



INNOVATION HAS A NAME. 2019 ANNUAL REPORT







Corporate Profile



A. O. Smith Corporation is a global leader applying innovative technologies and energy-efficient solutions to products manufactured and marketed worldwide. The company is one of the world's leading manufacturers of residential and commercial water heating equipment and boilers, as well as a manufacturer of water treatment products for residential and light commercial applications.

A. O. Smith is headquartered in Milwaukee, Wisconsin, with approximately 15,100 employees at operations in the United States, Canada, China, India, Mexico, the Netherlands, Turkey, the United Kingdom and Vietnam.

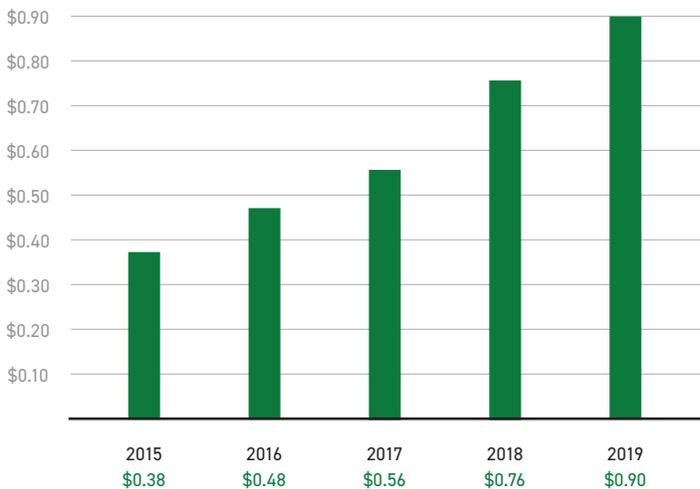
A. O. Smith Corporation is listed on the New York Stock Exchange and is part of the S&P 500 Index. The company has paid cash dividends on its common stock every year since 1940.

By the Numbers

As a global leader in water heating and boilers, A. O. Smith Corporation has a track record of success and a well-established history of strong dividend payouts. The 5-year compound annual growth rate of A. O. Smith's dividend is 25 percent.

DIVIDENDS

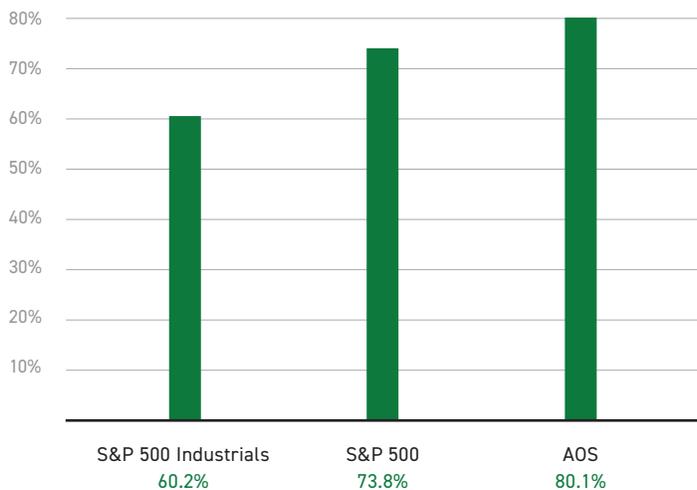
5-YEAR DIVIDEND CAGR: 25%



TOTAL STOCK RETURN

5-YEAR CUMULATIVE

As of December 31, 2019



Registrar, Stock Transfer Agent,
Dividend Reinvestment Agent
(for both classes of stock)

EQ Shareowner Services
1110 Centre Pointe Curve, Suite 101
Mendota Heights, MN 55120
800-468-9716

www.shareowneronline.com

Annual Meeting

The 2020 annual meeting of shareholders will be held on Wednesday, April 15, 2020, at 8:00 a.m. (CDT) at the Hilton Nashville Downtown, 121 4th Avenue South, Nashville, TN 37201.

Global Locations

A. O. Smith Corporation has a strong and growing presence around the globe. Employees live and work in 12 countries, and serve customers in more than 60 countries around the world.

GLOBAL LOCATIONS

Milwaukee, WI
(world headquarters)

Appleton, WI

Ashland City, TN

Austin, TX

Banbury, England

Bangalore, India

Bourges, France

Charlotte, NC

Cookeville, TN

Dubai, United Arab
Emirates

El Paso, TX

Fergus, Canada

Florence, KY

Franklin, TN

Groveport, OH

Haltom City, TX

Hanoi, Vietnam

Hong Kong SAR

Istanbul, Turkey

Johnson City, TN

Juarez, Mexico

Knoxville, TN

Lebanon, TN

McBee, SC

Nanjing, China

Nashville, TN

Phillipsburg, KS

Stratford, Canada

Veldhoven,
the Netherlands



Letter to Shareholders

MARCH 2020

Dear Shareholders:

As we put a close to the last decade, I would like to take this opportunity to reflect for a moment on 2019, and also share with you some of my thoughts for 2020 and beyond.

In 2019, A. O. Smith Corporation marked its 145th year in business, which is not a small feat and not something to be taken lightly. We've been able to thrive and grow over the decades by staying true to who we are: innovators who are providing top-of-the-line, cutting-edge solutions to today's toughest and most challenging water heating and water treatment issues.

I'm proud to say that, last April, we further fortified our forward-thinking team and continued to expand our capabilities with the \$107-million acquisition of Water-Right, Inc., a family-founded provider

of residential and commercial water quality solution products and systems for a wide variety of applications, including well water. The Appleton, WI-based company has already begun to prove its great value as the newest member of the A. O. Smith organization — meeting sales and financial targets in 2019. Just as important as we look to the future, Water-Right has further strengthened A. O. Smith's presence in the water quality dealer channel and specialty wholesale channel. And I am pleased to share that our growing platform of North America Water Treatment gained operating stabilization and further traction in 2019.

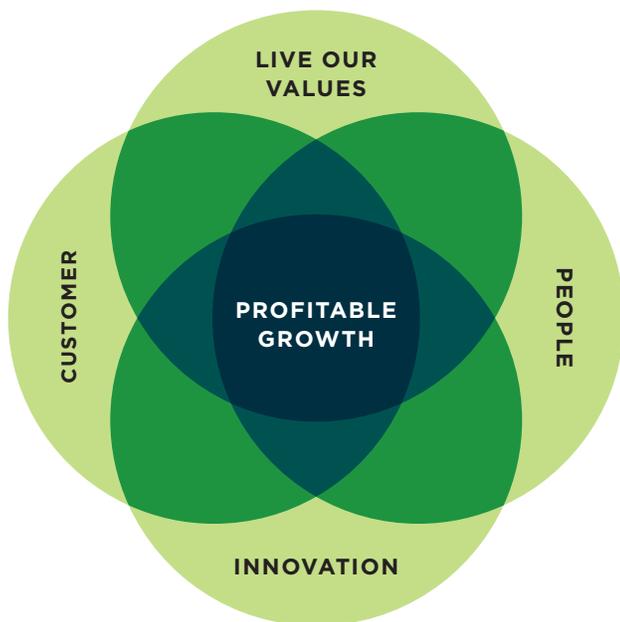


At Water-Right in Appleton, WI

Sales in our North America segment increased two percent to \$2.1 billion in 2019 compared with 2018, and it marked our fifth consecutive year of margin expansion. In China, we experienced headwinds. Our sales of \$827 million were negatively impacted by the overall economy in China, improvements in the channel inventory position held by our customers and a weaker China currency. Actions by our team in China in 2019 should put us in a better cost position as we enter 2020. Sales in India grew 13 percent in 2019, and we continue on our path to achieve breakeven performance in 2020. Ultimately, as a company, A. O. Smith was able to achieve \$3.0 billion in sales and \$370 million in net earnings in 2019, or \$2.22 per share.

As we have for the last several years, in 2019, we returned significant cash to our shareholders, repurchasing approximately 6.1 million shares of common stock for approximately \$288 million. In October, we also announced a dividend increase, with the five-year compound annual growth rate of our dividend at 25 percent. To that end, we proudly continued our status as an S&P 500 Dividend Aristocrat — a select group of a few dozen S&P 500 index members with a track record of increasing dividends for 25 consecutive years or more.

**A. O. SMITH'S
FUNDAMENTALS FOR SUCCESS**



At Hague Quality Water International® in Groveport, OH

A. O. Smith continues to be well positioned for the future, with a strong balance sheet and liquidity position. Cash provided by operations last year was approximately \$456 million. Our debt-to-capital ratio was 15 percent at the end of 2019. We have cash balances totaling approximately \$551 million, and our net cash position was approximately \$267 million at the end of the year.

Furthermore, in 2019, we continued to set the stage for the future by focusing on our company's time-tested formula for profitable growth — A. O. Smith's Fundamentals for Success. This four-pronged, long-term strategy keeps us true to who we are, while delivering the very best to our many constituencies.



At the A. O. Smith plant in Charlotte, NC

PEOPLE

To deliver the very best in innovations, we know that we need to hire, train and retain top-level talent. In 2019, we demonstrated strength in that arena as we secured numerous Top Workplace awards around the globe and in the communities where we work.

INNOVATION

Our teams proudly introduced an array of innovations to proactively address and provide customer-centric solutions to water heating and water treatment concerns worldwide. We're pleased to have the opportunity to showcase just a few of those innovative solutions in the last several pages of this annual report.

CUSTOMER

Our customers are key to our success. To that end, we were pleased to open several new and enhanced training centers in Ashland City, TN and China to ensure that our many contractors and valued partners have the hands-on learning opportunities they need to be successful with both installations and product service calls.



A. O. Smith employees at a community volunteering event in Milwaukee, WI

LIVE OUR VALUES

Above all, we remained focused on adhering to our Guiding Principles, the standards of conduct required of all A. O. Smith employees worldwide, and on carrying out our work with a single set of values: the A. O. Smith Values. That means doing business honestly, with integrity, and being good corporate citizens. In 2019, we built on our corporate responsibility and sustainability efforts as we worked toward establishing key performance indicators and goals that we will be measuring ourselves against in the future.

I'm excited, encouraged and inspired by the many great things that our teams have in the pipeline. As a global leader in the water technology industry, we believe that it is not only our opportunity — but our duty — to push the boundaries and bring cutting-edge ideas to life. We look forward to introducing many of those to the market in 2020. We couldn't do all of that without you — our shareholders — and your ongoing trust and support. Thank you for giving us this opportunity to be stewards of your investment as we create and shape the water technology of tomorrow.

Sincerely,

Kevin J. Wheeler
President and Chief Executive Officer



At A. O. Smith's Corporate Technology Center in Milwaukee, WI

Board of Directors

Kevin J. Wheeler

President & Chief Executive Officer
Elected to Board 2017²

Idelle K. Wolf

Retired President,
Barnes Distribution
Elected to Board 2005¹

Ajita G. Rajendra

Executive Chairman &
Former Chief Executive Officer
Elected to Board 2011²

Ronald D. Brown

Former Vice Chairman,
The Armor Group
Elected to Board 2001^{3,4}

Mark D. Smith

Retired Business Manager,
Strattec Security Corporation
Elected to Board 2001¹

Bruce M. Smith

Retired Chairman of the Board
of Managers & Former Chief
Executive Officer, Smith
Investment Company LLC
Elected to Board 1995^{2,3,4}

Paul W. Jones

Retired Executive Chairman
& Former Chief Executive Officer
Elected to Board 2004^{3,4}

Gene C. Wulf

Retired Director, Executive
Vice President & Chief Financial
Officer, Bemis Company, Inc.
Elected to Board 2003¹

William P. Greubel

Retired Chief Executive
Officer & Director, Wabash
National Corporation
Elected to Board 2006^{3,4}

Dr. Ilham Kadri

Chief Executive Officer
& Director, Solvay S.A.
Elected to Board 2016¹



From left to right, front to back, pictured at the Lochinvar facility in Lebanon, TN.

¹ Audit Committee

² Investment Policy Committee

³ Nominating and Governance Committee

⁴ Personnel and Compensation Committee

Senior Leadership



Patricia K. Ackerman

Senior Vice President, Investor Relations, Treasurer & Corporate Responsibility and Sustainability



Paul R. Dana

Senior Vice President – Global Operations



Anindadeb V. DasGupta

Senior Vice President – International; President – A. O. Smith Holdings (Barbados) SRL



Wallace E. "Eddie" Goodwin

Senior Vice President; President & General Manager – Lochinvar, LLC



Helen E. Gurholt

Vice President & Controller



Dr. Robert J. Heideman

Senior Vice President – Chief Technology Officer



D. Samuel Karge

Senior Vice President; President – North America Water Treatment



Daniel L. Kempken

Senior Vice President – Strategy & Corporate Development



Charles T. Lauber

Executive Vice President & Chief Financial Officer



Peter R. Martineau

Senior Vice President – Chief Information Officer



Mark A. Petrarca

Senior Vice President – Human Resources & Public Affairs



Ajita G. Rajendra

Executive Chairman



James F. Stern

Executive Vice President, General Counsel & Secretary



David R. Warren

Senior Vice President; President & General Manager – North America Water Heating



Kevin J. Wheeler

President & Chief Executive Officer

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2019

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 1-475

A. O. Smith Corporation

(Exact name of registrant as specified in its charter)

Delaware

(State of Incorporation)

11270 West Park Place, Milwaukee, Wisconsin
(Address of Principal Executive Office)

39-0619790

(I.R.S. Employer Identification No.)

53224-9508
(Zip Code)

(414) 359-4000

Registrant's telephone number, including area code

Securities registered pursuant to Section 12(b) of the Act:

<u>Title of Each Class</u>	<u>Shares of Stock Outstanding January 31, 2020</u>	<u>Name of Each Exchange on Which Registered</u>
Class A Common Stock (par value \$5.00 per share)	26,044,733	Not listed
Common Stock (par value \$1.00 per share)	135,926,301	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 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

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 No.

Indicate by check mark whether the registrant has submitted every Interactive Data File required to be submitted 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 such files).

Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) 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, or emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act.)

Yes No

The aggregate market value of voting stock held by non-affiliates of the registrant was \$42,999,781 for Class A Common Stock and \$6,432,921,438 for Common Stock as of June 30, 2019.

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of the company's definitive Proxy Statement for the 2020 Annual Meeting of Stockholders (to be filed with the Securities and Exchange Commission under Regulation 14A within 120 days after the end of the registrant's fiscal year and, upon such filing, to be incorporated by reference in Part III).

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PART 1

ITEM 1 - BUSINESS

Our company is comprised of two reporting segments: North America and Rest of World. Our Rest of World segment is primarily comprised of China, Europe and India. Both segments manufacture and market comprehensive lines of residential and commercial gas and electric water heaters, boilers, tanks and water treatment products. Both segments primarily manufacture and market in their respective regions of the world. Our Rest of World segment also manufactures and markets in-home air purification products in China.

NORTH AMERICA

We serve residential and commercial end markets in North America with a broad range of products including:

Water heaters. Our residential and commercial water heaters come in sizes ranging from 2.5 gallon (point-of-use) models to 4,000 gallon products with varying efficiency ranges. We offer electric, natural gas and liquid propane tank-type models as well as tankless (gas and electric), heat pump and solar tank units. Typical applications for our water heaters include residences, restaurants, hotels and motels, office buildings, laundries, car washes and small businesses.

Boilers. Our residential and commercial boilers range in size from 45,000 British Thermal Units (BTUs) to 6.0 million BTUs. Our boilers are primarily used in space heating applications for residences, hospitals, schools, hotels and other large commercial buildings.

Water treatment products. With the acquisition of Aquasana, Inc. (Aquasana) in 2016 we entered the water treatment market. We expanded our product offerings with the acquisitions of Hague Quality Water International (Hague) in 2017 and Water-Right, Inc. (Water-Right) in 2019. Our water treatment products range from point-of-entry water softeners, solutions for problem well water, and whole-home water filtration products to on-the-go filtration bottles and point-of-use carbon and reverse osmosis products. We also offer a complete line of food and beverage filtration products. Typical applications for our water treatment products include residences, restaurants, hotels and offices. A portion of our sales of water treatment products is comprised of replacement filters.

Other. In our North America segment, we also manufacture expansion tanks, commercial solar water heating systems, swimming pool and spa heaters, related products and parts.

A significant portion of our North America sales is derived from the replacement of existing products.

We believe we are the largest manufacturer and marketer of water heaters in North America with a leading share in both the residential and commercial markets. In the commercial markets for both water heating and space heating, we believe our comprehensive product lines and our high-efficiency products give us a competitive advantage in these portions of the markets. Our wholesale distribution channel, where we sell our products primarily under the A. O. Smith and State brands, includes more than 1,300 independent wholesale plumbing distributors serving residential and commercial end markets. We also sell our residential water heaters through the retail and maintenance, repair and operations (MRO) channels. In the retail channel, our customers include four of the six largest national hardware and home center chains, including a long-standing exclusive relationship with Lowe's where we sell A. O. Smith branded products.

Our Lochinvar brand is one of the leading residential and commercial boiler brands in the U.S. Approximately 40 percent of Lochinvar branded sales consist of residential and commercial water heaters while the remaining 60 percent of Lochinvar-branded sales consist primarily of boilers and related parts. Our commercial boiler distribution channel is primarily comprised of manufacturer representative firms, the remainder of our Lochinvar branded products are distributed through wholesale channels.

We sell our Aquasana branded products primarily directly to consumers through e-commerce as well as on-line retailers including Amazon and through other retail chains. Our water softener branded products and problem well water solutions, which include Hague, WaterBoss, Water-Right, WaterCare, and Evolve, are sold through water quality dealers. Our water softener products are also sold through home center retail chains. Our A. O. Smith branded water treatment products are sold through Lowe's and our wholesale distribution channels.

Our energy-efficient product offerings continue to be a sales driver for our business. Our commercial water heaters and our condensing boilers continue to be an option for commercial customers looking for high efficiency water and space heating with a short payback period through energy savings. We offer residential heat pump, condensing tank-type and tankless water heaters in North America, as well as other higher efficiency water heating solutions to round out our energy-efficient product offerings.

We sell our water heating products in highly competitive markets. We compete in each of our targeted market segments based on product design, reliability, quality of products and services, advanced technologies, energy efficiency, maintenance costs and price. Our principal water heating and boiler competitors in North America include Rheem, Bradford White, Rinnai, Aereco and Navien. Numerous other manufacturing companies also compete. Our principal water treatment competitors in the U.S. are Brita, Culligan, Kinetico, Pentair and Ecowater as well as numerous regional assemblers.

REST OF WORLD

We have operated in China for more than 20 years. In that time, we have been aggressively expanding our presence while building A. O. Smith brand recognition in the residential and commercial markets. The Chinese water heater market is predominantly comprised of electric wall-hung, gas tankless, combi-boiler, heat pump and solar water heaters. We believe we are one of the leading suppliers of water heaters to the residential market in China in dollar terms. We manufacture and market water treatment products, primarily residential reverse osmosis products. We also manufacture and market air purification products as well as range hoods and cooktops in China.

We sell water heaters in approximately 9,000 retail outlets in China, of which over 2,600 exclusively sell our products. Our water treatment products and air purification products are sold in over 8,100 and 3,300 retail outlets in China, respectively.

In 2008, we established a sales office in India and began importing products specifically designed for India. We began manufacturing water heaters in India in 2010 and water treatment products in 2015.

Our primary competitors in China in the electric water heater market segment are Haier and Midea, which are Chinese companies. We compete with Rinnai and Noritz in the gas tankless water heater market segment. Our principal competitors in the water treatment market are Qinyuan, Angel, Midea and Xiaomi. Our principal competitors in the China air purification market are Phillips, Panasonic and Sharp. In India, we compete with Bajaj and Havels in the water heater market and Eureka Forbes, Kent and Hindustan Unilever in the water treatment market.

In addition, we sell water heaters in the European and Middle Eastern markets and water treatment products in Hong Kong, Turkey and Vietnam, all of which combined comprised less than eight percent of total Rest of World sales in 2019.

RAW MATERIALS

Raw materials for our manufacturing operations, primarily consisting of steel, are generally available in adequate quantities. A portion of our customers are contractually obligated to accept price changes based on fluctuations in steel prices. There has been volatility in steel costs over the last several years.

RESEARCH AND DEVELOPMENT

To improve our competitiveness by generating new products and processes, we conduct research and development at our newly constructed Corporate Technology Center in Milwaukee, Wisconsin, our Global Engineering Center in Nanjing, China, and our operating locations. Our total expenditures for research and development in 2019, 2018 and 2017 were \$87.9 million, \$94.0 million and \$86.4 million, respectively.

PATENTS AND TRADEMARKS

We own and use in our businesses various trademarks, trade names, patents, trade secrets and licenses. We do not believe that our business as a whole is materially dependent upon any such trademark, trade name, patent, trade secret or license. However, our trade name is important with respect to our products, particularly in China, India and the U.S.

EMPLOYEES

We employed approximately 15,100 employees as of December 31, 2019, primarily non-union.

BACKLOG

Due to the short-cycle nature of our businesses, none of our operations sustain significant backlogs.

ENVIRONMENTAL LAWS

Our operations are governed by a variety of federal, foreign, state and local laws intended to protect the environment. Compliance with environmental laws has not had and is not expected to have a material effect upon the capital expenditures, earnings, or competitive position of our company. See Item 3.

AVAILABLE INFORMATION

We maintain a website with the address www.aosmith.com. The information contained on our website is not included as a part of, or incorporated by reference into, this Annual Report on Form 10-K. Other than an investor's own internet access charges, we make available free of charge through our website our Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to these reports as soon as reasonably practical after we have electronically filed such material with, or furnished such material to, the Securities and Exchange Commission (SEC). All reports we file with the SEC are also available free of charge via EDGAR through the SEC's website at www.sec.gov.

We are committed to sound corporate governance and have documented our corporate governance practices by adopting the A. O. Smith Corporate Governance Guidelines. The Corporate Governance Guidelines, Criteria for Selection of Directors, Financial Code of Ethics, the A. O. Smith Guiding Principles, as well as the charters for the Audit, Personnel and Compensation, Nominating and Governance and the Investment Policy Committees of the Board of Directors and other corporate governance materials, may be viewed on the company's website. Any waiver of or amendments to the Financial Code of Conduct or the A. O. Smith Guiding Principles also would be posted on this website; to date there have been none. Copies of these documents will be sent to stockholders free of charge upon written request of the corporate secretary at the address shown on the cover page of this Annual Report on Form 10-K.

We are also committed to growing our business in a sustainable and socially responsible manner consistent with our Guiding Principles. This commitment has driven us to design, engineer, and manufacture highly innovative and efficient products in an environmentally responsible manner that help reduce energy consumption, conserve water, and improve drinking water quality and public health. Consistent with this commitment, we issued our first Corporate Responsibility & Sustainability (CRS) report in 2018 detailing our company's historic and current CRS efforts. Our CRS report is available on our website. The report is not included as part of, or incorporated by reference into, this Annual Report on Form 10-K. To further demonstrate our commitment, in 2019, our company appointed Patricia K. Ackerman, to the role of Senior Vice President, Investor Relations, Treasurer, and Corporate Responsibility and Sustainability with specific responsibility for our CRS efforts.

ITEM 1A – RISK FACTORS

You should carefully consider the risk factors set forth below and all other information contained in this Annual Report on Form 10-K, including the documents incorporated by reference, before making an investment decision regarding our common stock. If any of the events contemplated by the following risks actually occurs, then our business, financial condition, or results of operations could be materially adversely affected. As a result, the trading price of our common stock could decline, and you may lose all or part of your investment. The risks and uncertainties below are not the only risks facing our company.

- *The effects of a global economic downturn could have a material adverse effect on our business*

Global economic growth remains uneven and could stall or reverse course. If this was to occur it could adversely affect consumer confidence and spending patterns which could result in decreased demand for the products we sell, a delay in purchases, increased price competition, or slower adoption of energy-efficient water heaters and boilers, or high quality water treatment products, which could negatively impact our profitability and cash flows. In addition, a deterioration in current economic conditions due to many factors or fears including public health crises, such as the current coronavirus concerns originating in China, could negatively impact our vendors and customers, which could result in an increase in bad debt expense, customer and vendor bankruptcies, interruption or delay in supply of materials, or increased material prices, which could negatively impact our ability to distribute, market and sell our products and our financial condition, results of operations and cash flows.

- *A portion of our business could be affected by further weakening of the Chinese economy*

Approximately 28 percent of our net sales in 2019 were attributable to China. Our sales in China decreased in 2019 compared to 2018 and 2017. We believe that decrease was due to weaker end-market demand as a result of a weakening Chinese economy, elevated channel inventory levels, and a higher mix of mid-price products versus premium price products. We derive a substantial portion of our sales in China from premium-tier products. Changes in consumer preferences, weakening consumer confidence and sentiment as well as economic uncertainty, including the unknown impact from the coronavirus, may prompt consumers there to postpone purchases, choose lower-priced products or different alternatives, or lengthen the cycle of replacement purchases. Further deterioration in the Chinese economy may adversely affect our financial condition, results of operations and cash flows.

- *Because we participate in markets that are highly competitive, our revenues and earnings could decline as we respond to competition*

We sell all of our products in highly competitive and evolving markets. We compete in each of our targeted markets based on product design, reliability, quality of products and services, advanced technologies, product performance, maintenance costs and price. Some of our competitors may have greater financial, marketing, manufacturing, research and development and distribution resources than we have; others may invest little in technology or product development but compete on price and the rapid replication of features, benefits, and technologies, and some are increasingly expanding beyond their existing manufacturing or geographic footprints. In North America, the gas tankless portion of the water heating market has for many years increased as a percentage of the overall market. While we have many gas tankless products, our market share for gas tankless products is lower than our market share for the remainder of the water heating market. Further expansion of the gas tankless portion of the North America market, which we believe was approximately nine percent of the residential market segment in 2019, could have an impact on our operating results. We cannot assure that our products will continue to compete successfully with those of our competitors. There could be new market participants that change the dynamics of those markets and it is possible that we will not be able to retain our customer base or improve or maintain our profit margins on sales to our customers, all of which could materially and adversely affect our financial condition, results of operations and cash flows.

- *Our business could be adversely impacted by changes in consumer purchasing behavior, consumer preferences and technological changes*

Consumer preferences for products and the methods in which they purchase products are constantly changing based on, among other factors, cost, convenience, environmental and social concerns and perceptions. Consumer purchasing behavior may shift the product mix in the markets we participate in or result in a shift to new distribution channels, including e-commerce, which continues to expand. For example, consumer preferences may shift toward more efficient gas products or electric powered products due to the increased attention on the impact of greenhouse gas emissions on the environment. In addition, technologies are ever changing. Our ability to timely develop and successfully market new products and to develop, acquire, and retain necessary intellectual property rights is essential to our continued success, but cannot reasonably be assured. It is possible that we will not be able to develop new technologies, products or distribution channels to align with consumer purchasing behavior

and consumer preferences, which could materially and adversely affect our financial condition, results of operations and cash flows.

- *The occurrence or threat of extraordinary events, including natural disasters, political disruptions, terrorist attacks, public health issues, and acts of war, could significantly disrupt production, or impact consumer spending*

As a global company with a large international footprint, we are subject to increased risk of damage or disruption to us, our employees, facilities, suppliers, distributors, or customers. Extraordinary events, including natural disasters, political disruptions, terrorist attacks, public health issues, and acts of war may disrupt our business and operations, impact our supply chain and access to necessary raw materials or could adversely affect the economy generally, resulting in a loss of sales and customers. One of our manufacturing plants is located within a floodplain that has experienced past flooding events. We also have other manufacturing facilities located in hurricane and earthquake zones. Any of these disruptions or other extraordinary events outside of our control that impact our operations or the operations of our suppliers and key distributors could affect our business negatively, harming operating results. In addition, these types of events also could negatively impact consumer spending in the impacted regions or depending on the severity, globally, which could materially and adversely affect our financial condition, results of operations and cash flows. For example, a strain of coronavirus surfaced in Wuhan, China and has led to store closures and a decrease of consumer traffic in China. While not yet quantifiable, we expect the effects of the coronavirus to have a material adverse impact on our operating results for the first quarter of 2020 and we continue to assess the financial impact for the remainder of 2020.

- *We sell our products and operate outside the U.S., and to a lesser extent, rely on imports and exports, which may present additional risks to our business*

Approximately 36 percent of our net sales in 2019 were attributable to products sold outside of the U.S., primarily in China and Canada, and to a lesser extent in Europe and India. We also have operations and business relationships outside the U.S. that comprise a portion of our manufacturing, supply, and distribution. Approximately 8,800 of our 15,100 employees as of December 31, 2019 were located in China. At December 31, 2019, approximately \$549 million of cash and marketable securities were held by our foreign subsidiaries, substantially all of which were located in China. International operations generally are subject to various risks, including: political, religious, and economic instability; local labor market conditions; new or increased tariffs or other trade restrictions, or changes to trade agreements; the impact of foreign government regulations, actions or policies; the effects of income taxes; governmental expropriation; the imposition or increases in withholding and other taxes on remittances and other payments by foreign subsidiaries; labor relations problems; the imposition of environmental or employment laws, or other restrictions or actions by foreign governments; and differences in business practices. Unfavorable changes in the political, regulatory, or trade climate, diplomatic relations, or government policies, particularly in relation to countries where we have a presence, including Canada, China, India and Mexico, could have a material adverse effect on our financial condition, results of operations and cash flows or our ability to repatriate funds to the U.S.

- *A material loss, cancellation, reduction, or delay in purchases by one or more of our largest customers could harm our business*

Net sales to our five largest customers represented approximately 39 percent of our sales in 2019. We expect that our customer concentration will continue for the foreseeable future. Our concentration of sales to a relatively small number of customers makes our relationships with each of these customers important to our business. We cannot assure that we will be able to retain our largest customers. Some of our customers may shift their purchases to our competitors in the future. The loss of one or more of our largest customers, any material reduction or delay in sales to these customers, or our inability to successfully develop relationships with additional customers could have a material adverse effect on our financial position, results of operations and cash flows.

- *A portion of our business could be adversely affected by a decline in North American new residential and commercial construction or a decline in replacement related volume*

Residential and commercial construction activity in North America has shown modest growth which could decline in the future. We believe that the significant majority of the markets we serve are for replacement of existing products, and residential water heater replacement volume was strong in 2017 and 2018 before declining in 2019. Changes in the replacement volume and in the construction market in North America could negatively affect us.

■ *Our international operations are subject to risks related to foreign currencies*

We have a significant presence outside of the U.S., primarily in China and Canada and to a lesser extent Europe, Mexico, and India, and therefore, hold assets, including \$443 million of cash and marketable securities denominated in Chinese renminbi, incur liabilities, earn revenues and pay expenses in a variety of currencies other than the U.S. dollar. The financial statements of our foreign subsidiaries are translated into U.S. dollars in our consolidated financial statements. Furthermore, typically our products are priced in foreign countries in local currencies. As a result, we are subject to risks associated with operating in foreign countries including fluctuations in currency exchange rates and interest rates, hyperinflation in some foreign countries or global exchange rate instability or volatility that strengthens the U.S. dollar against foreign currencies. As a result, an increase in the value of the U.S. dollar relative to the local currencies of our foreign markets has had and would continue to have a negative effect on our profitability. In addition to currency translation risks, we incur a currency transaction risk whenever one of our subsidiaries enters into either a purchase or sale transaction using a currency different from the operating subsidiaries' functional currency. The majority of our foreign currency transaction risk results from sales of our products in Canada which we manufacture in the U.S, and to a lesser extent from component purchases in Europe and payroll in Mexico. These risks may hurt our reported sales and profits in the future or negatively impact revenues and earnings translated from foreign currencies into U.S. dollars.

■ *Changes in regulations or standards could adversely affect our business*

Our products are subject to a wide variety of statutory, regulatory and industry standards and requirements related to, among other items, energy and water efficiency, environmental emissions, labeling and safety. While we believe our products are currently efficient, safe and environment-friendly, a significant change to regulatory requirements (whether federal, foreign, state or local) such as a transition to alternative energy sources as a replacement for gas combustion, or to industry standards, could substantially increase manufacturing costs, impact the size and timing of demand for our products, affect the types of products we are able to offer or put us at a competitive disadvantage, any of which could harm our business and have a material adverse effect on our financial condition, results of operations and cash flow.

■ *Our business may be adversely impacted by product defects*

Product defects can occur through our own product development, design and manufacturing processes or through our reliance on third parties for component design and manufacturing activities. We may incur various expenses related to product defects, including product warranty costs, product liability and recall or retrofit costs. While we maintain a reserve for product warranty costs based on certain estimates and our knowledge of current events and actions, our actual warranty costs may exceed our reserve, resulting in current period expenses and a need to increase our reserves for warranty charges. In addition, product defects and recalls may diminish the reputation of our brand. Further, our inability to cure a product defect could result in the failure of a product line or the temporary or permanent withdrawal from a product or market. Any of these events may have a material adverse impact on our financial condition, results of operations and cash flows.

■ *Our operations could be adversely impacted by material price volatility and supplier concentration*

The market prices for certain raw materials we purchase, primarily steel, have been volatile. Significant increases in the cost of any of the key materials we purchase could increase our cost of doing business and ultimately could lead to lower operating earnings if we are not able to recover these cost increases through price increases to our customers. Historically, there has been a lag in our ability to recover increased material costs from customers, and that lag could negatively impact our profitability. In addition, in some cases we are dependent on a limited number of suppliers for some of the raw materials and components we require in the manufacturing of our products. A significant disruption or termination of the supply from one of these suppliers could delay sales or increase costs which could result in a material adverse effect on our financial condition, results of operations and cash flows.

■ *An inability to adequately maintain our information systems and their security, as well as to protect data and other confidential information, could adversely affect our business and reputation*

In the ordinary course of business, we utilize information systems for day-to-day operations, to collect and store sensitive data and information, including our proprietary and regulated business information and personally identifiable information of our customers, suppliers and business partners, as well as personally identifiable information about our employees. Our information systems, like those of other companies, are susceptible to outages due to system failures, cybersecurity threats, failures on the part of third-party information system providers, natural disasters, power loss, telecommunications failures, viruses, fraud, theft,

malicious insiders or breaches of security. We have a response plan in place in the event of a data breach and we continue to take steps to maintain and improve data security and address these risks and uncertainties by implementing and improving internal controls, security technologies, insurance programs, network and data center resiliency and recovery processes. However, any operations failure or breach of security from increasingly sophisticated cyber threats could lead to disruptions of our business activities, the loss or disclosure of both our and our customers' financial, product and other confidential information and could result in regulatory actions and have a material adverse effect on our financial condition, results of operations and cash flows and our reputation.

- *We are subject to U.S. and global laws and regulations covering our domestic and international operations that could adversely affect our business and results of operations*

Due to our global operations, we are subject to many laws governing international relations, including those that prohibit improper payments to government officials and restrict where we can do business, what information or products we can supply to certain countries and what information we can provide to a non-U.S. government, including but not limited to the Foreign Corrupt Practices Act and the U.S. Export Administration Act. Violations of these laws may result in criminal penalties or sanctions that could have a material adverse effect on our financial condition, results of operations and cash flows.

- *Our results of operations may be negatively impacted by product liability lawsuits and claims*

Our products expose us to potential product liability risks that are inherent in the design, manufacture, sale and use of our products. While we currently maintain what we believe to be suitable product liability insurance, we cannot be certain that we will be able to maintain this insurance on acceptable terms, that this insurance will provide adequate protection against potential liabilities or that our insurance providers will be able to ultimately pay all insured losses. In addition, we self-insure a portion of product liability claims. A series of successful claims against us could materially and adversely affect our reputation and our financial condition, results of operations and cash flows.

- *Our success is dependent on developing and retaining highly qualified personnel*

Attracting and retaining talented employees is important to the continued success and growth of our business. Failure to retain key personnel, particularly on the leadership team, could have a material effect on our business and our ability to execute our business strategies in a timely and effective manner.

- *Sales growth of our boilers could stall resulting in lower than expected revenues and earnings*

The compound annual growth rate of our boiler sales has been approximately eight percent per year since our acquisition of Lochinvar in 2011, largely due to the transition in the boiler industry in the U.S. from lower efficiency, non-condensing boilers to higher efficiency, higher priced, condensing boilers, as well as new product introductions. We expect the transition to condensing boilers to continue, but if the transition to higher efficiency, higher priced, condensing boilers stalls as a result of lower energy costs, a U.S. recession occurs, or our competitors' technologies surpass our technology, our growth rate could be lower than expected and have a material adverse effect on our financial condition, results of operations and cash flows.

- *Potential acquisitions could use a significant portion of our capital and we may not successfully integrate future acquisitions or operate them profitably or achieve strategic objectives*

We will continue to evaluate potential acquisitions, and we could use a significant portion of our available capital to fund future acquisitions. If we complete any future acquisitions, we may not be able to successfully integrate the acquired businesses or operate them profitably or accomplish our strategic objectives for those acquisitions. If we complete any future acquisitions in new geographies, our unfamiliarity with local regulations and market customs may impact our ability to operate them profitably or achieve our strategic objectives for those acquisitions. Our level of indebtedness may increase in the future if we finance acquisitions with debt, which would cause us to incur additional interest expense and could increase our vulnerability to general adverse economic and industry conditions and limit our ability to service our debt or obtain additional financing. The impact of future acquisitions may have a material adverse effect on our financial condition, results of operations and cash flows.

- *We have significant goodwill and indefinite-lived intangible assets and an impairment of our goodwill or indefinite-lived intangible assets could cause a decline in our net worth*

Our total assets include significant goodwill and indefinite-lived intangible assets. Our goodwill results from our acquisitions, representing the excess of the purchase prices we paid over the fair value of the net tangible and intangible assets we acquired. We assess whether there have been impairments in the value of our goodwill or indefinite-lived intangible assets during the fourth quarter of each calendar year or sooner if triggering events warrant. If future operating performance at our businesses does not meet expectations, we may be required to reflect non-cash charges to operating results for goodwill or indefinite-lived intangible asset impairments. The recognition of an impairment of a significant portion of goodwill or indefinite-lived intangible assets would negatively affect our results of operations and total capitalization, the effect of which could be material. A significant reduction in our stockholders' equity due to an impairment of goodwill or indefinite-lived intangible assets may affect our ability to maintain the debt-to-capital ratio required under our existing debt arrangements. We have identified the valuation of goodwill and indefinite-lived intangible assets as a critical accounting policy. See "Management's Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies—Goodwill and Indefinite-lived Intangible Assets" included in Item 7 of this Annual Report on Form 10-K.

- *Our pension plans may require future pension contributions which could limit our flexibility in managing our company*

The projected benefit obligation liability of our defined benefit pension plans of \$869 million exceeded the fair value of the plan assets of \$832 million by approximately \$37 million at December 31, 2019. U.S. employees hired after January 1, 2010 have not participated in our defined benefit plan, and benefit accruals for the majority of current salaried and hourly employees ended on December 31, 2014. We forecast that we will not be required to make a contribution to the plan in 2020, and we do not plan to make any voluntary contributions. However, we cannot provide any assurance that contributions will not be required in the future. Among the key assumptions inherent in our actuarially calculated pension plan obligation and pension plan expense are the discount rate and the expected rate of return on plan assets. If interest rates and actual rates of return on invested plan assets were to decrease significantly, our pension plan obligations could increase materially. The size of future required pension contributions could result in us dedicating a significant portion of our cash flows from operations to making contributions which could negatively impact our flexibility in managing our company.

- *Certain members of the founding family of our company and trusts for their benefit have the ability to influence all matters requiring stockholder approval*

We have two classes of common equity: our Common Stock and our Class A Common Stock. The holders of Common Stock currently are entitled, as a class, to elect only one-third of our board of directors. The holders of Class A Common Stock are entitled, as a class, to elect the remaining directors. Certain members of the founding family of our company and trusts for their benefit (Smith Family) have entered into a voting trust agreement with respect to shares of our Class A Common Stock and shares of our Common Stock they own. As of December 31, 2019, through the voting trust, these members of the Smith Family own approximately 63.7 percent of the total voting power of our outstanding shares of Class A Common Stock and Common Stock, taken together as a single class, and approximately 96.5 percent of the voting power of the outstanding shares of our Class A Common Stock, as a separate class. Due to the differences in the voting rights between shares of our Common Stock (one-tenth of one vote per share) and shares of our Class A Common Stock (one vote per share), the Smith Family voting trust is in a position to control to a large extent the outcome of matters requiring a stockholder vote, including the adoption of amendments to our certificate of incorporation or bylaws or approval of transactions involving a change of control. This ownership position may increase if other members of the Smith Family enter into the voting trust agreement, and the voting power relating to this ownership position may increase if shares of our Class A Common Stock held by stockholders who are not parties to the voting trust agreement are converted into shares of our Common Stock. The voting trust agreement provides that, in the event one of the parties to the voting trust agreement wants to withdraw from the trust or transfer any of its shares of our Class A Common Stock, such shares of our Class A Common Stock are automatically exchanged for shares of our Common Stock held by the trust to the extent available in the trust. In addition, the trust will have the right to purchase the shares of our Class A Common Stock and our Common Stock proposed to be withdrawn or transferred from the trust. As a result, the Smith Family members that are parties to the voting trust agreement have the ability to maintain their collective voting rights in our company even if certain members of the Smith Family decide to transfer their shares.

ITEM 1B - UNRESOLVED STAFF COMMENTS

None.

ITEM 2 - PROPERTIES

Properties utilized by us at December 31, 2019 were as follows:

North America

In this segment, we have 17 manufacturing plants located in nine states and two non-U.S. countries, of which 14 are owned directly by us or our subsidiaries and three are leased from outside parties. The terms of leases in effect at December 31, 2019 expire between 2020 and 2025.

Rest of World

In this segment, we have six manufacturing plants located in four non-U.S. countries, of which four are owned directly by us or our subsidiaries and two are leased from outside parties. The terms of leases in effect at December 31, 2019 expire between 2020 and 2022.

Corporate and General

We consider our plants and other physical properties to be suitable, adequate, and of sufficient productive capacity to meet the requirements of our business. The manufacturing plants operate at varying levels of utilization depending on the type of operation and market conditions. The executive offices of the company, which are leased, are located in Milwaukee, Wisconsin.

ITEM 3 - LEGAL PROCEEDINGS

We are involved in various unresolved legal actions, administrative proceedings and claims in the ordinary course of our business involving product liability, property damage, insurance coverage, exposure to asbestos and other substances, patents and environmental matters, including the disposal of hazardous waste. Although it is not possible to predict with certainty the outcome of these unresolved legal actions or the range of possible loss or recovery, we believe, based on past experience, adequate reserves and insurance availability, that these unresolved legal actions will not have a material effect on our financial position or results of operations. A more detailed discussion of certain of these matters appears in Note 16 of Notes to Consolidated Financial Statements.

On May 28, 2019, a putative securities class action lawsuit was filed in the U.S. District Court for the Eastern District of Wisconsin against the Company and certain of its current or former officers. Subsequently, on November 22, 2019, a consolidated amended complaint was filed by the lead plaintiff. This action, now captioned as City of Birmingham Retirement and Relief System v. A. O. Smith Corporation, et al., asserts securities fraud claims under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 ("Exchange Act"), and seeks damages and other relief based upon the allegations in the complaint. On January 24, 2020, A. O. Smith and the other defendants moved to dismiss the consolidated amended complaint for failure to state a claim. Their motion is currently pending. A shareholder derivative lawsuit, captioned as Pierce v. A. O. Smith Corporation, et al. and based on similar allegations as the putative class action, was filed on August 20, 2019, also in the U.S. District Court for the Eastern District of Wisconsin. On November 6, 2019, the plaintiff in the derivative action moved to dismiss his lawsuit, and re-filed it in the U.S. District Court for the District of Delaware on November 12, 2019. The derivative action asserts claims under Sections 14(a) and 20(a) of the Exchange Act, as well as for breach of fiduciary duty, unjust enrichment, and waste of corporate assets, and seeks damages and other relief based upon the allegations in the complaint. On February 12, 2020, the parties filed a stipulation seeking to stay the derivative lawsuit pending resolution of the City of Birmingham lawsuit. On February 13, 2020, a second shareholder derivative suit, captioned as Jarozewski v. A. O. Smith Corporation, et al., was filed in the U.S. District Court for the District of Delaware, asserting claims under Sections 10(b), 14(a) and 20(a) of the Exchange Act, as well as for breach of fiduciary duty, unjust enrichment, and insider trading, and seeks damages and other relief based upon the allegations in the complaint. On February 19, 2020, the U.S. District Court for the District of Delaware entered the stipulation staying the Pierce lawsuit. Consequently, the Company anticipates that the Jarozewski lawsuit will be stayed as well.

ITEM 4 - MINE SAFETY DISCLOSURES

Not applicable.

EXECUTIVE OFFICERS OF THE COMPANY

Pursuant to General Instruction of G(3) of Form 10-K, the following is a list of our executive officers which is included as an unnumbered Item in Part I of this report in lieu of being included in our Proxy Statement for our 2020 Annual Meeting of Stockholders.

Name (Age)	Positions Held	Period Position Was Held
Patricia K. Ackerman (59)	Senior Vice President – Investor Relations, Treasurer and Corporate Responsibility and Sustainability	2019 to Present
	Vice President – Investor Relations & Treasurer	2008 to 2018
	Vice President and Treasurer	2006 to 2008
	Assistant Treasurer	1995 to 2006
Paul R. Dana (57)	Senior Vice President – Global Operations	2019 to Present
	Senior Vice President – Global Manufacturing	2016 to 2018
	Vice President – Global Manufacturing	2015
	President – APCOM, a division of State Industries, LLC, a subsidiary of the Company	2011 to 2017
	Vice President – Product Engineering	2006 to 2010
	Plant Manager – Productos de Agua, S. de R.L. de C.V.	1998 to 2005
Anindadeb V. DasGupta (54)	Senior Vice President	2018 to Present
	President – A. O. Smith Holdings (Barbados) SRL	2018 to Present
	Vice President, Global Head Strategic Marketing; Global Head e-commerce; Global GM Flex & Signage Business Lines – OSRAM GmbH, Munich and Hong Kong	2014 to 2018
Wallace E. Goodwin (64)	Senior Vice President	2018 to Present
	President and General Manager – Lochinvar, LLC	2018 to Present
	Senior Vice President and General Manager – Lochinvar, LLC	2011 to 2017
	President – APCOM, a division of State Industries, LLC	1999 to 2011
Robert J. Heideman (53)	Senior Vice President – Chief Technology Officer	2013 to Present
	Senior Vice President – Engineering & Technology	2011 to 2012
	Senior Vice President – Corporate Technology	2010 to 2011
	Vice President – Corporate Technology	2007 to 2010
	Director – Materials	2005 to 2007
	Section Manager	2002 to 2005
D. Samuel Karge (45)	Senior Vice President	2018 to Present
	President – North America Water Treatment	2018 to Present
	Vice President, Sales and Marketing – Zurn Industries	2016 to 2018
	Vice President & Platform Leader – Pentair Residential Filtration	2012 to 2016

Name (Age)	Positions Held	Period Position Was Held
Daniel L. Kempken (47)	Senior Vice President – Strategy and Corporate Development	2019 to Present
	Vice President and Controller	2011 to 2019
Charles T. Lauber (57)	Executive Vice President and Chief Financial Officer	2019 to Present
	Senior Vice President, Strategy and Corporate Development	2013 to 2019
	Senior Vice President – Chief Financial Officer – A. O. Smith Water Products Company	2006 to 2012
	Vice President – Global Finance – A. O. Smith Electrical Products Company	2004 to 2006
	Vice President and Controller – A. O. Smith Electrical Products Company	2001 to 2004
	Director of Audit and Tax	1999 to 2001
Peter R. Martineau (65)	Senior Vice President – Chief Information Officer	2016 to Present
	Vice President – Business Transformation	2013 to 2015
	Vice President – Customer Satisfaction	2010 to 2012
Mark A. Petrarca (56)	Senior Vice President – Human Resources and Public Affairs	2006 to Present
	Vice President – Human Resources and Public Affairs	2005 to 2006
	Vice President – Human Resources – A. O. Smith Water Products Company	1999 to 2004
Ajita G. Rajendra (68)	Executive Chairman	2018 to Present
	Chairman and Chief Executive Officer	2017 to 2018
	Chairman, President and Chief Executive Officer	2014 to 2017
	President and Chief Executive Officer	2013 to 2014
	President and Chief Operating Officer	2011 to 2012
	Executive Vice President	2006 to 2011
	President – A. O. Smith Water Products Company	2005 to 2011
	Senior Vice President	2005 to 2007
James F. Stern (57)	Executive Vice President, General Counsel and Secretary	2007 to Present
	Partner – Foley & Lardner LLP	1997 to 2007
David R. Warren (56)	Senior Vice President	2017 to Present
	President and General Manager – North America Water Heater	2017 to Present
	Vice President – International	2008 to 2017
	Managing Director – A.O. Smith Water Products Company B.V.	2004 to 2008
	Director, Reliance Sales	2002 to 2004
	Regional Sales Manager	1999 to 2002
	District Sales Manager	1990 to 1996
	Sales Coordinator	1989 to 1990

Name (Age)	Positions Held	Period Position Was Held
Kevin J. Wheeler (60)	President and Chief Executive Officer	2018 to Present
	President and Chief Operating Officer	2017 to 2018
	Senior Vice President	2013 to 2017
	President and General Manager – North America, India and Europe Water Heating	2013 to 2017
	Senior Vice President and General Manager – North America, India and Europe – A. O. Smith Water Products Company	2011 to 2012
	Senior Vice President and General Manager – U.S. Retail – A. O. Smith Water Products Company	2007 to 2011
	Vice President – International – A. O. Smith Water Products Company	2004 to 2007
	Managing Director – A. O. Smith Water Products Company B.V.	1999 to 2004

PART II

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

- (a) **Market Information.** Our Common Stock is listed on the New York Stock Exchange under the symbol AOS. Our Class A Common Stock is not listed. EQ Shareowner Services, P.O. Box 64874, St. Paul, Minnesota, 55164-0874 serves as the registrar, stock transfer agent and the dividend reinvestment agent for our Common Stock and Class A Common Stock.
- (b) **Holders.** As of January 31, 2020, the approximate number of stockholders of record of Common Stock and Class A Common Stock were 592 and 160, respectively. The actual number of stockholders is greater than this number of holders of record, and includes stockholders who are beneficial owners, but whose shares are held in street name by brokers and other nominees. This number of stockholders of record also does not include stockholders whose shares may be held in trust by other entities.
- (c) **Dividends.** Dividends declared on the common stock are shown in Note 18 of Notes to Consolidated Financial Statements appearing elsewhere herein.
- (d) **Stock Repurchases.** In the second quarter of 2019, our Board of Directors approved adding three million shares of Common Stock to an existing discretionary share repurchase authority. Under the share repurchase program, we may purchase our Common Stock through a combination of Rule 10b5-1 automatic trading plan and discretionary purchases in accordance with applicable securities laws. The number of shares purchased and the timing of the purchases will depend on a number of factors, including share price, trading volume and general market conditions, as well as working capital requirements, general business conditions and other factors, including alternative investment opportunities. The stock repurchase authorization remains effective until terminated by our Board of Directors which may occur at any time, subject to the parameters of any Rule 10b5-1 automatic trading plan that we may then have in effect. In 2019, we repurchased 6,113,038 shares at an average price of \$47.06 per share and at a total cost of \$287.7 million. As of December 31, 2019, there were 2,962,215 shares remaining on the existing repurchase authorization.

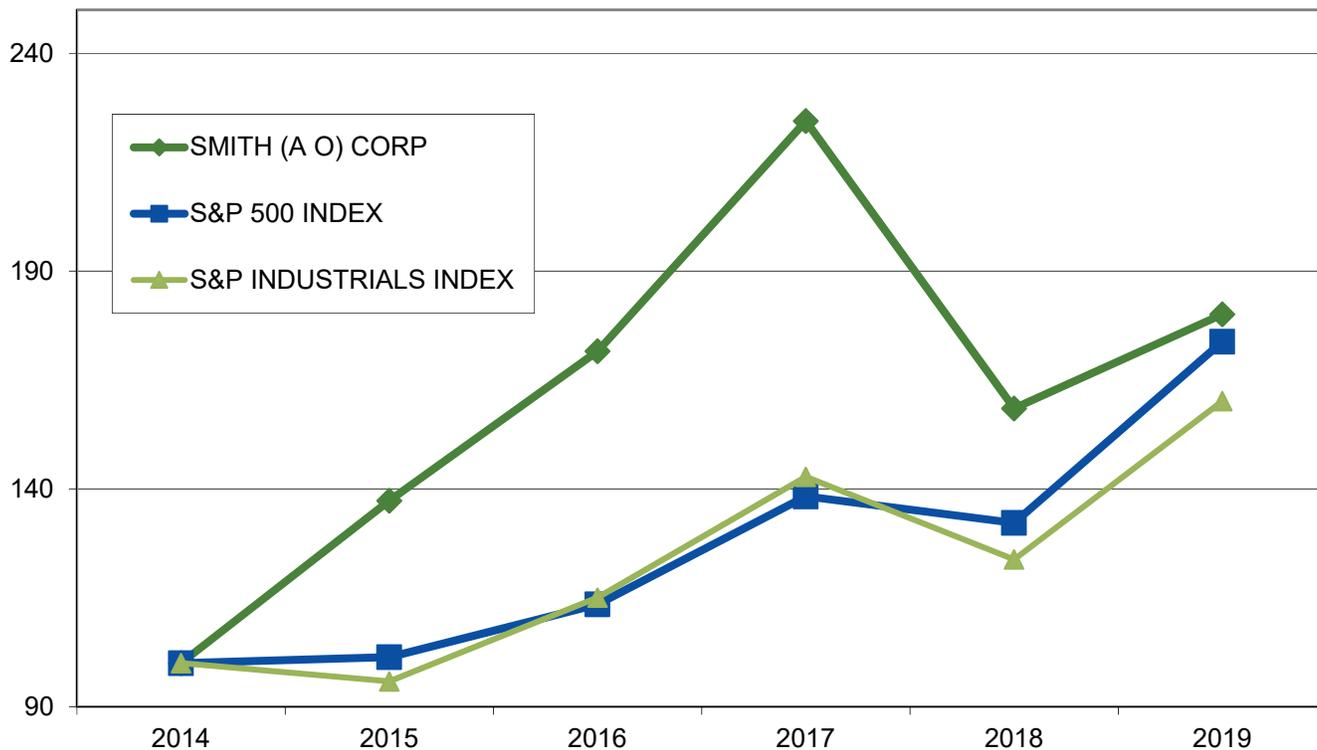
The following table sets forth the number of shares of common stock we repurchased during the fourth quarter of 2019:

ISSUER PURCHASES OF EQUITY SECURITIES					
Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that may yet be Purchased Under the Plans or Programs	
October 1 – October 31, 2019	414,700	\$ 48.17	414,700	3,739,015	
November 1 – November 30, 2019	370,800	50.20	370,800	3,368,215	
December 1 – December 31, 2019	406,000	47.02	406,000	2,962,215	

- (e) **Performance Graph.** The following information in this Item 5 of this Annual Report on Form 10-K is not deemed to be “soliciting material” or to be “filed” with the SEC or subject to Regulation 14A or 14C under the Securities Exchange Act of 1934 or to the liabilities of Section 18 of the Securities Exchange Act of 1934, and will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent we specifically incorporate it by reference into such a filing.

The graph below shows a five-year comparison of the cumulative shareholder return on our Common Stock with the cumulative total return of the Standard & Poor's (S&P) 500 Index, S&P 500 Select Industrials Index, which are published indices.

Comparison of Five-Year Cumulative Total Return
 From December 31, 2014 to December 31, 2019
 Assumes \$100 Invested with Reinvestment of Dividends



Company/Index	Indexed Returns					
	Base Period	12/31/14	12/31/15	12/31/16	12/31/17	12/31/18
A. O. Smith Corporation	100.0	137.3	171.6	224.5	158.5	180.1
S&P 500 Index	100.0	101.4	113.5	138.3	132.2	173.8
S&P 500 Select Industrial Index	100.0	95.8	115.1	142.8	123.8	160.2

ITEM 6 – SELECTED FINANCIAL DATA

(dollars in millions, except per share amounts)

	Years ended December 31,				
	2019	2018	2017 ⁽¹⁾	2016 ⁽²⁾	2015
Net sales	\$ 2,992.7	\$ 3,187.9	\$ 2,996.7	\$ 2,685.9	\$ 2,536.5
Net earnings ⁽¹⁾	\$ 370.0	\$ 444.2	\$ 296.5	\$ 326.5	\$ 282.9
Basic earnings per share of common stock ^(1,2)					
Net earnings	\$ 2.24	\$ 2.60	\$ 1.72	\$ 1.87	\$ 1.59
Diluted earnings per share of common stock ^(1,2)					
Net earnings	\$ 2.22	\$ 2.58	\$ 1.70	\$ 1.85	\$ 1.58
Cash dividends per common share ⁽²⁾	\$ 0.90	\$ 0.76	\$ 0.56	\$ 0.48	\$ 0.38

	Years ended December 31,				
	2019	2018	2017	2016	2015
Total assets	\$ 3,058.0	\$ 3,071.5	\$ 3,197.4	\$ 2,891.0	\$ 2,629.2
Long-term debt ⁽³⁾	277.2	221.4	402.9	316.4	236.1
Total stockholders' equity	1,666.8	1,717.0	1,644.9	1,511.4	1,442.3

⁽¹⁾ Due to the enactment of the U.S. Tax Cuts & Jobs Act in December 2017, we recorded a one-time charge of \$81.8 million in 2017, our estimate of the costs primarily associated with the repatriation of undistributed foreign earnings. These charges reduced 2017 earnings per share by \$0.47.

⁽²⁾ In September 2016, we declared a 100 percent stock dividend to holders of Common Stock and Class A Common Stock which is not included in cash dividends. Basic and diluted earnings per share are calculated using the weighted average shares outstanding which were restated for all periods presented to reflect the stock dividend.

⁽³⁾ Excludes the current portion of long-term debt.

ITEM 7 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

Our company is comprised of two reporting segments: North America and Rest of World. Our Rest of World segment is primarily comprised of China, Europe and India. Both segments manufacture and market comprehensive lines of residential and commercial gas and electric water heaters, boilers, tanks and water treatment products. Both segments primarily manufacture and market in their respective regions of the world. Our Rest of World segment also manufactures and markets in-home air purification products in China.

In our North America segment, we project our sales in the U.S. will grow approximately six percent in 2020 compared to 2019 due to higher water heater and boiler volumes resulting from expected industry-wide new construction growth and expansion of replacement demand. We continued to expand our North America water treatment platform in 2019 by acquiring Water-Right, Inc. and its affiliated entities (Water-Right) in April 2019. We expect sales of North America water treatment products to increase by 20 to 25 percent in 2020, compared to 2019, primarily due to volume growth and a full year of Water-Right sales.

In our Rest of World segment, we expect 2020 China sales to grow by approximately one percent in U.S. dollar terms and approximately 2.5 percent in local currency compared with 2019, as we believe the Chinese economy will continue to be weak. In addition, we expect our sales in India to grow between 15 and 20 percent in 2020 from approximately \$39 million in 2019.

Combining all of these factors, we expect our consolidated sales to grow 4.5 to 5.5 percent in 2020. Our 2020 guidance introduced on January 28, 2020, excludes the potential impact to our businesses from the coronavirus originating in China. As of the date of this filing, while not yet quantifiable, we now expect the coronavirus will have a material adverse impact on our operating results in the first quarter of 2020 and we continue to assess the financial impact for the remainder of 2020.

Our stated acquisition strategy includes a number of our water-related strategic initiatives. We will seek to continue to grow our core residential and commercial water heating, boiler and water treatment businesses throughout the world. We will also continue to look for opportunities to add to our existing operations in high growth regions demonstrated by our introduction of water treatment products in India and Vietnam and air purification products as well as range hoods and cooktops in China.

RESULTS OF OPERATIONS

Our sales in 2019 were \$2,993 million, a decline of 6.1 percent compared to our 2018 sales of \$3,188 million. The decrease in 2019 sales was primarily due to a 23 percent decline in China sales in U.S. dollar terms, which was largely a result of weaker end-market demand in the region, year over year channel inventory shifts, and a higher mix of sales of mid-price products versus premium price products than in the prior year. Excluding the unfavorable impact from currency translation, China sales declined 19 percent in 2019. The sales reduction in China more than offset the benefits of higher sales in North America, which were primarily a result of higher sales of water treatment products, including incremental sales from our acquisition, Water-Right, and water heater pricing actions related to steel and freight cost increases. The increase in North America sales was partially offset by lower residential water heater volumes. Our sales in 2018 were a company record \$3,188 million surpassing 2017 sales of \$2,997 million by 6.4 percent. The increase in sales in 2018 was primarily due to pricing actions related to higher steel costs and higher sales of boilers and residential water heaters in the U.S. as well as higher sales of water treatment products in China. Our global water treatment sales grew to approximately \$400 million in 2018. Total sales in China grew four percent in 2018. Excluding the impact of the appreciation of the Chinese currency against the U.S. dollar, our sales in China increased almost two percent in 2018.

Our gross profit margin in 2019 of 39.5 percent declined compared to our gross profit margin of 41.0 percent in 2018 primarily due to the lower sales volumes in China and a higher mix of mid-price products, which have lower margins, in that region. Our gross profit margin in 2018 of 41.0 percent was essentially flat compared to our gross profit margin of 41.1 percent in 2017.

Selling, general and administrative (SG&A) expenses were \$715.6 million in 2019 or \$38.2 million lower than in 2018. The decrease in SG&A expenses in 2019 was primarily due to lower advertising and selling expenses in China. SG&A expenses were \$31.0 million higher in 2018 than in 2017. The increase in SG&A expenses in 2018 to \$753.8 million was primarily due to higher advertising expenses related to brand building and higher product development engineering expenses in China.

On March 21, 2018, we announced a plan to transfer water heater, boiler and storage tank production from our Renton, Washington plant to our other U.S. plants. The majority of the consolidation of operations occurred in the second quarter of 2018. As a result of the relocation of production, we incurred pre-tax restructuring and impairment expenses of \$6.7 million in the first quarter of 2018, primarily related to employee severance and compensation-related costs, building lease exit costs and

the impairment of assets. These activities are reflected in “restructuring and impairment expenses” in the accompanying financial statements.

We are providing non-U.S. Generally Accepted Accounting Principles (GAAP) measures (adjusted earnings, adjusted earnings per share, and adjusted segment earnings) that exclude restructuring and impairment expenses. Reconciliations to measures on a GAAP basis are provided later in this section. We believe that the measures of adjusted earnings, adjusted EPS, and adjusted segment earnings provide useful information to investors about our performance and allow management and our investors to better understand our performance between periods without regard to items we do not consider to be a component of our core operating performance.

Interest expense was \$11.0 million in 2019 compared to \$8.4 million in 2018 and \$10.1 million in 2017. The increase in interest expense in 2019 was primarily due to higher debt levels to fund the acquisition of Water-Right and share repurchase activity. The decline in interest expense in 2018 compared to 2017 was a result of lower debt levels, primarily due to the repatriation of approximately \$312 million of cash from outside of the U.S, which was primarily used to pay down floating rate debt, as well as to fund our share repurchase activity and dividend payments. This decline was partially offset by higher interest rates in 2018.

Other income was \$18.0 million in 2019 compared to \$21.2 million in 2018 and \$21.3 million in 2017. The decrease in other income in 2019 compared to 2018 was primarily due to lower non-service cost related pension income and lower interest income.

Pension income in 2019 was \$6.2 million compared to \$8.7 million in 2018 and \$9.1 million in 2017. The service cost component of our pension income is reflected in cost of products sold and SG&A expenses. All other components of our pension income are reflected in other income.

Our effective income tax rate was 21.6 percent in 2019, compared with 20.4 percent in 2018 and 43.1 percent in 2017. Our effective income tax rates in 2019 and 2018 were lower than our adjusted effective income tax rate in 2017 due to lower federal income taxes related to the U.S. Tax Cuts and Jobs Act of 2017 (U.S. Tax Reform). Our effective income tax rate in 2019 was higher than 2018 primarily due to a change in geographic earnings mix. The effective income tax rate in 2017 was significantly higher due to one-time charges associated with U.S. Tax Reform of \$81.8 million, primarily related to the mandatory repatriation tax on undistributed foreign earnings that we are required to pay over eight years. Excluding the impact of the U.S. Tax Reform one-time charges, our adjusted effective income tax rate was 27.4 percent in 2017. We estimate our annual effective income tax rate for the full year 2020 will be approximately 21.5 to 22.0 percent.

North America

Sales in our North America segment were \$2,084 million in 2019 or \$39 million higher than sales of \$2,045 million in 2018. The increase in segment sales was primarily due to the incremental Water-Right sales of \$44 million, water heater pricing actions related to steel and freight cost increases, and higher sales of water treatment products, which were partially offset by lower residential water heater volumes. Sales in our North America segment were \$2,045 million in 2018 or \$140 million higher than sales of \$1,905 million in 2017. The increase in sales in 2018 compared to 2017 was primarily due to pricing actions related to higher steel costs and higher volumes of boilers and residential water heaters in the U.S. North America water treatment sales, including a full year of sales from Hague, which we purchased in 2017, and the launch of products at Lowe’s commencing in August 2018, incrementally added approximately \$29 million of sales in 2018.

North America segment earnings were \$488.9 million in 2019 compared to segment earnings of \$464.1 million and \$428.6 million in 2018 and 2017, respectively. Segment margins were 23.5 percent, 22.7 percent and 22.5 percent in 2019, 2018 and 2017, respectively. Adjusted segment earnings and segment margin in 2018, which exclude restructuring and impairment expenses, were \$470.8 million and 23.0 percent, respectively. The higher segment earnings and segment margin in 2019 compared to 2018 adjusted segment earnings and adjusted segment margin were primarily a result of pricing actions, lower steel costs, and higher sales of water treatment products, that included incremental volumes from our acquisition, Water-Right. These increases were partially offset by the unfavorable impact from lower residential water heater volumes. The higher adjusted segment earnings and adjusted segment margin in 2018 compared to 2017 were primarily due to the favorable impact from higher sales of residential water heaters and boilers and pricing actions in the U.S. that were partially offset by higher steel costs and one-time expenses associated with the launch of water treatment products at Lowe’s. We estimate our 2020 North America segment margin will be between 23.25 and 24.25 percent.

Rest of World

Sales in our Rest of World segment in 2019 were \$936 million or \$238 million lower than sales of \$1,174 million in 2018. Lower sales in 2019 compared to 2018 was largely a result of decreased China sales which declined 23 percent in U.S. dollar terms and 19 percent in local currency terms. The decline in China sales was primarily due to weaker end-market demand, elevated channel inventory levels for the first three quarters of 2019 that returned to a more normal range of two to three months by the end of 2019, and a higher mix of mid-price products versus premium priced products. In addition, the weaker Chinese currency

unfavorably impacted translated sales by approximately \$39 million. Sales in India grew approximately 13 percent in 2019 compared to 2018. Sales in China grew four percent in 2018 compared to 2017 primarily due to higher sales of water treatment products, including consumables, which were partially offset by lower sales of electric water heaters and air purifiers. The appreciation of the Chinese currency against the U.S. dollar contributed approximately \$23 million to segment sales in 2018. Excluding the benefit of the Chinese currency appreciation, sales in China increased 1.9 percent in 2018. Water heater and water treatment sales in India increased \$8 million, over 30 percent, in 2018 compared to 2017.

Rest of World segment earnings were \$40.2 million in 2019 compared to segment earnings of \$149.3 million in both 2018 and 2017. Segment margins were 4.3 percent in 2019 compared to 12.7 percent and 13.4 percent in 2018 and 2017, respectively. The decline in 2019 segment earnings and margin compared to 2018 was primarily due to lower sales in China and a higher mix of mid-price products, which have lower margins, that when combined, more than offset benefits to profits from lower SG&A expenses and material costs in that region. Currency translation reduced segment earnings by approximately \$3.0 million in 2019 compared to 2018. Segment earnings in 2018 were flat compared to 2017 primarily due to higher water treatment product sales and improved performance in India that were offset by lower sales of electric water heaters and air purifiers in China as well as higher SG&A expenses. Higher SG&A expenses in China were primarily due to higher advertising expenses related to brand building and higher product development engineering expenses. Segment margin declined in 2018 compared to 2017 as a result of the factors above. We expect our 2020 Rest of World segment margin will be approximately five percent.

LIQUIDITY AND CAPITAL RESOURCES

Our working capital was \$733.9 million at December 31, 2019 compared with \$853.2 million and \$973.1 million at December 31, 2018 and December 31, 2017, respectively. Approximately \$165 million in foreign cash, cash equivalents and marketable securities was repatriated in 2019 and utilized to repay floating rate debt, pay dividends and repurchase shares. The decline in cash, cash equivalents and marketable securities and sales-related decreases in accounts receivable partially offset by lower accounts payable balances explains the majority of the decline in working capital in 2019. Approximately \$312 million in foreign cash was repatriated in 2018 and utilized to repay floating rate debt, pay dividends and repurchase shares. The decline in cash, cash equivalents and marketable securities balances more than offset sales-related increases in accounts receivable and explains the majority of the decline in working capital in 2018. As of December 31, 2019, essentially all of our \$551.4 million of cash, cash equivalents and marketable securities was held by our foreign subsidiaries. We expect to repatriate approximately \$150 million in the first half of 2020 and use the proceeds to repay floating rate debt.

Cash provided by operating activities during 2019 was \$456.2 million compared with \$448.9 million during 2018 and \$326.4 million during 2017. The increase in cash flows in 2019 compared with 2018 was primarily due to lower outlays for working capital which offset lower earnings in 2019. The increase in cash flows in 2018 compared to 2017 was primarily due to higher earnings and lower outlays for working capital in 2018.

Our capital expenditures were \$64.4 million in 2019, \$85.2 million in 2018 and \$94.2 million in 2017. We broke ground in 2016 on the construction of a new water treatment and air purification products manufacturing facility in Nanjing, China, to support the expected growth of these products in China. The facility became operational in May 2018. Included in 2018 capital expenditures were approximately \$13 million related to capacity expansion in China. Included in 2017 capital expenditures were approximately \$24 million related to capacity expansion in China. For 2020, we project approximately \$80 million of capital expenditures and approximately \$85 million of depreciation and amortization expense.

In December 2016, we completed a \$500 million multi-currency five-year revolving credit facility with a group of nine banks. The facility has an accordion provision which allows it to be increased up to \$700 million if certain conditions (including lender approval) are satisfied. Borrowing rates under the facility are determined by our leverage ratio. The facility requires us to maintain two financial covenants, a leverage ratio test and an interest coverage test, and we were in compliance with the covenants as of December 31, 2019. The facility backs up commercial paper and credit line borrowings, and it expires on December 15, 2021. As a result of the long-term nature of this facility, the commercial paper and credit line borrowings as well as drawings under the facility are classified as long-term debt.

At December 31, 2019, we had available borrowing capacity of \$336.0 million under this facility. We believe that our combination of cash, available borrowing capacity and operating cash flow will provide sufficient funds to finance our existing operations for the foreseeable future.

Our total debt increased to \$284.0 million at December 31, 2019 compared with \$221.4 million at December 31, 2018. We repatriated approximately \$150 million cash and paid down debt, which was more than offset by the purchase of Water-Right and share repurchase activity exceeding cash generation in the U.S. As a result, our leverage, as measured by the ratio of total debt to total capitalization, was 14.6 percent at the end of 2019 compared with 11.4 percent at the end of 2018.

Our U.S. pension plan continues to meet all funding requirements under ERISA regulations. We were not required to make a contribution to our pension plan in 2019. We forecast that we will not be required to make a contribution to the plan in 2020, and we do not plan to make any voluntary contributions in 2020. For further information on our pension plans, see Note 13 of Notes to Consolidated Financial Statements.

In 2019, we repurchased 6,113,038 shares at an average price of \$47.06 per share and a total cost of \$287.7 million. Our Board of Directors increased the number of shares we are authorized to repurchase by 3,000,000 shares at its June 2019 meeting. A total of 2,962,215 shares remained on the existing repurchase authorization at December 31, 2019. Depending on factors such as stock price, working capital requirements and alternative investment opportunities, such as acquisitions, we expect to spend approximately \$200 million on share repurchase activity in 2020 using a combination of a 10b5-1 repurchase plan and opportunistic purchases.

We have paid dividends for 80 consecutive years with annual amounts increasing each of the last 28 years. We paid dividends of \$0.90 per share in 2019 compared with \$0.76 per share in 2018. We increased our dividend by nine percent in the fourth quarter of 2019, and the five-year compound annual growth rate of our dividend is approximately 25 percent.

Aggregate Contractual Obligations

A summary of our contractual obligations as of December 31, 2019, is as follows:

(dollars in millions)		Payments due by period			
Contractual Obligations	Total	Less Than 1 year	1 - 2 Years	3 - 5 Years	More than 5 years
Long-term debt	\$ 284.0	\$ 6.8	\$ 177.6	\$ 20.1	\$ 79.5
Fixed rate interest	26.0	3.7	6.8	5.7	9.8
Operating leases	64.9	14.0	19.5	8.6	22.8
Purchase obligations	145.9	145.8	0.1	-	-
Pension and post-retirement obligations	<u>49.3</u>	<u>9.8</u>	<u>2.2</u>	<u>2.0</u>	<u>35.3</u>
Total	<u>\$ 570.1</u>	<u>\$ 180.1</u>	<u>\$ 206.2</u>	<u>\$ 36.4</u>	<u>\$ 147.4</u>

As of December 31, 2019, our liability for uncertain income tax positions was \$9.7 million. Due to the high degree of uncertainty regarding timing of potential future cash flows associated with these liabilities, we are unable to make a reasonably reliable estimate of the amount and period in which these liabilities might be paid.

We utilize blanket purchase orders to communicate expected annual requirements to many of our suppliers. Requirements under blanket purchase orders generally do not become committed until several weeks prior to our scheduled unit production. The purchase obligation amount presented above represents the value of commitments that we consider firm.

Recent Accounting Pronouncements

Refer to *Recent Accounting Pronouncements* in Note 1 of Notes to Consolidated Financial Statements.

Critical Accounting Policies

Our accounting policies are described in Note 1 of Notes to Consolidated Financial Statements. Also as disclosed in Note 1, the preparation of financial statements in conformity with accounting principles generally accepted in the U.S. requires the use of estimates and assumptions about future events that affect the amounts reported in the financial statements and accompanying notes. Future events and their effects cannot be determined with absolute certainty. Therefore, the determination of estimates requires the exercise of judgment. Actual results inevitably will differ from those estimates, and such differences may be material to the financial statements.

The most significant accounting estimates inherent in the preparation of our financial statements include estimates associated with the evaluation of the impairment of goodwill and indefinite-lived intangible assets, as well as significant estimates used in the determination of liabilities related to warranty activity, product liability and pensions. Various assumptions and other factors underlie the determination of these significant estimates. The process of determining significant estimates is fact-specific and takes into account factors such as historical experience and trends, and in some cases, actuarial techniques. We monitor these significant factors and adjustments are made as facts and circumstances dictate. Historically, actual results have not significantly deviated from those determined using the estimates described above.

Goodwill and Indefinite-lived Intangible Assets

In conformity with U.S. Generally Accepted Accounting Principles (GAAP), goodwill and indefinite-lived intangible assets are tested for impairment annually or more frequently if events or changes in circumstances indicate that the assets might be impaired. We perform impairment reviews for our reporting units using a fair-value method based on management's judgments and assumptions. The fair value represents the estimated amount at which a reporting unit could be bought or sold in a current transaction between willing parties on an arms-length basis. The estimated fair value is then compared with the carrying amount of the reporting unit, including recorded goodwill. We are subject to financial statement risk to the extent that goodwill and indefinite-lived intangible assets become impaired. Any impairment review is, by its nature, highly judgmental as estimates of future sales, earnings and cash flows are utilized to determine fair values. However, we believe that we conduct thorough and competent annual valuations of goodwill and indefinite-lived intangible assets and that there has been no impairment in goodwill or indefinite-lived assets in 2019.

Product warranty

Our products carry warranties that generally range from one to ten years and are based on terms that are generally accepted in the market. We provide for the estimated cost of product warranty at the time of sale. The product warranty provision is estimated based upon warranty loss experience using actual historical failure rates and estimated costs of product replacement. The variables used in the calculation of the provision are reviewed at least annually. At times, warranty issues may arise which are beyond the scope of our historical experience. We provide for any such warranty issues as they become known and estimable. While our warranty costs have historically been within calculated estimates, it is possible that future warranty costs could differ significantly from those estimates. The allocation of the warranty liability between current and long-term is based on the expected warranty liability to be paid in the next year as determined by historical product failure rates. At December 31, 2019 and 2018, our reserve for product warranties was \$134.3 million and \$139.4 million, respectively.

Product liability

Due to the nature of our products, we are subject to product liability claims in the normal course of business. We maintain insurance to reduce our risk. Most insurance coverage includes self-insured retentions that vary by year. In 2019, we maintained a self-insured retention of \$7.5 million per occurrence with an aggregate insurance limit of \$125.0 million.

We establish product liability reserves for our self-insured retention portion of any known outstanding matters based on the likelihood of loss and our ability to reasonably estimate such loss. There is inherent uncertainty as to the eventual resolution of unsettled matters due to the unpredictable nature of litigation. We make estimates based on available information and our best judgment after consultation with appropriate advisors and experts. We periodically revise estimates based upon changes to facts or circumstances. We also utilize an actuary to calculate reserves required for estimated incurred but not reported claims as well as to estimate the effect of adverse development of claims over time. At December 31, 2019 and 2018, our reserve for product liability was \$33.1 million and \$39.3 million, respectively.

Pensions

We have significant pension benefit costs that are developed from actuarial valuations. The valuations reflect key assumptions regarding, among other things, discount rates, expected return on plan assets, retirement ages, and years of service. Consideration is given to current market conditions, including changes in interest rates in making these assumptions. Our assumption for the expected return on plan assets was 7.15 percent in 2019 and 2018. The discount rate used to determine net periodic pension costs increased to 4.32 percent in 2019 from 3.65 percent in 2018. For 2020, our expected return on plan assets is 6.75 percent and our discount rate is 3.18 percent.

In developing our expected return on plan assets, we evaluate our pension plan's current and target asset allocation, the expected long-term rates of return of equity and bond indices and the actual historical returns of our pension plan. Our plan's target allocation to equity managers is approximately 30 to 60 percent, with the remainder allocated primarily to bond managers, private equity managers and real estate managers. Our actual asset allocation as of December 31, 2019, was 42 percent to equity managers, 47 percent to bond managers, 10 percent to real estate managers, and one percent to private equity managers. We regularly review our actual asset allocation and periodically rebalance our investments to our targeted allocation when considered appropriate. Our pension plan's historical ten-year and 25-year compounded annualized returns are 9.2 percent and 9.3 percent, respectively. We believe that with our target allocation and the expected long-term returns of equity and bond indices as well as our actual historical returns, our 6.75 percent expected return on plan assets for 2020 is reasonable.

The discount rate assumptions used to determine future pension obligations at December 31, 2019 and 2018 were based on the Aon AA Only Above Median yield curve, which was designed by Aon to provide a means for plan sponsors to value the liabilities

of their postretirement benefit plans. The AA Only Above Median yield curve represents a series of annual discount rates from bonds with AA minimum average rating as rated by Moody's Investor Service, Standard & Poor's and Fitch Ratings. We will continue to evaluate our actuarial assumptions at least annually, and we will adjust the assumptions as necessary.

We recognized pension income of \$6.2 million, \$8.7 million, and \$9.1 million in 2019, 2018, and 2017, respectively.

Costs associated with our replacement retirement plan in 2019 were approximately \$6 million, consistent with 2018. We made changes to our pension plan including closing the plan to new entrants effective January 1, 2010, and the sunset of our plan for the majority of our employees on December 31, 2014. Lowering the expected return on plan assets by 25 basis points would decrease our net pension income for 2019 by approximately \$1.9 million. Lowering the discount rate by 25 basis points would increase our 2019 net pension income by approximately \$0.4 million.

In 2019, as part of our strategy to de-risk our defined benefit pension plan, the qualified defined benefit pension plan purchased a group annuity contract whereby an unrelated insurance company assumed a \$31 million obligation to pay and administer future annuity payments for certain retirees and beneficiaries.

Non-GAAP Measures

We provide non-GAAP measures (adjusted earnings, adjusted earnings per share (EPS) and adjusted segment earnings) that exclude restructuring and impairment expenses in 2018 and the impact of a one-time charge associated with U.S. Tax Reform in 2017.

We believe that the measures of adjusted earnings, adjusted EPS, and adjusted segment earnings provide useful information to investors about our performance and allow management and our investors to better understand our performance between periods without regard to items we do not consider to be a component of our core operating performance.

A. O. SMITH CORPORATION
Adjusted Earnings and Adjusted EPS
(dollars in millions, except per share data)
(unaudited)

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

	Years ended December 31,		
	2019	2018	2017
Net Earnings (GAAP)	\$ 370.0	\$ 444.2	\$ 296.5
Restructuring and impairment expenses, before tax ⁽¹⁾	-	6.7	-
Tax effect of restructuring and impairment expenses	-	(1.7)	-
U.S. Tax Reform income tax expense ⁽²⁾	-	-	81.8
Adjusted Earnings	<u>\$ 370.0</u>	<u>\$ 449.2</u>	<u>\$ 378.3</u>
Diluted EPS (GAAP)	\$ 2.22	\$ 2.58	\$ 1.70
Restructuring and impairment expenses per diluted share ⁽¹⁾	\$ -	\$ 0.4	\$ -
Tax effect of restructuring and impairment expenses per diluted share	-	(0.1)	-
U.S. Tax Reform income tax expense ⁽²⁾	-	-	0.47
Adjusted EPS	<u>\$ 2.22</u>	<u>\$ 2.61</u>	<u>\$ 2.17</u>

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

	Years ended December 31,		
	2019	2018	2017
Segment Earnings (GAAP)			
North America	\$ 488.9	\$ 464.1	\$ 428.6
Rest of World	<u>40.2</u>	<u>149.3</u>	<u>149.3</u>
Total Segment Earnings (GAAP)	<u>\$ 529.1</u>	<u>\$ 613.4</u>	<u>\$ 577.9</u>
Adjustments			
North America ⁽¹⁾	\$ -	\$ 6.7	\$ -
Rest of World	-	-	-
Total Adjustments	<u>\$ -</u>	<u>\$ 6.7</u>	<u>\$ -</u>
Adjusted Segment Earnings			
North America	\$ 488.9	\$ 470.8	\$ 428.6
Rest of World	<u>40.2</u>	<u>149.3</u>	<u>149.3</u>
Total Adjusted Segment Earnings	<u>\$ 529.1</u>	<u>\$ 620.1</u>	<u>\$ 577.9</u>

⁽¹⁾ We recognized \$6.7 million of restructuring and impairment expenses in connection with the move of manufacturing operations from our Renton, Washington facility to other U.S. facilities. For additional information, see Note 5 of Notes to Consolidated Financial Statements.

⁽²⁾ Excluding the impact of one-time U.S. Tax Reform charges, our 2017 adjusted effective income tax rate was 27.4 percent as compared to our effective income tax rate of 43.1 percent in 2017. For additional information, see Note 15 of Notes to Consolidated Financial Statements.

Outlook

We expect higher boiler, water heater, and water treatment sales in North America in 2020 and project segment sales to grow by approximately six percent compared to 2019. Although China channel inventory levels have normalized to the range of two to three months, we believe the Chinese economy will remain weak in 2020 and expect that 2020 sales in China will increase by one percent in U.S. dollar terms and 2.5 percent in local currency terms. As a result, we expect our consolidated sales to grow between 4.5 to 5.5 percent in 2020. We plan to achieve full-year earnings of between \$2.40 and \$2.50 per share, which excludes the potential impacts from future acquisitions. Our 2020 guidance above which was introduced on January 28, 2020, excludes the potential impact on our businesses from the coronavirus originating in China. As of the date of this filing, while not yet quantifiable, we now expect the effects of the coronavirus to have a material adverse impact on our operating results in the first quarter of 2020 and we continue to assess the financial impact for the remainder of the year.

OTHER MATTERS

Environmental

Our operations are governed by a number of federal, foreign, state, local and environmental laws concerning the generation and management of hazardous materials, the discharge of pollutants into the environment and remediation of sites owned by the company or third parties. We have expended financial and managerial resources complying with such laws. Expenditures related to environmental matters were not material in 2019 and we do not expect them to be material in any single year. We have reserves associated with environmental obligations at various facilities and we believe these reserves together with available insurance coverage are sufficient to cover reasonably anticipated remediation costs. Although we believe that our operations are substantially in compliance with such laws and maintain procedures designed to maintain compliance, there are no assurances that substantial additional costs for compliance will not be incurred in the future. However, since the same laws govern our competitors, we should not be placed at a competitive disadvantage.

Market Risk

We are exposed to various types of market risks, primarily currency. We monitor our risks in such areas on a continuous basis and generally enter into forward contracts to minimize such exposures for periods of less than one year. We do not engage in speculation in our derivatives strategies. Further discussion regarding derivative instruments is contained in Note 1 of Notes to Consolidated Financial Statements.

We enter into foreign currency forward contracts to minimize the effect of fluctuating foreign currencies. At December 31, 2019, we had net foreign currency contracts outstanding with notional values of \$205.6 million. Assuming a hypothetical ten percent movement in the respective currencies, the potential foreign exchange gain or loss associated with the change in exchange rates would amount to \$20.6 million. However, gains and losses from our forward contracts will be offset by gains and losses in the underlying transactions being hedged.

Our earnings exposure related to movements in interest rates is primarily derived from outstanding floating-rate debt instruments that are determined by short-term money market rates. At December 31, 2019, we had \$164.0 million in outstanding floating-rate debt with a weighted-average interest rate of 2.5 percent at year end. A hypothetical ten percent annual increase or decrease in the year-end average cost of our outstanding floating-rate debt would result in a change in annual pre-tax interest expense of approximately \$0.4 million.

Forward-Looking Statements

This filing contains statements that the Company believes 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,” “forecast,” “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 filing. Important factors that could cause actual results to differ materially from these expectations include, among other things, the following: a further weakening of the Chinese economy and/or a further decline in the growth rate of consumer spending or housing sales in China; negative impact to the company’s businesses as a result of the coronavirus, originating in China; negative impact to the company’s businesses from international tariffs and trade disputes; potential weakening in the high-efficiency boiler segment in the U.S.; significant volatility in raw material prices; inability of the company to implement or maintain pricing actions; potential weakening in U.S. residential or commercial construction or instability in the company’s replacement markets; foreign currency fluctuations; the company’s inability to successfully integrate or achieve its strategic objectives resulting from acquisitions; competitive pressures on the company’s businesses; the impact of potential information technology or data security breaches; changes in government regulations or regulatory requirements; and adverse developments in general economic, political and business conditions in key regions of the world. Forward-looking statements included in this filing are made only as of the date of this filing, 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.

ITEM 7A – QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

See “Market Risk” above.

ITEM 8 – FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
A. O. Smith Corporation

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of A. O. Smith Corporation (the Company) as of December 31, 2019 and 2018, the related consolidated statements of earnings, comprehensive earnings, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2019, and the related notes and financial statement schedule listed in the index at Item 15(a) (collectively referred to as the "consolidated financial statements"). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2019 and 2018, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2019, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2019, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated February 24, 2020 expressed an unqualified opinion thereon.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Critical Audit Matters

The critical audit matters communicated below are matters arising from the current period audit of the financial statements that were communicated or required to be communicated to the audit committee and that: (1) relate to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the consolidated financial statements, taken as a whole, and we are not, by communicating the critical audit matters below, providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

Product Warranty Liability Valuation

Description of the Matter

At December 31, 2019, the Company's product warranty liability was \$134.3 million. As discussed in Note 1 of the consolidated financial statements, the Company records a liability for the expected cost of warranty-related claims at the time of sale. The product warranty liability is estimated based upon warranty loss experience using actual historical failure rates and estimated cost of product replacement. Products generally carry warranties from one to ten years. The Company performs separate warranty calculations based on the product type and the warranty term and aggregates them.

Auditing the product warranty liability was complex due to the judgmental nature of the warranty loss experience assumptions, including the estimated product failure rate and the estimated cost of product replacement. In particular, it is possible that future product failure rates may not be reflective of historical product failure rates, or that a product quality issue has not yet been

identified as of the financial statement date. Additionally, the cost of product replacement could differ from estimates due to fluctuations in the replacement cost of the product.

How We Addressed the Matter in our Audit

We obtained an understanding, evaluated the design, and tested the operating effectiveness of controls over the Company's product warranty liability calculation. For example, we tested controls over management's review of the product warranty liability calculation, including the significant assumptions and the data inputs to the calculation.

To test the Company's calculation of the product warranty liability, our audit procedures included, among others, evaluating the methodology used, and testing the significant assumptions discussed above and the underlying data used by the Company in its analysis. We tested the validity and categorization of claims by product type and warranty period within the calculation and tested the completeness of the claims data against the Company's claim log. We recalculated the historical failure rates using actual claims data. We compared the estimated cost of replacement included in the product warranty liability with the current costs to manufacture a comparable product. We also analyzed subsequent claims data to identify changes in failure trends and assessed the historical accuracy of the prior year liability. Further, we inquired of operational and quality control personnel regarding quality issues and trends.

Accounting for Acquisitions – Valuation of Water-Right, Inc. Intangible Assets

Description of the Matter

During 2019, the Company completed its acquisition of Water-Right, Inc. for consideration of \$107.0 million, net of cash acquired, as discussed in Note 3 to the consolidated financial statements. The transaction was accounted for using the purchase method of accounting.

Auditing the Company's accounting for its acquisition of Water-Right, Inc. was complex due to the significant estimation uncertainty in the Company's determination of the fair value of identified intangible assets of \$60.4 million, which principally consisted of customer relationships and trademarks. The significant estimation uncertainty was primarily due to the sensitivity of the respective fair values to underlying assumptions about the future performance of the acquired business. The significant assumptions used to estimate the value of the intangible assets included discount rates and certain assumptions that form the basis of the forecasted results (including revenue growth rates, attrition rates and royalty rates). These significant assumptions are forward looking and could be affected by future economic and market conditions.

How We Addressed the Matter in our Audit

We obtained an understanding, evaluated the design, and tested the operating effectiveness of the Company's controls over its accounting for acquisitions. For example, we tested controls over the estimation process supporting the measurement of customer relationships and trademark intangible assets, including management's review of the significant assumptions used in the valuation models.

To test the estimated fair value of the customer relationship and trademark intangible assets, our audit procedures included, among others, evaluating the Company's valuation methodology, and testing the significant assumptions discussed above including the completeness and accuracy of the underlying data supporting the significant assumptions and estimates. We compared the revenue growth rates to third-party industry projections for the water treatment and purification market and to the historical performance of the acquired business. We involved our valuation specialists to assist with our evaluation of the methodology used by the Company and significant assumptions included in the fair value estimates. For example, we evaluated the discount rates by comparing them to discount rate ranges that were independently developed using publicly available market data for comparable peers. We also compared the customer attrition rates to historical customer retention rates and the royalty rate to relevant comparable licensing agreements.

/s/ Ernst & Young LLP

We have served as A. O. Smith Corporation's auditor since 1917.

Milwaukee, Wisconsin
February 24, 2020

CONSOLIDATED BALANCE SHEETS

December 31 (dollars in millions)

	2019	2018
Assets		
Current Assets		
Cash and cash equivalents	\$ 374.0	\$ 259.7
Marketable securities	177.4	385.3
Receivables	589.5	647.3
Inventories	303.0	304.7
Other current assets	<u>56.5</u>	<u>41.5</u>
Total Current Assets	1,500.4	1,638.5
Net property, plant and equipment	545.4	540.0
Goodwill	546.0	513.0
Other intangibles	338.4	293.1
Operating lease assets	46.9	-
Other assets	<u>80.9</u>	<u>86.9</u>
Total Assets	<u>\$ 3,058.0</u>	<u>\$ 3,071.5</u>
Liabilities		
Current Liabilities		
Trade payables	\$ 509.6	\$ 543.8
Accrued payroll and benefits	64.6	79.4
Accrued liabilities	143.7	120.4
Product warranties	41.8	41.7
Long-term debt due within one year	<u>6.8</u>	<u>-</u>
Total Current Liabilities	766.5	785.3
Long-term debt	277.2	221.4
Product warranties	92.4	97.7
Pension liabilities	27.8	49.4
Long-term operating lease liabilities	38.7	-
Other liabilities	<u>188.6</u>	<u>200.7</u>
Total Liabilities	1,391.2	1,354.5
Commitments and contingencies	-	-
Stockholders' Equity		
Preferred Stock	-	-
Class A Common Stock (shares issued 26,180,885 and 26,191,327)	130.9	131.0
Common Stock (shares issued 164,526,709 and 164,516,267)	164.5	164.5
Capital in excess of par value	509.0	496.7
Retained earnings	2,323.4	2,102.8
Accumulated other comprehensive loss	(348.3)	(350.8)
Treasury stock at cost	<u>(1,112.7)</u>	<u>(827.2)</u>
Total Stockholders' Equity	<u>1,666.8</u>	<u>1,717.0</u>
Total Liabilities and Stockholders' Equity	<u>\$ 3,058.0</u>	<u>\$ 3,071.5</u>

See accompanying notes which are an integral part of these statements.

CONSOLIDATED STATEMENT OF EARNINGS

Years ended December 31 (dollars in millions, except per share amounts)

	2019	2018	2017
Net sales	\$ 2,992.7	\$ 3,187.9	\$ 2,996.7
Cost of products sold	<u>1,812.0</u>	<u>1,882.4</u>	<u>1,764.3</u>
Gross profit	1,180.7	1,305.5	1,232.4
Selling, general and administrative expenses	715.6	753.8	722.8
Restructuring and impairment expenses	-	6.7	-
Interest expense	11.0	8.4	10.1
Other income - net	<u>(18.0)</u>	<u>(21.2)</u>	<u>(21.3)</u>
Earnings before provision for income taxes	472.1	557.8	520.8
Provision for income taxes	<u>102.1</u>	<u>113.6</u>	<u>224.3</u>
Net Earnings	<u>\$ 370.0</u>	<u>\$ 444.2</u>	<u>\$ 296.5</u>
Net Earnings Per Share of Common Stock	<u>\$ 2.24</u>	<u>\$ 2.60</u>	<u>\$ 1.72</u>
Diluted Net Earnings Per Share of Common Stock	<u>\$ 2.22</u>	<u>\$ 2.58</u>	<u>\$ 1.70</u>

CONSOLIDATED STATEMENT OF COMPREHENSIVE EARNINGS

Years ended December 31 (dollars in millions)

	2019	2018	2017
Net Earnings	\$ 370.0	\$ 444.2	\$ 296.5
Other comprehensive earnings (loss)			
Foreign currency translation adjustments	(1.3)	(38.4)	52.7
Unrealized net gain (loss) on cash flow derivative instruments, less related income tax (provision) benefit of (\$0.3) in 2019, (\$0.1) in 2018 and \$0.7 in 2017	0.9	0.2	(1.1)
Change in pension liability less related income tax (provision) benefit of \$(1.0) in 2019, \$4.3 in 2018 and \$(7.5) in 2017	<u>2.9</u>	<u>(13.1)</u>	<u>12.1</u>
Comprehensive Earnings	<u>\$ 372.5</u>	<u>\$ 392.9</u>	<u>\$ 360.2</u>

See accompanying notes which are an integral part of these statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

Years ended December 31 (dollars in millions)

	2019	2018	2017
Operating Activities			
Net earnings	\$ 370.0	\$ 444.2	\$ 296.5
Adjustments to reconcile earnings to cash provided by (used in) operating activities:			
Depreciation and amortization	78.3	71.9	70.1
U.S. Tax Reform income tax expense	-	-	81.8
Stock based compensation expense	13.3	10.1	9.9
Net changes in operating assets and liabilities, net of acquisitions:			
Current assets and liabilities	32.6	(40.0)	(127.8)
Noncurrent assets and liabilities	<u>(38.0)</u>	<u>(37.3)</u>	<u>(4.1)</u>
Cash Provided by Operating Activities	456.2	448.9	326.4
Investing Activities			
Acquisitions of businesses	(107.0)	-	(43.1)
Investments in marketable securities	(272.7)	(523.4)	(583.5)
Proceeds from sales of marketable securities	478.0	595.9	562.7
Capital expenditures	<u>(64.4)</u>	<u>(85.2)</u>	<u>(94.2)</u>
Cash Provided by (Used in) Investing Activities	33.9	(12.7)	(158.1)
Financing Activities			
Long-term debt incurred (repaid)	62.6	(189.0)	86.5
Common stock repurchases	(287.7)	(202.6)	(139.1)
Net (payments) proceeds from stock option activity	(0.5)	0.9	(0.9)
Payment of contingent consideration	(1.0)	(2.3)	(1.7)
Dividends paid	<u>(149.2)</u>	<u>(130.1)</u>	<u>(96.9)</u>
Cash Used in Financing Activities	<u>(375.8)</u>	<u>(523.1)</u>	<u>(152.1)</u>
Net increase (decrease) in cash and cash equivalents	114.3	(86.9)	16.2
Cash and cash equivalents-beginning of year	<u>259.7</u>	<u>346.6</u>	<u>330.4</u>
Cash and Cash Equivalents-End of Year	<u>\$ 374.0</u>	<u>\$ 259.7</u>	<u>\$ 346.6</u>

See accompanying notes, which are an integral part of these statements.

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

Years ended December 31 (dollars in millions)

	2019	2018	2017
Class A Common Stock			
Balance at the beginning of the year	\$ 131.0	\$ 131.2	\$ 131.6
Conversion of Class A Common Stock	<u>(0.1)</u>	<u>(0.2)</u>	<u>(0.4)</u>
Balance at the end of the year	\$ <u>130.9</u>	\$ <u>131.0</u>	\$ <u>131.2</u>
Common Stock			
Balance at the beginning of the year	\$ 164.5	\$ 164.5	\$ 164.4
Conversion of Class A Common Stock	<u>-</u>	<u>-</u>	<u>0.1</u>
Balance at the end of the year	\$ <u>164.5</u>	\$ <u>164.5</u>	\$ <u>164.5</u>
Capital in Excess of Par Value			
Balance at the beginning of the year	\$ 496.7	\$ 486.5	\$ 477.6
Conversion of Class A Common Stock	0.1	0.2	0.3
Issuance of share units	(6.2)	(6.0)	(4.9)
Vesting of share units	(2.2)	(2.4)	(2.9)
Stock based compensation expense	12.9	10.1	9.2
Exercises of stock options	0.7	1.4	1.4
Stock incentives	<u>7.0</u>	<u>6.9</u>	<u>5.8</u>
Balance at the end of the year	\$ <u>509.0</u>	\$ <u>496.7</u>	\$ <u>486.5</u>
Retained Earnings			
Balance at the beginning of the year	\$ 2,102.8	\$ 1,788.7	\$ 1,589.1
Net earnings	370.0	444.2	296.5
Cash dividends on stock	<u>(149.4)</u>	<u>(130.1)</u>	<u>(96.9)</u>
Balance at the end of the year	\$ <u>2,323.4</u>	\$ <u>2,102.8</u>	\$ <u>1,788.7</u>
Accumulated Other Comprehensive Loss			
Balance at the beginning of the year	\$ (350.8)	\$ (299.5)	\$ (363.2)
Foreign currency translation adjustments	(1.3)	(38.4)	52.7
Unrealized net gain (loss) on cash flow derivative instruments, less related income tax (provision) benefit of (\$0.3) in 2019, (\$0.1) in 2018 and \$0.7 in 2017	0.9	0.2	(1.1)
Change in pension liability less related income tax benefit (provision) of \$(1.0) in 2019, \$4.3 in 2018 and \$(7.5) in 2017	<u>2.9</u>	<u>(13.1)</u>	<u>12.1</u>
Balance at the end of the year	\$ <u>(348.3)</u>	\$ <u>(350.8)</u>	\$ <u>(299.5)</u>
Treasury Stock			
Balance at the beginning of the year	\$ (827.2)	\$ (626.5)	\$ (488.1)
Exercise of stock options, net of 87,918, 54,180 and 160,856 shares surrendered as proceeds and to pay taxes in 2019, 2018 and 2017, respectively	(0.2)	(0.7)	(2.4)
Stock incentives and directors' compensation	0.2	0.1	0.2
Shares repurchased	(287.7)	(202.6)	(139.1)
Vesting of share units	<u>2.2</u>	<u>2.5</u>	<u>2.9</u>
Balance at the end of the year	\$ <u>(1,112.7)</u>	\$ <u>(827.2)</u>	\$ <u>(626.5)</u>
Total Stockholders' Equity	\$ <u>1,666.8</u>	\$ <u>1,717.0</u>	\$ <u>1,644.9</u>

See accompanying notes which are an integral part of these statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Significant Accounting Policies

Organization. A. O. Smith Corporation (A. O. Smith or the Company) is comprised of two reporting segments: North America and Rest of World. The Rest of World segment is primarily comprised of China, Europe and India. Both segments manufacture and market comprehensive lines of residential and commercial gas and electric water heaters, boilers, tanks and water treatment products. Both segments primarily manufacture and market in their respective regions of the world. The Rest of World segment also manufactures and markets in-home air purification products in China.

Consolidation. The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries after elimination of intercompany transactions.

Use of estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States (U.S.) requires management to make estimates and assumptions that affect the amounts reported in the accompanying financial statements and notes. Actual results could differ from those estimates.

Fair value of financial instruments. The carrying amounts of cash, cash equivalents, marketable securities, receivables, floating rate debt and trade payables approximated fair value as of December 31, 2019 and 2018, due to the short maturities or frequent rate resets of these instruments. The fair value of term notes with insurance companies was approximately \$122.1 million as of December 31, 2019 compared with the carrying amount of \$120.0 million for the same date. The fair value of term notes with insurance companies was approximately \$120.0 million as of December 31, 2018 which approximated the carrying value.

Foreign currency translation. For all subsidiaries outside the U.S., with the exception of its Barbados, Hong Kong and Mexican companies and its non-operating companies in the Netherlands, the Company uses the local currency as the functional currency. For those operations using a functional currency other than the U.S. dollar, assets and liabilities were translated into U.S. dollars at year-end exchange rates, and revenues and expenses were translated at weighted-average exchange rates. The resulting translation adjustments were recorded as a separate component of stockholders' equity. The Barbados, Hong Kong, Mexican and Netherlands companies use the U.S. dollar as the functional currency. Gains and losses from foreign currency transactions were included in net earnings and were not significant in 2019, 2018, or 2017.

Cash and cash equivalents. The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Marketable securities. The Company considers all highly liquid investments with maturities greater than 90 days when purchased to be marketable securities. At December 31, 2019, the Company's marketable securities consisted of bank time deposits with original maturities ranging from 180 days to 12 months and were primarily located at investment grade rated banks in China.

Inventory valuation. Inventories are carried at lower of cost and net realizable value. Cost is determined on the last-in, first-out (LIFO) method for a majority of the Company's domestic inventories, which comprised 61 percent and 64 percent of the Company's total inventory at December 31, 2019 and 2018, respectively. Inventories of foreign subsidiaries, the remaining domestic inventories and supplies were determined using the first-in, first-out (FIFO) method.

Property, plant and equipment. Property, plant and equipment are stated at cost. Depreciation is computed primarily by the straight-line method. The estimated service lives used to compute depreciation are generally 25 to 50 years for buildings, three to 20 years for equipment and three to 15 years for software. Maintenance and repair costs are expensed as incurred.

Goodwill and other intangibles. Goodwill and indefinite-lived intangible assets are not amortized but are reviewed for impairment on an annual basis. Separable intangible assets, primarily comprised of customer relationships, that are not deemed to have an indefinite life are amortized on a straight-line basis over their estimated useful lives which range from five to 25 years.

1. Organization and Significant Accounting Policies (continued)

Impairment of long-lived and amortizable intangible assets. Property, plant and equipment and intangible assets subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If the sum of the expected undiscounted cash flows is less than the carrying value of the related asset or group of assets, a loss is recognized for the difference between the fair value and carrying value of the asset or group of assets. Such analyses necessarily involve significant judgment.

Product warranties. The Company's products carry warranties that generally range from one to ten years and are based on terms that are consistent with the market. The Company records a liability for the expected cost of warranty-related claims at the time of sale and is estimated based on the warranty period, product type and loss experience using actual historical failure rates and estimated costs of product replacement. The variables used in the calculation of the provision are reviewed by the Company at least annually. At times, warranty issues may arise which are beyond the scope of the Company's historical experience. The Company provides for any such warranty issues as they become known and estimable. The allocation of the warranty liability between current and long-term is based on expected warranty claims to be paid in the next year as determined by historical product failure rates.

The following table presents the Company's product warranty liability activity in 2019 and 2018:

Years ended December 31 (dollars in millions)	2019	2018
Balance at beginning of year	\$ 139.4	\$ 141.2
Expense	44.3	40.7
Claims settled	<u>(49.4)</u>	<u>(42.5)</u>
Balance at end of year	<u>\$ 134.3</u>	<u>\$ 139.4</u>

Derivative instruments. The Company utilizes certain derivative instruments to enhance its ability to manage currency as well as raw materials price risk. The Company does not enter into contracts for speculative purposes. The fair values of all derivatives are recorded in the consolidated balance sheets. The change in a derivative's fair value is recorded each period in current earnings or accumulated other comprehensive loss (AOCL), depending on whether the derivative is designated as part of a hedge transaction and if so, the type of hedge transaction. See Note 14, "Derivative Instruments" of the notes to consolidated financial statements for disclosure of the Company's derivative instruments and hedging activities.

Fair Value Measurements. Accounting Standards Codification (ASC) 820 *Fair Value Measurements*, among other things, defines fair value, establishes a consistent framework for measuring fair value and expands disclosure for each major asset and liability category measured at fair value on either a recurring basis or nonrecurring basis. ASC 820 clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, ASC 820 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows: (Level 1) observable inputs such as quoted prices in active markets; (Level 2) inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and (Level 3) unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

Assets and liabilities measured at fair value are based on the market approach which are prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.

Assets measured at fair value on a recurring basis are as follows (dollars in millions):

Fair Value Measurement Using	December 31, 2019	December 31, 2018
Quoted prices in active markets for identical assets (Level 1)	\$ 177.4	\$ 385.3
Significant other observable inputs (Level 2)	6.9	7.5

There were no changes in the valuation techniques used to measure fair values on a recurring basis.

1. Organization and Significant Accounting Policies (continued)

Revenue recognition. Substantially all of the Company's sales are from contracts with customers for the purchase of its products. Contracts and customer purchase orders are used to determine the existence of a sales contract. Shipping documents are used to verify shipment. For substantially all of its products, the Company transfers control of products to the customer at the point in time when title and risk are passed to the customer, which generally occurs upon shipment of the product. See Note 2, "Revenue Recognition" for disclosure of the Company's revenue recognition activities.

Advertising. The majority of advertising costs are charged to operations as incurred and amounted to \$110.7 million, \$132.1 million and \$126.9 million during 2019, 2018 and 2017, respectively. Included in total advertising costs are expenses associated with store displays for water heater, water treatment and air purification products in China that are amortized over 12 to 36 months which totaled \$28.5 million, \$38.7 million and \$43.0 million during 2019, 2018 and 2017, respectively.

Research and development. Research and development costs are charged to operations as incurred and amounted to \$87.9 million, \$94.0 million and \$86.4 million during 2019, 2018 and 2017, respectively.

Environmental costs. The Company accrues for costs associated with environmental obligations when such costs are probable and reasonably estimable. Costs of estimated future expenditures are not discounted to their present value. Recoveries of environmental costs from other parties are recorded as assets when their receipt is considered probable. The accruals are adjusted as facts and circumstances change.

Stock-based compensation. Compensation cost is recognized using the straight-line method over the vesting period of the award and forfeitures are recognized as they occur. In accordance with amended ASC 718, the Company recognized \$2.3 million, \$2.4 million, and \$11.6 million of discrete income tax benefits on settled stock based compensation awards during 2019, 2018, and 2017 respectively.

Income taxes. The provision for income taxes is computed using the asset and liability method, in accordance with ASC 740 *Income Taxes*, under which deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities and for operating losses and tax credit carryforwards. Deferred tax assets and liabilities are measured using the currently enacted tax rates that apply to taxable income in effect for the years in which those tax assets are expected to be realized or settled and are classified as noncurrent in the consolidated balance sheet. The Company records a valuation allowance to reduce deferred tax assets to the amount that is believed more likely than not to be realized.

The Company recognizes the tax benefit from an uncertain tax position only if it is more likely than not the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such positions are then measured based on the largest benefit that has a greater than 50 percent likelihood of being realized upon settlement.

Earnings per share of common stock. The Company is not required to use the two-class method of calculating earnings per share since its Class A Common Stock and Common Stock have equal dividend rights. The numerator for the calculation of basic and diluted earnings per share is net earnings. The following table sets forth the computation of basic and diluted weighted-average shares used in the earnings per share calculations:

	2019	2018	2017
Denominator for basic earnings per share - weighted-average shares outstanding	165,450,441	170,589,345	172,666,056
Effect of dilutive stock options, restricted stock and share units	<u>1,260,456</u>	<u>1,604,695</u>	<u>1,939,133</u>
Denominator for diluted earnings per share	<u>166,710,897</u>	<u>172,194,040</u>	<u>174,605,189</u>

1. Organization and Significant Accounting Policies (continued)

Recent Accounting Pronouncements

In December 2019, the Financial Accounting Standards Board (FASB) amended Accounting Standards Codification (ASC) 740, *Income Taxes* (issued under Accounting Standards Update (ASU) 2019-12, “Simplifying the Accounting for Income Taxes”). This amendment removes certain exceptions to the general principles of ASC 740, and clarifies and amends existing guidance to improve consistent application. The amendment requires adoption on January 1, 2021, with early adoption permitted. The Company is currently evaluating the impact ASU 2019-12 will have on its consolidated financial statements.

In January 2017, the FASB amended ASC 350, *Intangibles – Goodwill and Other* (issued under ASU 2017-04, “Simplifying the Test for Goodwill Impairment”). This amendment simplifies the test for goodwill impairment by only requiring an entity to perform an annual or interim goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount and recognize an impairment charge for the amount that the carrying amount exceeds the reporting unit’s fair value. Any loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. The amendment requires adoption on January 1, 2020. The Company does not expect that the adoption of ASU 2017-04 will have a material impact on its consolidated balance sheets, statements of earnings or statements of cash flows.

In June 2016, the FASB issued ASC 326, *Financial Instruments – Credit Losses* (issued under ASU 2016-13) which modifies the measurement of expected credit losses on certain financial instruments. ASU 2016-13 requires adoption on January 1, 2020. The adoption of ASU 2016-13 will not have a material impact on its consolidated balance sheets, statements of earnings or statements of cash flows.

In February 2016, the FASB amended ASC 842, *Leases* (issued under ASU 2016-02). This amendment requires the recognition of lease assets and lease liabilities on the balance sheet for most leasing arrangements classified as operating leases. The Company applied the modified retrospective transition method and elected the transition option to use the effective date of January 1, 2019, as the date of the initial application. The Company elected the package of practical expedients as well as a separate practical expedient not to separate lease and non-lease components. The Company did not elect the hindsight practical expedient. The adoption of ASU 2016-02 did not have a material impact on the Company’s consolidated balance sheets, statements of earnings or statements of cash flows. Refer to Note 4, Leases, for additional information.

2. Revenue Recognition

Substantially all of the Company’s sales are from contracts with customers for the purchase of its products. Contracts and customer purchase orders are used to determine the existence of a sales contract. Shipping documents are used to verify shipment. For substantially all of its products, the Company transfers control of products to the customer at the point in time when title and risk are passed to the customer, which generally occurs upon shipment of the product. Each unit sold is considered an independent, unbundled performance obligation. The Company’s sales arrangements do not include other performance obligations that are material in the context of the contract. The nature, timing and amount of revenue for a respective performance obligation are consistent for each customer. The Company measures the sales transaction price based upon the payment terms associated with the transaction and whether the sales price is subject to refund or adjustment. Sales and value added taxes are excluded from the measurement of transaction price. The Company’s payment terms for the majority of its customers are 30 to 90 days from shipment.

Additionally, certain customers in China pay the Company prior to the shipment of products resulting in a customer deposits liability of \$49.6 million and \$47.0 million at December 31, 2019 and December 31, 2018, respectively. The Company assesses collectability of customer receivables based on the creditworthiness of a customer as determined by credit checks and analysis, as well as the customer’s payment history. The Company’s allowance for doubtful accounts was \$6.7 million and \$6.4 million at December 31, 2019 and December 31, 2018, respectively.

Rebates and incentives are based on pricing agreements and are tied to sales volume. The amount of revenue is reduced for variable consideration related to customer rebates which are calculated using expected values and are based on program specific factors such as expected rebate percentages based on expected volumes. In situations where the customer has the right to return eligible products, the Company reduces revenue for its estimates of expected product returns, which are primarily based on an analysis of historical experience. Changes in such accruals may be required if actual sales volume differs from estimated sales volume or if future returns differ from historical experience. Shipping and handling costs billed to customers are included in net

2. Revenue Recognition (continued)

sales and the related costs are included in cost of products sold and are activities performed to fulfill the promise to transfer products.

Disaggregation of Net Sales

The Company is comprised of two reporting segments: North America and Rest of World. The Rest of World segment is primarily comprised of China, Europe and India. Both segments manufacture and market comprehensive lines of residential and commercial gas and electric water heaters, boilers, tanks and water treatment products. Both segments primarily manufacture and market in their respective regions of the world. The Rest of World segment also manufactures and markets in-home air purification products in China.

As each segment manufactures and markets products in its respective region of the world, the Company has determined that geography is the primary factor in reporting its sales. The Company further disaggregates its North America segment sales by major product line as each of North America's major product lines is sold through distinct distribution channels and these product lines may be impacted differently by certain economic factors. Within the Rest of World segment, particularly in China and India, the Company's major customers purchase across the Company's product lines, utilizing the same distribution channel regardless of product type. In addition, the impact of economic factors is unlikely to be differentiated by product line in the Rest of World segment.

The North America segment major product lines are defined as the following:

Water heaters The Company's water heaters are open water heating systems that heat potable water. Typical applications for water heaters include residences, restaurants, hotels and motels, office buildings, laundries, car washes and small businesses. The Company sells residential and commercial water heater products and related parts through its wholesale distribution channel, which includes more than 1,300 independent wholesale plumbing distributors. The Company also sells residential water heaters and related parts through retail and maintenance, repair and operations (MRO) channels. A significant portion of the Company's water heater sales in the North America segment is derived from the replacement of existing products.

Boilers The Company's boilers are closed loop water heating systems used primarily for space heating or hydronic heating. The Company's boilers are primarily used in applications in commercial settings for hospitals, schools, hotels and other large commercial buildings while residential boilers are used in homes, apartments and condominiums. The Company's boiler distribution channel is comprised primarily of manufacturer representative firms, with the remainder of our boilers distributed through wholesale channels. The Company's boiler sales in the North America segment are derived from a combination of replacement of existing products and new construction.

Water treatment products The Company's water treatment products range from point-of-entry water softeners, solutions for problem well water, and whole-home water filtration products to on-the-go filtration bottles and point-of-use carbon and reverse osmosis products. Typical applications for the Company's water treatment products include residences, restaurants, hotels and offices. The Company sells water treatment products through its wholesale and retail distribution channels, similar to water heater products and related parts. The Company's water treatment products are also sold through independent water quality dealers as well as directly to consumers including through internet sales channels. A portion of the Company's sales of water treatment products in the North America segment is comprised of replacement filters.

The following table disaggregates the Company's net sales by segment. As described above, the Company's North America segment sales are further disaggregated by major product line. In addition, the Company's Rest of World segment sales are disaggregated by China and all other Rest of World.

2. Revenue Recognition (continued)

Years ending December 31 (dollars in millions)	2019	2018	2017
North America			
Water heaters and related parts	\$1,742.6	\$1,757.0	\$1,663.0
Boilers and related parts	199.5	200.4	183.3
Water treatment products ⁽¹⁾	<u>141.4</u>	<u>87.3</u>	<u>58.5</u>
Total North America	2,083.5	2,044.7	1,904.8
Rest of World			
China	\$ 827.2	\$1,070.4	\$1,029.4
All other Rest of World	<u>108.6</u>	<u>103.2</u>	<u>86.9</u>
Total Rest of World	935.8	1,173.6	1,116.3
Inter-segment sales	<u>(26.6)</u>	<u>(30.4)</u>	<u>(24.4)</u>
Total Net Sales	<u>\$2,992.7</u>	<u>\$3,187.9</u>	<u>\$2,996.7</u>

⁽¹⁾ Includes the results of Water-Right and Hague Quality Water International (Hague) from the date of acquisition of April 8, 2019 and September 5, 2017, respectively.

3. Acquisitions

On April 8, 2019, the Company acquired 100 percent of the shares of Water-Right, Inc. and its affiliated entities (Water-Right), a Wisconsin-based water treatment company. With the addition of Water-Right, the Company grew its North America water treatment platform. Water-Right is included in the Company's North America segment for reporting purposes.

The Company paid an aggregate cash purchase price of \$107.0 million, net of cash acquired. In addition, the Company established a \$4.0 million escrow to satisfy any potential obligations of the former owners of Water-Right, should they arise.

The following table summarizes the preliminary estimate of the fair value of the assets acquired and liabilities assumed at the date of acquisition of Water-Right for purposes of allocating the purchase price. The Company is in the process of finalizing the fair value estimates; therefore, the allocation of the purchase price is subject to refinement. Significant assumptions used to estimate the fair value of intangible assets acquired include discount rates and certain assumptions that form the basis of the forecasted results, including revenue growth rates, attrition rates and royalty rates. The preliminary \$60.4 million of acquired identifiable intangible assets was comprised of the following: \$40.2 million of customer relationships being amortized over 20 years, \$19.0 million of trademarks not subject to amortization, and \$1.2 million of non-compete agreements being amortized over 7.5 years.

April 8, 2019 (dollars in millions)	
Current assets, net of cash acquired	\$ 9.7
Property, plant and equipment	8.6
Intangible assets	60.4
Goodwill	<u>31.0</u>
Total assets acquired	109.7
Current liabilities	<u>(2.7)</u>
Net assets acquired	<u>\$ 107.0</u>

As required under ASC 805 *Business Combinations*, Water-Right's results of operations have been included in the Company's consolidated financial statements from April 8, 2019, the date of acquisition. Revenues and pre-tax earnings associated with Water-Right included in the consolidated statement of earnings for the year ended December 31, 2019 totaled \$44.3 million and

3. Acquisitions (continued)

\$7.1 million, respectively, which included \$7.5 million of operating earnings less \$0.4 million of acquisition-related costs incurred by the Company resulting from the acquisition.

On September 5, 2017, the Company acquired 100 percent of the shares of Hague, an Ohio-based water softener company. With the addition of Hague, the Company grew its North America water treatment platform. Hague is included in the Company's North America segment for reporting purposes.

The Company paid an aggregate cash purchase price of \$43.1 million, net of \$4.1 million of cash acquired. In addition, the Company established a \$1.5 million holdback liability to satisfy any potential obligations of the former owners of Hague, should they arise. The Company also agreed to make a contingent payment of up to an additional \$2.0 million based on the amount by which products manufactured by or branded Hague increase over the two-year period ending June 30, 2019. In addition, the Company incurred acquisition-related costs of approximately \$0.2 million.

As of the acquisition date, the Company estimated the fair value of the holdback liability and additional contingent consideration at \$1.5 million and \$2.0 million, respectively. During 2018, the Company finalized the amount of acquisition date working capital, which resulted in a \$1.3 million payment to the former owners of Hague related to the aforementioned holdback. The Company also paid \$2.0 million of contingent payments associated with the amount by which sales of products manufactured by Hague increase over the two-year period ending June 30, 2019.

The following table summarizes the allocation of fair value of the assets acquired and liabilities assumed at the date of acquisition of Hague for purposes of allocating the purchase price. Significant assumptions used to estimate the fair value of intangible assets acquired include discount rates and certain assumptions that form the basis of the forecasted results, including revenue growth rates, attrition rates and royalty rates. The \$12.8 million of acquired intangible assets was comprised of \$1.1 million of trade names that are not subject to amortization and \$11.7 million of customer lists being amortized over 18 years.

<u>September 5, 2017 (dollars in millions)</u>	
Current assets, net of cash acquired	\$ 7.8
Property, plant and equipment	6.9
Intangible assets	12.8
Goodwill	<u>22.2</u>
Total assets acquired	49.7
Current liabilities	(5.6)
Long-term liabilities	<u>(1.0)</u>
Total liabilities assumed	<u>(6.6)</u>
Net assets acquired	<u>\$ 43.1</u>

4. Leases

The Company's lease portfolio consists of operating leases for buildings and equipment, such as forklifts and copiers, primarily in the United States and China. The Company defines a lease as a contract that gives the Company the right to control the use of a physical asset for a stated term. The Company pays the lessor for that right, with a series of payments defined in the contract and a corresponding right of use operating lease asset and liability are recorded. The Company has elected not to record leases with an initial term of 12 months or less on its condensed consolidated balance sheet. To determine balance sheet amounts, required legal payments are discounted using the Company's incremental borrowing rate. The incremental borrowing rate is the rate of interest that the Company would incur if it were to borrow, on a collateralized basis, an amount equal to the value of the leased item over a similar term, in a similar economic environment. Variable lease components not based on an index or rate are excluded from the measurement of the lease asset and liability and expensed as incurred for all asset classes.

Certain leases include one or more options to renew or terminate. Renewal terms can extend the lease term from one to five years and options to terminate can be effective within one year. The exercise of lease renewal or termination is at the Company's discretion and when it is determined to be reasonably certain to renew or terminate, the option is reflected in the measurement of lease asset and liability. The Company's lease agreements do not contain any material residual value guarantees or material restrictive covenants or material subleases. Cash flows associated with leases are materially consistent with the expense recorded in the condensed consolidated statement of earnings.

4. Leases (continued)

Supplemental balance sheet information related to leases is as follows:

(dollars in millions)

	December 31, 2019
Liabilities	
Short term: Accrued liabilities	\$ 12.0
Long term: Operating lease liabilities	<u>38.7</u>
Total operating lease liabilities	\$ 50.7
Less: Rent incentives and deferrals	<u>(3.8)</u>
Assets	
Operating lease assets	<u>\$ 46.9</u>

Lease Term and Discount Rate	December 31, 2019
Weighted-average remaining lease term	10 years
Weighted-average discount rate	3.93%

The components of lease expense were as follows:

(dollars in millions)

Lease Expense	Classification	Twelve months ended December 31, 2019
Operating lease expense ⁽¹⁾	Cost of products sold	\$ 3.0
	Selling, general and administrative expenses	17.6

⁽¹⁾ Includes short-term lease expense of \$2.0 million for the twelve months ended December 31, 2019. Includes variable lease cost of \$2.1 million for the twelve months ended December 31, 2019.

Rent expense, including payments under operating leases, was \$24.0 million and \$23.9 million in 2018 and 2017 respectively.

Maturities of lease liabilities were as follows:

(dollars in millions)

	December 31, 2019
2020	\$ 14.0
2021	10.5
2022	9.0
2023	4.9
2024	3.7
After 2024	<u>22.8</u>
Total lease payments	64.9
Less: imputed interest	<u>(14.2)</u>
Present value of operating lease liabilities	<u>\$ 50.7</u>

5. Restructuring and Impairment Expenses

On March 21, 2018, the Company announced a move of manufacturing operations from its Renton, Washington facility to other U.S. facilities. The Company recognized \$6.7 million of restructuring and impairment expenses, comprised of \$4.0 million of severance and compensation related costs, lease exit costs of \$2.1 million and impairment charges related to long-lived assets totaling \$0.6 million, as well as a corresponding \$1.7 million tax benefit related to the charges. As of December 31, 2019, the consolidation of the Renton facility to other U.S. facilities was complete.

The following table presents an analysis of the Company's restructuring reserve for the years ended December 31, 2019 and 2018:

(dollars in millions)

	Severance Costs	Lease Exit Costs	Fixed Assets Impairment	Total
Balance at January 1, 2018	\$ -	\$ -	\$ -	\$ -
Restructuring expense recognized	4.0	2.1	0.6	6.7
Cash payments and disposals	<u>(3.8)</u>	<u>(0.8)</u>	<u>(0.6)</u>	<u>(5.2)</u>
Balance at December 31, 2018	0.2	1.3	-	1.5
Cash payments and disposals	<u>(0.2)</u>	<u>(0.8)</u>	<u>-</u>	<u>(1.0)</u>
Balance at December 31, 2019	<u>\$ -</u>	<u>\$ 0.5</u>	<u>\$ -</u>	<u>\$ 0.5</u>

6. Statement of Cash Flows

Supplemental cash flow information is as follows:

Years ended December 31 (dollars in millions)	2019	2018	2017
Net change in current assets and liabilities, net of acquisitions:			
Receivables	\$ 62.4	\$ (54.6)	\$ (75.8)
Inventories	6.3	(7.7)	(37.5)
Other current assets	(4.8)	10.0	(9.0)
Trade payables	(35.4)	8.8	(5.1)
Accrued liabilities, including payroll and benefits	14.2	(3.5)	12.2
Income taxes	<u>(10.1)</u>	<u>7.0</u>	<u>(12.6)</u>
	<u>\$ 32.6</u>	<u>\$ (40.0)</u>	<u>\$ (127.8)</u>

7. Inventories

December 31 (dollars in millions)	2019	2018
Finished products	\$ 136.8	\$ 137.6
Work in process	21.7	23.3
Raw materials	<u>168.3</u>	<u>174.4</u>
Inventories, at FIFO cost	326.8	335.3
LIFO reserve	<u>(23.8)</u>	<u>(30.6)</u>
	<u>\$ 303.0</u>	<u>\$ 304.7</u>

The Company recognized after-tax LIFO income of \$(0.7) million, \$(0.4) million and \$(0.3) million in 2019, 2018 and 2017, respectively.

8. Property, Plant and Equipment

December 31 (dollars in millions)	2019	2018
Land	\$ 11.6	\$ 11.2
Buildings	334.1	323.3
Equipment	686.9	643.8
Software	<u>124.3</u>	<u>118.5</u>
	1,156.9	1,096.8
Less accumulated depreciation and amortization	<u>611.5</u>	<u>556.8</u>
	<u>\$ 545.4</u>	<u>\$ 540.0</u>

9. Goodwill and Other Intangible Assets

Changes in the carrying amount of goodwill during the years ended December 31, 2019 and 2018 consisted of the following:

(dollars in millions)	North America	Rest of World	Total
Balance at December 31, 2017	\$ 457.2	\$ 59.5	\$ 516.7
Currency translation adjustment	<u>(3.3)</u>	<u>(0.4)</u>	<u>(3.7)</u>
Balance at December 31, 2018	453.9	59.1	513.0
Acquisition	31.0	-	31.0
Currency translation adjustment	<u>2.0</u>	<u>-</u>	<u>2.0</u>
Balance at December 31, 2019	<u>\$ 486.9</u>	<u>\$ 59.1</u>	<u>\$ 546.0</u>

The carrying amount of other intangible assets consisted of the following:

December 31 (dollars in millions)	2019			2018		
	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
Amortizable intangible assets:						
Patents	\$ 3.7	\$ (3.5)	\$ 0.2	\$ 3.7	\$ (3.3)	\$ 0.4
Customer lists	<u>278.0</u>	<u>(123.6)</u>	<u>154.4</u>	<u>236.8</u>	<u>(108.2)</u>	<u>128.6</u>
Total amortizable intangible assets	281.7	(127.1)	154.6	240.5	(111.5)	129.0
Indefinite-lived intangible assets:						
Trade names	<u>183.8</u>	<u>-</u>	<u>183.8</u>	<u>164.1</u>	<u>-</u>	<u>164.1</u>
Total intangible assets	<u>\$ 465.5</u>	<u>\$(127.1)</u>	<u>\$338.4</u>	<u>\$ 404.6</u>	<u>\$(111.5)</u>	<u>\$ 293.1</u>

Amortization expenses of other intangible assets of \$15.8 million, \$14.3 million, and \$13.7 million were recorded in 2019, 2018 and 2017, respectively. In the future, excluding the impact of any future acquisitions, the Company expects amortization expense of approximately \$15.7 million annually and the intangible assets will be amortized over a weighted-average period of 13 years.

The Company concluded that no goodwill impairment existed at the time of the annual impairment tests which were performed in the fourth quarters of 2019, 2018 and 2017. No impairments of other intangible assets were recorded in 2019, 2018 and 2017.

10. Debt

December 31 (dollars in millions)	2019	2018
Bank credit lines, average year-end interest rates of 2.4% for 2019 and 3.4% for 2018	\$ 4.7	\$ 17.1
Revolving credit agreement borrowings, average year-end interest rates of 2.8% for 2019 and 3.5% for 2018	85.0	10.0
Commercial paper, average year-end interest rates of 2.2% for 2019 and 2.7% for 2018	74.3	74.3
Term notes with insurance companies, expiring 2029-2034, average year-end interest rates of 3.3% for 2019 and 3.3% for 2018	<u>120.0</u>	<u>120.0</u>
	284.0	221.4
Less long-term debt due within one year	<u>6.8</u>	<u>-</u>
Long-term debt	<u>\$ 277.2</u>	<u>\$ 221.4</u>

In December 2016, the Company completed a \$500 million multi-year multi-currency revolving credit agreement with a group of nine banks, which expires on December 15, 2021. The facility has an accordion provision which allows it to be increased up to \$700 million if certain conditions (including lender approval) are satisfied. Borrowings under the Company's bank credit lines and commercial paper borrowings are supported by the revolving credit agreement. As a result of the long-term nature of this facility, the commercial paper and credit line borrowings are classified as long-term debt at December 31, 2019 and 2018. At its option, the Company either maintains cash balances or pays fees for bank credit and services.

Scheduled maturities of long-term debt within each of the five years subsequent to December 31, 2019 are as follows:

Years ending December 31 (dollars in millions)	Amount
2020	\$ 6.8
2021	170.8
2022	6.8
2023	10.0
2024	10.0

11. Stockholders' Equity

The Company's authorized capital consists of three million shares of Preferred Stock \$1 par value, 27 million shares of Class A Common Stock \$5 par value, and 240 million shares of Common Stock \$1 par value. The Common Stock has equal dividend rights with Class A Common Stock and is entitled, as a class, to elect one-third of the Board of Directors and has 1/10th vote per share on all other matters. Class A Common Stock is convertible to Common Stock on a one for one basis.

There were 10,442 shares during 2019, 48,232 shares during 2018 and 73,792 shares during 2017, of Class A Common Stock converted into Common Stock. Regular dividends paid on the A. O. Smith Corporation Class A Common Stock and Common Stock amounted to \$0.90, \$0.76 and \$0.56 per share in 2019, 2018 and 2017, respectively.

In June 2019, our Board of Directors approved adding 3 million shares of Common Stock to an existing discretionary share repurchase authority. Under the share repurchase program, the Company may purchase the Common Stock through a combination of Rule 10b5-1 automatic trading plan and discretionary purchases in accordance with applicable securities laws. The number of shares purchased and the timing of the purchases will depend on a number of factors, including share price, trading volume and general market conditions, as well as working capital requirements, general business conditions and other factors, including alternative investment opportunities. The stock repurchase authorization remains effective until terminated by the Company's Board of Directors which may occur at any time, subject to the parameters of any Rule 10b5-1 automatic trading plan that the Company may then have in effect. In 2019, the Company repurchased 6,113,038 shares at an average price of \$47.06 per share and at a total cost of \$287.7 million. As of December 31, 2019, there were 2,962,215 shares remaining on the existing repurchase authorization. In 2018, the Company repurchased 3,797,800 shares at a cost of \$202.6 million. In 2017, the Company repurchased 2,533,350 shares at a cost of \$139.1 million.

11. Stockholders' Equity (continued)

At December 31, 2019, a total of 130,380 and 28,205,806 shares of Class A Common Stock and Common Stock, respectively, were held as treasury stock. At December 31, 2018, a total of 130,380 and 22,418,066 shares of Class A Common Stock and Common Stock, respectively, were held as treasury stock.

Changes to accumulated other comprehensive loss by component are as follows:

	Years ended December 31,	
	2019	2018
Cumulative foreign currency translation		
Balance at beginning of period	\$ (64.9)	\$ (26.5)
Other comprehensive gain (loss) before reclassifications	<u>(1.3)</u>	<u>(38.4)</u>
Balance at end of period	<u>(66.2)</u>	<u>(64.9)</u>
Unrealized net (loss) gain on cash flow derivatives		
Balance at beginning of period	(0.7)	(0.9)
Other comprehensive (loss) gain before reclassifications	(0.3)	0.6
Realized losses (gains) on derivatives reclassified to cost of products sold (net of tax (benefit) provision of (\$0.5) and \$0.2 in 2019 and 2018, respectively) ⁽¹⁾	<u>1.2</u>	<u>(0.4)</u>
Balance at end of period	<u>0.2</u>	<u>(0.7)</u>
Pension liability		
Balance at beginning of period	(285.2)	(272.1)
Other comprehensive (loss) gain before reclassifications	(9.5)	(27.0)
Amounts reclassified from accumulated other comprehensive loss ⁽¹⁾	<u>12.4</u>	<u>13.9</u>
Balance at end of period	<u>(282.3)</u>	<u>(285.2)</u>
Total accumulated other comprehensive loss, end of period	<u>\$(348.3)</u>	<u>\$(350.8)</u>
⁽¹⁾ Amounts reclassified from accumulated other comprehensive loss:		
Realized loss (gains) on derivatives reclassified to cost of products sold	1.7	(0.6)
Tax (benefit) provision	<u>(0.5)</u>	<u>0.2</u>
Reclassification net of tax	<u>\$ 1.2</u>	<u>\$ (0.4)</u>
Amortization of pension items:		
Actuarial losses	\$ 16.8 ⁽²⁾	\$ 19.0 ⁽²⁾
Prior year service cost	<u>(0.5)⁽²⁾</u>	<u>(0.5)⁽²⁾</u>
	16.3	18.5
Tax benefit	<u>(3.9)</u>	<u>(4.6)</u>
Reclassification net of tax	<u>\$ 12.4</u>	<u>\$ 13.9</u>

⁽²⁾ These accumulated other comprehensive loss components are included in the computation of net periodic benefit cost. See Note 13 "Pensions and Other Post-retirement Benefits" for additional details.

12. Stock Based Compensation

The Company adopted the A. O. Smith Combined Incentive Compensation Plan (the “Plan”) effective January 1, 2007. The Plan was reapproved by stockholders on April 16, 2012. The Plan is a continuation of the A. O. Smith Combined Executive Incentive Compensation Plan which was originally approved by stockholders in 2002. The number of shares available for granting of options or share units at December 31, 2019, was 1,855,560. Upon stock option exercise or share unit vesting, shares are issued from treasury stock.

Total stock based compensation expense recognized in 2019, 2018 and 2017 was \$13.3 million, \$10.1 million and \$9.9 million, respectively.

Stock Options

The stock options granted in 2019, 2018 and 2017 have three year pro rata vesting from the date of grant. Stock options are issued at exercise prices equal to the fair value of the Company’s Common Stock on the date of grant. For active employees, all options granted in 2019, 2018 and 2017 expire ten years after the date of grant. The Company’s stock options are expensed ratably over the three year vesting period. Included in stock option expense for 2019, 2018 and 2017 was \$6.4 million, \$4.4 million and \$4.7 million, respectively. Included in the stock option expense recognized in 2019, 2018 and 2017 is expense associated with the accelerated vesting of stock option awards for certain employees who either are retirement eligible or become retirement eligible during the vesting period.

Changes in options, all of which relate to the Company’s Common Stock, were as follows:

Years Ended December 31	2019		2018		2017	
	Number of Options	Weighted Avg. Per Share Exercise Price	Number of Options	Weighted Avg. Per Share Exercise Price	Number of Options	Weighted Avg. Per Share Exercise Price
Number of shares under options:						
Outstanding at beginning of year	2,432,689	33.05	2,263,126	27.73	2,664,333	21.69
Granted	557,045	49.49	373,220	61.62	358,150	50.16
Exercised ⁽¹⁾	(249,840)	18.55	(176,302)	22.93	(752,603)	16.93
Forfeited	<u>(11,544)</u>	<u>54.02</u>	<u>(27,355)</u>	<u>47.95</u>	<u>(6,754)</u>	<u>37.46</u>
Outstanding at end of year ⁽²⁾	<u>2,728,350</u>	<u>37.64</u>	<u>2,432,689</u>	<u>33.05</u>	<u>2,263,126</u>	<u>27.73</u>
Exercisable at end of year ⁽³⁾	<u>1,820,743</u>	<u>30.07</u>	<u>1,665,184</u>	<u>24.52</u>	<u>1,387,259</u>	<u>20.48</u>

- (1) The total intrinsic value of options exercised in 2019, 2018 and 2017 was \$7.7 million, \$6.8 million and \$29.1 million, respectively.
- (2) The weighted average remaining contractual life of options outstanding was 7 years at December 31, 2019, December 31, 2018, and December 31, 2017. The aggregate intrinsic value of options outstanding at December 31, 2019 was \$34.2 million.
- (3) The weighted average remaining contractual life of options exercisable was 6 years at December 31, 2019, December 31, 2018 and, December 31, 2017. The aggregate intrinsic value of options exercisable at December 31, 2019 was \$34.2 million.

	Number of Options	Weighted Avg. Per Share Exercise Price
Nonvested options at beginning of year	767,505	51.55
Granted	557,045	49.49
Vested	(408,648)	45.87
Forfeited	<u>(8,295)</u>	<u>53.88</u>
Nonvested options at end of year	<u>907,607</u>	<u>52.82</u>

The weighted-average fair value per option at the date of grant during 2019, 2018 and 2017, using the Black-Scholes option-pricing model, was \$10.83, \$14.80 and \$13.04, respectively. Assumptions were as follows:

12. Stock Based Compensation (continued)

	2019	2018	2017
Expected life (years)	5.5	5.7	5.7
Risk-free interest rate	2.7%	2.9%	2.4%
Dividend yield	1.6%	1.0%	1.0%
Expected volatility	22.8%	22.1%	26.5%

The expected lives of options for purposes of these models are based on historical exercise behavior. The risk free interest rates for purposes of these models are based on the U.S. Treasury yield curve in effect on the date of grant for the respective expected lives of the option. The expected dividend yields for purposes of these models are based on the dividends paid in the preceding four quarters divided by the grant date market value of the Common Stock. The expected volatility for purposes of these models are based on the historical volatility of the Common Stock.

Stock Appreciations Rights (SARs)

In 2015, certain non-U.S.-based employees were granted SARs. Each SAR award granted the employee the right to receive cash equal to the excess of the share price of the Company's Common Stock on the date that a participant exercises such right over the grant date value of the SAR. SARs granted had three-year pro rata vesting from the date of grant. SARs were issued at exercise prices equal to the fair value of the Company's Common Stock on the date of grant and expire ten years from the date of grant. The fair value and compensation expense related to SARs are measured at each reporting period using the Black-Scholes option-pricing model, using assumptions similar to stock option awards. No SARs were granted in 2019, 2018 or 2017. As of December 31, 2019, there were 14,880 SARs outstanding and exercisable. In 2018, there were 16,170 SARs outstanding and exercisable. In 2017, there were 23,660 SARs outstanding and 15,774 were exercisable. Stock based compensation expense attributable to SARs was minimal in 2019, 2018 and 2017.

Restricted Stock and Share Units

Participants may also be awarded shares of restricted stock or share units under the Plan. Share units vest three years after the date of grant. The Company granted 140,102, 106,581 and 107,853 share units under the plan in 2019, 2018 and 2017, respectively.

The share units were valued at \$6.9 million, \$6.6 million and \$5.4 million at the date of issuance in 2019, 2018 and 2017, respectively, based on the price of the Company's Common Stock at the date of grant. The shares units are recognized as compensation expense ratably over the three-year vesting period; however, included in share unit expense was expense associated with the accelerated vesting of share unit awards for certain employees who are retirement eligible or will become retirement eligible during the vesting period. Stock based compensation expense of \$6.9 million, \$5.7 million and \$5.2 million was recognized in 2019, 2018 and 2017, respectively. Certain non-U.S.-based employees receive the cash value of the share price at the vesting date in lieu of shares. Unvested cash-settled awards are remeasured at each reporting period.

A summary of share unit activity under the plan is as follows:

	Number of Units	Weighted-Average Grant Date Value
Issued and unvested at January 1, 2019	379,601	\$ 42.93
Granted	140,102	49.44
Vested	(147,642)	31.35
Forfeited	(5,959)	55.48
Issued and unvested at December 31, 2019	<u>366,102</u>	49.92

13. Pension and Other Post-retirement Benefits

The Company provides retirement benefits for all U.S. employees including benefits for employees of previously owned businesses which were earned up to the date of sale. The Company also has two foreign pension plans, neither of which is material to the Company's financial position.

The Company has a defined contribution plan which matches 100 percent of the first one percent of contributions made by participating employees and matches 50 percent of the next five percent of employee contributions. The Company also has defined contribution plans for certain hourly employees which provide for matching Company contributions.

The Company also has a defined benefit plan for salaried employees and its non-union hourly workforce. In 2009, the Company announced U.S. employees hired after January 1, 2010, would not participate in the defined benefit plan, and benefit accruals for the majority of current salaried and hourly employees sunset on December 31, 2014. An additional Company contribution is made to the defined contribution plan in lieu of benefits earned in a defined benefit plan. The Company also has defined benefit and contribution plans for certain union hourly employees.

The Company has unfunded defined-benefit post-retirement plans covering certain hourly and salaried employees that provide medical and life insurance benefits from retirement to age 65. Certain hourly employees retiring after January 1, 1996, are subject to a maximum annual benefit and salaried employees hired after December 31, 1993, are not eligible for post-retirement medical benefits.

13. Pension and Other Post-retirement Benefits (continued)

Obligations and Funded Status

Pension and Post-retirement Disclosure Information under ASC 715, *Compensation – Retirement Benefits* (ASC 715)

The following tables present the changes in benefit obligations, plan assets and funded status for domestic pension and post-retirement plans and the components of net periodic benefit costs.

Years ended December 31 (dollars in millions)	Pension Benefits		Post-retirement Benefits	
	2019	2018	2019	2018
Accumulated benefit obligation (ABO) at December 31	\$ 868.7	\$ 833.0	N/A	N/A
Change in projected benefit obligations (PBO)				
PBO at beginning of year	\$ (833.8)	\$ (922.7)	\$ (7.0)	\$ (7.6)
Service cost	(1.6)	(2.0)	(0.1)	(0.2)
Interest cost	(31.6)	(28.9)	(0.3)	(0.3)
Participant contributions	-	-	(0.1)	(0.1)
Actuarial (loss) gain including assumption changes	(98.6)	61.2	(1.2)	0.6
Benefits paid	<u>96.3</u>	<u>58.6</u>	<u>0.7</u>	<u>0.6</u>
PBO at end of year	\$ <u>(869.3)</u>	\$ <u>(833.8)</u>	\$ <u>(8.0)</u>	\$ <u>(7.0)</u>
Change in fair value of plan assets				
Plan assets at beginning of year	\$ 777.5	\$ 874.8	\$ -	\$ -
Actual return on plan assets	143.4	(39.3)	-	-
Contribution by the Company	7.8	0.6	0.5	0.5
Participant contributions	-	-	0.1	0.1
Benefits paid	<u>(96.3)</u>	<u>(58.6)</u>	<u>(0.6)</u>	<u>(0.6)</u>
Plan assets at end of year	\$ <u>832.4</u>	\$ <u>777.5</u>	\$ <u>-</u>	\$ <u>-</u>
Funded status	\$ (36.9)	\$ (56.3)	\$ (8.0)	\$ (7.0)
Amount recognized in the balance sheet				
Current liabilities	\$ (9.3)	\$ (7.1)	\$ (0.5)	\$ (0.5)
Non-current liabilities	<u>(27.6)</u>	<u>(49.2)</u>	<u>(7.5)</u>	<u>(6.5)</u>
Net pension liability at end of year	\$ <u>(36.9)*</u>	\$ <u>(56.3)*</u>	\$ <u>(8.0)</u>	\$ <u>(7.0)</u>
Amounts recognized in accumulated other comprehensive loss before tax				
Net actuarial loss (gain)	\$ 463.1	\$ 468.9	\$ (0.2)	\$ (1.4)
Prior service cost	<u>0.5</u>	<u>-</u>	<u>(1.8)</u>	<u>(2.2)</u>
Total recognized in accumulated other comprehensive loss	\$ <u>463.6</u>	\$ <u>468.9</u>	\$ <u>(2.0)</u>	\$ <u>(3.6)</u>

* In addition, the Company has a liability for a foreign pension plan of \$0.2 million at December 31, 2019 and 2018.

13. Pension and Other Post-retirement Benefits (continued)

Years ended December 31 (dollars in millions)	Pension Benefits			Post-retirement Benefits		
	2019	2018	2017	2019	2018	2017
Net periodic benefit cost						
Service cost	\$ 1.6	\$ 2.0	\$ 1.8	\$ 0.1	\$ 0.1	\$ 0.1
Interest cost	31.6	28.9	30.0	0.3	0.3	0.3
Expected return on plan assets	(57.3)	(58.1)	(58.4)	-	-	-
Amortization of unrecognized:						
Net actuarial loss (gain)	16.8	19.0	17.9	-	-	(0.1)
Prior service cost	<u>(0.5)</u>	<u>(0.5)</u>	<u>(0.4)</u>	<u>(0.4)</u>	<u>(0.4)</u>	<u>(0.4)</u>
Defined-benefit plan income	(7.8)	(8.7)	(9.1)	\$ -	\$ -	\$ (0.1)
Curtailment and other one-time charges	1.6	-	-			
Various U.S. defined contribution plans cost	<u>13.3</u>	<u>12.2</u>	<u>12.0</u>			
	<u>\$ 7.1</u>	<u>\$ 3.5</u>	<u>\$ 2.9</u>			
Other changes in plan assets and projected benefit obligation recognized in other comprehensive loss						
Net actuarial loss (gain)	\$ 12.6	\$ 36.1	\$ (3.8)	\$ 1.2	\$ (0.6)	\$ 1.1
Amortization of net actuarial (loss) gain	(18.4)	(19.0)	(17.9)	-	-	0.1
Amortization of prior service cost	<u>0.5</u>	<u>0.5</u>	<u>0.5</u>	<u>0.4</u>	<u>0.4</u>	<u>0.4</u>
Total recognized in other comprehensive loss	<u>(5.3)</u>	<u>17.6</u>	<u>(21.2)</u>	<u>1.6</u>	<u>(0.2)</u>	<u>1.6</u>
Total recognized in net periodic (benefit) cost and other comprehensive loss	<u>\$ (11.5)</u>	<u>\$ 8.9</u>	<u>\$ (30.3)</u>	<u>\$ 1.6</u>	<u>\$ (0.2)</u>	<u>\$ 1.5</u>

The estimated net actuarial loss and prior service cost for the pension plans that will be amortized from accumulated other comprehensive loss into net periodic benefit cost during 2020 are \$19.8 million and \$(0.5) million, respectively. The estimated net actuarial loss and prior year service cost for the post-retirement benefit plans that will be amortized from accumulated other comprehensive loss into net periodic benefit cost during 2020 are \$ - million and \$(0.3) million, respectively. As permitted under ASC 715, the amortization of any prior service cost was previously determined using a straight-line amortization of the cost over the average remaining service period of employees expected to receive benefits under the plan.

The 2019 and 2018 after tax adjustments for additional minimum pension liability resulted in other comprehensive gain (loss) of \$2.9 million and (\$13.1) million, respectively.

Actuarial assumptions used to determine benefit obligations at December 31 are as follows:

	Pension Benefits		Post-retirement Benefits	
	2019	2018	2019	2018
Discount rate	3.18%	4.32%	3.40%	4.46%

Actuarial assumptions used to determine net periodic benefit cost for the year ended December 31 are as follows:

Years ended December 31	Pension Benefits			Post-retirement Benefits		
	2019	2018	2017	2019	2018	2017
Discount rate	4.32%	3.65%	4.15%	4.45%	3.79%	4.40%
Expected long-term return on plan assets	7.15%	7.15%	7.50%	n/a	n/a	n/a
Rate of compensation increase	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%

Assumptions

In developing the expected long-term rate of return on plan assets assumption, the Company evaluated its pension plan's target and actual asset allocation and expected long-term rates of return of equity and bond indices. The Company also considered its pension plan's historical ten-year and 25-year compounded annualized returns of 9.2 percent and 9.3 percent, respectively.

13. Pension and Other Post-retirement Benefits (continued)

Assumed health care cost trend rates

Assumed health care cost trend rates as of December 31 are as follows:

	2019	2018
Health care cost trend rate assumed for next year	7.70%	6.00%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	5.00%	5.00%
Year that the rate reaches the ultimate trend rate	2029	2021

A one-percentage-point change in the assumed health care cost trend rates would not result in a material impact on the Company's consolidated financial statements.

Plan Assets

The Company's pension plan weighted asset allocations as of December 31 by asset category are as follows:

Asset Category	2019	2018
Equity securities	42%	40%
Debt securities	47	48
Real estate	10	10
Private equity	<u>1</u>	<u>2</u>
	<u>100%</u>	<u>100%</u>

13. Pension and Other Post-retirement Benefits (continued)

The following tables present the fair value measurement of the Company's plan assets as of December 31, 2019 and 2018 (dollars in millions):

Asset Category	Total	December 31, 2019		
		Quoted Prices in Active Markets for Identical Contracts (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Non-observable Inputs (Level 3)
Short-term investments	\$ 14.6	\$ 2.8	\$ 11.8	\$ -
Equity securities				
Common stocks	127.0	127.0	-	-
Commingled equity funds	113.4	-	113.4	-
Fixed income securities				
U.S. treasury securities	49.8	49.8	-	-
Other fixed income securities	225.1	-	225.1	-
Commingled fixed income funds	114.0	-	114.0	-
Options	(10.8)	-	(10.8)	-
Other types of investments				
Mutual funds	104.9	-	104.9	-
Real estate funds	82.3	-	-	82.3
Private equity	8.6	-	-	8.6
Total fair value of plan asset investments	\$ 828.9	\$ 179.6	\$ 558.4	\$ 90.9
Non-investment plan assets	3.4			
Total plan assets	\$ 832.3			

Asset Category	Total	December 31, 2018		
		Quoted Prices in Active Markets for Identical Contracts (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Non-observable Inputs (Level 3)
Short-term investments	\$ 14.4	\$ -	\$ 14.4	\$ -
Equity securities				
Common stocks	125.6	125.6	-	-
Commingled equity funds	104.3	-	104.3	-
Fixed income securities				
U.S. treasury securities	86.0	86.0	-	-
Other fixed income securities	185.8	-	185.8	-
Commingled fixed income funds	92.0	-	92.0	-
Other types of investments				
Mutual funds	73.6	-	73.6	-
Real estate funds	80.4	-	-	80.4
Private equity	13.2	-	-	13.2
Total fair value of plan asset investments	\$ 775.3	\$ 211.6	\$ 470.1	\$ 93.6
Non-investment plan assets	2.2			
Total plan assets	\$ 777.5			

13. Pension and Other Post-retirement Benefits (continued)

The short-term investments included in the Company's plan assets consist of cash and cash equivalents. The fair value of the remaining categories of the Company's plan assets are valued as follows: equity securities are valued using the closing stock price on a national securities exchange, which reflects the last reported sales price on the last business day of the year; fixed income securities are valued using institutional bond quotes, which are based on various market and industry inputs; mutual funds and real estate funds are valued using the net asset value of the fund, which is based on the fair value of the underlying securities; and private equity investments are valued at the estimated fair value at the previous quarter end, which is based on the proportionate share of the underlying portfolio investments.

The following table presents a reconciliation of the fair value measurements using significant unobservable inputs (Level 3) as of December 31, 2019 and 2018 (dollars in millions):

	Real estate funds	Private equity	Total
Balance at December 31, 2017	\$ 77.8	\$ 20.9	\$ 98.7
Actual return (loss) on plan assets:			
Relating to assets still held at the reporting date	2.6	(0.3)	2.3
Relating to assets sold during the period	-	(0.8)	(0.8)
Purchases, sales and settlements	<u>-</u>	<u>(6.6)</u>	<u>(6.6)</u>
Balance at December 31, 2018	80.4	13.2	93.6
Actual return (loss) on plan assets:			
Relating to assets still held at the reporting date	1.9	-	1.9
Relating to assets sold during the period	-	(1.4)	(1.4)
Purchases, sales and settlements	<u>-</u>	<u>(3.2)</u>	<u>(3.2)</u>
Balance at December 31, 2019	<u>\$ 82.3</u>	<u>\$ 8.6</u>	<u>\$ 90.9</u>

The Company's investment policies employ an approach whereby a diversified blend of equity and bond investments is used to maximize the long-term return of plan assets for a prudent level of risk. Equity investments are diversified across domestic and non-domestic stocks, as well as growth, value, and small to large capitalizations. Bond investments include corporate and government issues, with short-, mid- and long-term maturities, with a focus on investment grade when purchased. The Company's target allocation to equity managers is between 30 to 60 percent with the remainder allocated primarily to bonds, real estate, private equity managers and cash. Investment and market risks are measured and monitored on an ongoing basis through regular investment portfolio reviews, annual liability measurements and periodic asset/liability studies.

The Company's actual asset allocations are in line with target allocations. The Company regularly reviews its actual asset allocation and periodically rebalances its investments to the targeted allocation when considered appropriate.

There was no Company stock included in plan assets at December 31, 2019.

Cash Flows

The Company was not required to and did not make any contributions in 2019. The Company is not required to make a contribution in 2020.

13. Pension and Other Post-retirement Benefits (continued)

Estimated Future Payments

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

Years ending December 31 (dollars in millions)	Pension Benefits	Post-retirement Benefits
2020	\$ 66.8	\$ 0.5
2021	57.7	0.5
2022	57.1	0.5
2023	56.2	0.5
2024	55.4	0.5
2025 – 2029	270.9	2.3

14. Derivative Instruments

The Company utilizes certain derivative instruments to enhance its ability to manage currency exposure as well as raw materials price risk. Derivative instruments are entered into for periods consistent with the related underlying exposures and do not constitute positions independent of those exposures. The Company does not enter into contracts for speculative purposes. The contracts are executed with major financial institutions with no credit loss anticipated for failure of the counterparties to perform.

Cash Flow Hedges

With the exception of its net investment hedges, the Company designates that all of its hedging instruments are cash flow hedges. For derivative instruments that are designated and qualify as a cash flow hedge (i.e., hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), gains or losses on the derivative instrument are reported as a component of other comprehensive loss, net of tax, and are reclassified into earnings in the same line item associated with the forecasted transaction and in the same period or periods during which the hedged transaction affects earnings.

Foreign Currency Forward Contracts

The Company is exposed to foreign currency exchange risk as a result of transactions in currencies other than the functional currency of certain subsidiaries. The Company utilizes foreign currency forward purchase and sale contracts to manage the volatility associated with foreign currency purchases, sales and certain intercompany transactions in the normal course of business. Principal currencies for which the Company utilizes foreign currency forward contracts include the British pound, Canadian dollar, Euro and Mexican peso.

Gains and losses on these instruments are recorded in accumulated other comprehensive loss, net of tax, until the underlying transaction is recorded in earnings. When the hedged item is realized, gains or losses are reclassified from accumulated other comprehensive loss to the consolidated statement of earnings. The assessment of effectiveness for forward contracts is based on changes in the forward rates. These hedges have been determined to be effective. The majority of the amounts in accumulated other comprehensive loss for cash flow hedges are expected to be reclassified into earnings within one year.

The following table summarizes, by currency, the contractual amounts of the Company's foreign currency forward contracts that are designated as cash flow hedges:

December 31 (dollars in millions)	2019		2018	
	Buy	Sell	Buy	Sell
British pound	\$ -	\$ 1.3	\$ -	\$ 1.0
Canadian dollar	-	49.7	-	-
Euro	36.0	-	32.0	-
Mexican peso	<u>18.6</u>	<u>-</u>	<u>27.8</u>	<u>-</u>
Total	<u>\$ 54.6</u>	<u>\$ 51.0</u>	<u>\$ 59.8</u>	<u>\$ 1.0</u>

14. Derivative Instruments (continued)

Commodity Futures Contracts

In addition to entering into supply arrangements in the normal course of business, the Company also enters into futures contracts to fix the cost of certain raw material purchases, principally steel, with the objective of minimizing changes in cost due to market price fluctuations. The hedging strategy for achieving this objective is to purchase steel futures contracts on the New York Metals Exchange (NYMEX) and copper futures contracts on the open market of the London Metals Exchange (LME) or over the counter contracts based on the LME.

With NYMEX, the Company is required to make cash deposits on unrealized losses on steel derivative contracts.

Net Investment Hedges

The Company enters into certain foreign currency forward contracts to hedge the exposure to a portion of the Company's net investments in certain non-U.S. subsidiaries against the effect of exchange rate fluctuations on the translation of foreign currency balances to the U.S. dollar. For the derivative instruments that are designated and qualify as net investment hedges, gains and losses are reported in other comprehensive loss where they offset gains and losses recorded on the Company's net investments in its non-U.S. subsidiaries. These hedges are determined to be effective. The Company recognized \$ - and \$7.4 million of after-tax gains associated with hedges of a net investment in non-U.S. subsidiaries in currency translation adjustment in other comprehensive income in 2019 and 2018, respectively. The contractual amount of the Company's foreign currency forward contracts that are designated as net investment hedges is \$100.0 million as of December 31, 2019.

The following tables present the impact of derivative contracts on the Company's financial statements.

Fair value of derivatives designated as hedging instruments under ASC 815:

December 31 (dollars in millions)	Balance Sheet Location	Fair Value	
		2019	2018
Foreign currency contracts	Other current assets	\$ 8.4	\$ 3.9
	Other non-current assets	-	5.1
	Accrued liabilities	(1.5)	(0.6)
Commodities contracts	Accrued liabilities	-	(0.9)
Total derivatives designated as hedging instruments		\$ <u>6.9</u>	\$ <u>7.5</u>

The effect of cash flow hedges on the condensed consolidated statement of earnings:

Years ended December 31 (dollars in millions)

Derivatives in ASC 815 cash flow hedging relationships	Amount of gain (loss) recognized in other comprehensive loss on derivatives		Location of gain (loss) reclassified from accumulated other comprehensive loss into earnings	Amount of gain (loss) reclassified from accumulated other comprehensive loss into earnings	
	2019	2018		2019	2018
Foreign currency contracts	\$ 0.2	\$ 1.8	Cost of products sold	\$ (0.2)	\$ 0.3
Commodities contracts	<u>(0.5)</u>	<u>(1.1)</u>	Cost of products sold	<u>(1.5)</u>	<u>0.3</u>
	\$ <u>(0.3)</u>	\$ <u>0.7</u>		\$ <u>(1.7)</u>	\$ <u>0.6</u>

15. Income Taxes

The components of the provision (benefit) for income taxes consisted of the following:

Years ended December 31 (dollars in millions)	2019	2018	2017
Current:			
Federal	\$ 66.4	\$ 60.1	\$ 148.0
State	14.8	15.6	9.4
International	19.9	38.6	43.8
Deferred:			
Federal	0.4	(1.7)	23.5
State	1.8	1.5	5.8
International	(1.2)	(0.5)	(6.2)
	<u>\$ 102.1</u>	<u>\$ 113.6</u>	<u>\$ 224.3</u>

The provision for income taxes differs from the U.S. federal statutory rate due to the following items:

Years ended December 31	2019	2018	2017
Provision at U.S. federal statutory rate	21.0 %	21.0 %	35.0 %
State taxes, net of federal benefit	2.8	2.4	1.9
International income tax rate differential - China	(1.3)	(2.3)	(6.5)
International income tax rate differential - other	0.4	1.1	0.1
U.S. manufacturing credit	-	-	(1.4)
Research tax credits	(0.4)	(0.5)	(0.3)
Excess tax benefit on stock compensation	(0.5)	(0.4)	(2.2)
Other	(0.4)	(0.9)	0.8
	<u>21.6 %</u>	<u>20.4 %</u>	<u>27.4 %</u>
U.S. Tax Cuts & Jobs Act (U.S. Tax Reform)	-	-	15.7
	<u>21.6 %</u>	<u>20.4 %</u>	<u>43.1 %</u>

U.S. Tax Reform was enacted on December 22, 2017 and significantly changed U.S. corporate income tax laws. Among other things, U.S. Tax Reform reduced the U.S. corporate income tax rate to 21 percent commencing on January 1, 2018, implemented a territorial tax system and levied a one-time mandatory tax on undistributed earnings of foreign subsidiaries of U.S. companies.

As a result of U.S. Tax Reform, the Company recorded income tax expense of \$81.8 million in the fourth quarter of 2017. The income tax expense resulting from U.S. Tax Reform was included in the provision for income taxes on the Company's consolidated statement of earnings and consisted of two components: \$83.5 million of income tax expense related to the one-time mandatory tax on undistributed foreign earnings and a \$1.7 million income tax benefit resulting from the remeasurement of the Company's U.S. deferred tax assets and liabilities based on the lower U.S. corporate income tax rate. As permitted under the SEC Staff Accounting Bulletin 118, the amounts recorded during 2017 were subject to revisions in 2018.

The Company completed its accounting for the income tax effects of U.S. Tax Reform as of December 31, 2018 and determined that there was no material adjustment necessary to the provisional amounts it recorded in 2017. As allowed under ASU 2018-02 *Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*, the Company has elected not to reclassify the income tax effects of U.S. Tax Reform from accumulated other comprehensive losses to retained earnings.

Components of earnings before income taxes were as follows:

Years ended December 31 (dollars in millions)	2019	2018	2017
U.S.	\$ 400.3	\$ 376.0	\$ 329.9
International	71.8	181.8	190.9
	<u>\$ 472.1</u>	<u>\$ 557.8</u>	<u>\$ 520.8</u>

Total income taxes paid by the Company amounted to \$116.6 million, \$116.4 million, and \$131.1 million in 2019, 2018 and 2017, respectively.

15. Income Taxes (continued)

As of December 31, 2019, the Company has \$20.8 million accrued for its estimate of withholding taxes due upon repatriation of undistributed foreign earnings it considers to be not permanently reinvested. As of December 31, 2019, \$548.6 million of cash and cash equivalents and marketable securities were held by its foreign subsidiaries.

The tax effects of temporary differences of assets and liabilities between income tax and financial reporting are as follows:

December 31 (dollars in millions)	2019		2018	
	Assets	Liabilities	Assets	Liabilities
Employee benefits	\$ 27.3	\$ -	\$ 32.5	\$ -
Product liability and warranties	39.7	-	42.5	-
Inventories	-	0.3	-	0.6
Accounts receivable	16.3	-	18.3	-
Property, plant and equipment	-	34.9	-	36.3
Intangibles	-	61.3	-	57.3
Environmental liabilities	1.9	-	2.1	-
Undistributed foreign earnings	-	20.8	-	28.9
Tax loss and credit carryovers	15.2	-	17.5	-
All other	7.7	-	4.0	-
Valuation allowance	<u>(11.9)</u>	<u>-</u>	<u>(13.1)</u>	<u>-</u>
	<u>\$ 96.2</u>	<u>\$ 117.3</u>	<u>\$ 103.8</u>	<u>\$ 123.1</u>
Net liability		<u>\$ 21.1</u>		<u>\$ 19.3</u>

The Company believes it is more likely than not that it will realize its deferred tax assets through the reduction of future taxable income. The Company considered historical operating results in determining the probability of the realization of the deferred tax assets.

A reconciliation of the beginning and ending amounts of tax loss carryovers, credit carryovers and valuation allowances is as follows:

December 31 (dollars in millions)	Net Operating Losses and Tax Credits		Valuation Allowances	
	2019	2018	2019	2018
Beginning balance	\$ 17.5	\$ 19.8	\$ 13.1	\$ 15.0
Reductions	<u>(2.3)</u>	<u>(2.3)</u>	<u>(1.2)</u>	<u>(1.9)</u>
Ending balance	<u>\$ 15.2</u>	<u>\$ 17.5</u>	<u>\$ 11.9</u>	<u>\$ 13.1</u>

The Company has foreign net operating loss carryovers that expire in 2020 through 2027 and state and local net operating loss carryovers that expire between 2029 and 2030.

A reconciliation of the beginning and ending amount of unrecognized benefits is as follows:

(Dollars in millions)	2019	2018
Balance at January 1	\$ 8.3	\$ 6.2
Additions for tax positions of prior years	<u>1.4</u>	<u>2.1</u>
Balance at December 31	<u>\$ 9.7</u>	<u>\$ 8.3</u>

The amount of unrecognized tax benefits that, if recognized, would affect the effective income tax rate is \$0.8 million. The Company recognizes potential interest and penalties related to unrecognized tax benefits as a component of income tax expense. At December 31, 2019, there was an immaterial amount of interest and penalties accrued. The Company anticipates that there will not be a material decrease in the total amount of unrecognized tax benefits in 2020. The Company's U.S. federal income tax returns and its U.S. state and local income tax returns are subject to audit for the years 2016-2019 and 2002-2019, respectively. The Company is subject to non-U.S. income tax audits for the years 2013-2019.

16. Commitments and Contingencies

Environmental Contingencies

The Company is a potentially responsible party in judicial and administrative proceedings seeking to clean up sites which have been environmentally impacted. In each case, the Company has established reserves, insurance proceeds and/or a potential recovery from third parties. The Company believes any environmental claims will not have a material effect on its financial position or results of operations.

Product Liability and Other Matters

The Company is subject to various claims and pending lawsuits for product liability and other matters arising out of the conduct of the Company's business. With respect to product liability claims, the Company has self-insured a portion of its product liability loss exposure for many years. The Company has established reserves and has insurance coverage, which it believes are adequate to cover incurred claims. For the years ended December 31, 2019 and 2018, the Company had \$125 million of product liability insurance for individual losses in excess of \$7.5 million. The Company periodically reevaluates its exposure on claims and lawsuits and makes adjustments to its reserves as appropriate. The Company believes, based on current knowledge, consultation with counsel, adequate reserves and insurance coverage that the outcome of such claims and lawsuits will not have a material adverse effect on the Company's financial position, results of operations or cash flows.

Inventory Repurchase Arrangements

The Company maintains a commercial relationship with a supply-chain service provider (the Provider) in connection with the Company's business in China. In this capacity, the Provider offers order-entry, warehousing and logistics support. The Provider also offers asset-backed financing to certain of the Company's distributors in China to facilitate their working capital needs. To facilitate its financing support business, the Provider has collateralized lending facilities in place with multiple Chinese banks under which the Company has agreed to repurchase inventory if both requested by the banks and certain defined conditions are met, primarily related to the aging of the distributors' notes.

The Provider is required to indemnify the Company for any losses the Company would incur in the event of an inventory repurchase under these arrangements. Potential losses under the repurchase arrangements represent the difference between the repurchase price and net proceeds from the resale of product plus costs incurred in the process, less related distributor rebates.

Before considering any reduction of distributor rebate accruals of \$14.1 and \$25.1 million as of December 31, 2019 and December 31, 2018, respectively, and from the resale of the related inventory, the gross amount the Company would be obligated to repurchase, which would be contingent on the default of all of the outstanding loans, was approximately \$23.1 million and \$75.8 million as of December 31, 2019 and December 31, 2018, respectively. The Company's reserves for estimated losses under repurchase arrangements were immaterial as of December 31, 2019 and December 31, 2018.

17. Operations by Segment

The Company is comprised of two reporting segments: North America and Rest of World. The Rest of World segment is primarily comprised of China, Europe and India. Both segments manufacture and market comprehensive lines of residential and commercial gas and electric water heaters, boilers, tanks and water treatment products. Both segments primarily manufacture and market in their respective regions of the world. Our Rest of World segment also manufactures and markets in-home air purification products in China.

17. Operations by Segment (continued)

The accounting policies of the reportable segments are the same as those described in the “Summary of Significant Accounting Policies” outlined in Note 1. Segment earnings, defined by the Company as earnings before interest, taxes, general corporate and corporate research and development expenses, were used to measure the performance of the segments.

Years ended December 31 (dollars in millions)	Net Sales			Earnings		
	2019	2018	2017	2019	2018	2017
North America ⁽¹⁾	\$ 2,083.5	\$ 2,044.7	\$ 1,904.8	\$ 488.9	\$ 464.1	\$ 428.6
Rest of World	935.8	1,173.6	1,116.3	40.2	149.3	149.3
Inter-segment	<u>(26.6)</u>	<u>(30.4)</u>	<u>(24.4)</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total segments – sales, segment earnings	<u>\$ 2,992.7</u>	<u>\$ 3,187.9</u>	<u>\$ 2,996.7</u>	\$ 529.1	\$ 613.4	\$ 577.9
Corporate expenses				(46.0)	(47.2)	(47.0)
Interest expense				<u>(11.0)</u>	<u>(8.4)</u>	<u>(10.1)</u>
Earnings before income taxes				472.1	557.8	520.8
Provision for income taxes ⁽²⁾				<u>(102.1)</u>	<u>(113.6)</u>	<u>(224.3)</u>
Net earnings				<u>\$ 370.0</u>	<u>\$ 444.2</u>	<u>\$ 296.5</u>

⁽¹⁾ In 2018, the Company recognized \$6.7 million of restructuring and impairment expenses in connection with the move of manufacturing operations from our Renton, Washington facility to other U.S. facilities. For additional information, see Note 5 “Restructuring and Impairment Expenses.”

⁽²⁾ In 2017, the Company recorded a one-time charge of \$81.8 million associated with U.S. Tax Reform, primarily related to the repatriation of undistributed foreign earnings. For additional information, see Note 15 “Income Taxes.”

In 2019, sales to the North America segment’s two largest customers were \$421.1 million and \$378.9 million which represented 14 percent and 13 percent of the Company’s net sales, respectively. In 2018, sales to the North America segment’s two largest customers were \$425.3 million and \$355.6 million which represented 13 percent and 11 percent of the Company’s net sales, respectively. In 2017, sales to the North America segment’s two largest customers were \$361.4 million and \$335.2 million which represented 12 percent and 11 percent of the Company’s net sales, respectively.

Assets, depreciation and capital expenditures by segment

(dollars in millions)	Total Assets (December 31)			Depreciation and Amortization (Years Ended December 31)			Capital Expenditures (Years Ended December 31)		
	2019	2018	2017	2019	2018	2017	2019	2018	2017
North America	\$ 1,742.8	\$ 1,653.6	\$ 1,592.6	\$ 49.3	\$ 45.5	\$ 45.1	\$ 47.6	\$ 45.8	\$ 38.5
Rest of World	709.1	721.6	741.4	27.9	25.2	23.8	15.9	32.3	55.2
Corporate	<u>606.1</u>	<u>696.3</u>	<u>863.4</u>	<u>1.1</u>	<u>1.2</u>	<u>1.2</u>	<u>0.9</u>	<u>7.1</u>	<u>0.5</u>
Total	<u>\$ 3,058.0</u>	<u>\$ 3,071.5</u>	<u>\$ 3,197.4</u>	<u>\$ 78.3</u>	<u>\$ 71.9</u>	<u>\$ 70.1</u>	<u>\$ 64.4</u>	<u>\$ 85.2</u>	<u>\$ 94.2</u>

The majority of corporate assets consist of cash, cash equivalents, marketable securities and deferred income taxes.

17. Operations by Segment (continued)

Net sales and long-lived assets by geographic location

The following data by geographic area includes net sales based on product shipment destination and long-lived assets based on physical location. Long-lived assets include net property, plant and equipment, operating lease assets and other long-term assets.

(dollars in millions)	Long-lived Assets (December 31)			Net Sales (Years Ended December 31)			
	2019	2018	2017	2019	2018	2017	
United States	\$ 360.2	\$ 327.3	\$ 303.0	United States	\$ 1,868.7	\$ 1,820.8	\$ 1,698.1
China	266.7	252.6	250.8	China	825.4	1,071.2	1,034.9
Canada	4.2	3.1	3.2	Canada	168.5	175.0	163.7
Other Foreign	<u>42.1</u>	<u>42.9</u>	<u>47.1</u>	Other Foreign	<u>130.1</u>	<u>120.9</u>	<u>100.0</u>
Total	<u>\$ 673.2</u>	<u>\$ 625.9</u>	<u>\$ 604.1</u>	Total	<u>\$ 2,992.7</u>	<u>\$ 3,187.9</u>	<u>\$ 2,996.7</u>

18. Quarterly Results of Operations (Unaudited)

(dollars in millions, except per share amounts)

	1st Quarter		2nd Quarter		3rd Quarter		4th Quarter	
	2019	2018	2019	2018	2019	2018	2019	2018
Net sales	\$ 748.2	\$ 788.0	\$ 765.4	\$ 833.3	\$ 728.2	\$ 754.1	\$ 750.9	\$ 812.5
Gross profit	292.8	321.5	308.7	341.0	284.2	306.0	295.0	337.0
Net earnings	89.3	98.8	102.1	114.5	87.3	104.6	91.3	126.3
Basic earnings per share	0.53	0.58	0.61	0.67	0.53	0.61	0.56	0.75
Diluted earnings per share	0.53	0.57	0.61	0.66	0.53	0.61	0.56	0.74
Common dividends declared	0.22	0.18	0.22	0.18	0.22	0.18	0.24	0.22

Net earnings per share are computed separately for each period, and therefore, the sum of such quarterly per share amounts may differ from the total for the year.

In the first quarter of 2018, the Company recorded \$6.7 million of restructuring and impairment expenses associated with a move of manufacturing operations from its Renton, Washington facility to other U.S. facilities. These charges reduced after-tax earnings by \$5.0 million or \$0.03 per share.

19. Subsequent Event

In January 2020, an outbreak of a novel coronavirus (COVID-19) surfaced in Wuhan, China. The outbreak caused the Chinese government to require businesses to close and to restrict certain travel within the country. In cooperation with the government authorities, the Company's operations in China extended their Chinese New Year holiday shut down by approximately one to two weeks. As of the date of this filing, the Company has resumed operations, but at below normal levels. The majority of the stores where the Company's products are sold have temporarily closed and most of the stores that remain open are operating with reduced hours and are experiencing significant declines in customer traffic. In addition, as a significant portion of the Company's products in China require installation by a professional, actions taken to contain the spread of the virus have, in certain cases, limited access for installation. The duration and intensity of the impact of the coronavirus and resulting disruption to the Company's operations is uncertain. While our global supply chains are currently not affected, it is unknown whether or how they may be affected if such an epidemic persists for an extended period. While not yet quantifiable, the Company expects this situation will have a material adverse impact to its operating results in the first quarter of 2020 and continues to assess the financial impact for the remainder of the year.

ITEM 9 – CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A – CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (“the Exchange Act”)) as of the end of the period covered by this report. Based on the evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period our disclosure controls and procedures are effective in recording, processing, summarizing, and reporting, on a timely basis, information required to be disclosed by us in the reports that we file or submit under the Exchange Act, and that information is accumulated and communicated to the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely discussions regarding required disclosure.

Management Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)). Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our internal control over financial reporting based on the Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework). As allowed by Securities and Exchange Commission guidance, management excluded from its assessment Water-Right, which was acquired in 2019 and constituted 3.6 percent and 6.3 percent of total assets and net assets, respectively, as of December 31, 2019 and 1.5 percent and 1.4 percent of net sales and net earnings, respectively, for the year then ended. Based on this evaluation, our management has concluded that, as of December 31, 2019, our internal control over financial reporting was effective.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Ernst & Young LLP, an independent registered public accounting firm, has audited our consolidated financial statements and the effectiveness of internal controls over financial reporting as of December 31, 2019 as stated in their report which is included herein.

Changes in Internal Control Over Financial Reporting

There have been no changes in the company’s internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)) during the year ended December 31, 2019 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B - OTHER INFORMATION

None.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
A. O. Smith Corporation

Opinion on Internal Control over Financial Reporting

We have audited A. O. Smith Corporation's internal control over financial reporting as of December 31, 2019, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). In our opinion, A. O. Smith Corporation (the Company) maintained, in all material respects, effective internal control over financial reporting as of December 31, 2019, based on the COSO criteria.

As indicated in the accompanying Management Report on Internal Control Over Financial Reporting, management's assessment of and conclusion on the effectiveness of internal control over financial reporting did not include the internal controls of Water-Right, Inc., which is included in the 2019 consolidated financial statements of the Company and constituted 3.6 percent and 6.3 percent of total assets and net assets, respectively, as of December 31, 2019 and 1.5 percent and 1.4 percent of net sales and net earnings, respectively, for the year then ended. Our audit of internal control over financial reporting of the Company also did not include an evaluation of the internal control over financial reporting of Water-Right, Inc.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets of A. O. Smith Corporation as of December 31, 2019 and 2018, and the related consolidated statements of earnings, comprehensive earnings, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2019, and the related notes and financial statement schedule listed in the index at Item 15(a) and our report dated February 24, 2020 expressed an unqualified opinion thereon.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects.

Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Ernst & Young LLP

Milwaukee, Wisconsin
February 24, 2020

PART III

ITEM 10 - DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information included under the headings “Election of Directors” and “Board Committees” in our definitive Proxy Statement for the 2020 Annual Meeting of Stockholders (to be filed with the Securities and Exchange Commission (SEC) under Regulation 14A within 120 days after the end of the registrant’s fiscal year) is incorporated herein by reference. The information required regarding Executive Officers of the company is included in Part I of this Annual Report on Form 10-K under the caption “Executive Officers of the Company.”

We have a separately designated Audit Committee on which Gene C. Wulf, Dr. Ilham Kadri, Mark D. Smith and Idelle K. Wolf serve, with Mr. Wulf, as Chairperson. All members are independent under applicable SEC and New York Stock Exchange rules; the Board of Directors of the company has concluded that Ms. Wolf and Mr. Wulf are “audit committee financial experts” in accordance with SEC rules.

We have adopted a Financial Code of Ethics applicable to our principal executive officer, principal financial officer and principal accounting officer. As a best practice, this code has been executed by key financial and accounting personnel as well. In addition, we have adopted a general code of business conduct for our directors, officers and all employees, which is known as the A. O. Smith Guiding Principles. The Financial Code of Ethics, the A. O. Smith Guiding Principles and other company corporate governance matters are available on our website at www.aosmith.com. We are not including the information contained on our website as a part of or incorporating it by reference into, this Form 10-K. We intend to disclose on this website any amendments to, or waivers from, the Financial Code of Ethics or the A. O. Smith Guiding Principles that are required to be disclosed pursuant to SEC rules. There have been no waivers of the Financial Code of Ethics or the A. O. Smith Guiding Principles. Stockholders may obtain copies of any of these corporate governance documents free of charge by writing to the Corporate Secretary at the address on the cover page of this Form 10-K.

The information included under the heading “Compliance with Section 16(a) of the Securities Exchange Act” in our definitive Proxy Statement for the 2020 Annual Meeting of Stockholders (to be filed with the SEC under Regulation 14A within 120 days after the end of the registrant’s fiscal year) is incorporated herein by reference.

ITEM 11 - EXECUTIVE COMPENSATION

The information included under the headings “Executive Compensation,” “Director Compensation,” “Report of the Personnel and Compensation Committee” and “Compensation Committee Interlocks and Insider Participation” in the company’s definitive Proxy Statement for the 2020 Annual Meeting of Stockholders (to be filed with the SEC under Regulation 14A within 120 days after the end of the registrant’s fiscal year) is incorporated herein by reference.

ITEM 12 - SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information included under the headings “Principal Stockholders” and “Security Ownership of Directors and Management” in our definitive Proxy Statement for the 2020 Annual Meeting of Stockholders (to be filed with the SEC under Regulation 14A within 120 days after the end of the registrant’s fiscal year) is incorporated herein by reference.

Equity Compensation Plan Information

The following table provides information about our equity compensation plans as of December 31, 2019.

Plan Category	Number of securities to be issued upon the exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in the first column)
Equity compensation plans approved by security holders	3,321,472 ⁽¹⁾	\$37.64 ⁽²⁾	1,855,560 ⁽³⁾
Equity compensation plans not approved by security holders	—	—	—
Total	<u>3,321,472</u>	<u>\$37.64</u>	<u>1,855,560</u>

⁽¹⁾ Consists of 2,728,350 shares subject to stock options, 313,763 shares subject to employee share units and 279,359 shares subject to director share units.

⁽²⁾ Represents the weighted average exercise price of outstanding options and does not take into account outstanding share units.

⁽³⁾ Represents securities remaining available for issuance under the A. O. Smith Combined Incentive Compensation Plan. If any awards lapse, expire, terminate or are cancelled without issuance of shares, or shares are forfeited under any award, then such shares will become available for issuance under the A. O. Smith Combined Incentive Compensation Plan, hereby increasing the number of securities remaining available.

ITEM 13 - CERTAIN RELATIONSHIPS, RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

The information included under the headings “Director Independence and Financial Literacy”, “Compensation Committee Interlocks and Insider Participation” and “Procedure for Review of Related Party Transactions” in our definitive Proxy Statement for the 2020 Annual Meeting of Stockholders (to be filed with the SEC under Regulation 14A within 120 days after the end of the registrant’s fiscal year) is incorporated herein by reference.

ITEM 14 - PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information included under the heading “Report of the Audit Committee” in our definitive Proxy Statement for the 2020 Annual Meeting of Stockholders (to be filed with the SEC under Regulation 14A within 120 days after the end of the registrant’s fiscal year) required by this Item 14 is incorporated herein by reference.

PART IV

ITEM 15 - EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) The following documents are filed as part of this Annual Report on Form 10-K:

1. Financial Statements of the Company

Form 10-K
Page Number

The following consolidated financial statements of A. O. Smith Corporation are included in Item 8:

Consolidated Balance Sheets at December 31, 2019 and 2018.....	28
For each of the three years in the period ended December 31, 2019:	
- Consolidated Statement of Earnings	29
- Consolidated Statement of Comprehensive Earnings	29
- Consolidated Statement of Cash Flows	30
- Consolidated Statement of Stockholders' Equity	31
Notes to Consolidated Financial Statements.....	32 - 58

2. Financial Statement Schedules

Schedule II - Valuation and Qualifying Accounts.....	67
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Schedules not included have been omitted because they are not applicable.

3. Exhibits - see the Index to Exhibits on pages 64 - 65 of this report. Each management contract or compensatory plan or arrangement required to be filed as an exhibit to this report on Form 10-K are listed as Exhibits 10(a) through 10(m) in the Index to Exhibits.

Pursuant to the requirements of Rule 14a-3(b)(10) of the Securities Exchange Act of 1934, as amended, we will, upon request and upon payment of a reasonable fee not to exceed the rate at which such copies are available from the SEC, furnish copies to our security holders of any exhibits listed in the Index to Exhibits.

INDEX TO EXHIBITS

<u>Exhibit Number</u>	<u>Description</u>
(3)(i)	Restated Certificate of Incorporation of A. O. Smith Corporation as amended through April 11, 2016, incorporated by reference to Exhibit 3i(b) in the quarterly report on Form 10-Q for the quarter ended March 31, 2016.
(3)(ii)	By-laws of A. O. Smith Corporation as amended October 13, 2015, incorporated by reference to Exhibit 3.1 in the current report on Form 8-K dated October 16, 2015.
(4)	<p>(a) Restated Certificate of Incorporation of A. O. Smith Corporation as amended through April 11, 2016, incorporated by reference to Exhibit 3i(b) in the quarterly report on Form 10-Q for the quarter ended March 31, 2016.</p> <p>(b) Amended and Restated Credit Agreement, dated as of December 12, 2012, among A. O. Smith Corporation, A. O. Smith Enterprises Ltd., A. O. Smith International Holdings B.V., and the financial institutions and agents party thereto, incorporated by reference to Exhibit 4.1 in the current report on Form 8-K dated December 12, 2012.</p> <p>(c) Amendment No. 1 dated as of December 15, 2016, to the Amended and Restated Credit Agreement, dated as of December 12, 2012, among A. O. Smith Corporation, A. O. Smith Enterprises Ltd., A. O. Smith International Holdings B.V., and the financial institutions and agents party thereto, incorporated by reference to Exhibit 4(c) in the annual report on Form 10-K for the fiscal year ended December 31, 2016.</p> <p>(d) The corporation has instruments that define the rights of holders of long-term debt that are not being filed with this Registration Statement in reliance upon Item 601(b)(4)(iii) of Regulation S-K. The Registrant agrees to furnish to the SEC, upon request, copies of these instruments.</p>
(10)	<p>Material Contracts</p> <p>(a) A. O. Smith Combined Incentive Compensation Plan, incorporated by reference to Exhibit A of the Proxy Statement filed on March 5, 2012 for the 2012 Annual Meeting of Stockholders.</p> <p>(b) A. O. Smith Corporation Executive Life Insurance Plan, as amended January 1, 2009, incorporated by reference to Exhibit 10(b) of the annual report on Form 10-K for the fiscal year ended December 31, 2008.</p> <p>(c) A. O. Smith Nonqualified Deferred Compensation Plan, adopted December 1, 2008, incorporated by reference to Exhibit 10(c) of the annual report on Form 10-K for the fiscal year ended December 31, 2008.</p> <p>(d) A. O. Smith Corporation Executive Supplemental Pension Plan, as amended January 1, 2009, incorporated by reference to Exhibit 10(d) of the annual report on Form 10-K for the fiscal year ended December 31, 2008.</p> <p>(e) A. O. Smith Corporation Executive Incentive Compensation Award Agreement, incorporated by reference to Exhibit 4.5 of Form S-8 Registration Statement filed by the corporation on July 30, 2007 (Reg. No. 333-144950).</p> <p>(f) A. O. Smith Corporation Executive Incentive Compensation Award Agreement, incorporated by reference to Exhibit 10.1 of the quarterly report on Form 10-Q for the quarter ended March 31, 2012.</p> <p>(g) A. O. Smith Corporation Executive Incentive Compensation Award Agreement, incorporated by reference to Exhibit 10 of the quarterly report on Form 10-Q for the quarter ended March 31, 2016.</p> <p>(h) Offer Letter to Ajita G. Rajendra, dated September 20, 2004, incorporated by reference to Exhibit 10.M of the annual report on Form 10-K for the fiscal year ended December 31, 2007.</p>

INDEX TO EXHIBITS (continued)

<u>Exhibit Number</u>	<u>Description</u>
	(i) Amendment to Offer Letter to Ajita G. Rajendra dated December 10, 2015, incorporated by reference to Exhibit 10(i) of the annual report on Form 10-K for the fiscal year ended December 31, 2015.
	(j) A. O. Smith Corporation Senior Leadership Severance Plan, incorporated by reference to Exhibit 10.1 of the quarterly report for Form 10-Q for the quarter ended June 30, 2009.
	(k) Form of A. O. Smith Corporation Special Retention Award Agreement, incorporated by reference to Exhibit 10.1 of the quarterly report on Form 10-Q for the quarter ended March 31, 2011.
	(l) Stockholder Agreement dated as of December 9, 2008, between A. O. Smith Corporation and each Smith Investment Company stockholder who becomes a signatory thereto, incorporated by reference to Exhibit 10.3 of the current report on Form 8-K dated December 9, 2008.
	(m) Summary of Directors' Compensation incorporated by reference to Exhibit 10.1 of the quarterly report on Form 10-Q for the quarter ended June 30, 2019.
(21)	Subsidiaries.
(23)	Consent of Independent Registered Public Accounting Firm.
(31.1)	Certification by the Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act, dated February 24, 2020.
(31.2)	Certification by the Executive Vice-President and Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act, dated February 24, 2020.
(32.1)	Written Statement of the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350.
(32.2)	Written Statement of the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350.
(101)	The following materials from A. O. Smith Corporation's Annual Report on Form 10-K for the fiscal year ended December 31, 2019 are filed herewith, formatted in XBRL (Extensive Business Reporting Language): (i) the Consolidated Balance Sheets as of December 31, 2019 and 2018, (ii) the Consolidated Statement of Earnings for the three years ended December 31, 2019, (iii) the Consolidated Statement of Comprehensive Earnings for the three years ended December 31, 2019, (iv) the Consolidated Statement of Cash Flows for the three years ended December 31, 2019, (v) the Consolidated Statement of Stockholders' Equity for the three years ended December 31, 2019 and (vi) the Notes to Consolidated Financial Statements.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on behalf of the undersigned, thereunto duly authorized.

A. O. SMITH CORPORATION

Date: February 24, 2020

By: /s/ Ajita G. Rajendra
Ajita G. Rajendra
Executive Chairman of
the Board of Directors

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below as of February 24, 2020 by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<i>Name and Title</i>	<i>Signature</i>
AJITA G. RAJENDRA Executive Chairman of the Board of Directors	<u> /s/ Ajita G. Rajendra </u> Ajita G. Rajendra
KEVIN J. WHEELER Director President and Chief Executive Officer	<u> /s/ Kevin J. Wheeler </u> Kevin J. Wheeler
CHARLES T. LAUBER Executive Vice President and Chief Financial Officer	<u> /s/ Charles T. Lauber </u> Charles T. Lauber
HELEN E. GURHOLT Vice President and Controller	<u> /s/ Helen E. Gurholt </u> Helen E. Gurholt
RONALD D. BROWN Director	<u> /s/ Ronald D. Brown </u> Ronald D. Brown
WILLIAM P. GREUBEL Director	<u> /s/ William P. Greubel </u> William P. Greubel
PAUL W. JONES Director	<u> /s/ Paul W. Jones </u> Paul W. Jones
DR. ILHAM KADRI Director	<u> /s/ Dr. Ilham Kadri </u> Dr. Ilham Kadri
BRUCE M. SMITH Director	<u> /s/ Bruce M. Smith </u> Bruce M. Smith
MARK D. SMITH Director	<u> /s/ Mark D. Smith </u> Mark D. Smith
IDELLE K. WOLF Director	<u> /s/ Idelle K. Wolf </u> Idelle K. Wolf
GENE C. WULF Director	<u> /s/ Gene C. Wulf </u> Gene C. Wulf

A. O. SMITH CORPORATION

SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS

(Dollars in millions)

Years ended December 31, 2019, 2018 and 2017

Description	<u>Balance at Beginning of Year</u>	<u>Charged to Costs and Expenses</u>	<u>Acquisition of Businesses</u>	<u>Deductions</u>	<u>Balance at End of Year</u>
2019:					
Valuation allowance for trade and notes receivable	\$ 6.4	\$ 0.3	\$ -	\$ (0.1)	\$ 6.6
Valuation allowance for deferred tax assets	13.1	-	-	(1.2)	11.9
2018:					
Valuation allowance for trade and notes receivable	\$ 5.3	\$ 1.5	\$ -	\$ (0.4)	\$ 6.4
Valuation allowance for deferred tax assets	15.0	-	-	(1.9)	13.1
2017:					
Valuation allowance for trade and notes receivable	\$ 6.3	\$ -	\$ 0.2	\$ (1.2)	\$ 5.3
Valuation allowance for deferred tax assets	13.1	1.9	-	-	15.0

Exhibit 21

SUBSIDIARIES: The following lists all subsidiaries and affiliates of A. O. Smith Corporation.

<u>Name of Subsidiary</u>	<u>Jurisdiction in Which Incorporated</u>
AOS Holding Company	Delaware
A. O. Smith Water Treatment (North America) Holdings, Inc.	Delaware
SICO Acquisition, LLC	Delaware
Takagi - A. O. Smith Tankless Water Heater Company LLC	Delaware
Mineral-Right, Inc.	Kansas
American Water Heater Company	Nevada
Hague Europe, LLC	Ohio
Lochinvar, LLC	Tennessee
State Industries, LLC.	Tennessee
A. O. Smith Water Treatment (North America), Inc.	Texas
Clean Water Testing, LLC	Wisconsin
Water-Right Financial Services, LLC	Wisconsin
Water-Right Services, LLC	Wisconsin
Water-Right, Inc.	Wisconsin
A. O. Smith Holdings (Barbados) SRL	Barbados
A. O. Smith Enterprises Ltd.	Canada
A. O. Smith (China) Environmental Products Co., Ltd.	China
A. O. Smith (China) Investment Co., Ltd.	China
A. O. Smith (China) Water Heater Co., Ltd.	China
A. O. Smith (China) Water Products Co., Ltd.	China
A. O. Smith (Shanghai) HVAC Co., Ltd.	China
A. O. Smith (Wuhan) HVAC Co., Ltd.	China
A. O. Smith L'eau chaude S.a.r.l.	France
Waterboss Europe, SRL	France
A. O. Smith (Hong Kong) Limited	Hong Kong SAR
A. O. Smith India Water Products Private Limited	India
Products de Agua, S. de R.L. de C.V.	Mexico
A.O. Smith Holdings I B.V.	The Netherlands
A.O. Smith Holdings II B.V.	The Netherlands
A.O. Smith Holdings III B.V.	The Netherlands
A.O. Smith International Holdings B.V.	The Netherlands
A.O. Smith Products v.o.f.	The Netherlands
A.O. Smith Water Products Company B.V.	The Netherlands
AO Smith Su Teknolojileri Anonim Sirketi	Turkey
A. O. Smith Water FZE	United Arab Emirates
Lochinvar Limited	United Kingdom
A. O. Smith Vietnam Company Limited	Vietnam

Exhibit 23

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the Registration Statements (Form S-8 Nos. 333-144950 and 333-170436) pertaining to the A. O. Smith Combined Incentive Compensation Plan of our reports dated February 24, 2020, with respect to the consolidated financial statements and schedule of A. O. Smith Corporation, and the effectiveness of internal control over financial reporting of A. O. Smith Corporation, included in this Annual Report (Form 10-K) for the year ended December 31, 2019.

/s/ Ernst & Young LLP

Milwaukee, Wisconsin

February 24, 2020

Exhibit 31.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, Kevin J. Wheeler, certify that;

1. I have reviewed this annual report on Form 10-K of A. O. Smith Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any changes in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 24, 2020

/s/ Kevin J. Wheeler

Kevin J. Wheeler

President and Chief Executive Officer

Exhibit 31.2

CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, Charles T. Lauber, certify that;

1. I have reviewed this annual report on Form 10-K of A. O. Smith Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any changes in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 24, 2020

/s/ Charles T. Lauber

Charles T. Lauber

Executive Vice President and Chief Financial Officer

Exhibit 32.1

Certification Pursuant to 18 U.S.C. Section 1350,
As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

In connection with the Annual Report of A. O. Smith Corporation (the “Company”) on Form 10-K for the fiscal year ended December 31, 2019, as filed with the Securities and Exchange Commission on the date hereof (the “Report”). I, Kevin J. Wheeler, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 24, 2020

/s/ Kevin J. Wheeler

Kevin J. Wheeler
President and Chief Executive Officer

This certification accompanies this Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

Exhibit 32.2

Certification Pursuant to 18 U.S.C. Section 1350,
As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

In connection with the Annual Report of A. O. Smith Corporation (the “Company”) on Form 10-K for the fiscal year ended December 31, 2019, as filed with the Securities and Exchange Commission on the date hereof (the “Report”). I, Charles T. Lauber, Executive Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 24, 2020

/s/ Charles T. Lauber

Charles T. Lauber
Executive Vice President and Chief Financial Officer

This certification accompanies this Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

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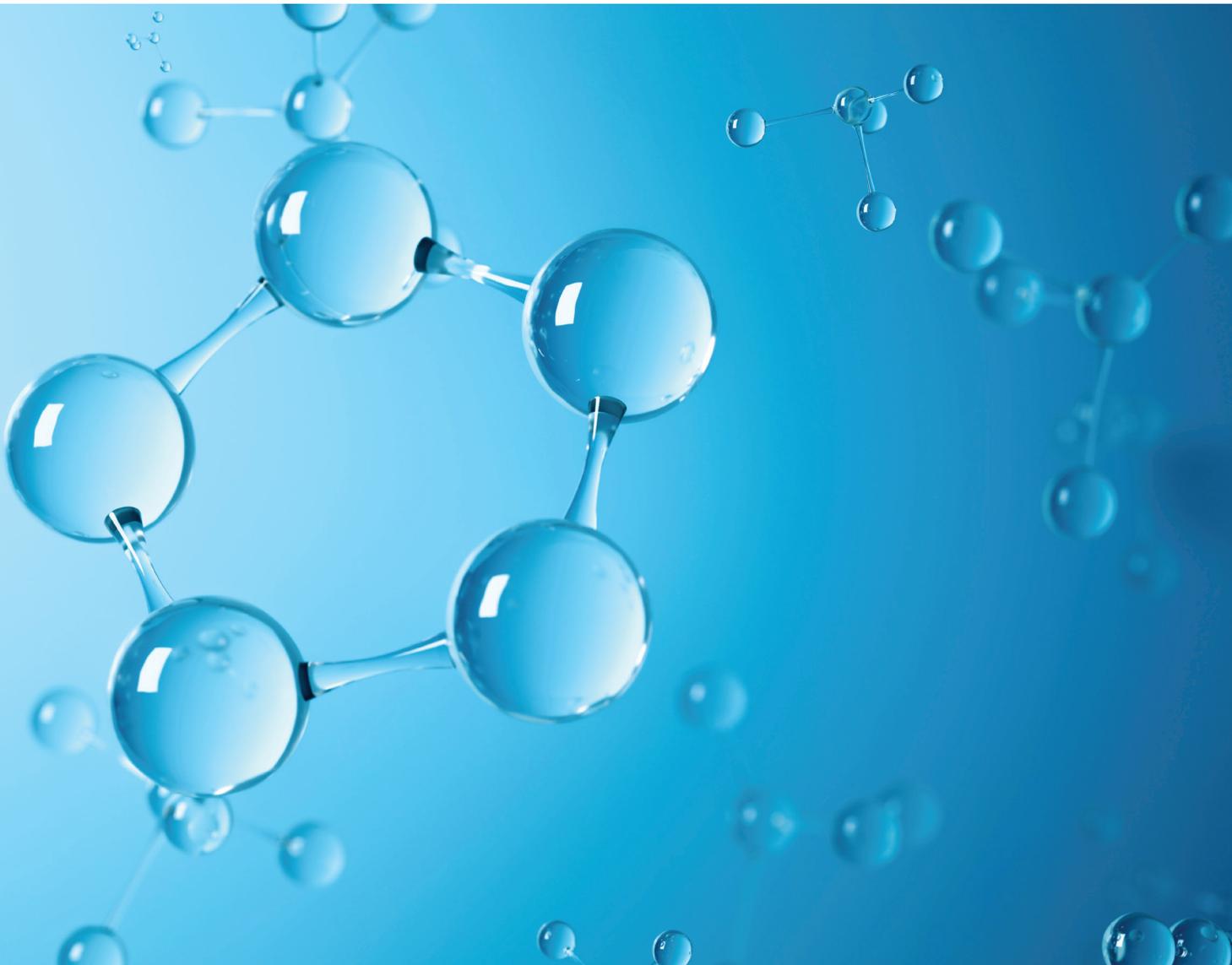
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Innovation: It's in Our DNA

A. O. Smith Corporation is proud to be known as one of the world's leading providers of water heating and water treatment solutions. As a leader, we refuse to sit quietly.

Each and every day at A. O. Smith, we are working on developing state-of-the-art solutions that are pushing new boundaries and paving the way in our industry.

The following are just a few examples of the many technologies that we unveiled in 2019...technologies and solutions that clearly showcase that innovation is in our DNA.



Supplying State-of-the-Art Solutions

Providing Plumbers Peace of Mind with a New Electric Tankless Series

A. O. Smith brought a number of new features and benefits to the water heating market this fall with the introduction of its new ProLine® Electric Tankless lineup, available in three sizes, with 45 different models ranging from 2.4kW to 32kW and Uniform Energy Factor up to 0.93.

The new water heaters – available in a variety of voltage options – have two key innovative features that make them a standout in the market. The units feature Dry Fire Protection, so the units only run when the chamber is full of water. This means peace of mind for plumbers and electricians who don't have to worry about dry fires. Additionally, the units have Scale Reduction Technology, which reduces scale formation on the elements and chamber walls. This, in turn, helps to reduce service requirements.

*A. O. Smith's ProLine®
Electric Tankless lineup*



Expanding into New Markets in China

A. O. Smith expanded into new markets in 2019 as it broadened its product offering in China with the addition of the Fume-Free Double-Suction Kitchen Range Hood. The hood features a unique two-sided ventilation system to immediately extract cooking fumes.

As A. O. Smith made its entrance into China's kitchen appliance industry, it also ushered in easy, clean-coating technology. Oil and dirt on the surface of range hoods has been a difficult problem...until now. For the new range hood, A. O. Smith developed a new coating formulation process to create an easy-to-clean surface that wipes clean in a single swipe.

The new A. O. Smith Fume-Free Double-Suction Range Hood has already earned four patents in China, with one more patent and a technical secret pending.



A. O. Smith's Fume-Free Double-Suction Kitchen Range Hood in China



A. O. Smith's HeatBot® premium water heater in India

Re-envisioning Water Heating in India

Our team in India tackled and addressed a number of consumer concerns as it rolled out its new top-of-the-line, premium water heater: the A. O. Smith HeatBot® water heater. The HeatBot models, available in 15L and 25L, feature a smart timer that allows consumers to automatically schedule when they want their unit to turn on and off, ensuring that the HeatBot models are always "shower-ready."

Additionally, the control panel on the HeatBot heater is positioned at the bottom of the unit, which is proving to be a game changer in India, where water heaters are typically installed on the bathroom wall, near the ceiling. Now, consumers can easily view and access the control panel.

The HeatBot line has earned a five-star rating from the Bureau of Energy Efficiency (BEE) in India – the highest level of energy efficiency in the country.

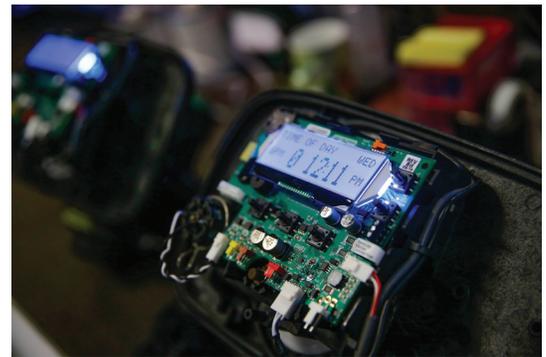
At Water-Right's Clean Water Testing
lab in Appleton, WI



Giving Consumers More Tools and Feedback Information

In 2019, Water-Right expanded the use of its exclusive Wi-Fi-enabled Wripli® technology platform, making it available across Water-Right's residential air-injection filtration line. The Wripli software connects these models and their top-of-the-line water softeners and conditioners to the Internet of Things (IoT), putting valuable data in the hands of consumers. When consumers opt in to the program, they can use an app to monitor their water usage in real time or switch their units to vacation mode. Additionally, users can choose to receive real-time alerts from their system regarding needed maintenance.

And it doesn't stop there. Consumers can immediately share their system performance information with their trusted water quality dealer, which – in turn – allows dealers to identify potential issues in advance and make adjustments to the product settings remotely.



Water-Right's exclusive Wripli® technology

Paving the Way and Pushing Boundaries

Addressing Water Contamination Issues Head On

In 2019, Aquasana rolled out its OptimH2O® whole-house water filter, an innovative system certified to reduce more than 99 percent of lead and cysts and 98 percent of PFOA/PFOS. Additionally, the OptimH2O system is also designed to reduce 90 percent of chlorine/chloramines from every tap for instantly cleaner, better-tasting water throughout the entire home.

The OptimH2O system has been independently tested and certified by the International Association of Plumbing and Mechanical Officials (IAPMO) to NSF/ANSI Standard 53 for the reduction of both soluble and particulate forms of lead and cysts, and to NSF Standard P473 for the reduction of PFOA/PFOS.



Aquasana's OptimH2O®
filtration system

Heating Water and Producing Power at the Same Time

At the start of the year, the Lochinvar team, in partnership with the Danish company EC POWER, launched the XRGI® 25 cogeneration, micro combined heat and power system that is able to produce heat and electricity from a single fuel source.

With its built-in generator, the system produces about 25 kW of electricity, which can supplement the electricity supply coming from the local grid. Meanwhile, the systems naturally give off heat from their gas engines. That heat can then be used to heat large amounts of water, which can be used for domestic or hydronic applications.

The XRGI line has already earned the “Blue Angel” eco-label in Germany and has been certified by the EPA, as it helps to lower greenhouse gas emissions.



Lochinvar's XRGI® 25 cogeneration, micro CHP system launched in partnership with Danish company EC Power



A. O. Smith's ENERGY STAR-certified Atmospheric Water Heater

Introducing Another First-of-Its-Kind Water Heater

As a leader in innovation, A. O. Smith has rolled out the first-ever ENERGY STAR-certified residential gas-fired water heater that doesn't require any electricity to operate. The new Atmospheric Water Heaters, available in 40- and 50-gallon sizes, address installation barrier issues because they don't need to be located near an electrical outlet.

A. O. Smith engineers designed and patented a damper door on the unit that uses energy from gas pressure to automatically capture and trap in heat. This, in turn, improves the performance and energy savings of the water heater while retaining the convenience of a traditional installation — same gas connection and same venting.

Continuing to Lead the Way in Heat Pump Technology

A. O. Smith announced another “first” in 2019 with the introduction of the first-ever integrated commercial heat pump water heater designed for light commercial applications, such as restaurants, schools, and retail buildings or any other facility that would traditionally use a standard commercial electric water heater.

The new offering from A. O. Smith provides higher efficiency and 50% more storage capacity than any residential heat pump on the market. Furthermore, a unit can save up to \$3,500 in annual energy costs, compared to a standard electric commercial water heater.

Additionally, the unique, integrated design means that all the components are in one unit, making for easy installation and maintenance. The models also feature a compact design, allowing them to fit in smaller footprints.



A.O. Smith's integrated commercial heat pump water heater for light commercial applications



At the A. O. Smith plant in McBee, SC

Delighting Customers and Consumers



Innovating in the Delivery of Services

*At the A. O. Smith Training Center
in Ashland City, TN*

In 2019, innovation didn't just come in the way of new products. It was also front and center in the way that we're training contractors, distributors and other professionals handling A. O. Smith products.

The North America Water Heating team proudly unveiled its state-of-the-art A. O. Smith University video production and training center, featuring global broadcast capability. The aim of the center is to provide contractors with the knowledge required to ensure smooth installations and easier product service, regardless of the challenges. The new, Tennessee-based facility allows customers to attend trainings either virtually or in person, with hands-on learning opportunities in three fully functional residential, commercial and tankless product labs.

Similarly, halfway around the globe, A. O. Smith China unveiled an HVAC Operating Center and a construction field training center. The facilities are equipped with nearly 100 stations where trainees can build their product knowledge and obtain experiential training on a range of installation situations.



Combining A. O. Smith Technologies to Tackle Consumer Concerns

A. O. Smith China has launched a new under-the-sink reverse osmosis water purifier series that addresses a major need in the market: drinkable hot water straight from the tap. Previously, consumers were purchasing two separate devices to get the job done – one device to purify water and another device to heat water.

A. O. Smith introduced a new single dispenser that can do it all with a substantially smaller under-the-sink footprint. The new water purifier series features a fast flow rate and an enviable water efficiency of up to 60 percent – nearly double the water efficiency of other water purification units on the market.

A. O. Smith's under-the-sink, single-dispenser RO purifier in China

Expanding A. O. Smith's High-Efficiency Commercial Water Heater Line

In 2019, A. O. Smith proudly introduced the new Cyclone® LV as an extension of the company's flagship high-efficiency commercial gas water heater line. The first-of-its-kind, 220/250-gallon large-storage water heater, available in 150,000 – 500,000 BTUs, gives commercial customers an integrated solution for high draw rate applications in a much smaller footprint and is the latest advancement in A. O. Smith's industry-leading Cyclone family of condensing gas water heaters.

The new easy-to-install units feature A. O. Smith's state-of-the-art helical coil heat exchangers with modulating fire rates that maximize heat transfer and efficiency, as well as multiple powered anodes that help protect the tank.

A. O. Smith's Cyclone® LV





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