



# A.O. Smith Corporation (AOS)

Updated February 2<sup>nd</sup>, 2024 by Jonathan Weber

## Key Metrics

<b>Current Price:</b>	\$78	<b>5 Year CAGR Estimate:</b>	7.2%	<b>Market Cap:</b>	\$11.6B
<b>Fair Value Price:</b>	\$77	<b>5 Year Growth Estimate:</b>	6.0%	<b>Ex-Dividend Date:</b>	04/29/24 <sup>1</sup>
<b>% Fair Value:</b>	102%	<b>5 Year Valuation Multiple Estimate:</b>	-0.4%	<b>Dividend Payment Date:</b>	05/16/24 <sup>2</sup>
<b>Dividend Yield:</b>	1.6%	<b>5 Year Price Target</b>	\$102	<b>Years Of Dividend Growth:</b>	30
<b>Dividend Risk Score:</b>	A	<b>Retirement Suitability Score:</b>	B	<b>Rating:</b>	Hold

## 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 30 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 30. The company generated revenues of \$990 million during the quarter, which represents an increase of 6% compared to the prior year's quarter. A.O. Smith's revenues were up by a nice 7% in North America, while revenues saw a smaller increase in the rest of the world, which was in line with the recent trend, as North America sales grew faster than international sales in the previous quarter, too.

A.O. Smith generated earnings-per-share of \$0.97 during the fourth quarter, which was up 13% on a year over year basis. This was possible thanks to a combination of higher revenues, higher margins, and buybacks that reduced the share count. A.O. Smith has announced its guidance for 2024. The company is forecasting earnings-per-share in a range of \$3.90 to \$4.15, which reflects that management expects earnings-per-share to grow meaningfully this year. At the midpoint of the guidance range, A.O. Smith's earnings-per-share would be up 6% versus the earnings-per-share A.O. Smith generated last year. A.O. Smith is forecasting that revenue will increase by 3% to 5% this year.

## Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
<b>EPS</b>	\$1.22	\$1.58	\$1.85	\$2.17	\$2.61	\$2.23	\$2.12	\$3.02	\$3.14	\$3.81	<b>\$4.03</b>	<b>\$5.39</b>
<b>DPS</b>	\$0.30	\$0.38	\$0.48	\$0.56	\$0.76	\$0.90	\$0.98	\$1.12	\$1.20	\$1.28	<b>\$1.28</b>	<b>\$1.88</b>
<b>Shares<sup>3</sup></b>	179	176	173	172	171	164	163	160	153	149	<b>145</b>	<b>130</b>

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 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.

<sup>1</sup> Estimated date

<sup>2</sup> Estimated date

<sup>3</sup> 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	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	20.3	21.6	23.0	25.4	16.5	21.5	25.9	28.5	18.2	21.5	19.4	19.0
Avg. Yld.	1.2%	1.1%	1.1%	1.0%	1.9%	1.9%	1.8%	1.3%	2.1%	1.6%	1.6%	1.8%

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 very high levels seen in the past, we think a reduction in the fair value multiple is justified. Based on the earnings estimate for 2024, shares are trading marginally ahead of fair value, following a share price increase since our last update.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	24.6%	24.1%	25.9%	25.8%	29.1%	40.4%	46.2%	37.1%	38.2%	33.6%	31.8%	34.9%

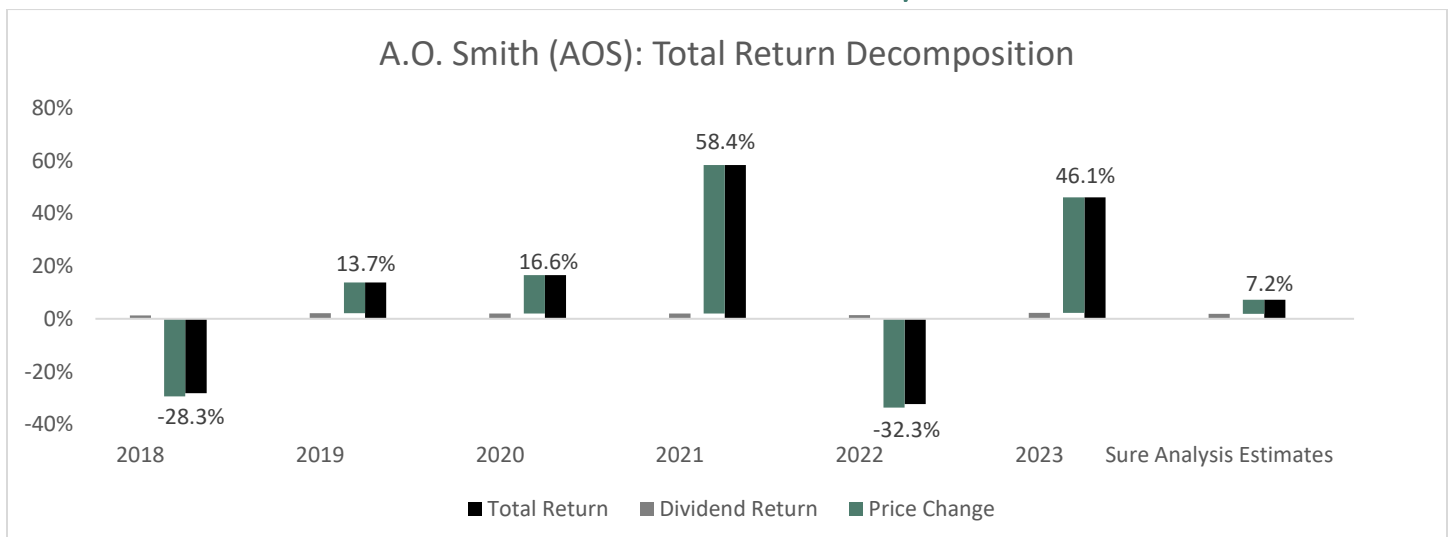
A.O. Smith has raised its dividend at a highly attractive pace during the last decade. Over the last five years the company's average dividend growth rate is at a high level of more than 20%. This was partially possible due to payout ratio increases. A.O. Smith will likely continue to raise the dividend 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 meaningful earnings-per-share growth in the coming years. Shares should provide solid returns of around 7% from here, which is why we rate this quality stock a hold today.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
<b>Revenue</b>	2,356	2,537	2,686	2,997	3,188	2,993	2,895	3,539	3,754	3,853
<b>Gross Profit</b>	859	1,010	1,114	1,232	1,306	1,181	1,108	1,311	1,330	1,485
<b>Gross Margin</b>	36.5%	39.8%	41.5%	41.1%	41.0%	39.5%	38.3%	37.0%	35.4%	38.5%
<b>SG&amp;A Exp.</b>	572	611	663	723	754	716	660	701	671	727
<b>D&amp;A Exp.</b>	60	63	65	70	72	78	80	78	77	78
<b>Operating Profit</b>	287	399	452	510	552	465	448	610	659	757
<b>Operating Margin</b>	12.2%	15.7%	16.8%	17.0%	17.3%	15.5%	15.5%	17.2%	17.5%	19.7%
<b>Net Profit</b>	208	283	327	297	444	370	345	487	236	557
<b>Net Margin</b>	8.8%	11.2%	12.2%	9.9%	13.9%	12.4%	11.9%	13.8%	6.3%	14.4%
<b>Free Cash Flow</b>	178	279	366	232	364	392	505	566	321	598
<b>Income Tax</b>	79	120	136	224	114	102	99	139	(12)	177

## Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
<b>Total Assets</b>	2,515	2,629	2,891	3,197	3,072	3,058	3,161	3,474	3,332	3,214
<b>Cash &amp; Equivalents</b>	319	324	330	347	260	374	573	443	391	340
<b>Accounts Receivable</b>	475	501	519	593	647	590	585	634	581	596
<b>Inventories</b>	208	223	251	297	305	303	300	448	516	497
<b>Goodwill &amp; Int. Ass.</b>	737	712	800	825	806	884	871	993	968	970
<b>Total Liabilities</b>	1,134	1,187	1,376	1,553	1,355	1,391	1,312	1,642	1,585	1,370
<b>Accounts Payable</b>	394	425	529	535	544	510	595	746	626	600
<b>Long-Term Debt</b>	224	249	324	410	221	284	113	197	345	127
<b>Shareholder's Equity</b>	1,381	1,442	1,515	1,645	1,717	1,667	1,848	1,832	1,748	1,844
<b>LTD/E Ratio</b>	0.16	0.17	0.21	0.25	0.13	0.17	0.06	0.11	0.20	0.07

## Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
<b>Return on Assets</b>	8.5%	11.0%	11.8%	9.7%	14.2%	12.1%	11.1%	14.7%	6.9%	17.0%
<b>Return on Equity</b>	15.3%	20.0%	22.1%	18.8%	26.4%	21.9%	19.6%	26.5%	13.2%	31.0%
<b>ROIC</b>	13.3%	17.2%	18.5%	15.2%	22.2%	19.0%	17.6%	24.4%	11.4%	27.4%
<b>Shares Out.</b>	179	176	173	172	171	164	163	160	153	149
<b>Revenue/Share</b>	12.95	14.17	15.19	17.16	18.51	17.95	17.81	21.94	24.10	25.51
<b>FCF/Share</b>	0.98	1.56	2.07	1.33	2.11	2.35	3.11	3.51	2.06	3.96

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

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