

Why We Own Xylem: Modernising the World's Water Systems

Under the streets of Dallas, some of the city's most valuable water was disappearing without anyone seeing it.

The problem was not a lack of water technology. It was knowing where, across a vast network of ageing pipes, the losses were occurring - and finding them without digging up streets or interrupting supply.

Dallas Water Utilities began using Xylem's in-pipe acoustic technologies to inspect its large water mains while they remained in service. According to the [customer case study published by Xylem](#), the programme helped the utility locate and repair more than 285 leaks. Estimated water savings reached 7.2 million gallons a day, and water-main leaks almost halved from 40 per 100 miles to fewer than 21.

The environmental benefit is easy to understand: less treated water is lost. But the business case matters just as much. Water that no longer leaks into the ground can be supplied to customers. The utility avoids emergency repairs, makes better decisions about capital expenditure and recovers recurring revenue.

That small story beneath one city illustrates the larger reason Xylem is in the Delta Outcomes Global Leaders portfolio.

Water is becoming an economic constraint

Water is not a niche environmental theme. It is essential infrastructure for cities, agriculture, manufacturing, power generation, mining, semiconductors and data centres.

The pressure on that infrastructure is increasing. Population growth, urbanisation and industrial development are lifting demand. Climate change is making supply less predictable. In many places, ageing networks lose significant volumes before the water ever reaches a customer. Pollution and inadequate wastewater treatment further reduce the usable supply.

The [World Bank](#) estimates that four billion people experience water scarcity and that water underpins around 1.7 billion jobs. Reliable water systems are therefore not only a public-health need. They are part of the productive infrastructure on which economic growth depends.

The investable opportunity is not simply “more water”. It is helping customers move, measure, treat, reuse and manage water much more intelligently.

What Xylem actually does

Xylem provides equipment, digital systems and services across the water cycle.

Its pumps and treatment systems move and clean water. Smart meters and sensors show utilities and industrial customers what is happening across their networks. Software combines those data streams so operators can detect leaks, anticipate failures, optimise energy use and decide where maintenance spending will have the greatest effect. Its service businesses help customers operate, maintain and upgrade these systems.

The result is a company that participates in several linked needs:

- replacing and upgrading essential water infrastructure;
- reducing leakage and other forms of non-revenue water;
- treating wastewater and enabling reuse;
- improving water quality and regulatory compliance;
- making water systems less energy- and labour-intensive; and
- helping water-intensive industries secure the supply required for growth.

Xylem is not selling a single product into a single end market. It combines physical equipment, measurement, software and domain expertise across municipal and industrial customers.

That breadth matters. A pump may solve one part of a customer's problem. A connected system that reveals how the whole network is performing can become more valuable over time - and harder to replace.

Where it fits. Xylem sits primarily within Delta's **Nature Innovation** theme because its technologies help customers measure, treat, reuse and manage water more intelligently. Delta's other themes are **Climate Action** and **Human Advancement**. The themes overlap in the real economy - efficient water systems can reduce energy use and improve public health - but we give each company one primary classification to keep the portfolio understandable.

How the advantage becomes earnings

For an investment case, a large social need is not enough. The company must have a credible way to turn that need into durable earnings.

Xylem's advantage begins with specialist water expertise, recognised brands and an installed base built over many years. Equipment such as pumps, meters and treatment systems is mission-critical. Failure can interrupt water supply, industrial production or regulatory compliance. Customers therefore place a premium on reliability, service capability and proven performance.

The installed base creates demand for replacement equipment, spare parts, monitoring and maintenance. Digital products can deepen the relationship by connecting previously separate assets and data. Xylem can consequently earn from the original equipment, the continuing service requirement and the customer's gradual modernisation of the wider system.

The commercial logic can be seen in Sheffield. Yorkshire Water brought data from thousands of sensors and meters into a common Xylem platform. In a [case study published by Xylem](#), the utility reported a 57% reduction in visible leaks, a 32% reduction in leakage in priority areas and almost 30% fewer annual distribution-main repairs.

Those are customer outcomes rather than abstract product features. They also explain why a utility may continue investing: the technology can conserve water while lowering operating and repair costs.

What the latest results tell us

Xylem's second-quarter 2026 results showed both the strength of demand and the importance of execution.

Orders reached \$3.1 billion, rising 41% organically. Revenue was \$2.3 billion, up only 1% organically, illustrating that large orders and projects do not become revenue immediately. Adjusted EBITDA margin expanded by 1.5 percentage points to 23.3%, supported by productivity, pricing and business mix. Adjusted earnings per share rose 16% to \$1.46.

The composition of those orders is telling. They included the largest order in Xylem's history - a roughly \$850 million, 23-year outsourced water contract with Dow - alongside a 20-year agreement with another of the world's largest chemical companies and more than 300% growth in data-centre orders. Against that, revenue in China fell 27%, and around two percentage points of revenue were deliberately walked away from as the company simplifies its portfolio around its most profitable products and customers.

Management narrowed its full-year organic revenue-growth expectation to 2–3%, but raised adjusted earnings guidance to \$5.55–\$5.70 a share. In other words, near-term revenue growth remains measured, while margin improvement is doing more of the work. The full [Q2 2026 release is available here](#).

This distinction matters. We do not own Xylem simply because demand for water solutions sounds compelling. We look for evidence that demand is becoming orders, that orders convert into profitable revenue and cash, and that management can improve the economics of the combined business.

That is the causal chain we test as investors: ageing, stressed water systems create structural demand; Xylem's installed base, specialist expertise and connected technology help it win the work; equipment, services and software convert that adoption into revenue, cash and profit; and disciplined valuation determines whether those economics justify ownership.

A financially strong business - improving, with more to prove

A compelling theme only matters if the company behind it can fund it, year after year. A business that cannot protect its margins or convert orders into cash will struggle to keep investing in the pumps, treatment systems, meters and software its impact case depends on, however durable the demand looks. So before we get carried away with the story, we ask a simpler question: is this a genuinely well-run, profitable company? On margins and earnings growth, the answer is clearly yes. On returns on capital and shareholder returns, the honest answer is more modest - held back by a large acquisition and an uneven share price - and the stronger case lies ahead.

Profitability. Xylem's operating profitability has improved every year. Its adjusted operating margin rose from 14.6% in 2023 to 16.0% in 2024 and 17.8% in 2025, while a broader measure - adjusted EBITDA margin, operating profit before interest, tax, depreciation and amortisation - rose from 18.9% to 22.2% over the same period, reached a quarterly record of 23.3% in the second quarter of 2026, and is guided to 23.1%–23.5% for the full year. Returns on capital are the weaker part of the picture, and we say so plainly. Return on shareholders' equity - essentially, how much profit the company generates for every dollar shareholders have invested - was 6.0% in 2023 and around 8.3%–8.4% in 2024 and 2025, below the roughly 9% hurdle we hold the business to, largely because the all-share acquisition of water-treatment specialist Evoqua in 2023 added a large goodwill base to the balance sheet. Return on invested capital, across both debt and equity, has hovered around that hurdle, at 9.6%, 8.6% and 9.6% over the three years. Projections point to both measures rising steadily - return on invested capital to above 11% in 2027 and close to 13% in 2028 - as margins expand on a capital base that is no longer growing through large acquisitions, but that is a forecast, not yet a result.

Earnings growth. Here the record is genuinely strong. Adjusted earnings per share rose from \$3.78 in 2023 to \$4.28 in 2024 and \$5.08 in 2025 - growth of around 16% a year, comfortably outpacing revenue growth of around 11% a year that was itself flattered by the acquisition. The quality of that growth improved in 2025, when adjusted earnings per share rose 19% on revenue growth of 5.5%: the business is not just getting bigger, it is getting more profitable as it grows. Reported earnings per share, which carry the amortisation of acquired intangible assets and restructuring costs, grew a slower 7% in 2025, which is why we watch both measures. Momentum has continued into 2026, with second-quarter adjusted earnings per share up 16% and ahead of market expectations, and full-year guidance raised. Projections point to adjusted earnings per share of around \$6.50 in 2027, although the source of growth is expected to shift from margin expansion toward revenue as the order book converts.

Shareholder returns - the case ahead. Ultimately, none of this matters to an investor unless it shows up in the share price, and here the record has been more uneven than the operating

progress would suggest. Over the five years to the end of 2025, Xylem's total shareholder return - share price growth plus dividends - compounded at roughly 7% a year, with strong years in 2021 and 2025 bracketing a fall of around 7% in 2022 and low single-digit returns in 2023 and 2024. The shares then gave back around 11% in 2026 to late July, before recovering somewhat after second-quarter results. That is a respectable but not a demonstrably strong record, and it has lagged the improvement in margins and earnings. The case ahead rests on that gap closing. The shares now trade at around 21 times this year's expected earnings, down from around 27 times in 2024 and 2025, so returns from here would need to come from earnings growth and cash returned to shareholders rather than a higher valuation multiple. If adjusted earnings per share grow as projected - by around 28% between 2025 and 2027 - and the valuation merely holds, the return case improves materially; if order conversion disappoints and margin gains stall, it will not.

Taken together, this gives us confidence that Xylem has the operating profitability and earnings momentum to keep funding the water-system investment its impact case depends on, and a credible, evidenced path to the returns on capital and shareholder returns this thesis needs - though one that is not yet proven in the numbers.

Leadership we can trust

A good business also needs to be well led, and Xylem's governance rests on sound structural foundations. The roles of Chief Executive and Chair are held separately, every director stands for election each year, and a single class of listed stock means no shareholder carries outsized voting power. The Audit Committee is fully independent even on our stricter tenure-based standard, and the board has refreshed meaningfully, with two-thirds of its members joining within the last six years. Pay is firmly tied to results: close to nine-tenths of the Chief Executive's target pay is performance-based and at risk, and half of long-term awards vest only against three-year relative total shareholder return and cumulative earnings targets, backed by clawback provisions and a bar on hedging or pledging shares - which is why we supported the executive-pay resolution at the 2026 annual meeting. Our engagement priorities are forward-looking: continued board refreshment so that independent board leadership and the key committees meet our stricter tenure-based independence standard, a view our 2026 votes on board composition also reflected; and fuller public disclosure of the conclusions of the board's annual effectiveness review.

That foundation is matched by a sound and improving capital-allocation record. Return on invested capital was above our roughly 9% cost-of-equity hurdle in 2023 and 2025, dipping only modestly below it in 2024 as the business absorbed its largest acquisition, and is projected to rise steadily from here. Total debt has fallen from 1.7 times EBITDA in 2023 to around 1.0 times in 2025, and management has used that balance-sheet strength opportunistically, deploying around \$650 million into share repurchases in the second quarter of 2026 while the shares traded well below their highs, alongside a targeted, roughly \$200

million acquisition in mobile water treatment. Taken together, this gives us confidence that Xylem is overseen by capable, accountable leadership that acts in the long-term interests of shareholders and other stakeholders alike.

Doing well by solving a real problem

The impact case and the financial case are connected.

A customer normally buys Xylem's equipment or software because it needs to reduce water loss, avoid a failure, lower operating cost, meet a quality standard or expand capacity. If the solution works, the customer receives an economic benefit and the water system should become more efficient or resilient.

Water scarcity, pollution and mismanagement damage rivers, lakes, wetlands and the natural systems that depend on them, while Xylem's treatment and smart-infrastructure technologies can reduce those pressures. That remains a relevant outcome of the company's work. But it is not the starting point of our investment case: the starting point is the essential economic need to modernise water systems, Xylem's competitive position within that investment cycle and its ability to convert customer value into durable earnings.

Xylem's latest sustainability report estimates that, between 2019 and 2025, its solutions helped customers:

- enable the reuse of 22.33 billion cubic metres of water;
- prevent 13.05 billion cubic metres of polluted water from entering communities and waterways;
- reduce 4.32 billion cubic metres of non-revenue water; and
- reduce water's carbon footprint by 8.10 million tonnes of CO₂e.

These are company-calculated, cumulative figures rather than independently verified outcomes for every installation. They should be read with that limitation in mind. Even so, Xylem publishes the definitions and calculation approach behind the measures in its [2025 Sustainability Report](#), allowing investors to track progress rather than relying only on a statement of intent.

For us, that is the more useful way to think about impact: not as a label attached to a portfolio, but as evidence about what a company's products enable customers to achieve.

Value, decision, and tension

We own Xylem because three things line up: a durable, structural need to modernise the world's water systems that persists through the economic cycle; a business whose margins and earnings have improved markedly, with returns on capital and shareholder returns that have been more modest so far but are expected to strengthen as the acquisition base is

absorbed; and a board and management team we trust to act in shareholders' and stakeholders' long-term interests, with two clearly named governance priorities we continue to press.

We do not own it on the assumption that every large order converts smoothly into profitable revenue, that municipal budgets will keep pace with need, or that margin improvement can substitute indefinitely for growth. The central tension is that Xylem's recent earnings progress has been driven more by productivity, pricing and portfolio simplification than by revenue: organic revenue is expected to grow only 2–3% this year even as orders rose 41% in the latest quarter. Gains of that kind eventually run out, so the thesis needs the record order book to become revenue growth from 2027 onward. The shares' fall to around 21 times this year's expected earnings reduces, but does not remove, the risk of paying too much. A high-quality company can still be a poor investment if too much future success is already reflected in its share price. We therefore adjust position size as the balance between business quality, expected growth, risk and prospective return changes - valuation discipline, not enthusiasm for the theme, governs that decision.

What could break the chain

No structural trend makes an investment inevitable. A number of things could weaken this thesis, and we watch for all of them:

- **Demand and conversion risk.** Municipal budgets can be slow and politically constrained, and utilities face affordability pressure and a more cautious capital-spending environment ahead of elections. Large orders can be uneven, and their conversion to revenue can take time; electric-metering project delays have already trimmed this year's revenue outlook, and the gap between 41% order growth and 1% organic revenue growth in the latest quarter is one reason we continue to watch execution carefully.
- **Contract and integration risk.** Long-duration outsourced water contracts, including the 23-year Dow agreement, must be delivered profitably over decades rather than quarters. Xylem must also continue integrating acquisitions, and simplifying its portfolio, while converting its broader range into genuine commercial advantage.
- **Financial-quality durability risk.** Margins and earnings have improved strongly, but return on shareholders' equity remains below our hurdle and return on invested capital only modestly above it. Industrial demand can weaken, China orders and revenue fell by around 30% in the latest quarter, and inflation, tariffs and currency movements can pressure costs. The projected rise in returns needs to be delivered, not merely forecast, for the financial case to hold through a weaker cycle.
- **Impact-case risk.** The case can fail on its own terms. Xylem's cumulative outcome figures are company-calculated, and the customer results we cite come from case

studies the company itself publishes. Leak detection and smart networks deliver outcomes only if utilities act on the data, and water savings can be offset if pumping and treatment energy use rises faster than efficiency improves.

The thesis would weaken materially if the record order book failed to convert into organic revenue growth, if margin expansion stalled before revenue growth resumed, if returns on invested capital failed to rise clearly above our hurdle, if board refreshment made no progress against our independence priority, or if verified customer outcomes contradicted Xylem's own reported figures. It would also weaken if the valuation left no margin of safety for those risks.

The ownership test

Xylem earns its place in the portfolio because it helps solve an increasingly important economic problem through products and services customers are willing to pay for.

Its opportunity is created by the need to modernise the world's water systems. Its competitive position comes from specialist expertise, trusted equipment, an extensive installed base and the ability to connect physical infrastructure with measurement and digital intelligence. Its earnings should grow if it converts that position into profitable revenue, service income and cash. Its real-world outcomes provide evidence that the products are doing something useful.

The financial and governance tests matter as much as the theme. Xylem's margins and earnings have improved markedly, with returns on capital and shareholder returns still to catch up; and its board rests on sound foundations, with two named priorities we will keep pressing. The investment case rests on Xylem continuing to turn the engineering necessity of modern water systems into durable cash flows, funded by improving financial strength and overseen by leadership we trust - not on a theme alone.

That is what owning a share should make understandable: not a ticker symbol, a fund label or a fashionable theme, but a real business, solving a real problem, with a financial mechanism that can reward long-term owners - provided management keeps delivering and the price remains sensible.

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