

SMITH A O CORP
Form 10-Q
May 05, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2014.

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 or other jurisdiction of
incorporation or organization)

39-0619790
(I.R.S. Employer
Identification No.)

11270 West Park Place, Milwaukee, Wisconsin
(Address of principal executive office)

53224-9508
(Zip Code)

(414)359-4000

(Registrant's telephone number, including area code)

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 electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted 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 and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated Filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act.) Yes No

Class A Common Stock Outstanding as of April 30, 2014 13,167,192 shares

Common Stock Outstanding as of April 30, 2014 77,439,970 shares

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A. O. SMITH CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

(dollars in millions, except for per share data)

(unaudited)

	Three Months Ended March 31,	
	2014	2013
Net sales	\$ 552.2	\$ 509.6
Cost of products sold	356.3	330.3
Gross profit	195.9	179.3
Selling, general and administrative expenses	130.9	120.0
Restructuring, impairment and settlement expenses net		1.7
Interest expense	1.4	1.5
Other income	(1.3)	(1.0)
Earnings before provision for income taxes	64.9	57.1
Provision for income taxes	18.2	18.1
Net Earnings	\$ 46.7	\$ 39.0
Net Earnings Per Share of Common Stock	\$ 0.51	\$ 0.42
Diluted Net Earnings Per Share of Common Stock	\$ 0.51	\$ 0.42
Dividends Per Share of Common Stock	\$ 0.15	\$ 0.10

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE EARNINGS

(dollars in millions)

(unaudited)

	Three Months Ended March 31,	
	2014	2013
Net earnings	\$ 46.7	\$ 39.0
Other comprehensive (loss) earnings		

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Foreign currency translation adjustments	(10.4)	(1.5)
Unrealized net gain on cash flow derivative instruments, less related income tax provision of \$(0.5) in 2014 and \$(0.4) in 2013	0.9	0.7
Adjustment to pension liability, less related income tax provision of \$(3.3) in 2014 and \$(3.9) in 2013	5.3	6.3
Comprehensive Earnings	\$ 42.5	\$ 44.5

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents**PART I - FINANCIAL INFORMATION****ITEM 1 - FINANCIAL STATEMENTS**

A. O. SMITH CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(dollars in millions)

	(unaudited) March 31, 2014	December 31, 2013
Assets		
Current Assets		
Cash and cash equivalents	\$ 369.8	\$ 380.7
Marketable securities	102.7	105.3
Receivables	455.6	458.7
Inventories	197.4	193.4
Deferred income taxes	40.0	40.1
Other current assets	32.7	27.4
Total Current Assets	1,198.2	1,205.6
Property, plant and equipment	777.5	758.7
Less accumulated depreciation	375.2	367.4
Net property, plant and equipment	402.3	391.3
Goodwill	431.5	433.5
Other intangibles	320.4	324.8
Other assets	28.8	36.3
Total Assets	\$ 2,381.2	\$ 2,391.5
Liabilities		
Current Liabilities		
Trade payables	\$ 341.4	\$ 387.1
Accrued payroll and benefits	43.1	61.7
Accrued liabilities	91.8	81.2
Product warranties	46.2	46.7
Long-term debt due within one year	14.0	14.2
Total Current Liabilities	536.5	590.9
Long-term debt	213.0	177.7
Pension liabilities	108.6	110.7
Other liabilities	179.7	183.5

Total Liabilities	1,037.8	1,062.8
Stockholders Equity		
Class A Common Stock, \$5 par value: authorized 14,000,000 shares; issued 13,232,412 and 13,288,516	66.2	66.4
Common Stock, \$1 par value: authorized 120,000,000 shares; issued 82,121,384 and 82,065,280	82.1	82.1
Capital in excess of par value	593.9	589.7
Retained earnings	1,015.2	982.2
Accumulated other comprehensive loss	(263.3)	(259.1)
Treasury stock at cost	(150.7)	(132.6)
Total Stockholders Equity	1,343.4	1,328.7
Total Liabilities and Stockholders Equity	\$ 2,381.2	\$ 2,391.5

See accompanying notes to unaudited condensed consolidated financial statements

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A. O. SMITH CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(dollars in millions)

(unaudited)

	Three Months Ended March 31,	
	2014	2013
Operating Activities		
Net earnings	\$ 46.7	\$ 39.0
Adjustments to reconcile net earnings to cash provided by (used in) operating activities:		
Depreciation and amortization	14.8	14.1
Pension expense	6.6	6.9
Loss on disposal of assets	0.4	
Net changes in operating assets and liabilities, net of acquisition:		
Current assets and liabilities	(56.7)	(28.9)
Noncurrent assets and liabilities	0.5	3.0
Cash Provided by Operating Activities continuing operations	12.3	34.1
Cash Used in Operating Activities discontinued operations	(0.5)	(0.8)
Cash Provided by Operating Activities	11.8	33.3
Investing Activities		
Capital expenditures	(25.3)	(18.4)
Acquisition of business		(3.6)
Investment in marketable securities	(33.7)	(31.7)
Net proceeds from sale of marketable securities	33.6	83.0
Cash (Used in) Provided by Investing Activities	(25.4)	29.3
Financing Activities		
Long-term debt incurred (retired)	36.2	(15.5)
Common stock repurchases	(21.3)	(3.5)
Net proceeds from stock option activity	1.6	5.8
Dividends paid	(13.8)	(9.4)
Cash Provided by (Used in) Financing Activities	2.7	(22.6)
Net (decrease) increase in cash and cash equivalents	(10.9)	40.0
Cash and cash equivalents beginning of period	380.7	266.9

Cash and Cash Equivalents	End of Period	\$	369.8	\$	306.9
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See accompanying notes to unaudited condensed consolidated financial statements

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PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

A. O. SMITH CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2014

(unaudited)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Accordingly, they do not include all of the information and footnotes required for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three month period ended March 31, 2014 are not necessarily indicative of the results expected for the full year. It is suggested that the accompanying condensed consolidated financial statements be read in conjunction with the audited consolidated financial statements and the notes thereto included in the company's latest Annual Report on Form 10-K filed with the SEC on February 20, 2014.

On April 15, 2013, the company's stockholders approved a proposal to increase the company's authorized shares of Common Stock and the company's board of directors declared a two-for-one stock split of the company's Class A Common Stock and Common Stock (including treasury shares) in the form of a 100 percent stock dividend to stockholders of record on April 30, 2013 and payable on May 15, 2013. All references in the financial statements and footnotes to the number of shares outstanding, price per share, per share amounts and stock based compensation data have been recast to reflect the split for all periods presented.

2. Acquisition

On February 14, 2013, the company acquired 100 percent of the shares of MiM Isitma Sogutma Havalandirma ve Aritma Sistemleri San. Tic. A.S. (MiM), a privately-held Turkish water treatment company. The addition of MiM expanded the company's product offerings and gave the company access to the Eastern Europe and Black Sea region water treatment markets. MiM is included in the Rest of World segment.

The company paid an aggregate cash purchase price of \$3.6 million, net of cash received of \$1.9 million in the first quarter of 2013 for MiM. In addition the company assumed debt of \$1.7 million and recorded contingent consideration of \$1.1 million, the fair value of the contingent payment due to the former owners of MiM if certain targets are met for growth in sales, gross profits and operating profits through 2017.

The fair value of the purchase price resulted in an allocation to acquired intangible assets totaling \$4.3 million of which \$2.4 million was assigned to customer lists which are being amortized over ten years.

MiM's results of operations have been included in the company's financial statements from February 14, 2013, the date of acquisition. Revenues and pre-tax results associated with MiM included in results of operations in the three months ended March 31, 2013 were not material to the company's net sales or pre-tax earnings.

Table of Contents**3. Restructuring, Impairment and Settlement Expenses – Net**

In the first quarter of 2013, the company announced a move of manufacturing operations from its Fergus, Ontario facility to other North American facilities and recognized \$12.7 million of restructuring and impairment expenses, comprised of \$5.2 million of severance costs and impairment charges related to long-lived assets totaling \$7.5 million, and a corresponding \$3.2 million tax benefit related to the charges. The majority of the consolidation of operations occurred in the second quarter of 2013.

On March 11, 2013, the company entered into a settlement agreement with a former supplier regarding previous overcharges and warranty costs. The terms of the settlement agreement resulted in an \$11.0 million cash payment to the company, a pre-tax gain of \$11.0 million and \$4.2 million of income tax expense.

The following table presents an analysis of the company's restructuring, impairment and settlement reserve as of and for three months ended March 31, 2014:

(dollars in millions)

	Inventory Obsolescence	Severance Costs	Equipment Relocation	Total
Balance at December 31, 2013	\$ 1.7	\$ 1.5	\$ 0.4	\$ 3.6
Cash payments/disposals	(0.4)	(0.5)	(0.2)	(1.1)
Balance at March 31, 2014	\$ 1.3	\$ 1.0	\$ 0.2	\$ 2.5

4. Inventories

(dollars in millions)

	March 31, 2014	December 31, 2013
Finished products	\$ 96.7	\$ 88.8
Work in process	12.6	12.3
Raw materials	109.4	113.6
Inventories, at FIFO cost	218.7	214.7
LIFO reserve	(21.3)	(21.3)
Net inventory	\$ 197.4	\$ 193.4

5. Long-Term Debt

The company has a \$400 million multi-currency revolving credit agreement with a group of eight banks, which expires on December 12, 2017. The facility has an accordion provision which allows it to be increased up to \$500 million if certain conditions (including lender approval) are satisfied. Borrowings under bank credit lines and commercial paper borrowings are supported by the \$400 million revolving credit agreement. As a result of the long-term nature of this facility, the company's commercial paper and credit line borrowings are classified as

long-term debt at March 31, 2014.

Table of Contents**6. Product Warranties**

The company offers warranties on the sales of certain of its products and records an accrual for the estimated future claims. The following table presents the company's warranty liability activity.

(dollars in millions)	2014	2013
Balance at January 1	\$ 136.6	\$ 129.6
Expense	16.6	15.0
Claims settled	(17.3)	(15.7)
Balance at March 31	\$ 135.9	\$ 128.9

7. Earnings per Share of Common Stock

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:

	Three Months Ended March 31,	
	2014	2013
Denominator for basic earnings per share - weighted average shares	91,230,882	92,551,062
Effect of dilutive stock options, restricted stock and share units	735,113	633,828
Denominator for diluted earnings per share	91,965,995	93,184,890

8. Stock Based Compensation

The company adopted the A. O. Smith Combined Incentive Compensation Plan (the "plan") effective January 1, 2007. The plan was reapproved 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 March 31, 2014 was 2,340,137. Upon stock option exercise or share unit vesting, shares are issued from treasury stock.

Total stock based compensation expense recognized in the three months ended March 31, 2014 and 2013 was \$5.8 million and \$4.0 million, respectively.

Stock Options

The stock options granted in the three months ended March 31, 2014 and 2013, have three year pro-rata vesting from the date of grant. Stock options are issued at exercise prices equal to the fair value of Common Stock on the date of grant. For active employees, all options granted in 2014 and 2013 expire ten years after date of grant. The company's stock options are expensed ratably over the three year vesting period, however included in stock option expense for

the three months ended March 31, 2014 and 2013 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. Stock based compensation cost attributable to stock options in the three months ended March 31, 2014 and 2013 was \$2.8 million and \$1.8 million, respectively.

Table of Contents**8. Stock Based Compensation (continued)**

Changes in option awards, all of which relate to Common Stock, were as follows for the three months ended March 31, 2014:

	Weighted-Avg. Per Share Exercise Price	Number of Options	Average Remaining Contractual Life	Aggregate Intrinsic Value (dollars in millions)
Outstanding at January 1, 2014	\$ 22.37	1,440,623		
Granted	46.49	297,900		
Exercised	26.33	(6,268)		
Outstanding at March 31, 2014	26.50	1,732,255	8 years	