



# Autumn 2018 Analyst Presentation



## 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” 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: a further slowdown in the growth rate of the Chinese economy or our key markets and/or a further decline in the growth rate of consumer spending or housing stock sold in China; potential weakening in the high efficiency boiler market segment in the U. S.; significant volatility in raw material prices; our inability to implement or maintain pricing actions; potential weakening in U. S. residential or commercial construction or instability in our replacement markets; foreign currency fluctuations; inability to successfully integrate or achieve our strategic objectives resulting from future acquisitions; competitive pressures on our businesses; the impact of potential information technology or data security breaches; changes in government regulations or regulatory requirements; the impact from U.S. Tax Reform and projections for effective tax rates and one-time expenses under the new law; and adverse developments in general economic, political and business conditions in the key regions of the world. 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” .



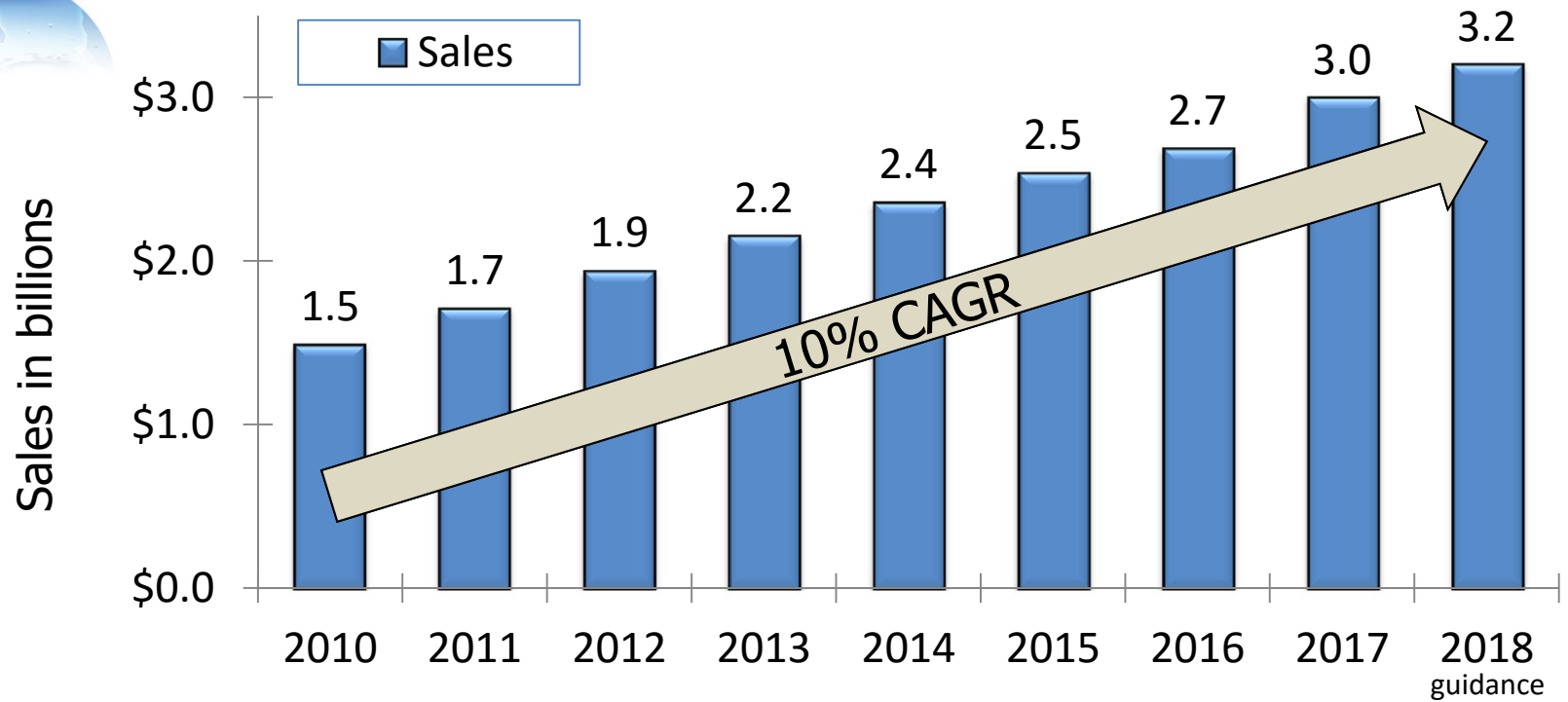
## Investment Case

- Manufacturer of residential and commercial water heaters, boilers and water treatment products
- Market share leader in major product lines
- Stable/growing North American replacement market; operating leverage from incremental new construction and replacement
- Strong balance sheet and cash flow to support future growth, share repurchase and acquisitions
- Strength of our premium brand, distribution, manufacturing and innovation provide clear market advantage in China
- 85 percent replacement in water heater and boiler demand



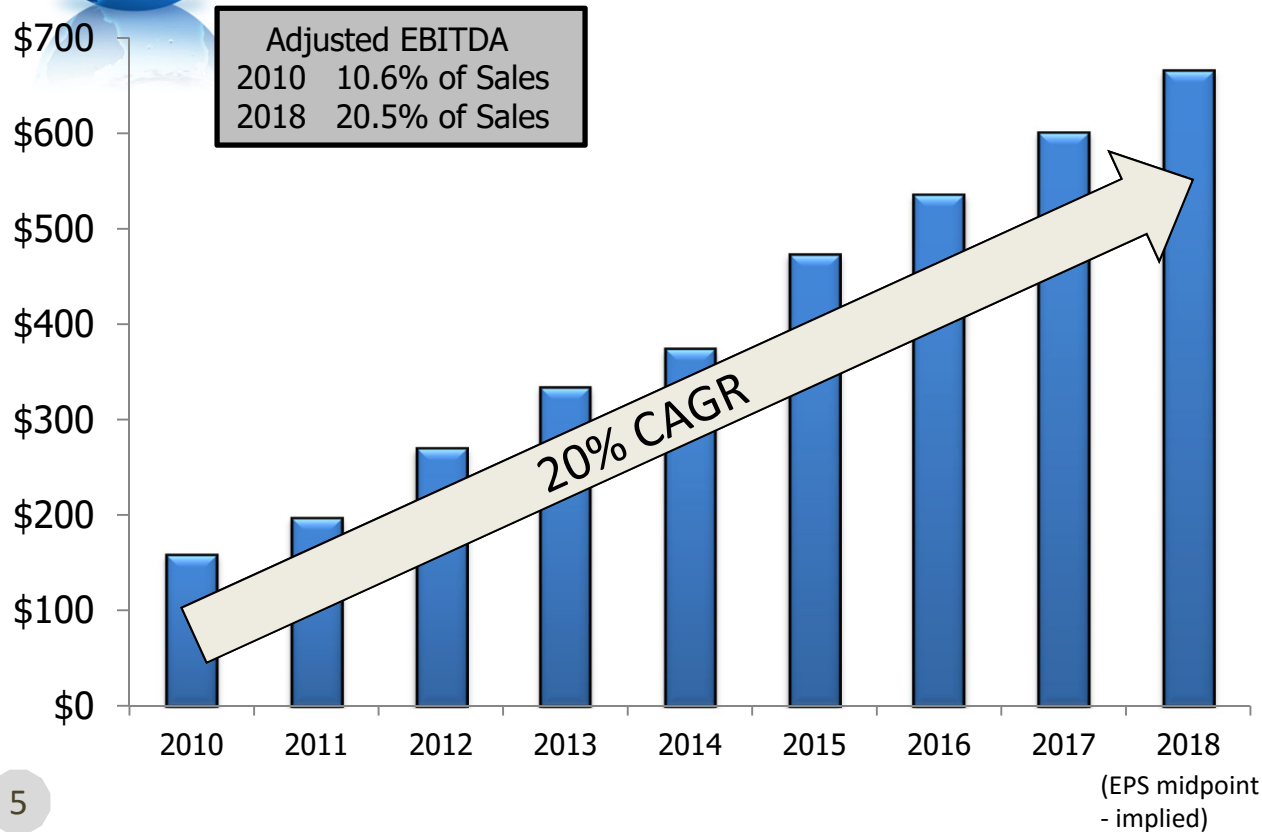


## Sales Growth: 10 Percent CAGR





## Adjusted EBITDA: 20 Percent CAGR

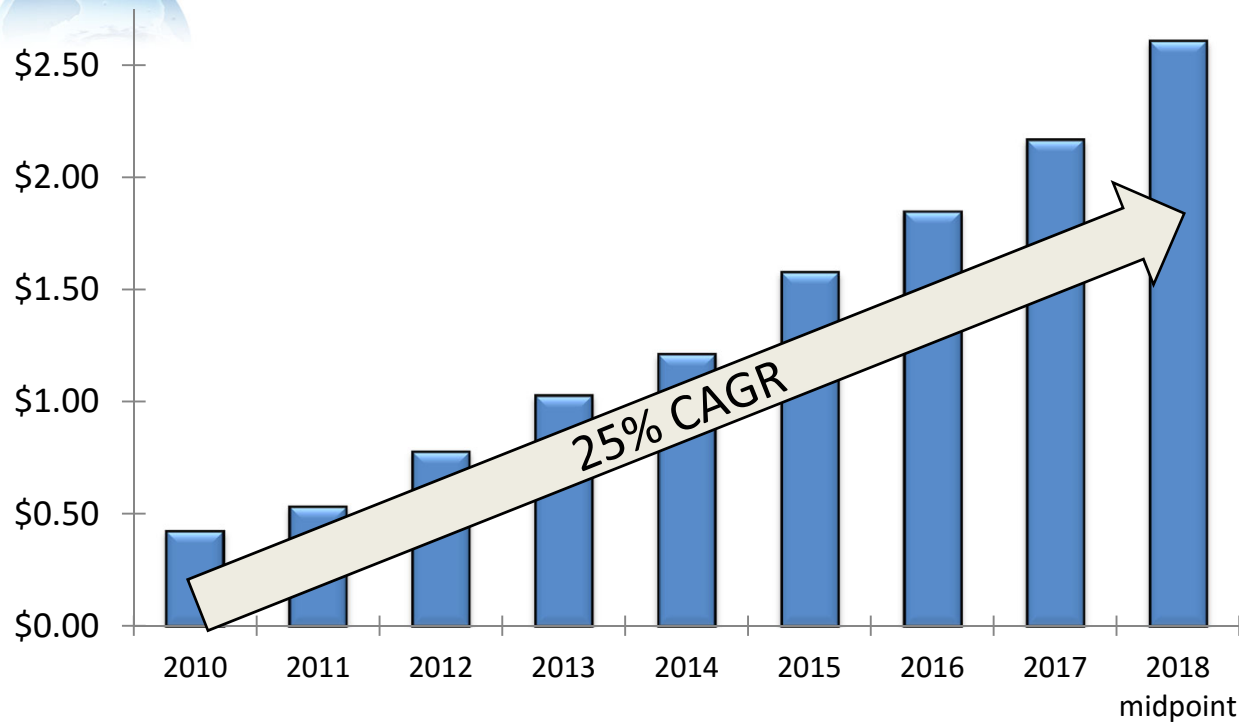


### NOTE

2010 through 2014 adjusted for non-operating pension costs and certain non-recurring items



## Adjusted Earnings Per Share: 25 Percent CAGR



### NOTE

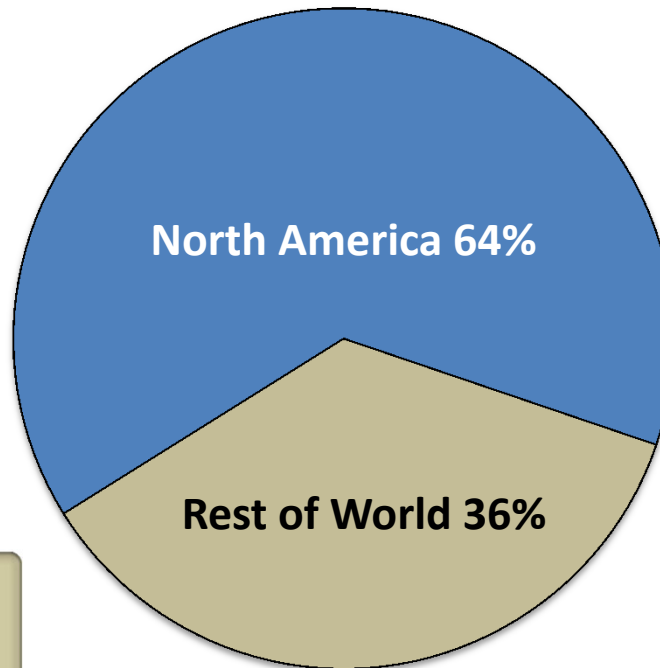
2010 through 2014 adjusted for non-operating pension costs and certain non-recurring items; 2017 adjusted for U.S. Tax Reform expense; 2018 adjusted for restructuring & impairment expenses



# Segment Revenue

**NA**

- Boilers
- Water Heaters
- Water Treatment



**ROW**

- China/India = 95%
- Europe/Middle East = 5%

2017 full year

**A.O. SMITH**  
史密斯  
热水·净水·采暖·空气净化

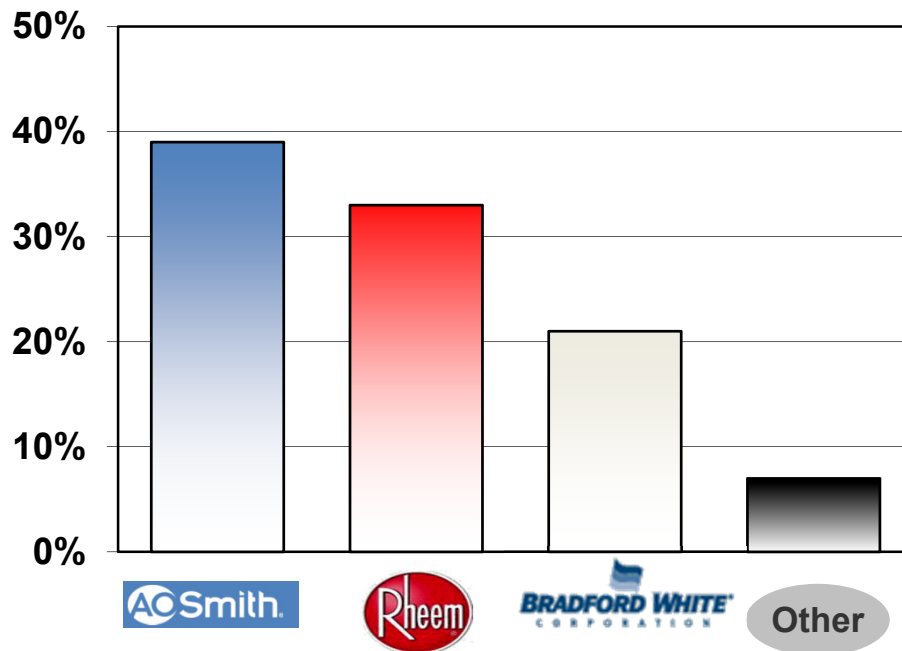
**Lochinvar**  
High Efficiency Water Heaters, Boilers and Pool Heaters

**HAGUE**  
Quality Water®



# U.S. Water Heater Market Segment

## Residential Market



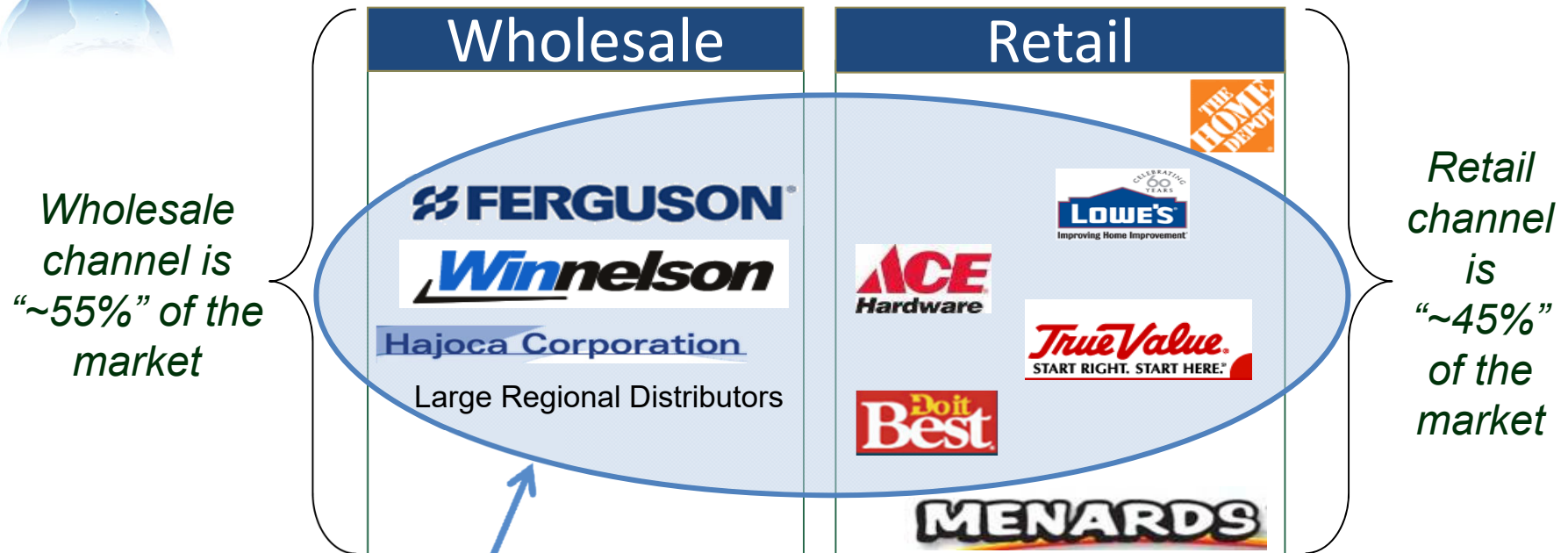
AHRI data + tankless:  
AOS actual shipments  
and AOS estimates of  
competitors' shipments

*2017 market share data*





# U.S. Residential Water Heater Market Segment



Wholesale channel is “~55%” of the market

Retail channel is “~45%” of the market

A. O. Smith's Customers

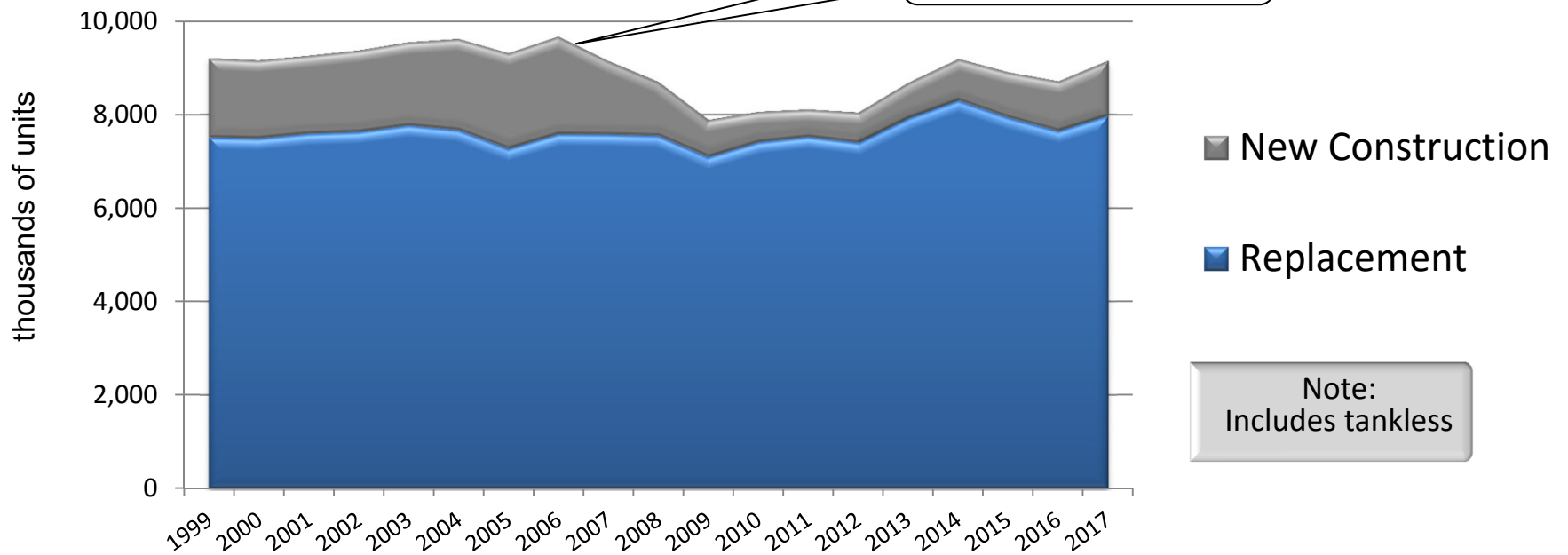
2017 – 9.2 mm Units



# Water Heaters - Strong Replacement Sales

## U. S. Residential Water Heaters

Peak housing starts: 2.1 million

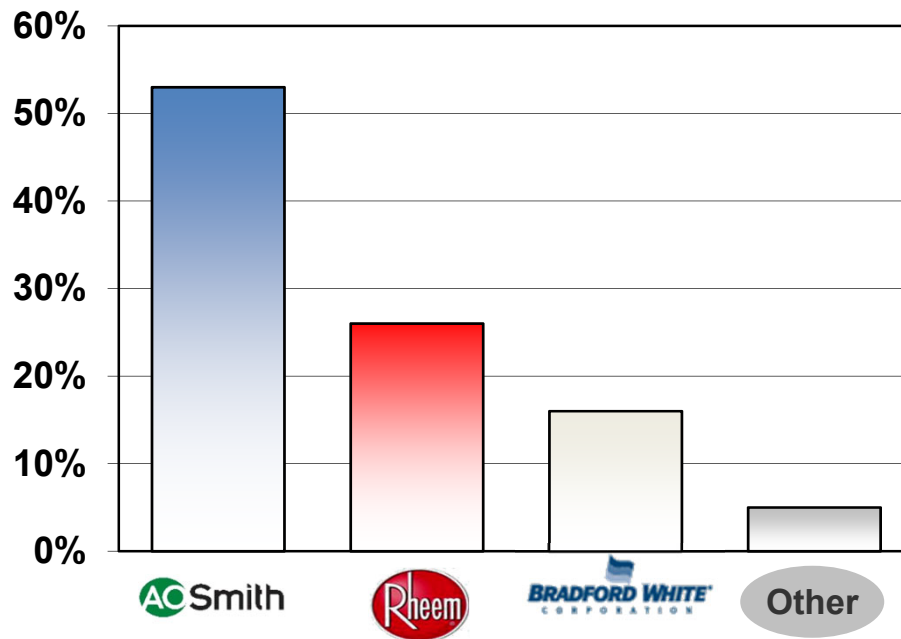




# U.S. Water Heater Market Segment

## Commercial Gas Market\*

2017 market share data



### AHRI data:

AOS actual shipments and  
AOS estimate of competitors'  
shipments

\* Commercial gas water heater  
segment as defined by AHRI,  
total 2017 commercial units as  
reported by AHRI = 94,000 units



## Energy Efficient Cyclone

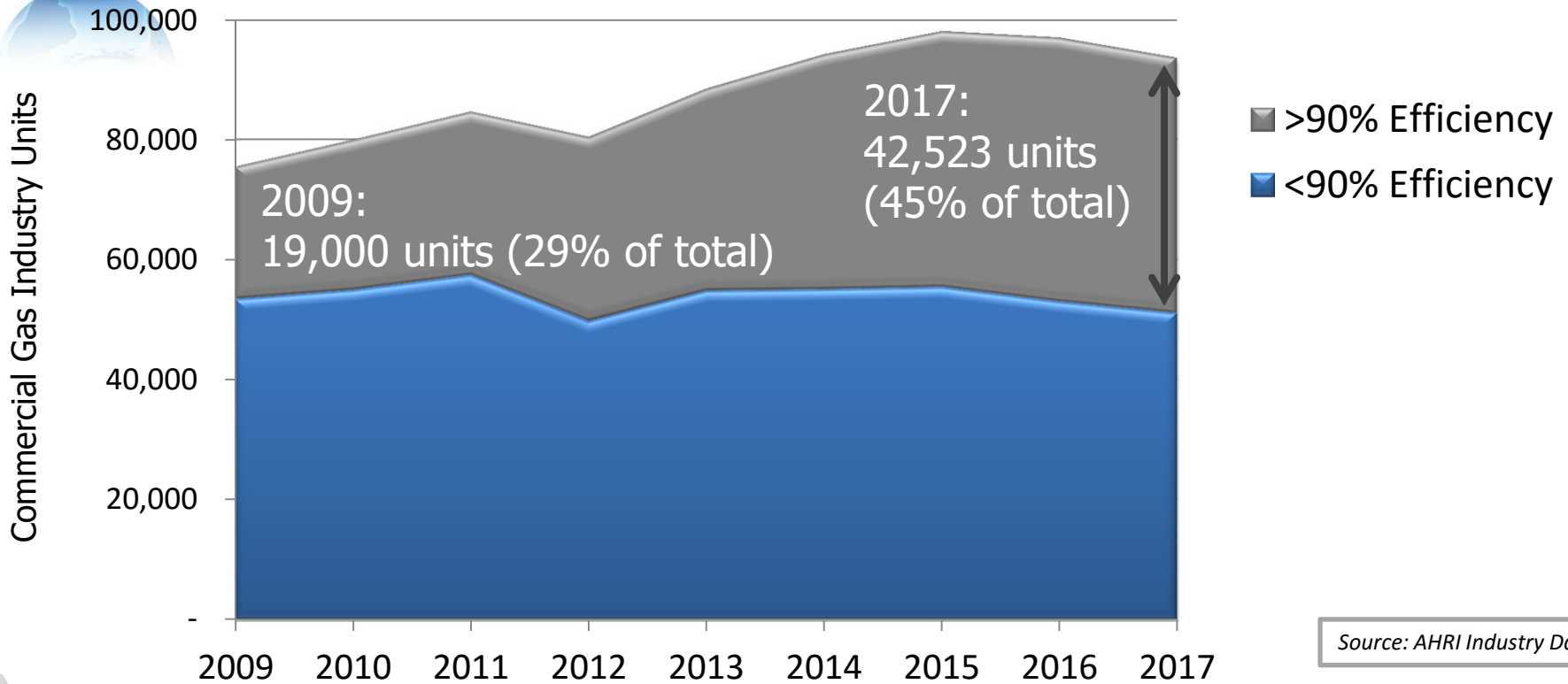
- Game changing energy efficient commercial product launched in 1997 and recently upgraded
- Up to 96% thermal efficiency dramatically lowers operating costs offering short payback
- Represents 63% of AOS commercial gas water heater revenues



*Innovation, training and 24/7 National account customer service drive market leadership*

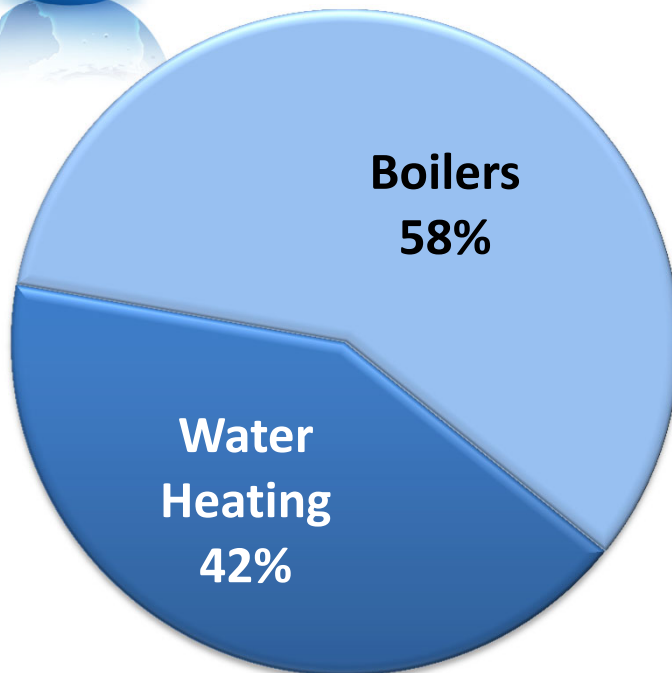


## U.S. Commercial Gas Market: Energy Efficient Units more than Doubled in Seven Years to 45 percent of units sold in 2017





## Lochinvar End Markets

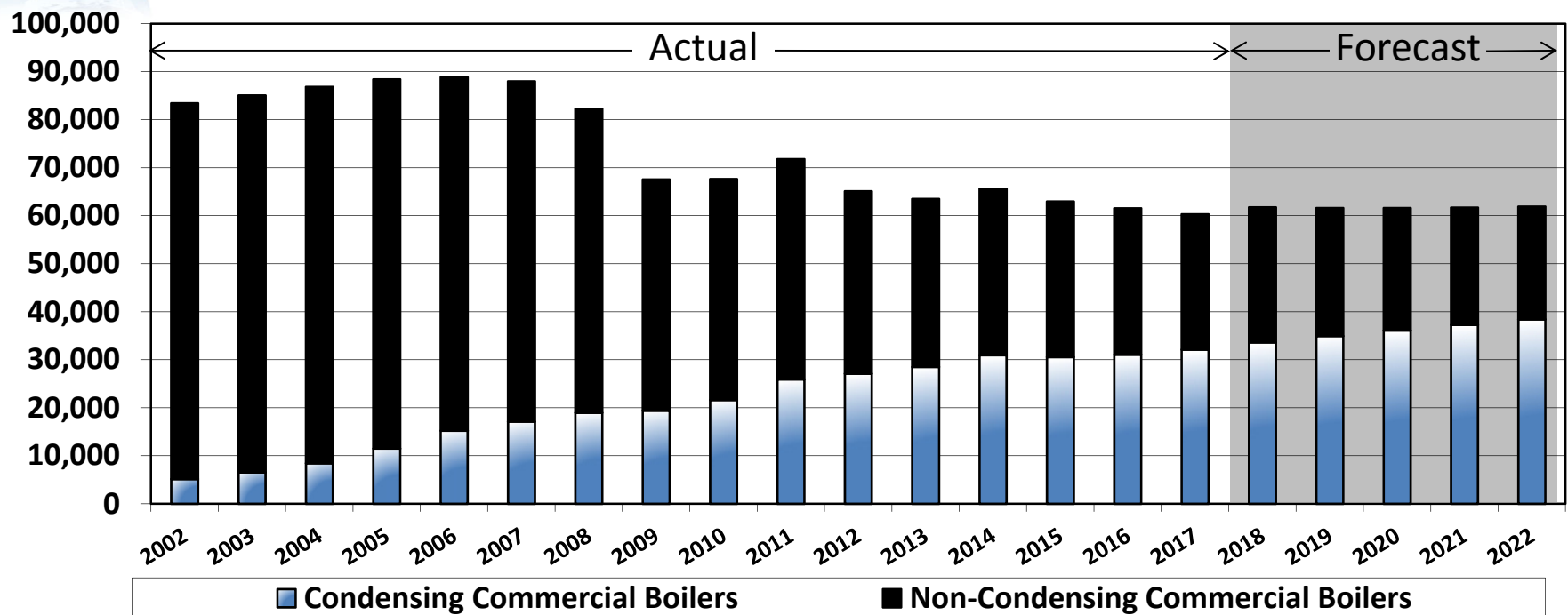


2/3 commercial end markets; 1/3 residential end markets



## Trend to Higher Efficiency, Condensing Boilers – 53 percent of units sold in 2017

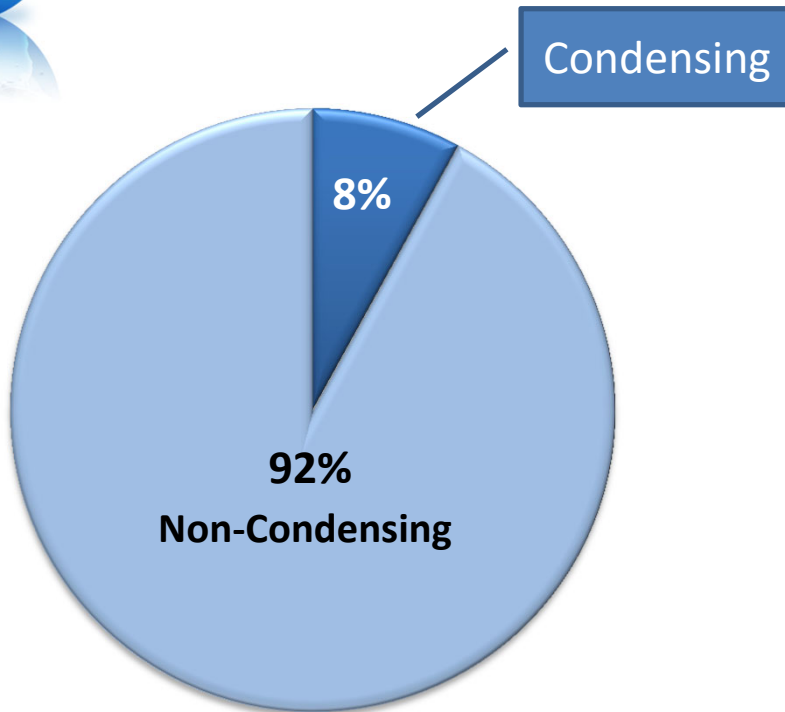
North American Commercial Boiler Volume (Units)



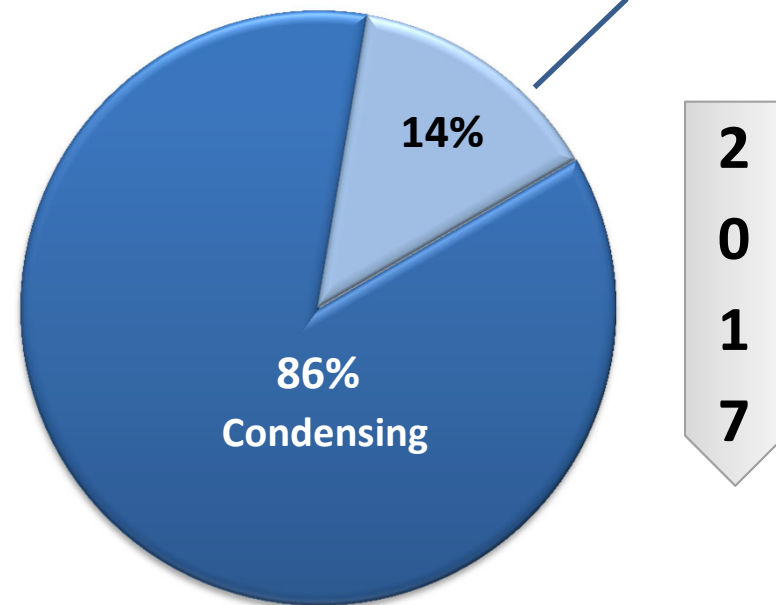


## Boiler Sales Dollars\* Condensing vs. Non-Condensing

2  
0  
0  
4



Non-Condensing



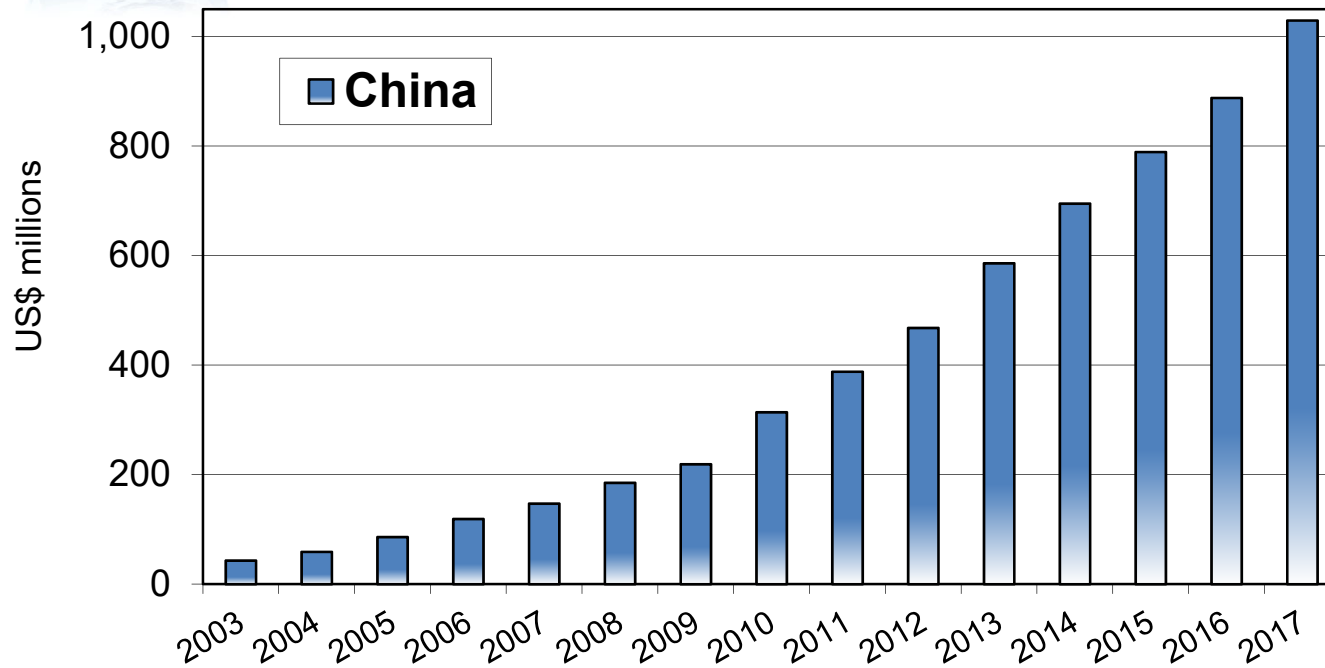
2  
0  
1  
7

\*Residential Boilers & Commercial Boilers





## China Exceeds \$1 B; now 34% of Sales & Growing



China sales have grown 21% (CAGR) over the last 10 years



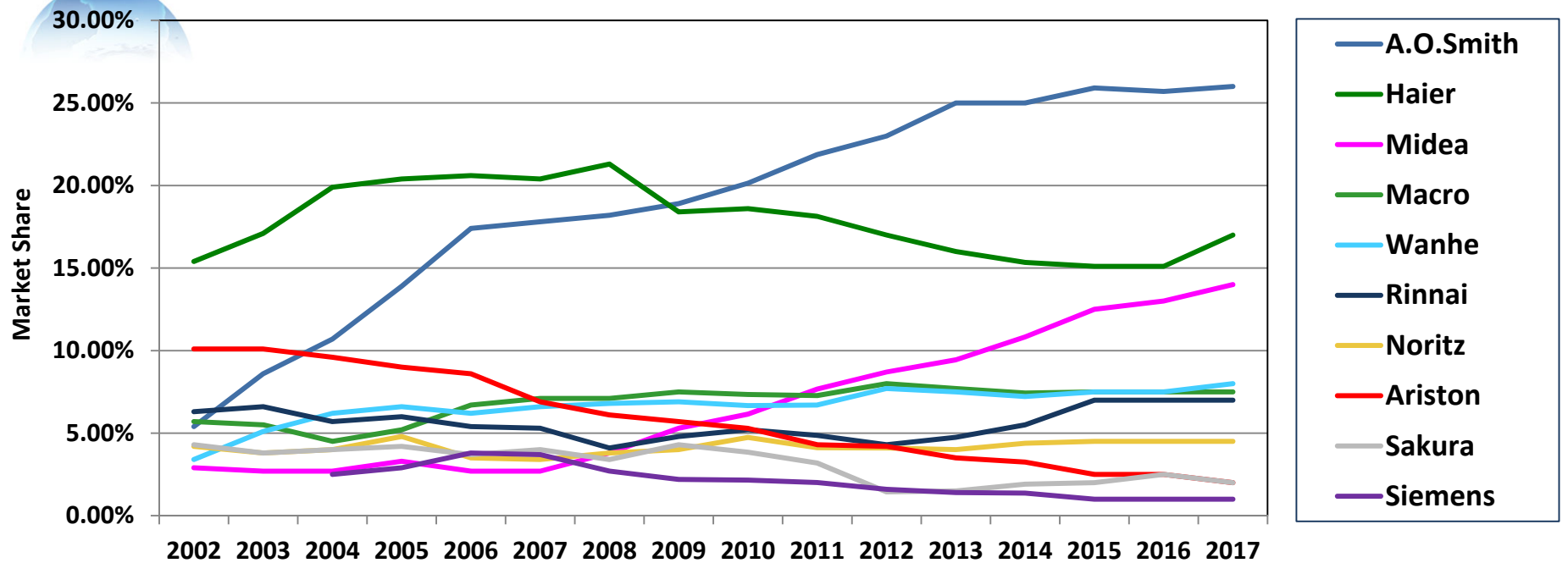
## AOS China Built on:

- Premium Brand
- Extensive Distribution and Service Network
- Innovative New Products & World Class Manufacturing
- Local Management Team and Organizational Development





# Fifteen Year Water Heater Market Share Trend

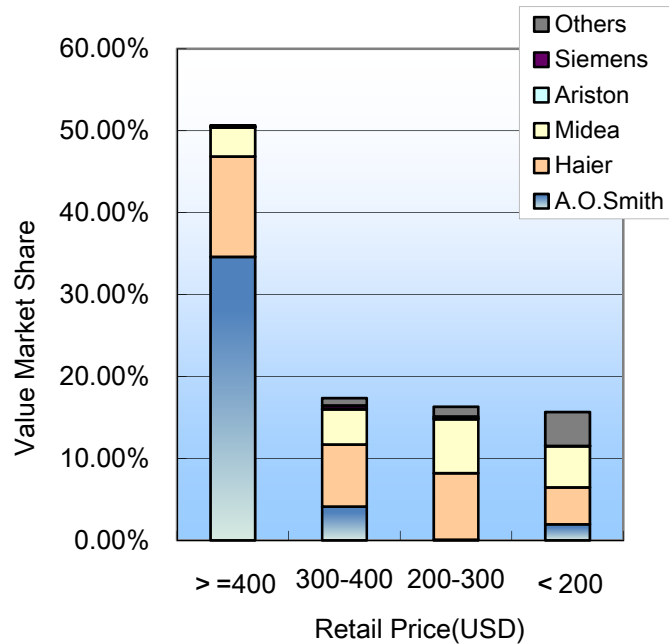


Leading residential brands measured in currency; Tier One Market: GFK - CMM data sampling several thousand largest retail stores, December 2017

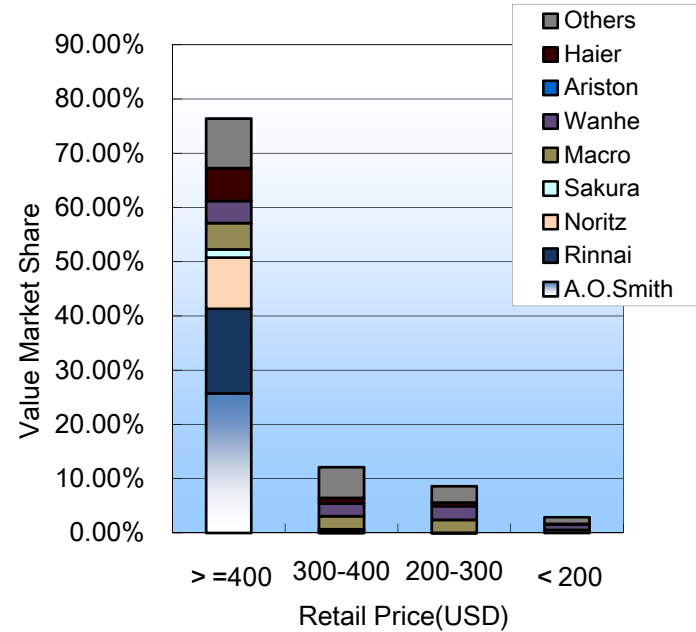


# Market Share by Price Category

## Electric Market Share



## Gas Market Share

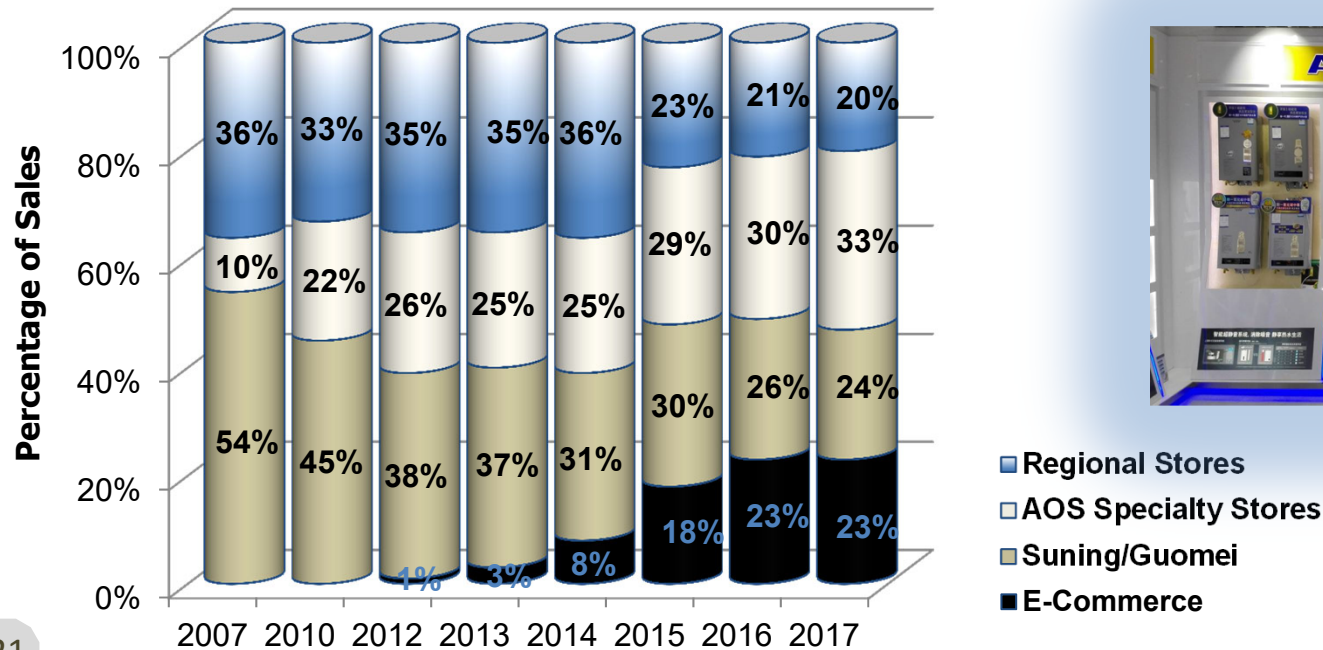


Data Source: CMM Retail Survey December 2017-150 Best Selling Models



# Broad Distribution Channel

- Over 9,000 retail counters in China
- 30% of outlets in Tier 1 cities; 70% in Tier 2/3 cities





# Product Line developed in China





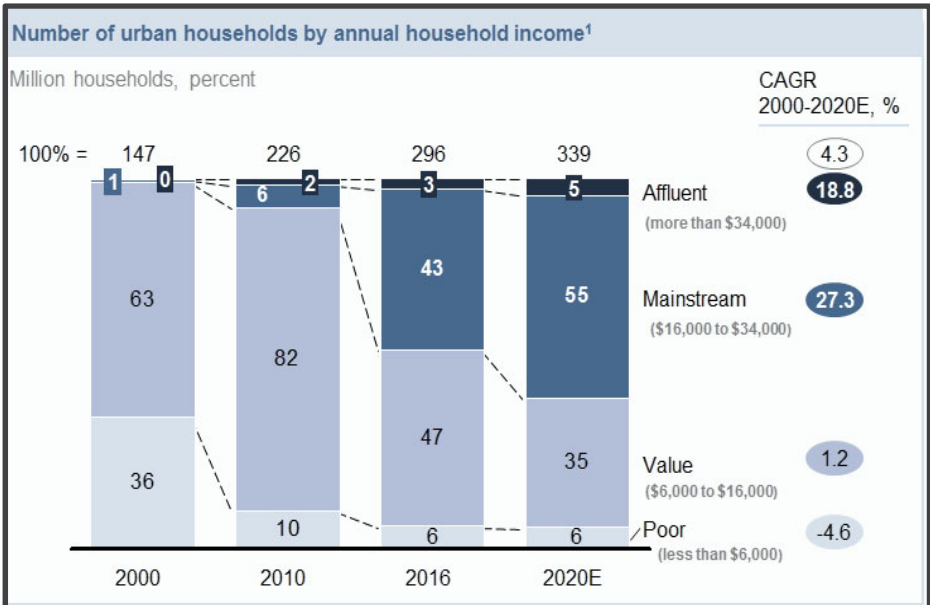
# Professional Team of Local Management





# Mega Trends - China

Significant growth in AOS target demographic



**A. O. Smith customer demographic continues to grow rapidly**

**Growth of 10 times during this decade**

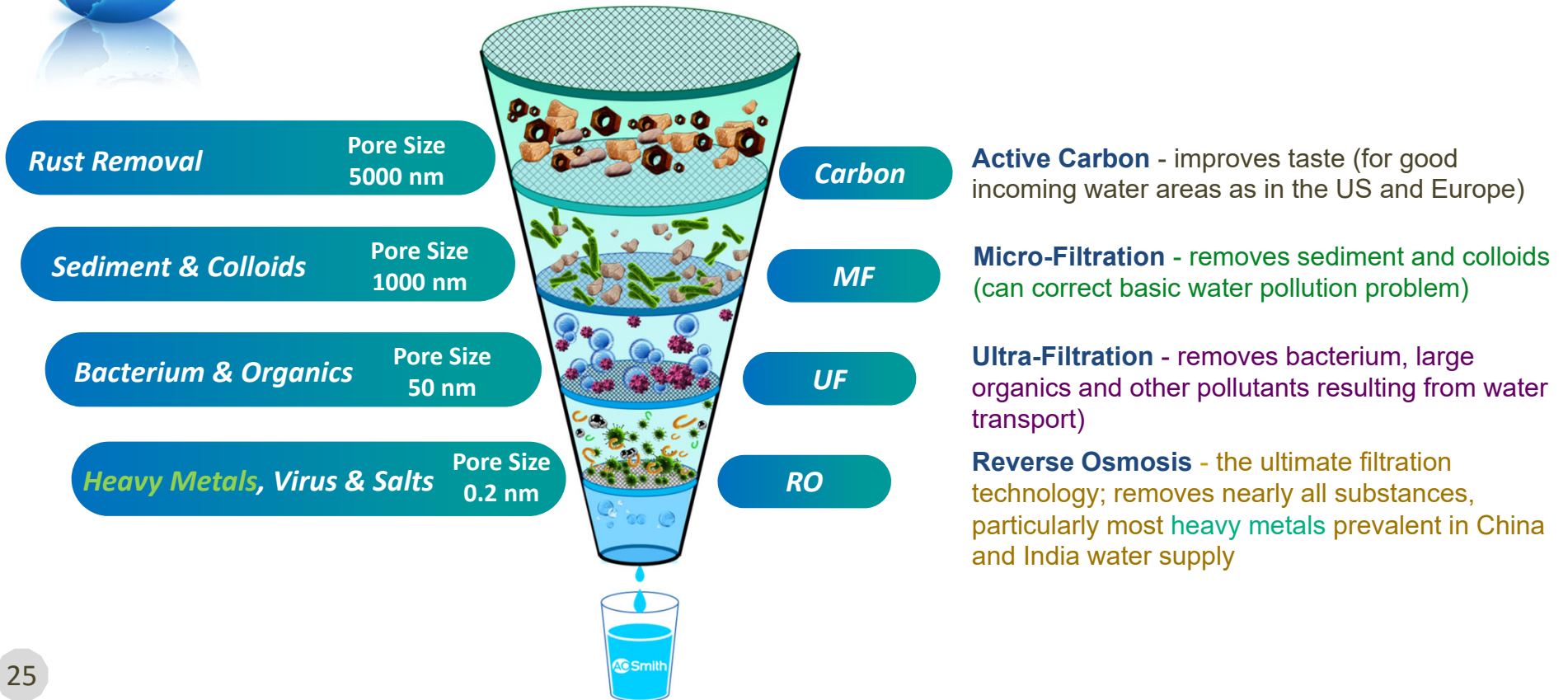
- 2010: 18 mm households
- 2020: 200 mm households

Source: McKinsey Insights China – December 2015





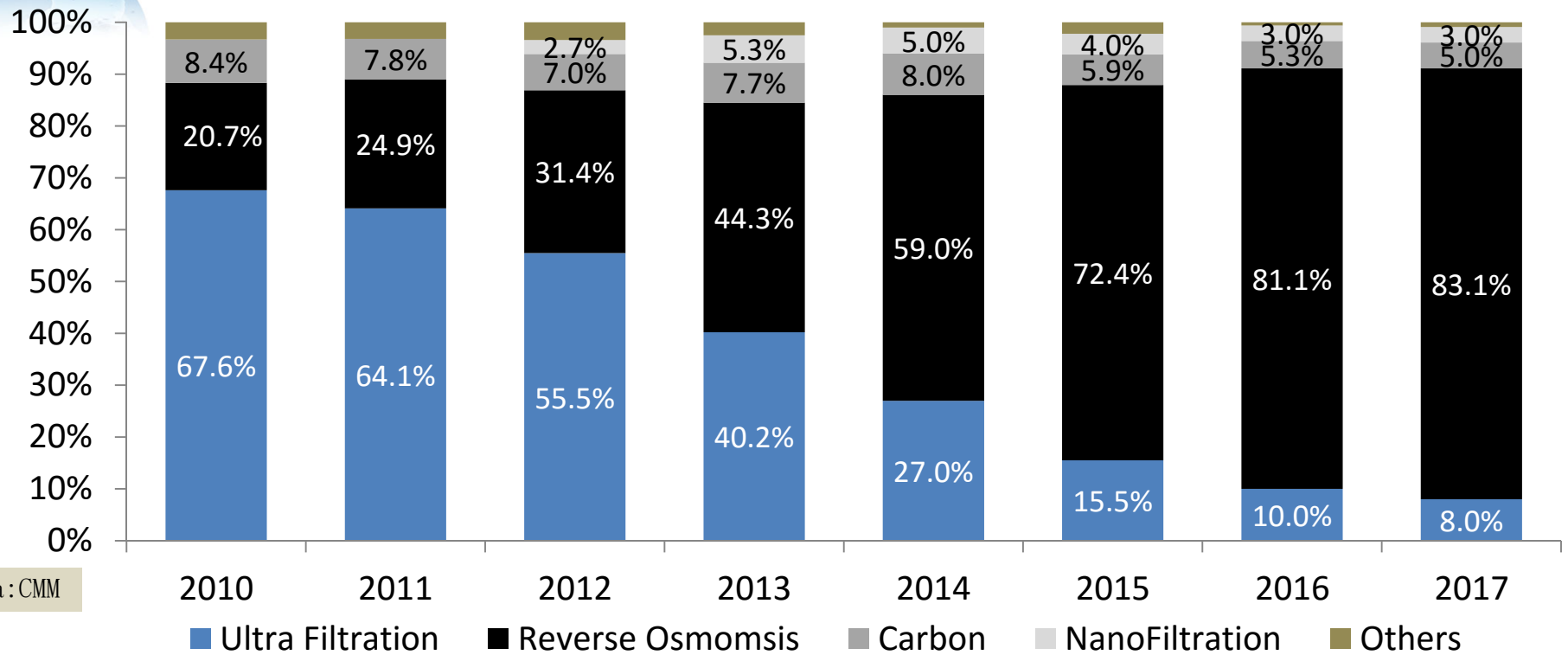
# Different Water Treatment Technologies





# Reverse Osmosis Is Gaining Market Share

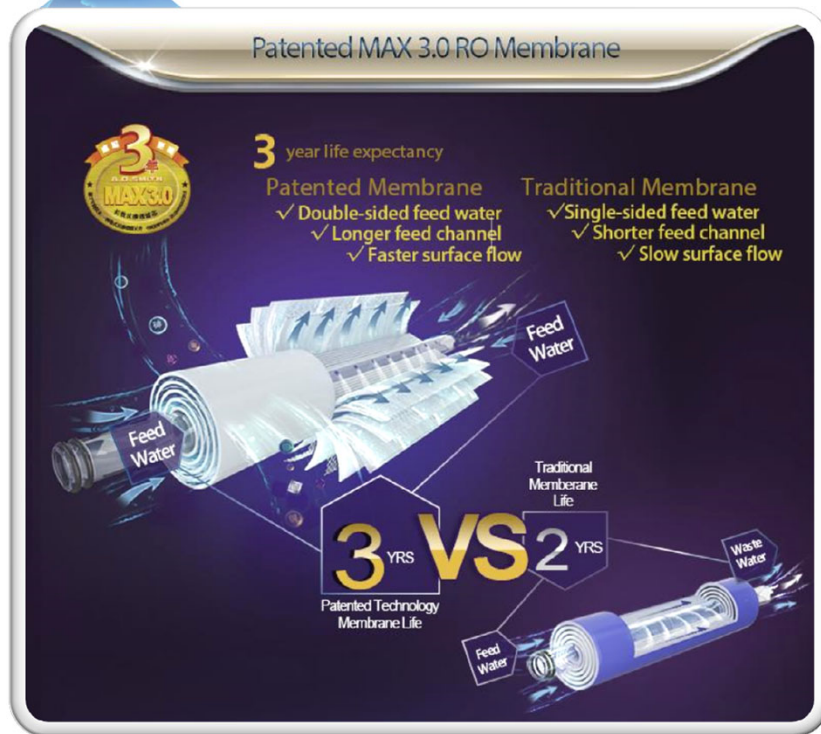
## CMM Water Treatment Market by Technology



Data: CMM



## Side Stream Membrane Technology



- Unique patented design
- Increases RO membrane life - industry leading three year life
- Reduces waste water up to 75% percent - 3 gallons clean to 1 gallon waste
- Provides market place differentiation

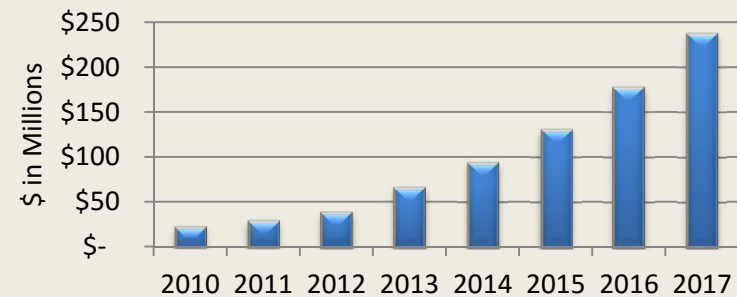


## Tankless water treatment – enabled by side-stream membrane technology

- Provides immediate clean water
- Minimizes risk of post RO membrane contamination
  - No storage tank needed
- Leverages membrane rolling capabilities to produce hi-flow RO products
  - Constant flow rates up to 0.9 gallons per minute

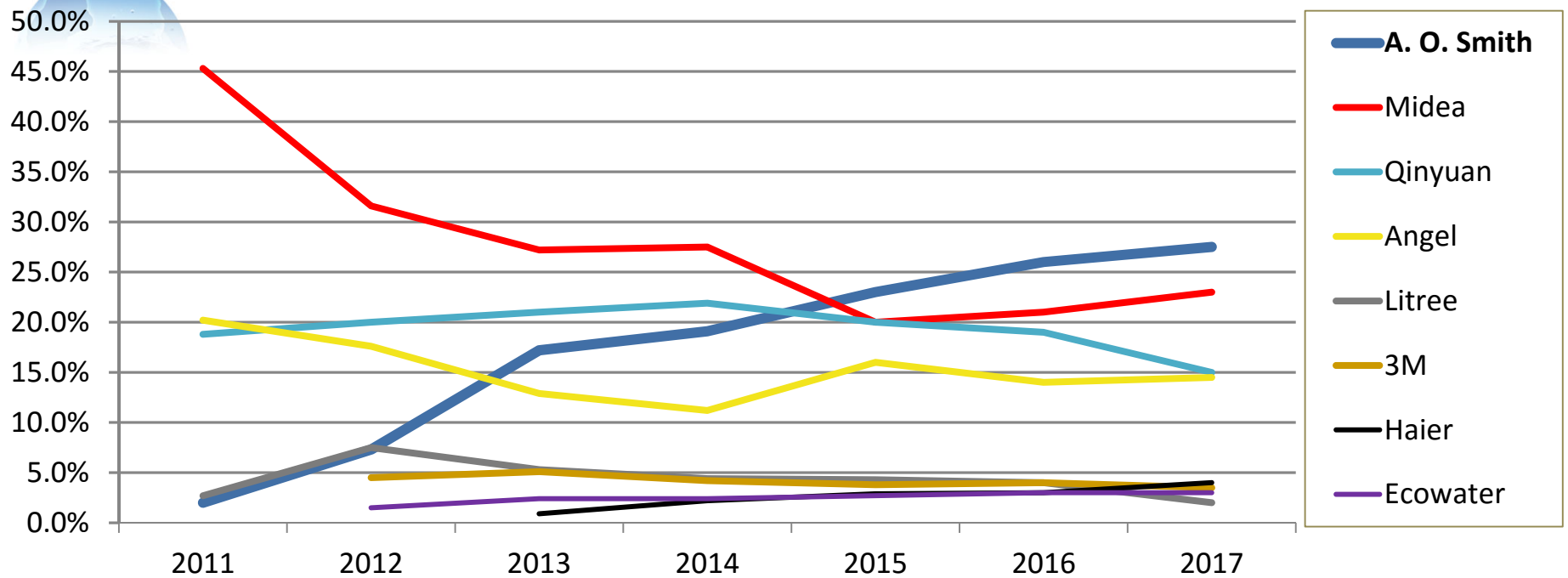


China Water Treatment Sales





## Major Brands CMM Market Share By Value Water Purifier



Data Source: CMM-GFK December -2017



# Air purifiers - the market need is clearly visible

Bird's Nest – Beijing:

PM 2.5  
45

PM 2.5  
453

A healthy  
day

A very  
unhealthy  
day



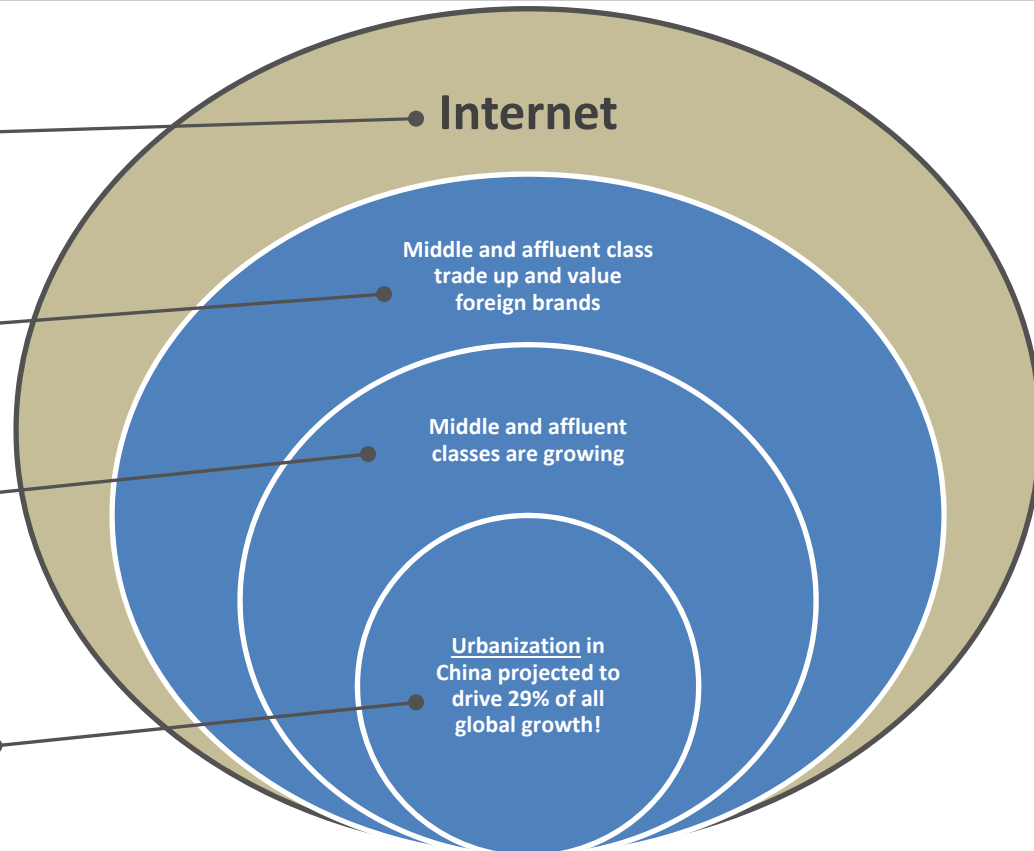
# China Mega Trends Driving Growth

- We are positioned to reach consumers using the internet

- A. O. Smith is a strong foreign brand

- Our Premium Consumer brand is positioned for the middle and affluent classes

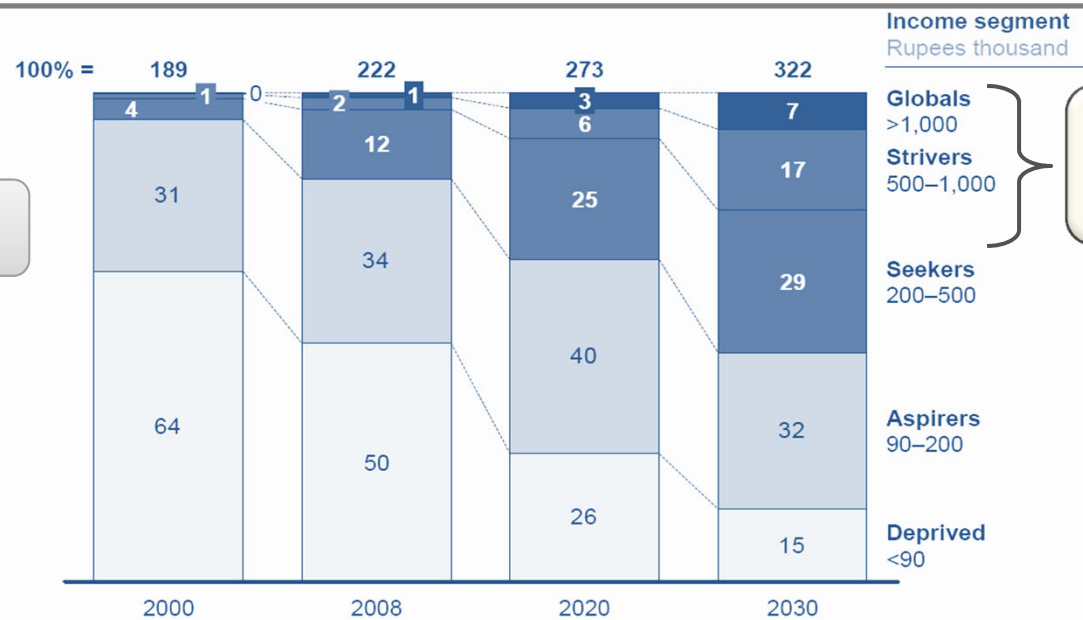
- A. O. Smith has manufacturing capacity and channel footprint to capitalize





# Mega Trends - India

## Significant growth in AOS target demographic



A. O. Smith target demographic: upper middle class

Millions of households, percent, 2000 prices

SOURCE: India Urbanization Econometric Model Updated 2010





# Building Distribution



- A cities (pop >1.5 Mn) Distribution in 25 out of 25 cities
- B Class cities (pop .5 to 1.5) Mn) Distribution in 63 of 68
- Class C cities (pop .1 to .5 Mn) Distribution 316 of 400

## NATIONAL RETAILERS



## REGIONAL RETAILERS



 Headquarters and Manufacturing (Bengaluru)

 Major Distribution Locations



## Business Model In India Similar to China

- Attractive Growth Demographics
- Leveraging Global Capabilities with Products Designed for the Indian Market
- Building Brand & Expanding our Distribution
- Introducing New Product Categories with Water Treatment
- Local Management



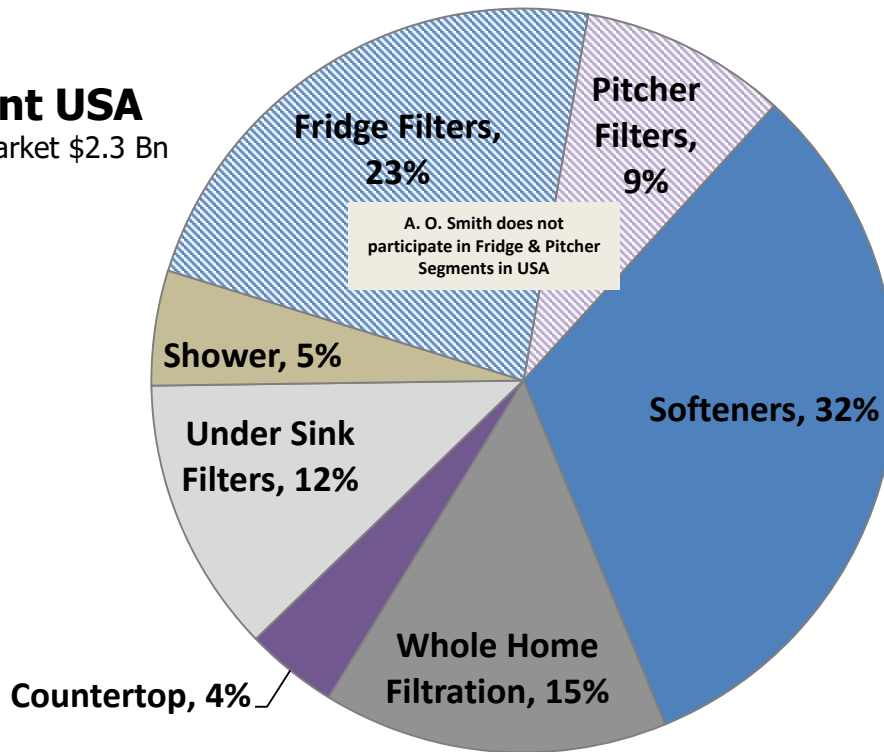
**We are committed for the long term opportunity**



# USA Water Treatment Segments

## Water Treatment USA

Addressable A. O. Smith Market \$2.3 Bn



## Estimated Total USA Market Size \$3.5 Bn\*

Market size as by equipment sales value

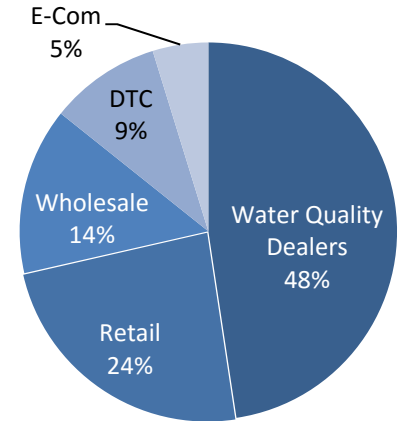
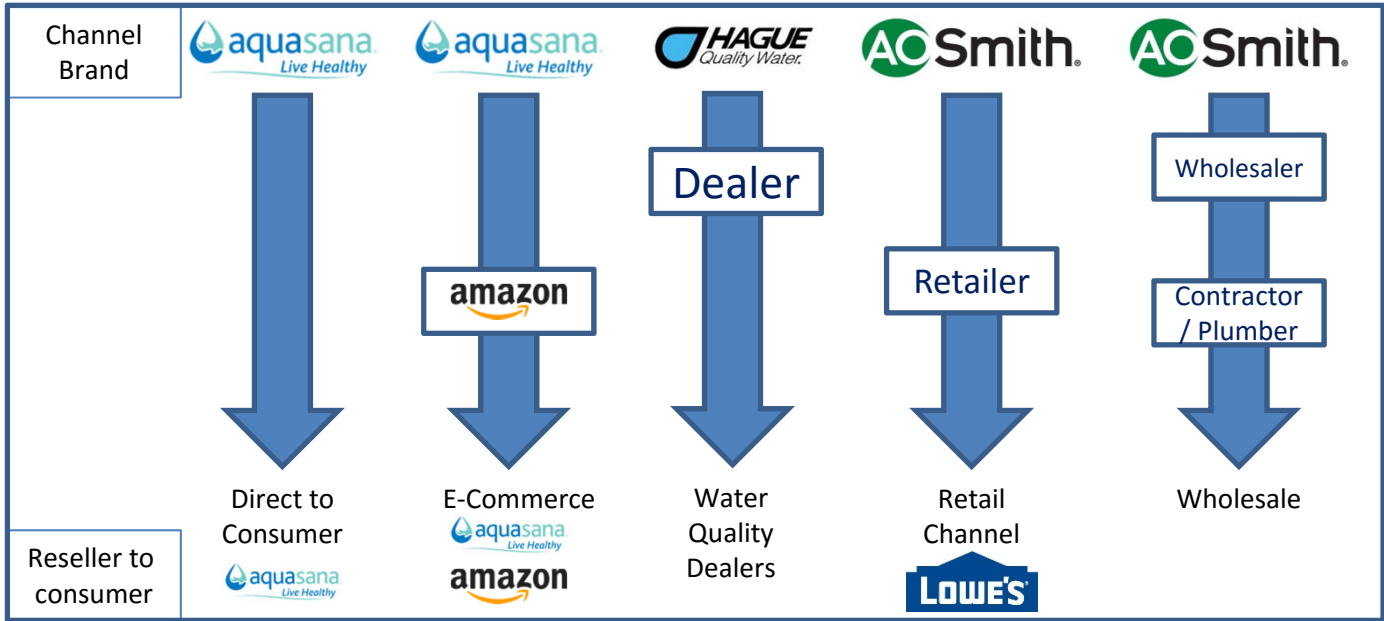
\*A. O. Smith Primary Quantitative, Market Segmentation Research, April 2017



# Complete Channel Strategy



## Water Treatment Channels



Sources:  
 • A. O. Smith Primary Quantitative, Market Segmentation Research, April 2017  
 • Water Quality Association 2017 Consumer Opinion Study

36 A. O. Smith can participate in all channels; most competitors operate in 1-2 of these channels



# Comprehensive Product Offering

## Point of Entry Products



Whole Home Filtration



Whole Home Softeners/Filters

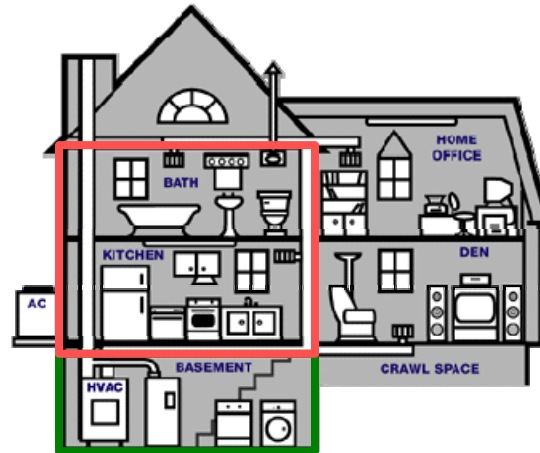


Image source: United States EPA Water Sense 2008

## Point of Use Products



Whole Kitchen Filtration



Tankless RO Systems

## Non-Installed Products



Clean Water Machine



On-the-Go Filter Bottles



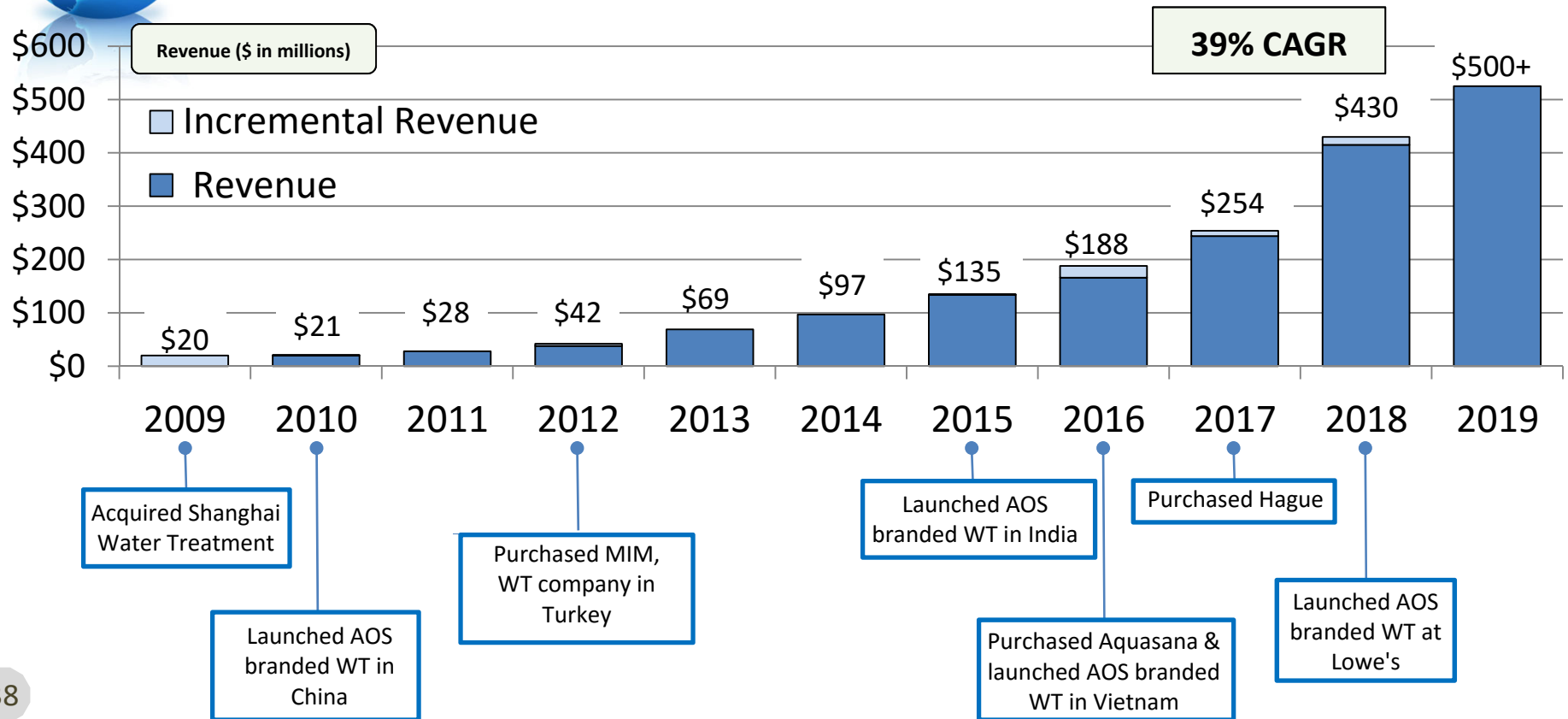
Traditional RO Systems



Under Sink Filtration



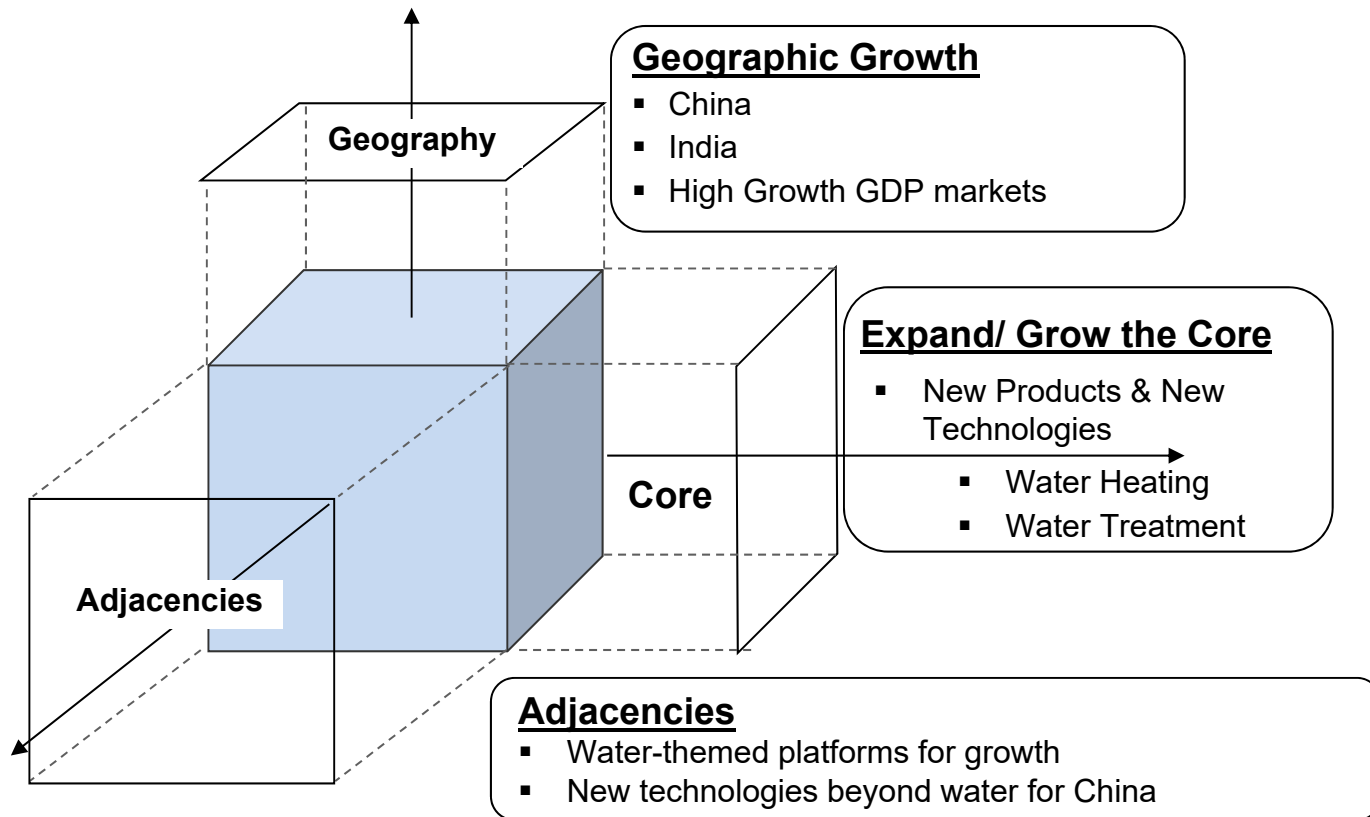
# Evolution of Global Water Treatment



# Acquisition Strategy



# Growth Strategy: Acquisitions







## Investment Criteria

- Value creation opportunities
- ROIC in excess of cost of capital by 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

**AOS**  
LISTED  
**NYSE**



## A. O. Smith's Capital Allocation Options

- Organic growth (capital expenditures)
- Acquisitions
  - \$425 million net cash
  - 10 percent leverage ratio (debt/total capital)
- Return cash to shareholders: over \$330 million projected in 2018
  - Dividends
    - Increased dividend two times in 2018; over 30 percent CAGR over last five years
  - Share repurchase
    - Expect to repurchase approximately \$135 million\* in 2018 on a 10b5-1 plan, in addition, plan to opportunistically repurchase \$65 million in the open market



# Investment Case: Growth and Stability



**Above Average Growth**

**Strong Cash Flow**

**Margin Expansion**

**High Replacement Demand**

**Attractive Dividend Yield**

**Optionality of Balance Sheet**

# INVESTOR CONTACT

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Email: [packerman@aosmith.com](mailto:packerman@aosmith.com)

# APPENDIX



## Third Quarter Results

\$ in millions

	2018	2017	change	% chg.
Sales	\$ 754.1	\$ 749.9	\$ 4.2	1%
Net Earnings	\$ 104.6	\$ 93.7	\$ 10.9	12%
Earnings Per Share	\$ 0.61	\$ 0.54	\$ 0.07	13%



## Third Quarter Sales

\$ in millions

	2018	2017	change	% chg.
North America	\$ 486.9	\$ 486.0	\$ 0.9	Flat
Rest of World	274.1	270.1	4.0	1%
Intersegment	<u>(6.9)</u>	<u>(6.2)</u>	<u>(0.7)</u>	
Total	<u>\$ 754.1</u>	<u>\$ 749.9</u>	<u>\$ 4.2</u>	1%



## Third Quarter Earnings

\$ in millions, except percentages

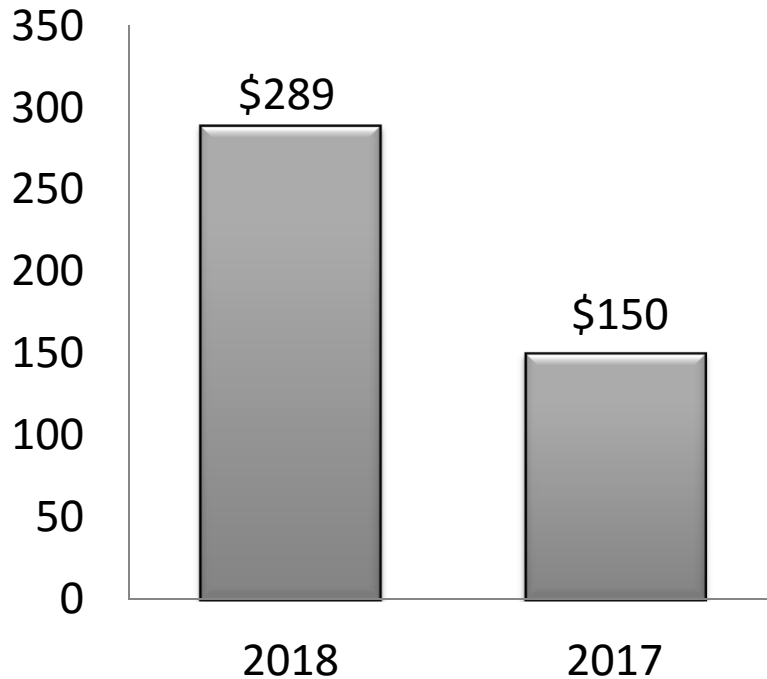
	2018	2017	change	% chg.
<u>Segment Earnings</u>				
North America	\$ 105.6	\$ 110.2	\$ (4.6)	-4%
Rest of World	<u>39.1</u>	<u>33.8</u>	<u>5.3</u>	16%
Total Segment Earnings	144.7	144.0	\$ 0.7	Flat
Corporate	(11.2)	(9.9)	(1.3)	-15%
Interest Expense	<u>(2.0)</u>	<u>(2.5)</u>	<u>0.5</u>	
Pre-tax Earnings	131.5	131.6	(0.1)	Flat
Tax Provision	<u>(26.9)</u>	<u>(38.0)</u>	<u>-</u>	
Net Earnings	\$ <u>104.6</u>	\$ <u>93.7</u>	\$ <u>10.9</u>	12%
<u>Segment Margin</u>				
North America	21.7%	22.7%		
Rest of World	14.3%	12.5%		





## Year-do-date Cash Flow from Operations

(\$ in millions)



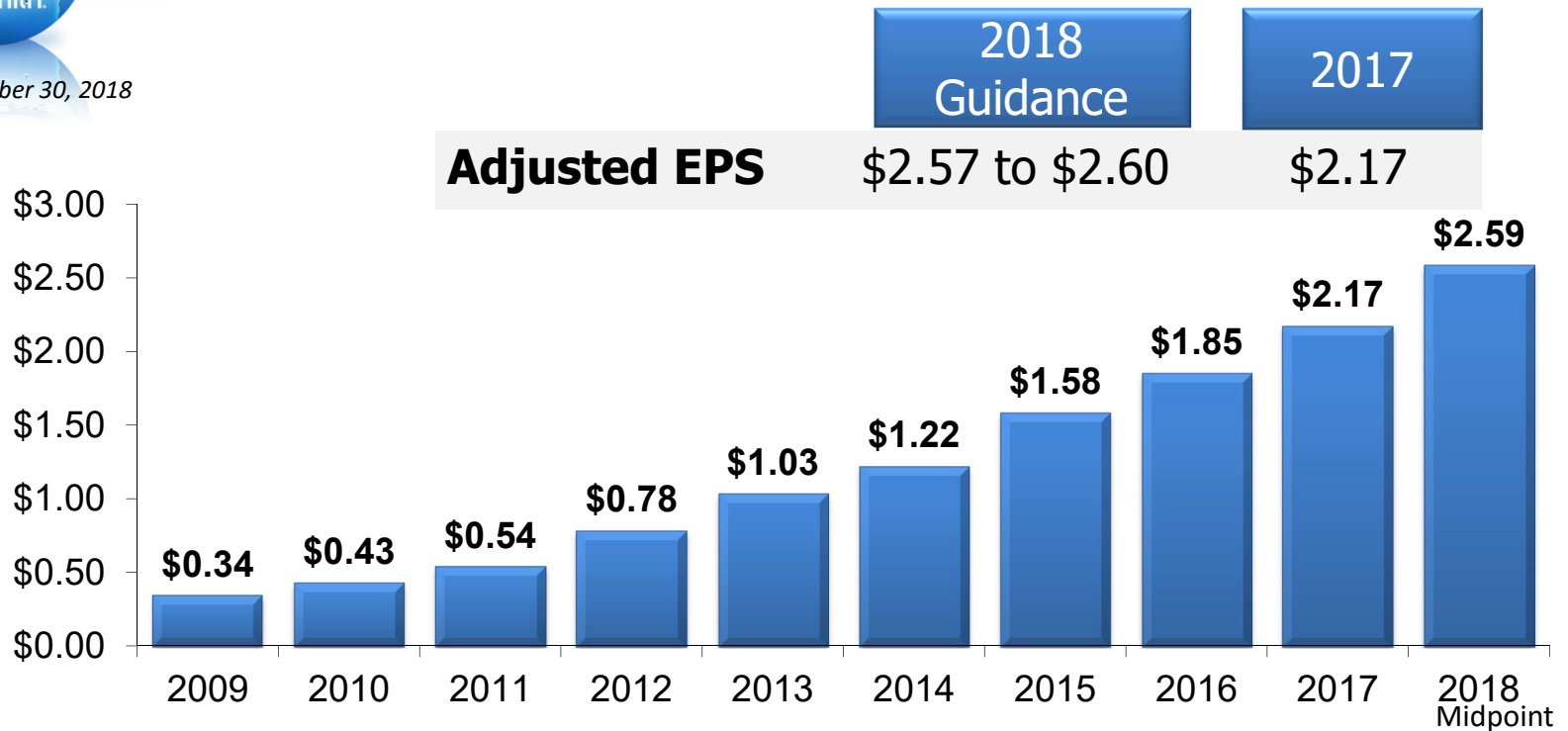
### Highlights

- Operating cash provided by operations of \$289 million
- Debt to capital ratio of 10%
- Cash balance: \$618 million
- Net cash position: \$425 million
- Stock repurchase: 1.7 million shares totaling approximately \$106 million



As of October 30, 2018

## 2018 EPS Guidance and 2017 EPS



Note: 2009 through 2014 and 2017 and 2018 are adjusted EPS and all years are adjusted for stock splits

\* 2017 excludes \$0.47 per share related to U.S. tax reform

\* 2018 excludes \$0.03 per share related to plant closing



## 2018 Assumptions

(\$ in millions)

2018 Projections

Operating Cash Flow	approximately	\$ 475
Capital Expenditures	approximately	\$ 85
Depreciation and Amortization	approximately	\$ 75
Corporate/Other Expense	approximately	\$ 48
Effective Tax Rate	approximately	21%
Stock Repurchase	approximately	\$ 200*
Share Count - Diluted	approximately	172.5 million

\*subject to acquisitions, cash flow and working capital needs

*As of October 30, 2018*



## 2018 Outlook

- U.S. residential water heater industry volumes increase approximately 250,000 to 300,000 units, including tankless;
- U.S. commercial water heater volumes down approximately five percent
- Announced 10% average price increase on U.S. wholesale water heaters related to steel and other cost inflation effective early June
- Total year China currency translation benefits (\$12 million drag during Q4)
- Smaller expected losses in India than in 2017
- Lower China sales growth
- NA water treatment Lowe's launch



## 2018 Outlook - continued

- Revenue growth approximately seven percent in USD
- Adjusted EPS between \$2.57 and \$2.60
- North America adjusted segment margin expected to be approximately 22.50 percent
- Rest of World segment margin expected to be approximately 13 percent
- Preliminary 2019 revenue guidance: grow 5.5 to 7 percent in local currency and 4 to 5.5 percent in USD



## Adjusted 2018 EPS Guidance and Adjusted 2017 EPS

(unaudited)

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

	2018 Guidance	2017
<b>Diluted EPS (GAAP)</b>	\$ 2.54 - 2.57	\$ 1.70
Restructuring and impairment per diluted share	0.03	-
U.S. Tax Reform income tax expense per diluted share	<u>-</u>	<u>0.47</u>
<b>Adjusted EPS</b>	\$ <u>2.57 - 2.60</u>	\$ <u>2.17</u>



# Corporate Responsibility and Sustainability – Aligns with our Values

A. O. Smith will preserve its good name



Social Contribution



A. O. Smith will be a good citizen

Environmental Impacts



Ethics and Compliance  
Fundamentals for Success



A. O. Smith will emphasize innovation



Diverse & Safe Workforce



A. O. Smith will be a good place to work

Product Responsibility





## Products – Efficiency, Conservation and Innovation

### Energy Efficiency

- We believe our global product portfolio is the most efficient in the industry
- Our electric residential water heaters achieve efficiency factors of .95 or above
- Our highly efficient Cyclone condensing commercial water heaters represent 24% of commercial units sold
- 83 percent of Lochinvar branded boilers achieve over 90 percent thermal efficiency
- 55 percent of our China products exceed government efficiency standards

### Conservation

- Our patented Reverse Osmosis (RO) membrane wastes 50 percent less water than traditional RO and represents over 90 percent of A. O. Smith branded water treatment sales







## Manufacturing Plants – Reducing Energy Usage, Water Consumption and Environmental Impacts

- Chairman's Green Star award established in 2009– annual competition given to the plant which demonstrates the largest social, economic and environmental benefit over a three year period
- Johnson City, TN - plant certified Leadership in Energy and Environmental Design (LEED) Silver since 2011 and certified Energy Star ®
- Ashland City, TN - largest water heater plant in the world – reduced electricity usage by 9 percent as a result of a plant-wide lighting project in 2011 and reduced water usage by 36 percent as a result of an enhanced parts washing process implemented in 2014
- Nanjing, China – implemented an innovative pre-treatment process as an alternative to phosphorus pre-treating, reducing chemical discharges and improving corrosion resistance of our water heater tanks





## People – Doing Business Safely, with Integrity and Supporting Communities

- Established in 1954, the President's Safety Award annually recognizes the plant with best record for workplace safety
- Established in 1955, the A. O. Smith Foundation supports our communities
- Guiding Principles established in 1999 describes our code of conduct and values
- Values Recognition Program established in 1995 recognizes employee contributions to community involvement

