

# Xylem's Acquisition of Evoqua Water Technologies for \$7.5bn

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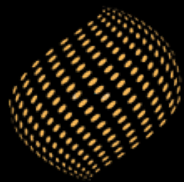
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# DEAL INTRODUCTION

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## DETAILS ABOUT THE DEAL

Global water technology company Xylem Inc. announced its plan to acquire clean technology firm Evoqua Water Technologies in January 2023.

Expected to be finalised mid-year, this will be an all-stock transaction valued at approximately \$7.5bn. Evoqua shareholders will receive 0.480 shares of Xylem for each Evoqua share, representing a value of \$52.89 per share or a 29% premium based on Xylem and Evoqua closing prices as of 20 January 2023. Upon closing, Xylem shareholders will own approximately 75% and Evoqua shareholders will own approximately 25% of the combined company on a fully diluted basis.

## REASONS FOR M&A

The combined water company will be uniquely positioned to develop and deliver solutions for water and wastewater treatment. The purchase will give Xylem advanced water treatment capabilities and access to customers in the life sciences, electronics, energy, and food industries. It will make industrial customers a much bigger part of Xylem's business, which mostly serves the utility, commercial, and residential sectors.

Evoqua complements Xylem's portfolio of solutions with advanced water and wastewater treatment capabilities. Xylem expects the combination to unlock new growth opportunities and to deliver run-rate cost synergies of \$140 million within three years, driven by scale efficiencies in procurement, network optimization and corporate costs.



# INDUSTRY OVERVIEW

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## WATER TREATMENT

Water-related M&A experienced a significant surge in activity in the past couple of years. At 498 announced deals, a 34% increase was experienced in 2021 from the prior year, a trend that continued in 2022 - Q3 has contributed a disproportionate number of deals in 2022, with private US utility investment accounting for 70 new M&A deals in the second half of the year alone - a total of over 300 transactions, including 126 in Q3 2022.

As environmental and corporate sustainability continues to shape the M&A landscape, one can expect consistent activity within the industry throughout the rest of 2023. Described as “what oil was to the last [century]; a resource whose limited supply will pose increasingly critical challenges” by M&A executive managing director Stephen Crisham at Generational Group, it is likely that water will not necessarily face the same extent of decline in deal activity or volume that other industries will experience in today’s recessionary economic climate. (Bluefield Research)





# **ACQUIRER OVERVIEW**

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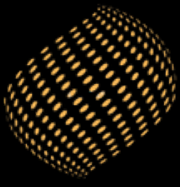
**TICKER: XYL**

## **XYLEM**

**Xylem is a global water technology company that provides solutions for water and wastewater management, as well as for the transportation, treatment, and analysis of water. The company was founded in 2011 as a spin-off from ITT Corporation and is headquartered in Rye Brook, New York.**

**Xylem operates in more than 150 countries and has a broad portfolio of products and services, including water pumps, filtration systems, and measurement and control technologies. The company's products and services are used in a variety of industries, including utilities, industrial, commercial, and residential.**

**Xylem's mission is to provide sustainable water solutions that improve the quality of life for people and communities around the world. The company is committed to addressing the global water challenges of scarcity, quality, and resilience through innovation and collaboration. Xylem has been recognized for its commitment to sustainability and corporate responsibility, including being named to the Dow Jones Sustainability Index and receiving the U.S. Water Prize for its efforts to advance water sustainability.**



## **BUSINESS MODEL**

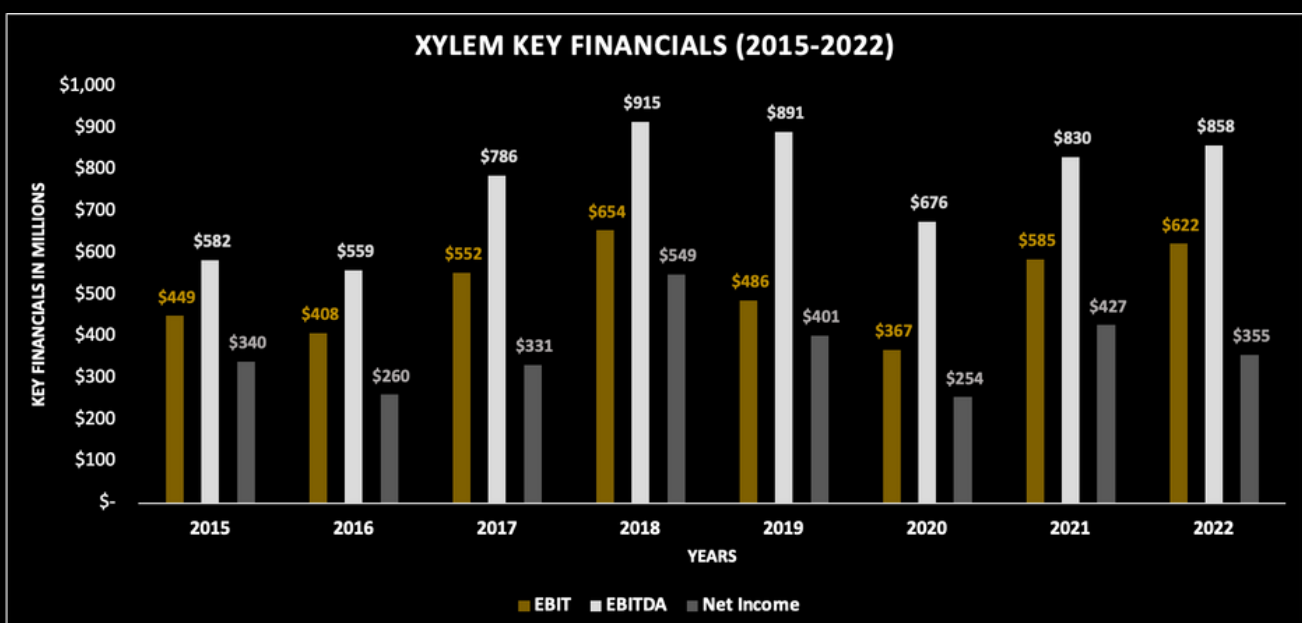
Xylem operates in four main segments, including Water Infrastructure, Applied Water, Measurement & Control Solutions and Advanced Infrastructure Analytics. The Water Infrastructure segment includes the sale of pumps, treatment equipment, and other products and services related to water transportation, treatment, and distribution.

Applied Water refers to the sale of pumps, valves, and other products and services for a wide range of applications, including residential, commercial, and agricultural use.

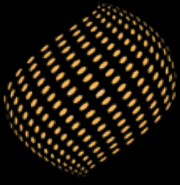
Measurement & Control Solutions includes the sale of measurement and monitoring devices, software, and services for water quality analysis and management.

Advanced Infrastructure Analytics includes the sale of software and data analytics services for water infrastructure management and optimisation.

## **KEY FINANCIALS**







## **ESG PRACTICES**

**Xylem is committed to reducing its environmental footprint and has set a goal of achieving carbon neutrality by 2025. The company is investing in renewable energy and energy efficiency measures, as well as reducing water usage in its operations and supply chain. Xylem also designs and produces products that help its customers reduce water waste, improve water quality, and enhance water reuse.**

**Xylem is also committed to promoting social responsibility in its operations and in the communities where it operates. The company has a strong focus on diversity and inclusion and is working to increase the representation of underrepresented groups in its workforce.**

**The company also has a comprehensive code of conduct that governs its operations and requires compliance with all applicable laws and regulations. Xylem's board of directors is also committed to transparency and accountability, regularly reporting on its ESG performance and engaging with stakeholders on these issues.**





# TARGET OVERVIEW

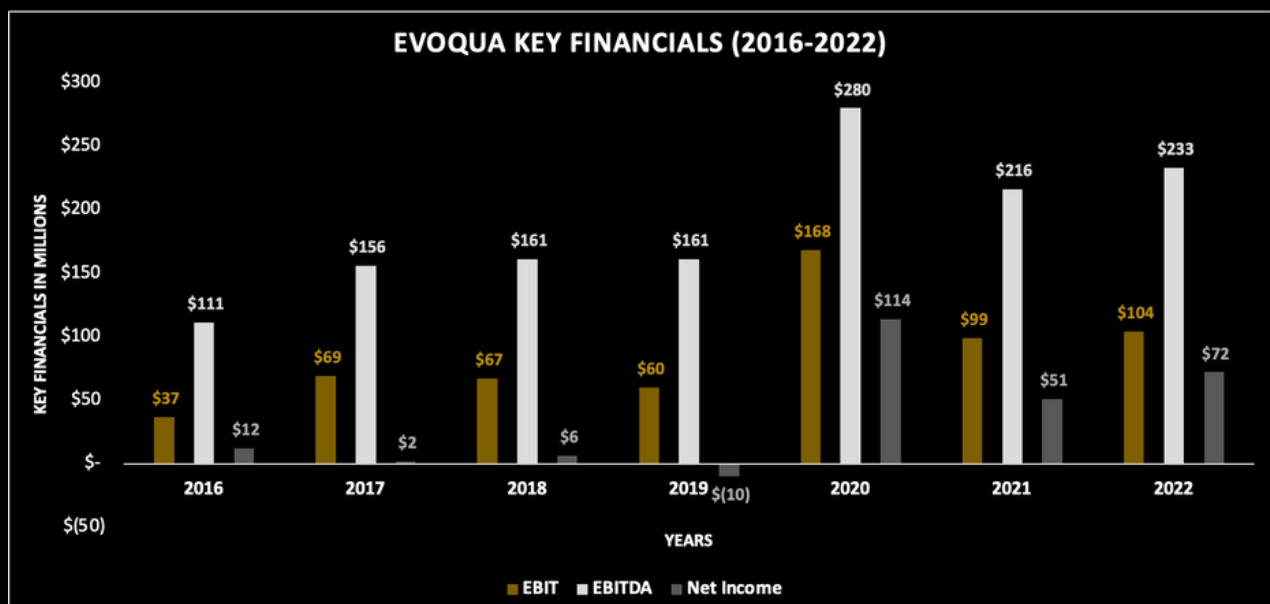
TICKER: AQUA

## EVOQUA WATER TECHNOLOGIES

Evoqua Water Technologies is a leading provider of water and wastewater treatment solutions and services. The company serves customers in a wide range of industries, including municipal, industrial, commercial, and healthcare. Evoqua was formed in 2014 as a result of a spinoff from Siemens Water Technologies and is headquartered in Pittsburgh, Pennsylvania.

Evoqua's product and service offerings include water and wastewater treatment systems, mobile and temporary water treatment solutions, disinfection systems, filtration systems, and process water treatment systems. The company also provides a range of services, including maintenance and repair, membrane cleaning, and analytical services.

## KEY FINANCIALS







## **BUSINESS MODEL**

Evoqua operates in four main business segments, including Integrated Solutions & Services, Applied Product Technologies, Advanced Treatment, and Treatment & Transport.

Integrated Solutions & Services includes Evoqua's customized solutions and services that meet the unique needs of each customer.

Applied Product Technologies focuses on the sale of a wide range of products, including disinfection systems, filtration systems, and process water treatment systems.

Advanced Treatment includes the sale of advanced treatment systems, such as membrane bioreactors and reverse osmosis systems, for use in industrial and municipal applications.

The Treatment & Transport segment comprises the sale of products and services related to water and wastewater transport and treatment, including pumps, mixers, and aerators.

## **ESG PRACTICES**

Evoqua is aiming to recycle and reuse more water than withdrawn by 2035 to address water risks related to climate change. To achieve this target, Evoqua plans to create water management plans for its facilities to streamline their water usage and implement new water recycling and reuse initiatives. Additionally, Evoqua is aiming to reach net-zero greenhouse gas emissions by 2050 and has established science-based targets through evaluation of its scope 1,2 and 3 emissions. This enables the company to develop greenhouse gas emission reduction targets in line with Paris Agreement's 1.5°C pathway.



# DEAL ANALYSIS

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## STRENGTHS

The acquisition of Evoqua enables Xylem to address critical markets, particularly industrial water, and to innovate with digital solutions. This will be a crucial market for Xylem to capitalise on as, according to Precedence Research, the global water and wastewater treatment market size is projected to surpass around USD 497.5 billion by 2030.

This new combined company can deliver a portfolio of advanced technologies, integrated services, and application expertise across the water cycle to a broad new client base. The acquisition is expected to create significant synergies and cash flow, supporting continued strategic growth and investment, with this transaction generating approximately \$100 million in **gross proceeds**.

## WEAKNESSES

Xylem's stock prices tumbled by more than 8% following the news of this acquisition, suggesting that investors consider the valuation of Evoqua excessive at 22x of its FY23E **EBITDA**. Another potential issue Xylem will likely face is the short-term issues surrounding efficiency when two large companies like this merge. A brief period following the merger where efficiency is significantly lower could be expected as the new firm decides on the new structure of the company.



# DEAL ANALYSIS

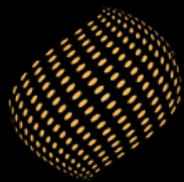
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## OPPORTUNITIES

The acquisition provides Xylem with capabilities to tackle new problems in the industry, whilst benefiting from synergies that can realize lower costs and more innovative solutions. The global water demand is expected to exceed supply by 40% by 2030, which is expected to drive demand for water technology solutions. Furthermore, the acquisition provides opportunities to expand the combined company's technologies to new markets around the world.

## THREATS

The global water industry is highly competitive, and there is a risk of losing market share to competitors. There may be unanticipated difficulties in integrating the two companies and realizing the expected synergies. Although this is considered minimal due to little expected overlap in the two businesses' operations. Xylem's long-term growth strategy has been achieved because of M&A leading to Xylem consistently outperforming the S&P 500 global water index as a result, this deal will have heavy scrutinisation from regulatory bodies.



# VALUATION ANALYSIS

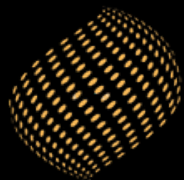
## COMPARABLE COMPANIES ANALYSIS

	Low	Average	High
Valuation multiple	1.53x	2.98x	5.74x
Implied Enterprise value	2659	5175	9967
Net Debt	746.8	746.8	746.8
Implied equity value	1912.31	4428.48	9220.52
Equity Value per share	15.69	36.34	75.66
Overvalued (Undervalued)	161%	13%	-46%
Premium (Discount)	70.33%	31.29%	-43.06%

[Please click on the table to access full model.](#)

As shown in the model, the CCA-Implied Share price of Evoqua is \$36.34 in the base case. This represents a an overvaluation of 13% by the market at the time of the acquisition offer since Evoqua was trading at around \$41.

When looking at profitability, Evoqua's EV/EBITDA **multiple** of 20.58x appears to be higher than majority of its competitors, whereas their **P/E ratio** of 66.02x also supports the higher price that the stock was currently trading based on the earnings of the company.



# VALUATION ANALYSIS

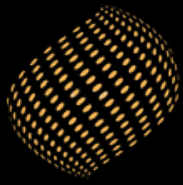
## DISCOUNTED CASH FLOW MODEL (EVOQUA)

		Sensitivity Analysis				
		WACC				
		5.2%	6.2%	7.2%	8.2%	9.2%
TGR	2.0%	44.75	32.28	24.62	19.43	15.68
	2.5%	53.32	36.88	27.43	21.30	17.01
	3.0%	65.77	42.91	30.92	23.54	18.55
	3.5%	85.52	51.16	35.35	26.26	20.36
	4.0%	121.61	63.15	41.15	29.62	22.52

[Please click on the table to access full model.](#)

The Discounted Cash Flow (DCF) Analysis was used to calculate the value of Evoqua's share price at the time of its acquisition by Xylem, yielding a value of \$30.92. This figure appears to be lower compared to the \$50 share price the company is currently trading at. The model's sensitivity analysis revealed that Evoqua's share price could potentially range from \$15.68 to \$121.61. It is noteworthy that Xylem's share price in the year leading up to their acquisition ranged from \$30.30 to \$52.17, which suggests that our calculation sits in the lower end of their 52 week range.

It is important to keep in mind that the model was built on several assumptions, including a Terminal Growth Rate of 3% in the base case and a Weighted Average Cost of Capital (WACC) of 7.2% in the base case, which was determined using the **CAPM model**. As a result, the value of the share price obtained from the DCF Analysis was influenced by these assumptions.



# VALUATION ANALYSIS

## DISCOUNTED CASH FLOW MODEL (XYLEM)

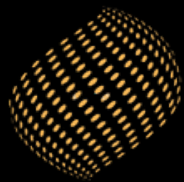
		Sensitivity Analysis				
		WACC				
		8.2%	8.7%	9.2%	9.7%	10.2%
TGR	2.0%	74.53	68.71	63.70	59.33	55.50
	2.5%	79.44	72.79	67.12	62.24	57.99
	3.0%	85.30	77.58	<b>71.10</b>	65.58	60.82
	3.5%	92.39	83.29	75.77	69.46	64.08
	4.0%	101.16	90.20	81.34	74.01	67.86

[Please click on the table to access full model.](#)

The Discounted Cash Flow (DCF) Analysis was used to calculate the value of Xylem's share price at the time of its acquisition, yielding a value of \$71.10. This figure appears to be lower compared to the \$106 share price the company is currently trading at. The model's sensitivity analysis revealed that Xylem's share price could potentially range from \$55.50 to \$101.16. It is noteworthy that Xylem's share price in the year leading up to their acquisition interest in Evoqua ranged from \$71.96 to \$118.25, which follows the predicted range determined by the DCF model.

Terminal Growth Rate of 3% and a Weighted Average Cost of Capital (WACC) of 9.2% were used as the main assumptions of the model. WACC was determined using the **CAPM model**.





# VALUATION ANALYSIS

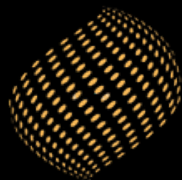
## FULL MERGER MODEL

x		Sensitivity Analysis				
		WACC				
		4.96%	5.96%	6.96%	7.96%	8.96%
TGR	0.3%	210.27	171.97	145.20	125.43	110.25
	0.7%	226.12	182.00	151.99	130.26	113.81
	1.0%	240.12	190.58	<b>157.68</b>	134.25	116.72
	1.3%	256.41	200.27	163.98	138.60	119.86
	1.6%	275.63	211.30	170.98	143.36	123.25

[Please click on the table to access full model.](#)

Due to creating two DCF models for both the acquirer and target companies, a full merger model was conducted, combining every necessary income statement, balance sheet and cash flow items to evaluate the impact of the acquisition on the acquirer's price. The full merger suggests that Xylem's share price could correct itself to \$157.68 when all the benefits of the acquisition is realised. Given that Xylem's current share price is around \$107, this acquisition promises a great value creation for Xylem, mainly due to the fact that they were able to acquire one of the main competitors in the industry.

The model was built on several assumptions, including a Terminal Growth Rate of 1% in the base case and a Weighted Average Cost of Capital (WACC) of 6.96% in the base case, which was determined using the CAPM model. The values are lower than the company's individual DCF since the growth would be limited after the acquisition and the WACC would be significantly impacted by the increase in debt that is used to finance the acquisition.



# VALUATION ANALYSIS

## ACCRETION / DILUTION ANALYSIS

Post-merger EPS Calculation	
Revenues	7,259
Less: COGS	4,639
<b>Gross Profit</b>	<b>2,620</b>
Less: Operating Expense	1,899
<b>EBIT</b>	<b>721</b>
Interest Foregone on Cash	-
<b>PBT</b>	<b>721</b>
Less: Income Tax	139
<b>Net Income</b>	<b>582</b>
Outstanding Diluted Shares of Combined Company	273
<b>EPS of Combined Company</b>	<b>2.135</b>
<b>EPS of Acquirer Standalone</b>	<b>1.96</b>
<b>Accretive/Dilutive</b>	<b>Accretive</b>
<b>Accretive/Dilutive</b>	<b>0.17</b>
<b>Accretive/Dilutive (%)</b>	<b>9%</b>

[Please click on the table to access full model.](#)

The accretion / dilution analysis suggests a 9% accretion in the case of a merger since the combined company's earnings per share appear to be higher than the earnings per share of the standalone company. This conclusion overall follows the conclusion drawn in the full merger model, indicating that Xylem would be able to highly benefit from this acquisition when all the synergies are realised.



# CONCLUSION

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**Xylem's acquisition of Evoqua Water Technologies is expected to have a significant impact on the water technology industry. The new combined company will be more diversified and powerful, allowing it to provide innovative digital solutions and advanced technologies across the water cycle. This will enable Xylem to better address critical markets, particularly industrial water.**

**Additionally, the operational efficiencies and cost savings through shared resources are expected to drive down prices in the industry, providing more accessible and affordable water solutions for consumers and communities. This merger is expected to deliver run-rate cost synergies of \$140m within three years, driven by scale efficiencies in procurement, network optimization, and corporate costs.**

**Furthermore, the acquisition is expected to accelerate innovation in the industry. Through leveraging their combined resources, Xylem and Evoqua can create new solutions to tackle challenging needs for consumers and communities. This is particularly important as the global population grows, and demand for clean water continues to increase.**





## GLOSSARY

**CAPM Model:** *Capital Asset Pricing Model is a method to estimate the WACC of a company by taking into account the expected rate of return for an investment*

**EBIT:** *Earnings before Interest and Tax. A useful measure in measuring a company's ability to undertake its operations and pay off debt.*

**EPS:** *Earnings per share represents company's net profit divided by the number of shares outstanding. It is a useful ratio used to compare companies in the same industry to understand profitability.*

**Gross Proceeds:** *The term refers to all the expenses incurred in the transaction, including broker commissions or legal fees.*

**P/E Ratio:** *Price to earnings ratio represents the company's share price divided by its earnings per share, a useful tool to determine the analyse company's share price relative to other players in the same industry*

**Synergies:** *Improved conditions of the acquirer company as a result of the revenue and cost integrations after a transaction.*

**Terminal Growth Rate (TGR):** *A growth rate that a company is expected to grow at forever based on the market and industry conditions.*

**Valuation Multiples:** *Financial tool providing one metric as a ratio of another; often used to compare similar companies.*

**WACC:** *Cost of capital used to represent a firm's after-tax costs from all resources.*



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