



**AO Smith**<sup>®</sup>

Second Quarter 2014 Results



# Forward Looking Statements

This presentation contains statements that we believe are “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements generally can be identified by the use of words such as “may,” “will,” “expect,” “intend,” “estimate,” “anticipate,” “believe,” “continue,” “guidance”, “aspirations”, or words of similar meaning. All forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those anticipated as of the date of this presentation. Important factors that could cause actual results to differ materially from these expectations include, among other things, the following: uncertain costs, savings and timeframes associated with the implementation of the new enterprise resources planning system; potential weakening in the high efficiency boiler segment in the U. S.; the ability to execute our acquisition strategy; significant volatility in raw material prices; competitive pressures on the company's businesses; inability to implement pricing actions; instability in the company's replacement markets; strength or duration of any recoveries in U. S. residential or commercial construction; a further slowdown in the growth of the Chinese economy; foreign currency fluctuations and adverse general economic conditions and capital market deterioration.

Forward-looking statements included in this presentation are made only as of the date of this presentation, and the company is under no obligation to update these statements to reflect subsequent events or circumstances. All subsequent written and oral forward-looking statements attributed to the company, or persons acting on its behalf, are qualified entirely by these cautionary statements. This presentation contains certain non-GAAP financial measures as that term is defined by the SEC. Non-GAAP financial measures are generally identified by “Adjusted” (Adj.) or “Non-GAAP” .

# Notice Regarding Financial Information



- ▶ This presentation contains non-GAAP financial information. Reconciliations from GAAP to non-GAAP measures are contained in the appendix of this presentation.
- ▶ All information should be read in conjunction with the historical financial statements and financial information contained in A. O. Smith's Annual Report on Form 10-K, periodic reports on Form 10-Q and Form 8-K, and public announcements of financial information.
- ▶ Copies of these reports are available on the Investor Relations section of A. O. Smith's website at <http://www.aosmith.com/investors/>



# Second Quarter Highlights

- ▶ Record second quarter sales of \$595 million
  - Revenue eight percent higher
  - China sales up 17 percent
- ▶ Adjusted earnings of \$.66 per share
  - Increase of 27 percent over \$.52 per share last year
- ▶ Cash returned to shareholders
  - YTD share repurchase totaled \$60.8 million
  - 25 percent dividend increase in January



# Second Quarter Results

	2014	2013	change	% chg.
Sales	\$ 595.4	\$ 549.1	\$ 46.3	8%
Net Earnings	57.3	42.1		
Non-operating Pension (after-tax)	3.0	3.0		
Other adjustments (see below)	-	3.1		
Adjusted Earnings	\$ 60.3	\$ 48.2	\$ 12.1	25%

Other adjustments (after-tax)  
2013: \$3.1 restructuring & impairment expenses

(\$ in millions)



## Second Quarter Adjusted EPS

	2014	2013	change	% chg.
EPS	\$0.63	\$0.45		
Non-operating Pension	0.03	0.03		
Other adjustments (see below)	<u>-</u>	<u>0.04</u>		
Adjusted EPS	<u><u>\$0.66</u></u>	<u><u>\$ 0.52</u></u>	\$ 0.14	27%

Other adjustments:  
2013: \$.04 per share restructuring & impairment expenses



## Second Quarter Sales

	2014	2013	change	% chg.
North America	\$ 410.1	\$ 389.0	\$ 21.1	5%
Rest of World	193.6	169.5	\$ 24.1	14%
Intersegment	<u>(8.3)</u>	<u>(9.4)</u>	<u>\$ 1.1</u>	
Total	<u>\$ 595.4</u>	<u>\$ 549.1</u>	<u>\$ 46.3</u>	8%

(\$ in millions)



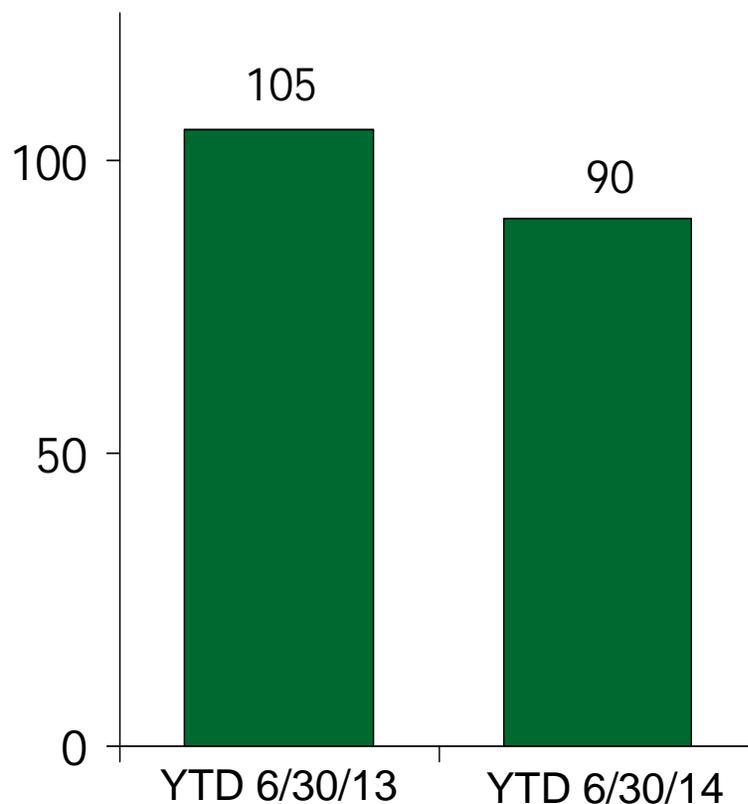
## Second Quarter Adjusted Earnings

	2014	2013	change	% chg.
North America	\$ 67.1	\$ 62.8	\$ 4.3	7%
Rest of World	29.3	22.4	6.9	31%
Total Operating	96.4	85.2	11.2	13%
Adjusted Corporate	(11.5)	(13.3)	1.8	14%
Interest Expense	(1.4)	(1.6)	0.2	13%
Adjusted Pre-tax Earnings	83.5	70.3	13.2	19%
Income Tax Expense	(23.2)	(22.1)	(1.1)	-5%
Adjusted Earnings	<u>\$ 60.3</u>	<u>\$ 48.2</u>	<u>\$ 12.1</u>	25%
<u>Adjusted Operating Margin</u>				
North America	16.4%	16.1%		
Rest of World	15.1%	13.2%		

(\$ in millions, except margins)



# Operating Cash Flow



\$ in millions

## Second Quarter Highlights

- ▶ Cash flow of \$90 million
- ▶ Debt to capital ratio of 16%
- ▶ Cash balance: \$497 million
- ▶ Net cash position: \$246 million
- ▶ Year -to-date stock repurchase: 1.3 million shares totaling \$60.8 million



# Adjusted 2014 EPS Guidance and Adjusted 2013 EPS

The following is a reconciliation of diluted EPS to adjusted EPS (non-GAAP) (all items are net of tax):

	2014 Guidance	2013
<b>Diluted EPS (GAAP)</b>	\$2.20 - \$2.26	\$ 1.83
Non-operating pension costs per diluted share	0.14	0.13
Settlement income per diluted share	-	(0.07)
Restructuring and impairment expenses per diluted share	-	0.17
<b>Adjusted EPS</b>	<u>\$2.34 - \$ 2.40</u>	<u>\$ 2.06</u>

*As of July 22, 2014*



## 2014 Outlook: 140 year Anniversary

- ▶ China revenue grows at least two times China GDP; higher advertising spend in the second half of 2014
- ▶ China water treatment gaining traction
- ▶ Lochinvar branded annual sales growth approximately 10 percent
  - Transition in North America to higher efficiency boilers continues
- ▶ U. S. construction benefit
  - Residential water heater industry volumes approximately 9 million units, including tankless water heaters
  - Commercial water heater industry volumes at approximately 162,000 units
- ▶ Wholesale price increase effective May 1
- ▶ Incremental enterprise resources planning expense of \$10 million heavily weighted to Q3

*July 22, 2014*



## Revision to 2015 Outlook

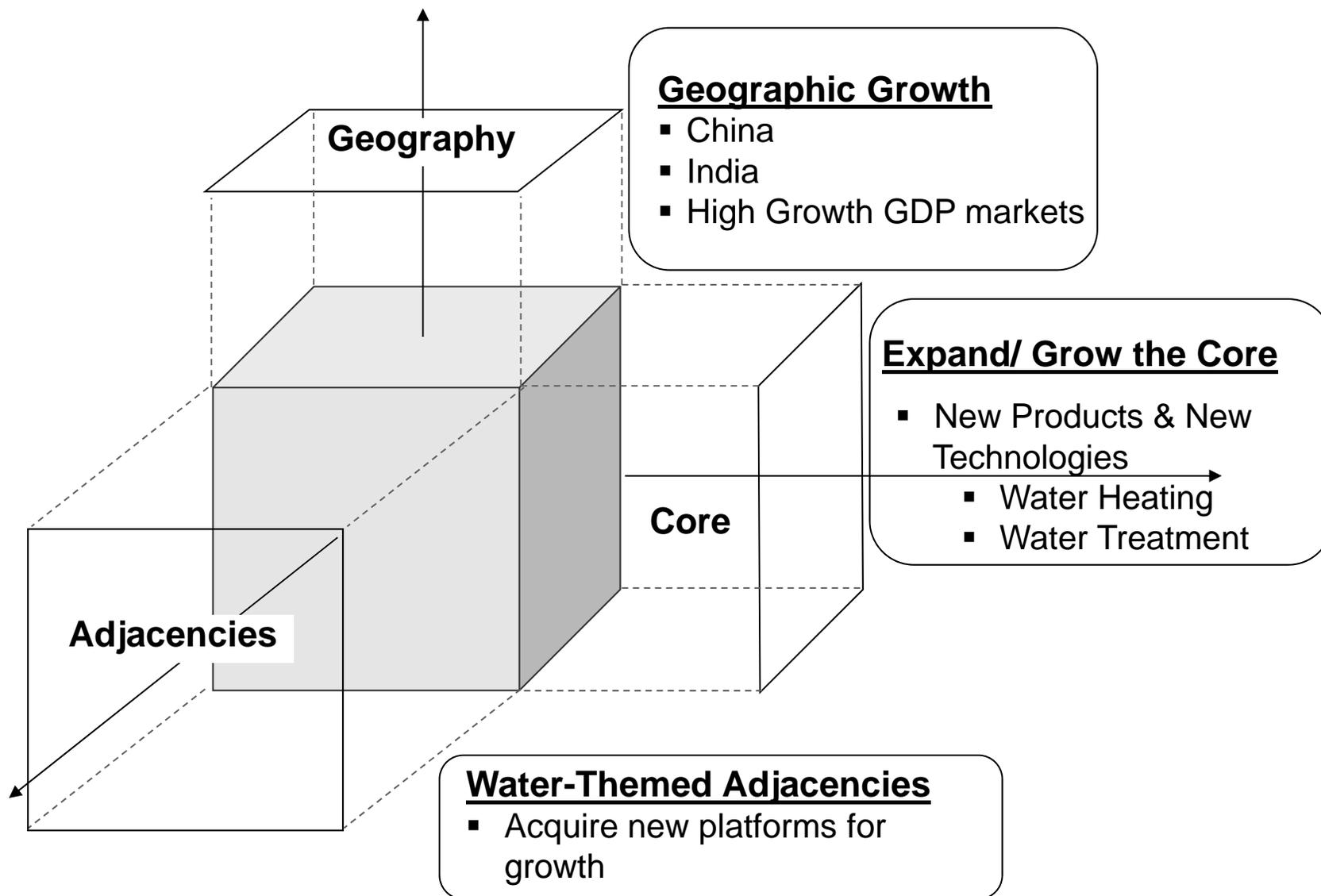
	Revised 2015	Previous 2015	change	% chg.
Sales	> \$2.5 B	> \$2.5 B	no change	
NA Margins	16%	16%	no change	
ROW Margins	14%	13%	1%	8%
EPS	\$ 2.60	\$ 2.50	\$ 0.10	4%

Revised 2015 represents 11 percent increase over 2014 guidance midpoint

*July 22, 2014*



# A. O. Smith Growth Strategy





# Investment Criteria

- ▶ Value creation opportunities
- ▶ ROIC in excess of cost of capital by second or third year
- ▶ Meet risk adjusted IRR hurdle rates
- ▶ Margin accretion with growth rates higher than U. S. GDP
- ▶ Accretive to earnings in the first year





*Answers to your questions...*





# Appendix





# Adjusted 2014 EPS Guidance and Adjusted 2013 EPS

The following is a reconciliation of diluted EPS to adjusted EPS (non-GAAP) (all items are net of tax):	2014 Guidance	2013
<b>Diluted EPS (GAAP)</b>	\$2.20 - \$2.26	\$ 1.83
Non-operating pension costs per diluted share	0.14	0.13
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Settlement income per diluted share	-	(0.07)
<b>Adjusted EPS</b>	<u>\$2.34 - 2.40</u>	<u>\$ 2.06</u>

*As of July 22, 2014*



# Adjusted Earnings & Adjusted EPS

(dollars in millions, except per share data)

The following is a reconciliation of net earnings and diluted EPS to adjusted earnings (non-GAAP) and adjusted EPS (non-GAAP):

Three Months Ended June 30,		
2014	2013	
<b>Net Earnings (GAAP)</b>	\$ 57.3	\$ 42.1
Non-operating pension costs, before tax	5.0	4.8
Tax effect of non-operating pension costs	(2.0)	(1.8)
Restructuring and impairment expenses, before tax	-	4.2
Tax effect of restructuring and impairment expenses	-	(1.1)
Settlement income, before tax	-	-
Tax effect of settlement income	-	-
<b>Adjusted Earnings</b>	<u>\$ 60.3</u>	<u>\$ 48.2</u>
<b>Diluted EPS (GAAP)</b>	\$ 0.63	\$ 0.45
Non-operating pension costs per diluted share, before tax	0.05	0.05
Tax effect of non-operating pension costs per diluted share	(0.02)	(0.02)
Restructuring and impairment expenses per diluted share, before tax	-	0.05
Tax effect of restructuring and impairment expenses per diluted share	-	(0.01)
Settlement income per diluted share, before tax	-	-
Tax effect of settlement income per diluted share	-	-
<b>Adjusted EPS</b>	<u>\$ 0.66</u>	<u>\$ 0.52</u>



# Adjusted Segment Operating Earnings

(dollars in millions)

The following is a reconciliation of reported segment operating earnings to adjusted segment operating earnings (non-GAAP):

## Segment Operating Earnings (GAAP)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
North America	\$ 63.2	\$ 55.0	\$ 118.5	\$ 109.1
Rest of World	<u>29.3</u>	<u>22.4</u>	<u>54.4</u>	<u>40.7</u>
Total Segment Operating Earnings (GAAP)	<u>\$ 92.5</u>	<u>\$ 77.4</u>	<u>\$ 172.9</u>	<u>\$ 149.8</u>
Adjustments:				
North America	\$ 3.9	\$ 7.8	\$ 7.7	\$ 13.0
Rest of World	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total Adjustments	<u>\$ 3.9</u>	<u>\$ 7.8</u>	<u>\$ 7.7</u>	<u>\$ 13.0</u>
Adjusted Segment Operating Earnings				
North America	\$ 67.1	\$ 62.8	\$ 126.2	\$ 122.1
Rest of World	<u>29.3</u>	<u>22.4</u>	<u>54.4</u>	<u>40.7</u>
Total Adjusted Segment Operating Earnings	<u>\$ 96.4</u>	<u>\$ 85.2</u>	<u>\$ 180.6</u>	<u>\$ 162.8</u>

Additional Information:

## Adjustments: North America Segment

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Non-operating pension costs	\$ 3.9	\$ 3.6	\$ 7.7	\$ 7.1
Restructuring and impairment expenses	-	4.2	-	16.9
Settlement income	<u>-</u>	<u>-</u>	<u>-</u>	<u>(11.0)</u>
Total North America Segment Adjustments	<u>\$ 3.9</u>	<u>\$ 7.8</u>	<u>\$ 7.7</u>	<u>\$ 13.0</u>



# Adjusted Earnings & Adjusted EPS

(dollars in millions, except per share data)

The following is a reconciliation of net earnings and diluted EPS to adjusted earnings (non-GAAP) and adjusted EPS (non-GAAP):

	Six Months Ended June 30,	
	2014	2013
<b>Net Earnings (GAAP)</b>	\$ 104.0	\$ 81.1
Non-operating pension costs, before tax	9.8	9.6
Tax effect of non-operating pension costs	(3.8)	(3.6)
Restructuring and impairment expenses, before tax	-	16.9
Tax effect of restructuring and impairment expenses	-	(4.3)
Settlement income, before tax	-	(11.0)
Tax effect of settlement income	-	4.2
<b>Adjusted Earnings</b>	<u>\$ 110.0</u>	<u>\$ 92.9</u>
<b>Diluted EPS (GAAP)</b>	\$ 1.14	\$ 0.87
Non-operating pension costs per diluted share, before tax	0.10	0.10
Tax effect of non-operating pension costs per diluted share	(0.04)	(0.04)
Restructuring and impairment expenses per diluted share, before tax	-	0.19
Tax effect of restructuring and impairment expenses per diluted share	-	(0.05)
Settlement income per diluted share, before tax	-	(0.12)
Tax effect of settlement income per diluted share	-	0.05
<b>Adjusted EPS</b>	<u>\$ 1.20</u>	<u>\$ 1.00</u>