling, while generally binding upon the IRS, was based on certain factual statements and representations. If any such factual statements or representations were incomplete or untrue in any material respect, or if the facts on which the IRS Ruling were based were materially different from the facts at the time of the Spin-off, the IRS could modify or revoke the IRS Ruling retroactively.

As discussed above, certain requirements for tax-free treatment that are not covered in the IRS Ruling were addressed in the opinion of counsel. The opinion of counsel is not binding on the IRS. Accordingly, the IRS may reach conclusions with respect to the Spin-off that are different from the conclusions reached in the opinion. Like the IRS Ruling, the opinion was based on certain factual statements and representations, which, if incomplete or untrue in any material respect, could alter counsel's conclusions.

If all or a portion of the Spin-off does not qualify as a tax-free transaction because any of the factual statements or representations in the IRS Ruling or the legal opinion are incomplete or untrue, or because the facts upon which the IRS Ruling is based were materially different from the facts at the time of the Spin-off, ITT would recognize a substantial gain for U.S. Federal income tax purposes. In such case, under U.S. Treasury regulations each member of the ITT consolidated group at the time of the Spin-off (including us and our subsidiaries), would be jointly and severally liable for the entire amount of any resulting U.S. Federal income tax liability.

Notwithstanding the foregoing, the Spin-off will be taxable to ITT (but not to ITT shareholders) pursuant to Section 355(e) of the Internal Revenue Code if there are one or more acquisitions (including issuances) of the stock of either us or ITT, representing 50% or more, measured by vote or value, of the then-outstanding stock of either corporation and the acquisition or acquisitions are deemed to be part of a plan or series of related transactions that include the Spin-off. Any acquisition of our common stock within two years before or after the Spin-off (with exceptions, including public trading by less-than-5% shareholders and certain compensatory stock issuances) generally will be presumed to be part of such a plan unless that presumption is rebutted. The tax liability resulting from the application of Section 355(e) would be substantial. In addition, under U.S. Treasury regulations, each member of the ITT consolidated group at the time of the Spin-off (including us and our subsidiaries) would be severally liable for the resulting U.S. Federal income tax liability.

We have agreed not to enter into any transaction that could cause any portion of the Spin-off to be taxable to ITT, including under Section 355(e). Pursuant to the Tax Matters Agreement, dated as of October 25, 2011 among ITT, Exelis and Xylem, we have also agreed to indemnify ITT and Exelis for any tax liabilities resulting from such transactions, and ITT and Exelis have agreed to indemnify us for any tax liabilities resulting from such transactions

entered into by ITT or Exelis. These obligations may discourage, delay or prevent a change of control of our Company.

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. Among other things, the court could require the return of assets or our shares to ITT, voiding the liens of Xylem and claims against ITT, or providing ITT with a claim for money damages against us.

The measure of insolvency for purposes of the fraudulent conveyance laws will vary depending on which jurisdiction's law is applied. Generally, however, an entity would be considered insolvent if either the fair saleable value of its assets is less than the amount of its liabilities (including the probable amount of contingent liabilities), or it is unlikely to be able to pay its liabilities as they become due. No assurance can be given as to what standard a court would apply to determine insolvency or that a court would determine that we, ITT or Exelis were solvent at the time of or after giving effect to the Spin-off.

The Spin-off could also be challenged under state corporate distribution statutes. Under the Indiana Business Corporation Law, a corporation may not make distributions to its shareholders if, after giving effect to the distribution, (i) the corporation would not be able to pay its debts as they become due in the usual course of business; or (ii) the corporation's total assets would be less than the sum of its total liabilities. No assurance can be given that a court will not later determine that the distribution of our shares in connection with the Spin-off was unlawful.

Under the Distribution Agreement, from and after the Spin-off, we will be responsible for the debts, liabilities and other obligations related to the business or businesses which we own and operate following the consummation of the Spin-off. Although we do not expect to be liable for any of these or other obligations not expressly assumed by us pursuant to the Distribution Agreement, it is possible that we could be required to assume responsibility for certain obligations retained by ITT or Exelis should ITT or Exelis fail to pay or perform its retained obligations (for example, tax, asbestos and/or environmental liabilities).

In connection with our separation, 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 many 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	1,156,000	Owned
Stockholm	Sweden	Administration and Research & Development	172,000	2019
Shenyang	China	Manufacturing	125,000	Owned
Yellow Springs	OH	Administration and Manufacturing	108,000	Owned
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

In December 2013, we completed the move of our corporate headquarters to 1 International Drive, Rye Brook, NY. The new headquarters consists of approximately 67,000 square feet of office space for a lease period ending in December 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, 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 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 April 2013, the Company filed a notice of appeal before the Tribunal Supremo, the Supreme Court of Spain and in June 2013, the Company filed an appellate brief with the Supreme Court, which was admitted. These appellate proceedings are expected to last one to two years.

On October 4, 2013, the Company and Xylem Group LLC entered into a settlement agreement with respect to the proceedings in the U.S. District Court for the Northern District of Georgia originally commenced on October 26, 2011 regarding the Company's use of the "XYLEM" mark. Pursant to the settelment agreement, both parties released each other from all extisting claims, and all claims have been dismissed by the U.S. District Court for the Northern District of Georgia with prejudice.

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
Steven R. Loranger	61	President and Chief Executive Officer (2013)	• Chairman Emeritus of Xylem Inc. Board of Directors (2011) • Chairman, President and Chief Executive Officer, ITT Corporation (2004)
Michael T. Speetzen	44	Senior VP and Chief Financial Officer (2011)	• VP of Finance, ITT Fluid and Motion Control (2009)
Christopher R. McIntire	50	Senior VP and President, Global Analytics and Treatment (2013)	• Senior VP and President, Analytics (2011) • President and Chief Operating Officer, Nova Analytics (2006)
Kenneth Napolitano	52	Senior VP and President, Global Applied Water Systems (2013)	• Senior VP and President, Applied Water Systems (2012) • Senior VP and President, Residential and Commercial Water (2011) • President, Residential and Commercial Water (2009)
Angela A. Buonocore	56	Senior VP and Chief Communications Officer (2011)	• Senior VP and Chief Communications Officer, ITT Corporation (2008)
Nicholas R. Colisto	47	Senior VP and Chief Information Officer (2012)	• VP and Chief Information Officer, Hovnanian Enterprises, Inc. (2008)
Robyn T. Mingle	48	Senior VP and Chief Human Resources Officer (2011)	• Senior VP of Human Resources, Hovnanian Enterprises, Inc. (2003)
Colin R. Sabol	46	Senior VP and President, Global Dewatering (2013)	• Senior VP and Chief Strategy and Growth Officer (2011) • VP of Marketing and Business Development, ITT Fluid and Motion Control (2009)

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

PART II

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

2013 and 2012 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, 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
Fiscal Year ended December 31, 2012			
First Quarter	$28.87	$24.82	$0.1012
Second Quarter	28.54	23.02	0.1012
Third Quarter	26.00	22.43	0.1012
Fourth Quarter	27.67	23.41	0.1012

The closing price of our common stock on the NYSE on January 31, 2014 was $33.36 per share. As of January 31, 2014, there were 16,626 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 2014, we declared a dividend of $0.128 per share to be paid on March 19, 2014 for shareholders of record on February 19, 2014.

There have been no unregistered offerings of our common stock during 2013.

Fourth Quarter 2013 Share Repurchase Activity

The following table summarizes our purchases of our common stock for the quarter ended December 31, 2013:

(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)
10/1/13 - 10/31/13	—	—	—	$259.5
11/1/13 - 11/30/13	0.6	$34.03	0.6	$239.1
12/1/13 - 12/31/13	0.1	$33.56	0.1	$234.6

(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, 2013 and there are 1.0 million shares (approximately $35 million based on a share price of $34.60 per share) 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, 2013, 0.7 million shares were repurchased at an average price of $33.94 per share for a total cost of $25 million. There are up to $200 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, 2013. 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

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 and combined financial data for the five years ended December 31, 2013. 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 and combined financial statements and the notes thereto included in this Report.

	Year Ended December 31,				
(in millions, except per share data)	2013	2012	2011 (c)	2010 (b)	2009
Results of Operations Data:					
Revenue	$3,837	$3,791	$3,803	$3,202	$2,849
Gross profit	1,499	1,502	1,461	1,214	1,037
Gross margin	39.1 %	39.6 %	38.4 %	37.9 %	36.4 %
Operating income	363	443	395	388	276
Operating margin	9.5 %	11.7 %	10.4 %	12.1 %	9.7 %
Net income	228	297	279	329	263
Per Share Data:					
Earnings per share:					
Basic	$1.23	$1.60	$1.51	$1.78	$1.42
Diluted	1.22	1.59	1.50	1.78	1.42
Basic shares outstanding (a)	185.2	185.8	185.1	184.6	184.6
Diluted shares outstanding (a)	186.0	186.2	185.3	184.6	184.6
Cash dividends per share	$0.4656	$0.4048	$0.1012	$—	$—
Balance Sheet Data (at period end):					
Cash and cash equivalents	$533	$504	$318	$131	$81
Working capital*	930	859	834	759	636
Total assets	4,896	4,679	4,400	3,742	2,542
Total debt	1,241	1,205	1,206	4	4

* The Company calculates Working Capital as follows: Net Accounts Receivable + Net Inventory - 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 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.

(c) In 2011, we acquired YSI Incorporated, which contributed revenue of $35 million in 2011 and $371 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 and combined 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, 2013. 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 and combined financial statements to “ITT” or “parent” refer to ITT Corporation (former parent of Xylem) and its consolidated subsidiaries (other than Xylem).

On and prior to October 31, 2011 (the "Distribution Date"), our financial position and results of operations consisted of the water equipment and services businesses of ITT Corporation (“WaterCo”). The Spin-off (the "Spin-off") was completed pursuant to the Distribution Agreement, dated as of October 25, 2011, among ITT, Exelis Inc. and Xylem. After the Distribution Date, ITT did not beneficially own any shares of Xylem common stock and, following such date, financial results of Xylem are not consolidated in ITT’s financial reporting. 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 our Distribution Date, while our financial results for Xylem post Spin-off are prepared on a stand-alone basis. In addition, 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 an