



A.O. Smith Corporation (AOS)

Updated February 7th, 2022 by Jonathan Weber

Key Metrics

Current Price:	\$74	5 Year CAGR Estimate:	5.1%	Market Cap:	\$12B
Fair Value Price:	\$66	5 Year Growth Estimate:	6.0%	Ex-Dividend Date:	01/28/22 ¹
% Fair Value:	113%	5 Year Valuation Multiple Estimate:	-2.4%	Dividend Payment Date:	02/15/22 ²
Dividend Yield:	1.5%	5 Year Price Target	\$88	Years Of Dividend Growth:	28
Dividend Risk Score:	A	Retirement Suitability Score:	C	Last Dividend Increase:	7.7%

Overview & Current Events

A.O. Smith is a leading manufacturer of residential and commercial water heaters, boilers and water treatment products. A.O. Smith generates two-thirds of its sales in North America, and most of the rest in China, whereas the rest of the world is just a small market for A.O. Smith. A.O. Smith has raised its dividend for 28 years in a row, making the company a Dividend Aristocrat. A.O. Smith was founded in 1874 and is headquartered in Milwaukee, WI.

A.O. Smith reported its fourth quarter earnings results on January 27. The company generated revenues of \$995 million during the quarter, which represents an increase of 19% compared to the prior year's quarter. A.O. Smith's revenues were up 27% in North America, while revenue growth was significantly lower in the rest of the world, where sales during the quarter were up 3% year over year, partially due to COVID measures in China.

A.O. Smith generated earnings-per-share of \$0.87 during the fourth quarter, which was up by 18% on a year over year basis. This can mostly be explained by the solid revenue performance, which lifted the company's profits at a comparable level, despite commodity price headwinds. A.O. Smith has also offered its guidance for 2022. The company is now forecasting earnings-per-share in a range of \$3.35 and \$3.55, which reflects that management expects earnings-per-share to meaningfully grow this year as well. At the midpoint of the guidance range, A.O. Smith's earnings-per-share would rise by an attractive 14% compared to 2021's earnings-per-share of \$3.02.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	\$0.78	\$1.03	\$1.22	\$1.58	\$1.85	\$2.17	\$2.61	\$2.23	\$2.12	\$3.02	\$3.45	\$4.62
DPS	\$0.18	\$0.23	\$0.30	\$0.38	\$0.48	\$0.56	\$0.76	\$0.90	\$0.98	\$1.12	\$1.12	\$1.65
Shares³	185	182	179	176	173	172	171	164	163	160	157	145

A.O. Smith has grown its earnings-per-share by 20% annually since 2009, which is a very attractive growth rate. The company's profits grew relatively consistently during that time frame. The last financial crisis did not have an overly large impact on A.O. Smith's profits, as the company easily remained profitable. A.O. Smith raised its dividend during every year of the financial crisis, and the dividend growth rate over the last decade averaged more than 20%.

Thanks to a healthy housing market in the U.S., the company has enjoyed consistent growth in the domestic market throughout most of the last decade. A.O. Smith's sales performance was even more impressive in China, where sales have grown by ~20% per year on average during the last decade. China's huge population, its robust GDP growth, and the booming of its middle class are major tailwinds in this important market. In addition, thanks to the severe pollution of the country, the demand for air purifiers should remain strong as well. The coronavirus was hurting A.O. Smith in its two core markets US and China, which is why 2020's results were worse than those from 2019. The company has recovered easily in 2021, however. The same growth factors as in China are in place in India as well, which is why A.O. Smith sees India as an important future growth market.

¹ Estimated date

² Estimated date

³ In Millions

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	16.4	20.2	20.3	21.6	23.0	25.4	16.5	21.5	25.9	28.5	21.4	19.0
Avg. Yld.	1.4%	1.1%	1.2%	1.1%	1.1%	1.0%	1.9%	1.9%	1.8%	1.3%	1.5%	1.9%

A.O. Smith's valuation was low during the financial crisis, but the stock's earnings multiple expanded quickly over the following years. A.O. Smith was valued at more than 20 times earnings throughout the majority of the last decade. We believe that a 19 times earnings multiple would represent a fair valuation for the company's shares. This is less than the company's long-term median earnings multiple, but since A.O. Smith's growth will not remain at the 20%+ levels seen in the past, we think a reduction in the fair value multiple is justified. Based on the earnings estimate for 2022, shares are trading above fair value today, which could put some pressure on total returns going forward.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	23.1%	22.3%	24.6%	24.1%	25.9%	25.8%	29.1%	40.4%	46.2%	37.1%	32.5%	35.6%

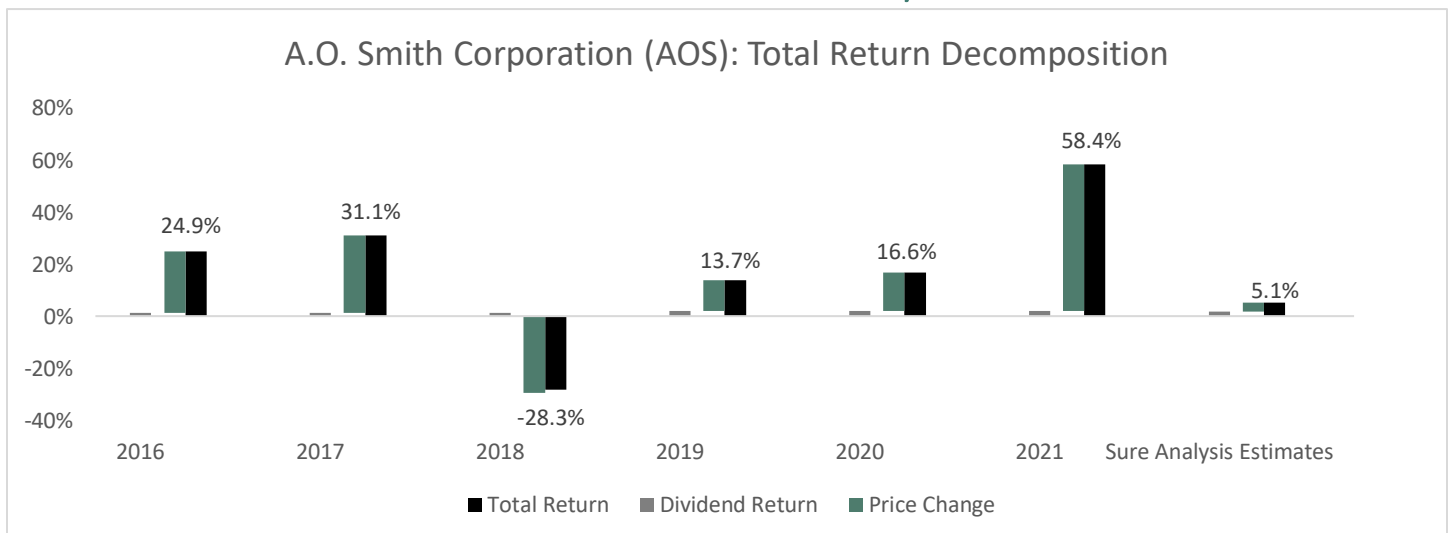
A.O. Smith has raised its dividend at a highly attractive pace during the last decade. Over the last five years the company's average dividend growth rate is at a high level of more than 20%. This was partially possible due to payout ratio increases. A.O. Smith will likely continue to raise the dividend at a compelling pace, which will result in further growth in the company's payout ratio. Despite the payout ratio increases, the dividend looks relatively safe, we believe.

A.O. Smith has exposure to the housing industry, which means that the company's underlying operations are impacted by troubles in the housing market. A.O. Smith not only sells to homebuilders, as replacement demand means that A.O. Smith also finds willing buyers during recessions. Its earnings-per-share declined by 25% between 2008 and 2009.

Final Thoughts & Recommendation

A.O. Smith has been a quality growth stock that provided excellent dividend growth and substantial share price gains in the past. Demand for A.O. Smith's products should remain strong in the long run in both the US and foreign markets, which is why we forecast solid earnings-per-share growth in the coming years. Shares will not provide especially attractive returns from the current level, however, which is why we rate the stock a hold for now.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	1,939	2,154	2,356	2,537	2,686	2,997	3,188	2,993	2,895	3,539
Gross Profit	652	774	859	1,010	1,114	1,232	1,306	1,181	1,108	1,311
Gross Margin	33.6%	35.9%	36.5%	39.8%	41.5%	41.1%	41.0%	39.5%	38.3%	37.0%
SG&A Exp.	451	525	572	611	663	723	754	716	660	701
D&A Exp.	55	60	60	63	65	70	72	78	80	78
Operating Profit	202	249	287	399	452	510	552	465	448	610
Operating Margin	10.4%	11.6%	12.2%	15.7%	16.8%	17.0%	17.3%	15.5%	15.5%	17.2%
Net Profit	159	170	208	283	327	297	444	370	345	487
Net Margin	8.2%	7.9%	8.8%	11.2%	12.2%	9.9%	13.9%	12.4%	11.9%	13.8%
Free Cash Flow	74	182	178	279	366	232	364	392	505	566
Income Tax	71	67	79	120	136	224	114	102	99	139

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	2,279	2,392	2,515	2,629	2,891	3,197	3,072	3,058	3,161	3,474
Cash & Equivalents	267	381	319	324	330	347	260	374	573	443
Accounts Receivable	425	459	475	501	519	593	647	590	585	634
Inventories	163	193	208	223	251	297	305	303	300	448
Goodwill & Int. Ass.	774	758	737	712	800	825	806	884	871	993
Total Liabilities	1,085	1,063	1,134	1,187	1,376	1,553	1,355	1,391	1,312	1,642
Accounts Payable	329	387	394	425	529	535	544	510	595	746
Long-Term Debt	244	192	224	249	324	410	221	284	113	197
Shareholder's Equity	1,194	1,329	1,381	1,442	1,515	1,645	1,717	1,667	1,848	1,832
D/E Ratio	0.20	0.14	0.16	0.17	0.21	0.25	0.13	0.17	0.06	0.11

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	6.9%	7.3%	8.5%	11.0%	11.8%	9.7%	14.2%	12.1%	11.1%	14.7%
Return on Equity	13.9%	13.5%	15.3%	20.0%	22.1%	18.8%	26.4%	21.9%	19.6%	26.5%
ROIC	10.6%	11.5%	13.3%	17.2%	18.5%	15.2%	22.2%	19.0%	17.6%	24.4%
Shares Out.	185	182	179	176	173	172	171	164	163	160
Revenue/Share	10.41	11.61	12.95	14.17	15.19	17.16	18.51	17.95	17.81	21.94
FCF/Share	0.40	0.98	0.98	1.56	2.07	1.33	2.11	2.35	3.11	3.51

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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