

HALOZYME THERAPEUTICS INC  
Form SC 13D/A  
July 02, 2008

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

SCHEDULE 13D  
Under the Securities Exchange Act of 1934  
(Amendment No. 3)\*

HALOZYME THERAPEUTICS, INC.  
(Name of Issuer)

Common Stock, \$0.001 par value per share  
(Title of Class of Securities)

406 37H 109  
(CUSIP Number)

Third Security, LLC  
The Governor Tyler  
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Radford, Virginia 24141  
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(Name, Address and Telephone Number of Person  
Authorized to Receive Notices and Communications)

June 23, 2008  
(Date of Event which Requires Filing of this Statement)

If the filing person has previously filed a statement on Schedule 13G to report the acquisition which is the subject of this Schedule 13D, and is filing this schedule because of Rule 13d-1(e), (f) or (g), check the following box " .

NOTE: Schedules filed in paper format shall include a signed original and five copies of the schedule, including all exhibits. See §240.13d-7 for other parties to whom copies are to be sent.

\* The remainder of this cover page shall be filled out for a reporting person's initial filing on this form with respect to

the subject class of securities, and for any subsequent amendment containing information which would alter disclosures provided in a prior cover page.

The information required on the remainder of this cover page shall not be deemed to be “filed” for the purpose of Section 18 of the Securities Exchange Act of 1934 (“Act”) or otherwise subject to the liabilities of that section of the Act but shall be subject to all other provisions of the Act (however, see the Notes).



1 NAMES OF REPORTING PERSONS  
I.R.S. IDENTIFICATION NOS. OF ABOVE PERSONS

RANDAL J. KIRK

2 CHECK THE APPROPRIATE BOX IF A MEMBER OF GROUP

(a)

(b)

3 SEC USE ONLY

4 SOURCE OF FUNDS

PF

5 CHECK IF DISCLOSURE OF LEGAL PROCEEDINGS IS REQUIRED  
PURSUANT TO ITEM 2(d) OR 2(e)

6 CITIZENSHIP OR PLACE OF ORGANIZATION

United States

7 SOLE VOTING POWER

NUMBER OF 380,000  
SHARES

BENEFICIALLY 8 SHARED VOTING POWER

OWNED BY 14,801,569  
EACH

REPORTING 9 SOLE DISPOSITIVE POWER

PERSON WITH 380,000

10 SHARED DISPOSITIVE POWER

14,801,569

11 AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH REPORTING PERSON

15,181,569

12 CHECK IF THE AGGREGATE AMOUNT IN ROW (11) EXCLUDES  
CERTAIN SHARES

13 PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (11)

19.1%

14 TYPE OF REPORTING PERSON  
IN

1 NAMES OF REPORTING PERSONS  
I.R.S. IDENTIFICATION NOS. OF ABOVE PERSONS

NEW RIVER MANAGEMENT V, LP I.R.S. Identification No.: 56-2652938

2 CHECK THE APPROPRIATE BOX IF A MEMBER OF GROUP (a) o  
(b) x

3 SEC USE ONLY

4 SOURCE OF FUNDS

WC

5 CHECK IF DISCLOSURE OF LEGAL PROCEEDINGS IS REQUIRED o  
PURSUANT TO ITEM 2(d) OR 2(e)

6 CITIZENSHIP OR PLACE OF ORGANIZATION

United States

7 SOLE VOTING POWER

NUMBER OF 0

SHARES 8 SHARED VOTING POWER

BENEFICIALLY OWNED BY 6,328,853

EACH 9 SOLE DISPOSITIVE POWER

REPORTING PERSON WITH 0

10 SHARED DISPOSITIVE POWER

6,328,853

11 AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH REPORTING PERSON  
6,328,853

12 CHECK IF THE AGGREGATE AMOUNT IN ROW (11) EXCLUDES o  
CERTAIN SHARES

13 PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (11)  
8.0%

14 TYPE OF REPORTING PERSON  
PN

This Amendment No. 3 (the “Amendment”) amends and supplements the Statement on Schedule 13D, dated May 15, 2007 and filed on May 24, 2007, as amended by Amendment No. 1 dated May 30, 2007 and filed on June 5, 2007, and Amendment No. 2 dated March 19, 2008 and filed on March 24, 2008 (the “Original Schedule 13D”), relating to the Common Stock, par value \$0.001 per share (the “Common Stock”), of Halozyme Therapeutics, Inc., a Delaware corporation (the “Company”). Mr. Randal J. Kirk (“Mr. Kirk”) is filing this Amendment to disclose the acquisition by Kirkfield, L.L.C., a Virginia limited liability company (“Kirkfield”), of an aggregate of 1,299,886 shares of Common Stock in open market purchases and private transactions, as described in Item 5(c) below. As described in this Amendment, some of the Common Stock that is beneficially owned by Mr. Kirk is directly beneficially owned by one of the following entities, each of which is controlled by Mr. Kirk: Radford Investments Limited Partnership, a Delaware limited partnership (“Radford”), Randal J. Kirk (2000) Limited Partnership, a Delaware limited partnership (“2000LP”), RJK, L.L.C., a Virginia limited liability company (“RJK”), Third Security Staff 2001 LLC, a Virginia limited liability company (“Staff 2001”), New River Management IV, LP, a Virginia limited partnership (“NRM IV”), New River Management V, LP, a Delaware limited partnership (“NRM V”) and Kirkfield.

Except as set forth below, there are no changes to the information set forth in the Original Schedule 13D.

## Item 2. Identity and Background.

Item 2 of the Original Schedule 13D is hereby amended and restated to read in its entirety as follows:

“This Statement is being filed on behalf of Mr. Kirk, Radford, 2000LP, RJK, Staff 2001, NRM IV, NRM V and Kirkfield (collectively, the “Reporting Persons”).

(a)-(c) The address of the principal business office of each of the Reporting Persons is The Governor Tyler, 1881 Grove Avenue, Radford, Virginia 24141. The present principal occupation/employment of Mr. Kirk is Senior Managing Director and Chief Executive Officer of Third Security, LLC, an investment management firm founded by Mr. Kirk. The principal business of each of Radford, 2000LP, RJK, Staff 2001, NRM IV, NRM V and Kirkfield is investment.

(d)-(e) During the last five years, none of the Reporting Persons or, to the best of the Reporting Persons' knowledge, any of the managers or joint holders of the Reporting Persons, has been convicted in a criminal proceeding (excluding traffic violations or similar misdemeanors) or been a party to a civil proceeding of a judicial or administrative body of competent jurisdiction and as a result of such proceeding is or was subject to a judgment, decree or final order enjoining future violations of, or prohibiting or mandating activities subject to, federal or state securities laws or finding any violation with respect to such laws.

(f) Mr. Kirk is a citizen of the United States. Radford, 2000LP and NRM V are entities organized under the laws of Delaware. NRM IV, RJK, Staff 2001 and Kirkfield are entities organized under the laws of the Commonwealth of Virginia.”

Item 3. Source and Amount of Funds or Other Consideration.

Item 3 of the Original Schedule 13D is hereby amended and supplemented as follows:

“Kirkfield acquired 1,299,886 shares of Common Stock reported herein through open market purchases and private transactions for an aggregate purchase price of approximately \$7.48 million using Kirkfield’s working capital. In addition, Kirkfield acquired a warrant entitling the holder to purchase 136,300 shares at an exercise price of \$1.75 per share for a purchase price of approximately \$570,000 using Kirkfield's working capital.”

Item 5. Interest in Securities of the Issuer.

Item 5(a) of the Original Schedule 13D is hereby amended and restated to read in its entirety as follows:

“(a) The aggregate number and percentage of shares of Common Stock to which this statement relates is 15,181,569 shares of Common Stock, representing 19.1% of the 79,517,144 shares of Common Stock outstanding as of the date of this statement, based upon the number of shares disclosed by the Company as of May 1, 2008, in the Company’s Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2008 (the most recent available filing by the Company with the Securities and Exchange Commission). Mr. Kirk directly beneficially owns 380,000 shares of Common Stock to which this statement relates (10,000 of such shares of Common Stock he has the right to acquire pursuant to immediately exercisable stock options). The remaining 14,801,569 shares of Common Stock to which this statement relates are directly beneficially owned as follows:

Owner	Shares
Radford	3,000,000
2000LP	2,189,050
RJK	522,460
Staff 2001	135,000
NRM IV	1,326,320
NRM V	6,328,853
Kirkfield	1,299,886

Mr. Kirk could be deemed to have indirect beneficial ownership of the shares of Common Stock directly beneficially owned by Radford, 2000LP, RJK, Staff 2001, NRM IV, NRM V and Kirkfield.”

Item 5(b) of the Original Schedule 13D is hereby amended and restated to read in its entirety as follows:

“(b) Number of shares of Common Stock as to which such persons have:

- (i) sole power to vote or to direct the vote – 380,000
- (ii) shared power to vote or to direct the vote – 14,801,569 (1)
- (iii) sole power to dispose of or to direct the disposition of – 380,000
- (iv) shared power to dispose of or to direct the disposition of – 14,801,569 (1)

(1) Includes shares of Common Stock held by the following entities over which Mr. Kirk (or an entity over which he exercises exclusive control) exercises exclusive control: 3,000,000 shares of Common Stock held by Radford; 2,189,050 shares of Common Stock held by 2000LP; 522,460 shares of Common Stock held by RJK; 135,000 shares of Common Stock held by Staff 2001; 1,326,320 shares of Common Stock held by NRM IV, 6,328,853 shares held by NRM V and 1,299,886 shares held by Kirkfield.”

Item 5(c) of the Original Schedule 13D is hereby amended and supplemented as follows:

“(c) Kirkfield made the following purchases on the open market during the past 60 days:

Date of Purchase	Purchase Price	Number of Shares
6/11/2008	\$ 5.35	5,000
6/11/2008	\$ 5.30	14,600
6/11/2008	\$ 5.29	15,400
6/11/2008	\$ 5.28	13,412
6/11/2008	\$ 5.27	1,588
6/11/2008	\$ 5.26	24,200
6/11/2008	\$ 5.25	37,100
6/11/2008	\$ 5.24	4,139
6/12/2008	\$ 5.45	5,000
6/12/2008	\$ 5.44	2,759
6/12/2008	\$ 5.43	14,983
6/12/2008	\$ 5.42	11,728
6/12/2008	\$ 5.41	20,593
6/12/2008	\$ 5.40	1,937
6/13/2007	\$ 5.62	1,874
6/13/2007	\$ 5.60	4,951
6/13/2007	\$ 5.59	5,921
6/13/2007	\$ 5.58	4,741
6/13/2007	\$ 5.57	1,300
6/13/2007	\$ 5.56	2,938
6/13/2007	\$ 5.50	3,100
6/13/2007	\$ 5.49	6,501
6/13/2007	\$ 5.48	2,499
6/13/2007	\$ 5.47	8,700

Date of Purchase	Purchase Price	Number of Shares
6/13/2007	\$ 5.46	3,200
6/16/2008	\$ 5.80	2,300
	228.1	214.7
LIFO reserve	(21.3)	(21.3)
	\$ 206.8	\$ 193.4

## 5. Long-Term Debt

The company has a \$400 million multi-currency revolving credit agreement with 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 June 30, 2014.

## 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
Expense	15.7	16.7
Claims settled	(15.2)	(15.8)
Balance at June 30,	\$ 136.4	\$ 129.8



**Table of Contents****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		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Denominator for basic earnings per share weighted average shares	90,509,155	92,655,557	90,868,025	92,603,598
Effect of dilutive stock options and share units	647,158	576,351	690,957	605,088
Denominator for diluted earnings per share	91,156,313	93,231,908	91,558,982	93,208,686

**8. Stock Based Compensation**

The company adopted the A. O. Smith Combined Incentive Compensation Plan (the plan) effective January 1, 2007. Stockholders reapproved the plan 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, restricted stock or share units under the plan at June 30, 2014 was 2,317,722. Upon stock option exercise or share unit vesting, shares are issued from treasury stock.

Total stock based compensation cost recognized in the three months ended June 30, 2014 and 2013 was \$2.0 million and \$2.4 million, respectively. Total stock based compensation cost recognized in the six months ended June 30, 2014 and 2013 was \$7.8 million and \$6.4 million, respectively.

*Stock Options*

The stock options granted in the six months ended June 30, 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. Options are expensed ratably over the three-year vesting period; however included in the stock option expense for the three and six months ended June 30, 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 June 30, 2014 and 2013 was \$0.9 million and \$1.1 million, respectively. Stock based compensation expense attributable to stock options in the six months ended June 30, 2014 and 2013 was \$3.7 million and \$2.9 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 six months ended June 30, 2014:

	Weighted- Average Per Share Exercise Price	Six Months Ended June 30, 2014	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	13.99	(91,269)		
Outstanding at June 30, 2014	27.19	1,647,254	8 years	\$ 31.8
Exercisable at June 30, 2014	\$ 19.94	992,670	7 years	\$ 27.7

The weighted-average fair value per option at the date of grant during the six months ended June 30, 2014 and 2013 using the Black-Scholes option-pricing model was \$16.55 and \$12.45, respectively. Assumptions were as follows:

	Six Months Ended June 30,	
	2014	2013
Expected life (years)	6.0	6.1
Risk-free interest rate	2.7%	2.0%
Dividend yield	1.1%	1.1%
Expected volatility	36.6%	38.4%

The expected life is based on historical exercise behavior and the projected exercise of unexercised stock options. The risk free interest rate is based on the U.S. Treasury yield curve in effect on the date of grant for the expected life of the option. The actual dividend yield is based on the actual annual dividends divided by the grant date market value of the company's common stock. The expected volatility is based on the historical volatility of the company's common stock.

*Restricted Stock and Share Units*

Participants may also be awarded shares of restricted stock or share units under the plan. The company granted 110,310 and 141,700 share units under the plan in the six months ended June 30, 2014 and 2013, respectively. The share units were valued at \$5.1 million and \$4.9 million at the dates of issuance in 2014 and 2013, respectively, based on the company's stock price at the dates of grant. The company's share units are recognized as compensation expense ratably over the three-year vesting period; however included in share unit expense in the three and six months ended

June 30, 2014 and 2013 is expense associated with accelerated vesting of share unit awards for certain employees who either are retirement eligible or will become retirement eligible during the vesting period. Share based compensation expense attributable to share units of \$1.1 million and \$1.3 million was recognized in the three months ended June 30, 2014 and 2013, respectively. Share based compensation expense attributable to share units of \$4.1 million and \$3.5 million was recognized in the six months ended June 30, 2014 and 2013, respectively.

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

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, 2014	446,036	\$ 26.14
Granted	110,310	46.48
Vested	(144,476)	21.63
Issued and unvested at June 30, 2014	441,870	\$ 33.23

**9. Pensions**

The following table presents the components of the company's net pension expense:

(dollars in millions)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Service cost	\$ 1.8	\$ 2.2	\$ 3.9	\$ 4.5
Interest cost	11.4	9.9	22.4	19.7
Expected return on plan assets	(15.2)	(15.4)	(30.2)	(30.8)
Amortization of unrecognized loss	8.8	10.6	17.6	21.0
Amortization of prior service cost	(0.2)	(0.2)	(0.5)	(0.4)
Defined benefit plan expense	\$ 6.6	\$ 7.1	\$ 13.2	\$ 14.0

The company did not make a contribution to its U.S. pension plan in 2013 and is not required to make a contribution in 2014.

**10. Operations by Segment**

The company is comprised of two reporting segments: North America and Rest of World. Both segments manufacture and market comprehensive lines of residential and commercial gas, gas tankless and electric water heaters. Both segments primarily manufacture and market in their respective regions of the world. The Rest of World segment is primarily comprised of China, Europe and India. The North America segment also manufactures and globally markets specialty commercial water heating equipment, condensing and non-condensing boilers and water system tanks. The Rest of World segment also manufactures and markets water treatment products, primarily in Asia.



**Table of Contents****10. Operations by Segment (continued)**

The company's operations by segment are as follows:

(dollars in millions)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Net sales				
North America	\$ 410.1	\$ 389.0	\$ 798.6	\$ 767.7
Rest of World	193.6	169.5	366.4	307.8
Inter-segment sales	(8.3)	(9.4)	(17.4)	(16.8)
	\$ 595.4	\$ 549.1	\$ 1,147.6	\$ 1,058.7
Operating earnings				
North America <sup>(1)</sup> <sup>(3)</sup> <sup>(4)</sup>	\$ 63.2	\$ 55.0	\$ 118.5	\$ 109.1
Rest of World	29.3	22.4	54.4	40.7
	92.5	77.4	172.9	149.8
Corporate expense <sup>(2)</sup>	(12.5)	(14.5)	(26.6)	(28.3)
Interest expense	(1.4)	(1.6)	(2.8)	(3.1)
Earnings before income taxes	78.6	61.3	143.5	118.4
Provision for income taxes	21.3	19.2	39.5	37.3
Net earnings	\$ 57.3	\$ 42.1	\$ 104.0	\$ 81.1
(1) Includes non-operating pension costs of:	\$ (3.9)	\$ (3.6)	\$ (7.7)	\$ (7.1)
(2) Includes non-operating pension costs of:	(1.1)	(1.2)	(2.1)	(2.4)
(3) Includes restructuring and impairment expenses of:		(4.2)		(16.9)
(4) Includes settlement income of:				11.0

**11. Fair Value Measurements**

ASC 820, *Fair Value Measures and Disclosures*, 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.

**Table of Contents****11. Fair Value Measurements (continued)**

Assets and liabilities measured at fair value on a recurring basis are as follows:

(dollars in millions)	June 30, 2014	December 31, 2013
Fair Value Measurement Using		
Quoted prices in active markets for identical assets (Level 1)	\$ 103.6	\$ 107.0

There were no changes in the company's valuation techniques used to measure fair values on a recurring basis during the six months ended June 30, 2014.

**12. Derivative Instruments**

ASC 815 *Derivatives and Hedging* as amended, requires that all derivative instruments be recorded on the balance sheet at fair value and establishes criteria for designation and effectiveness of the hedging relationships. The accounting for changes in the fair value of a derivative instrument depends on whether it has been designated and qualifies as a part of a hedging relationship and, further, on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, the company must designate the hedging instrument, based upon the exposure hedged, as a fair value hedge, cash flow hedge, or a hedge of a net investment in a foreign operation.

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), the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive loss, net of tax, and is 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. The amount by which the cumulative change in the value of the hedge more than offsets the cumulative change in the value of the hedged item (i.e., the ineffective portion) is recorded in earnings, net of tax, in the period the ineffectiveness occurs.

The company utilizes certain derivative instruments to enhance its ability to manage currency 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.

*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. Currencies for which the company utilizes foreign currency forward contracts include the British pound, Canadian dollar, Chinese renminbi, Euro, Indian rupee 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 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.

**Table of Contents****12. Derivative Instruments (continued)**

The majority of the amounts in accumulated other comprehensive loss for cash flow hedges is expected to be reclassified into earnings within one year and all of the hedges will be reclassified into earnings no later than December 31, 2015.

The following table summarizes, by currency, the contractual amounts of the company's foreign currency forward contracts:

(dollars in millions)

	June 30,			
	2014		2013	
	Buy	Sell	Buy	Sell
British pound	\$	\$ 0.9	\$	\$ 1.1
Canadian dollar		56.7		17.7
Chinese renminbi			1.7	
Euro	7.1	0.8	11.6	1.0
Indian rupee			7.0	
Mexican peso	11.5		16.4	
<b>Total</b>	<b>\$ 18.6</b>	<b>\$ 58.4</b>	<b>\$ 36.7</b>	<b>\$ 19.8</b>

*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 copper, with the objective of minimizing changes in cost due to market price fluctuations. The hedging strategy for achieving this objective is to purchase commodity futures contracts on the open market of the London Metals Exchange (LME) or over the counter contracts based on the LME.

The minimal after-tax gain on the effective portion of the contracts as of June 30, 2014 was recorded in accumulated other comprehensive loss, and will be reclassified into cost of products sold in the period in which the underlying transaction is recorded in earnings. The effective portion of the contracts will be reclassified within one year. Commodity hedges outstanding at June 30, 2014 involve a total of approximately 0.8 million pounds of copper.

The impact of derivative contracts on the company's financial statements is as follows:

Fair value of derivatives designated as hedging instruments under:

(dollars in millions)

	Balance Sheet Location	June 30,	December 31,
		2014	2013
Foreign currency contracts	Other current assets	\$ 1.0	\$ 1.9

Accrued liabilities	(0.3)	(0.2)
Total derivatives designated as hedging instruments	\$ 0.7	\$ 1.7

**Table of Contents****12. Derivative Instruments (continued)**

The effect of derivatives designated as hedging instruments on the Statement of Earnings is as follows:

Three Months Ended June 30 (dollars in millions):

	Amount of gain (loss) recognized in OCI on derivative (effective portion)		Location of gain (loss) reclassified from accumulated OCI into earnings (effective portion)	Amount of gain (loss) reclassified from accumulated OCI into earnings (effective portion)		Location of gain (loss) recognized in earnings on derivative (ineffective portion)	Amount of gain (loss) recognized in earnings on a derivative (ineffective portion)	
	2014	2013		2014	2013		2014	2013
Derivatives in ASC 815 cash flow hedging relationships								
Foreign currency contracts	\$ (1.9)	(0.4)	Cost of products sold	0.7	0.9	N/A		
Commodities contracts	0.3	\$ (0.1)	Cost of products sold	\$ 0.1	\$ (0.1)	Cost of products sold	\$	\$
	\$ (1.6)	\$ (0.5)		\$ 0.8	\$ 0.8		\$	\$

Six Months Ended June 30 (dollars in millions):

Derivatives in ASC 815 cash flow hedging relationships	Amount of gain (loss) recognized in OCI on derivative (effective portion)	Location of gain (loss) reclassified from accumulated OCI into earnings (effective portion)	Amount of gain (loss) reclassified from accumulated OCI into earnings (effective portion)	Location of gain (loss) recognized in earnings on derivative	Amount of gain (loss) recognized in earnings on a derivative (ineffective portion)

			OCI into earnings (effective portion)			(ineffective portion)		
	2014	2013		2014	2013		2014	2013
Foreign currency contracts	0.8	1.4	Cost of products sold	1.8	1.5	N/A		
Commodities contracts	\$	\$ (0.2)	Cost of products sold	\$	\$ (0.1)	Cost of products sold	\$	\$
	\$ 0.8	\$ 1.2		\$ 1.8	\$ 1.4		\$	\$

### 13. Income Taxes

The effective tax rate for the three and six months ended June 30, 2014 was 27.1 percent and 27.5 percent, respectively. The company estimates that its annual effective tax rate for the full year of 2014 will be between 27.0 and 28.0 percent. The full year effective tax rate in 2013 was 28.2 percent.

As of June 30, 2014, the company had \$1.3 million of unrecognized tax benefits of which \$0.9 million would affect its effective tax rate if recognized. The company recognizes potential interest and penalties related to unrecognized tax benefits as a component of tax expense.

The U.S. federal tax returns for 2009 - 2013 are subject to audit. The company is subject to state and local audits for tax years 2000 - 2013. The company is also subject to non-U.S. income tax examinations for years 2006 - 2013.

**Table of Contents****14. Changes in Accumulated Other Comprehensive Loss by Component**

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

(dollars in millions)

	Three Months Ended June 30,	
	2014	2013
<b>Cumulative Foreign Currency Translation</b>		
Balance at beginning of period	\$ 9.5	\$ 18.0
Other comprehensive gain (loss) before reclassifications	2.7	(4.1)
Balance at end of period	12.2	13.9
<b>Unrealized Net Gain on Cash Flow Derivatives</b>		
Balance at beginning of period	1.9	1.4
Other comprehensive loss before reclassifications	(1.1)	(0.4)
Realized gains on derivatives reclassified to cost of products sold (net of tax provision of \$0.3 and \$0.3 in 2014 and 2013, respectively)	(0.4)	(0.5)
Balance at end of period	0.4	0.5
<b>Pension Liability</b>		
Balance at beginning of period	(274.7)	(334.4)
Other comprehensive loss before reclassifications	(2.1)	(5.0)
Amounts reclassified from accumulated other comprehensive loss: <sup>(1)</sup>	5.3	6.3
Balance at end of period	(271.5)	(333.1)
Accumulated other comprehensive loss, end of period	\$ (258.9)	\$ (318.7)
<sup>(1)</sup> Amortization of pension items:		
Actuarial losses	\$ 8.7 <sup>(2)</sup>	\$ 10.4 <sup>(2)</sup>
Prior year service cost	(0.2) <sup>(2)</sup>	(0.2) <sup>(2)</sup>
	8.5	10.2
Tax benefit	(3.2)	(3.9)
Reclassification net of tax	\$ 5.3	\$ 6.3

<sup>(2)</sup> These accumulated other comprehensive loss components are included in the computation of net periodic pension cost. See Note 9 - Pensions for additional details



**Table of Contents****14. Changes in Accumulated Other Comprehensive Loss by Component (continued)**

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

(dollars in millions)

	Six Months Ended June 30,	
	2014	2013
<b>Cumulative Foreign Currency Translation</b>		
Balance at beginning of period	\$ 19.9	\$ 19.5
Other comprehensive loss before reclassifications	(7.7)	(5.6)
Balance at end of period	12.2	13.9
<b>Unrealized Net Gain on Cash Flow Derivatives</b>		
Balance at beginning of period	1.0	0.7
Other comprehensive earnings before reclassifications	0.5	0.7
Realized gains on derivatives reclassified to cost of products sold (net of tax provision of \$0.7 and \$0.5 in 2014 and 2013, respectively)	(1.1)	(0.9)
Balance at end of period	0.4	0.5
<b>Pension Liability</b>		
Balance at beginning of period	(280.0)	(340.7)
Other comprehensive loss before reclassifications	(2.1)	(5.0)
Amounts reclassified from accumulated other comprehensive loss: <sup>(1)</sup>	10.6	12.6
Balance at end of period	(271.5)	(333.1)
Accumulated other comprehensive loss, end of period	\$ (258.9)	\$ (318.7)
<sup>(1)</sup> Amortization of pension items:		
Actuarial losses	\$ 17.6 <sup>(2)</sup>	\$ 21.0 <sup>(2)</sup>
Prior year service cost	(0.5) <sup>(2)</sup>	(0.4) <sup>(2)</sup>
	17.1	20.6
Tax benefit	(6.5)	(8.0)
Reclassification net of tax	\$ 10.6	\$ 12.6

<sup>(2)</sup> These accumulated other comprehensive loss components are included in the computation of net periodic pension cost. See Note 9 - Pensions for additional details





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**PART I - FINANCIAL INFORMATION**

**ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**  
**OVERVIEW**

We are a leading manufacturer of water heaters and boilers, serving a diverse mix of residential and commercial end markets principally in the U.S. with a strong and growing international presence. Our company is comprised of two reporting segments: North America and Rest of World. Both segments manufacture and market comprehensive lines of residential and commercial gas, gas tankless and electric water heaters. Both segments primarily manufacture and market in their respective region of the world. Our Rest of World segment is primarily comprised of China, Europe and India. The North America segment also manufactures and globally markets specialty commercial water heating equipment, condensing and non-condensing boilers and water systems tanks. The Rest of World segment also manufactures and markets water treatment products, primarily for Asia.

Sales in the North America segment grew approximately five percent in the second quarter of 2014 due to higher sales of U.S. water heaters and Lochinvar branded products. As a result of new home construction and expansion of the replacement market, we expect the residential water heater industry's unit shipments to grow approximately four percent in 2014. We expect the commercial water heater industry's growth in units shipped to be approximately three percent in 2014. Driven by a continued transition in the boiler industry from non-condensing boilers to condensing boilers, we expect sales of Lochinvar branded products to grow approximately ten percent in 2014.

Sales in the Rest of World segment grew approximately 14 percent in the second quarter of 2014, primarily as a result of a 17 percent growth in sales in China. We expect sales in China to grow at least at a rate of approximately two times the growth in China's gross domestic product (GDP) as consumer demand for water heaters and water treatment products and distribution expansion contribute to our growth.

**RESULTS OF OPERATIONS**

**SECOND QUARTER AND FIRST SIX MONTHS OF 2014 COMPARED TO 2013**

Sales for the second quarter of 2014 were \$595.4 million or approximately eight percent higher than sales of \$549.1 million in the second quarter of 2013. Sales in the first half of 2014 increased to \$1,147.6 million from \$1,058.7 million in the same period last year. The increase in sales in both the second quarter and first half of the year is primarily due to higher sales in China. Sales in China grew 17 percent and 21 percent in the second quarter and first half of 2014, respectively, as compared to the same periods of 2013. The second quarter of 2014 also benefitted from higher sales of water heaters in the U.S. and Lochinvar branded products.

Gross profit margin in the second quarter of 2014 of 36.3 percent was almost equal to the gross profit margin of 36.1 percent in the second quarter of 2013. Our gross profit margin in the first half of 2014 increased slightly to 35.9 percent from 35.6 percent in the first half of 2013.

Selling, general and administrative (SG&A) expenses in the second quarter and first half of 2014 increased by \$5.8 million and \$16.7 million, respectively, as compared to the same periods last year. The increase in SG&A expenses in both periods in 2014 was primarily due to higher selling and advertising costs in support of increased volumes in China.



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On March 28, 2013, our board of directors approved a plan to transfer residential water heater production from our Fergus, Ontario plant to our other North American facilities. The majority of our production was consolidated in the second quarter of 2013. As a result of the capacity reduction, we incurred pre-tax restructuring and impairment expenses of \$4.2 million and \$16.9 million in the second quarter and first half of 2013, respectively, related to employee severance costs and impairment of assets.

In addition, included in operating earnings in the first half of 2013 is a pre-tax gain of \$11.0 million from a first quarter settlement with a former supplier related to previous overcharges and warranty costs.

Interest expense in the second quarter of 2014 was \$1.4 million compared to \$1.6 million in the same period last year. Interest expense in the first half of 2014 was \$2.8 million compared to \$3.1 million in the same period last year.

Other income was \$1.2 million in the second quarter of 2014, up from \$0.7 million in the same period last year. Other income in the first half of 2014 was \$2.5 million, up from \$1.7 million in the first half of 2013. The increase in other income in the second quarter and first half of 2014 was partially due to increased interest income as compared to the same periods last year. The second quarter and first half of 2013 were also negatively impacted by devaluation of the Indian rupee.

Our effective tax rates for the second quarter and first half of 2014 were 27.1 percent and 27.5 percent, respectively. Our effective tax rates for the second quarter and first half of 2013 were 31.3 percent and 31.5 percent, respectively. The lower effective tax rates in both periods of 2014 were primarily due to earnings mix where a higher percentage of our pre-tax earnings was earned in jurisdictions with relatively lower tax rates as compared to the same periods in the prior year. The 2014 effective tax rates were also impacted by a one-time tax benefit associated with a revised domestic manufacturers deduction from a prior year resulting in an increased income tax benefit on an amended prior year tax return filed in the second quarter of 2014.

Our pension costs and credits are developed from actuarial valuations. The valuations reflect key assumptions regarding, among other things, discount rates, expected return on assets, retirement ages, and years of service. We consider current market conditions including changes in interest rates in making these assumptions. Our assumption for the expected rate of return on plan assets is 7.75 percent in 2014 compared to 8.00 percent in 2013. The discount rate used to determine net periodic pension costs increased from 4.05 percent in 2013 to 4.85 percent in 2014. Pension expense for the first half of 2014 was \$13.2 million compared to \$14.0 million in the first half of 2013. Total pension expense for 2014 is expected to be \$28.6 million. Our pension costs are reflected in cost of products sold and SG&A expense.

We are providing non-GAAP measures (adjusted earnings, adjusted earnings per share, adjusted segment operating earnings and adjusted segment operating margins) that exclude certain items as well as non-operating pension costs consisting of interest cost, expected return on plan assets, amortization of actuarial gains (losses) and curtailments. Prior year results are provided on a comparable basis. Reconciliations to measures on a GAAP basis are provided later in this section.

### *North America*

Sales in the North America segment were \$410.1 million in the second quarter of 2014 or \$21.1 million higher than sales of \$389.0 million in the second quarter of 2013. Sales for the first half of 2014 were \$798.6 million or \$30.9 million higher than sales of \$767.7 million in the same period last



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year. The increased sales in the second quarter and first six months of 2014 were primarily due to higher sales of commercial and residential water heaters in the U.S., as well as higher sales of Lochinvar branded products.

North America operating earnings were \$63.2 million in the second quarter of 2014 or approximately 15 percent higher than earnings of \$55.0 million in the same period of 2013. Operating earnings in the first half of 2014 were \$118.5 million or approximately nine percent higher than operating earnings of \$109.1 million in the first half of 2013. Adjusted segment operating earnings were \$67.1 million in the second quarter of 2014 compared to \$62.8 million in the second quarter of 2013. Adjusted segment operating earnings were \$126.2 million in the first half of 2014 compared to \$122.1 million in the first half of last year. Adjusted operating margin of 16.4 percent in the second quarter of 2014 was slightly higher than 16.1 percent in the same period last year. Adjusted operating margin of 15.8 percent in the first half of 2014 percent was almost equal to 15.9 percent in the same period in 2013. Increased volumes of water heaters and boilers in the U.S., partially offset by higher steel prices contributed to higher adjusted operating earnings in the second quarter and first half of 2014.

Adjusted segment operating earnings exclude non-operating pension costs in all periods presented. Adjusted segment operating earnings in the second quarter of 2013 also exclude \$4.2 million of pre-tax restructuring and impairment charges associated with the transfer of production from Fergus, Ontario. Adjusted segment operating earnings in the first half of 2013 also exclude \$16.9 million of pre-tax restructuring and impairment charges associated with the transfer of production from Fergus, Ontario and an \$11.0 million pre-tax gain on the settlement with a former supplier.

### *Rest of World*

Sales in the Rest of World segment were \$193.6 million in the second quarter of 2014 or \$24.1 million higher than sales of \$169.5 million in the second quarter of 2013. Sales in the first half of 2014 were \$366.4 million or \$58.6 million higher than sales of \$307.8 million in the first half of 2013. Sales of water heaters and water treatment products in China grew 17 percent and 21 percent in the second quarter and first half of 2014, respectively, as compared to the same periods in 2013.

Rest of World operating earnings were \$29.3 million in the second quarter of 2014 or approximately 31 percent higher than operating earnings of \$22.4 million in the second quarter of 2013. Operating earnings in the first half of 2014 were \$54.4 million or approximately 34 percent higher than operating earnings of \$40.7 million in the first half of 2013. The 2014 second quarter operating margin of 15.1 percent was higher than operating margin of 13.2 percent in the same period last year. Operating margin of 14.8 percent in the first half of 2014 was higher than operating margin of 13.2 percent in the same period last year. The improved operating earnings and operating margin in the second quarter and first half of 2014 were due to higher sales in China and improvements in profitability associated with water treatment products in China. Operating margin in the second quarter of 2014 also benefitted from lower selling and advertising costs as a percent of sales in China compared with the same period last year.

### **Outlook**

While a sustained housing recovery in North America remains elusive, we are benefitting from strong residential replacement water heater business as well as strength in commercial water heater volumes. In addition, Lochinvar has continued to meet our growth expectations with its ten percent year-to-date increase in sales. The growth of our China business has continued to exceed two times that country's GDP growth, as customers have continued to demand our high-value water heating and water treatment products. Given confidence from our strong first half, we upgraded our



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guidance for 2014. We believe A. O. Smith Corporation will achieve full-year GAAP earnings of between \$2.20 and \$2.26 per share, and achieve full-year adjusted earnings of between \$2.34 and \$2.40 per share.

The strength in profitability in our Rest of World segment has given us confidence to upgrade our high-level outlook for 2015. We revised our 2015 Rest of World segment operating margin forecast to 14 percent and reduced our estimated shares outstanding to reflect our share repurchase activity. As a result, we upgraded our 2015 earnings outlook relating to our existing portfolio of businesses to \$2.60 per share from \$2.50 per share, which represents a ten percent increase over the mid-point of our 2014 adjusted EPS guidance. We maintained our 2015 projection for revenues relating to our existing portfolio of businesses of over \$2.5 billion, which implies organic growth of seven to nine percent per year. North America segment operating margin forecast remains at 16 percent.

## **Liquidity & Capital Resources**

Working capital of \$683.9 million at June 30, 2014 was \$69.2 million higher than at December 31, 2013. Higher cash balances in China, higher inventory balances in North America and lower accounts payable balances in China account for the majority of the increase. As of June 30, 2014, almost all of the \$496.6 million of cash, cash equivalents and marketable securities was held by our foreign subsidiaries. We would incur a cost to repatriate these funds to the U.S. and have accrued \$54.8 million for the repatriation of a portion of these funds.

Cash provided by continuing operating activities in the first half of 2014 was \$90.9 million compared with \$106.4 million during the same period last year. The reduced operating cash flows were primarily related to larger working capital requirements, which were partially offset by higher earnings. For the full year 2014, we expect total cash provided by continuing operating activities to be \$240 to \$250 million.

Capital expenditures totaled \$50.8 million in the first half of 2014, compared with \$38.2 million spent in the year ago period. We are projecting 2014 capital expenditures to be \$75 to \$85 million, including approximately \$20 million to support our enterprise resource planning software implementation. Full year depreciation and amortization is expected to be approximately \$65 million.

In December 2012, we completed a \$400 million multi-currency credit facility with a group of eight banks which expires in December 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. 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 June 30, 2014.

The facility backs up commercial paper and credit line borrowings. As a result of the long-term nature of this facility, our commercial paper and credit line borrowings, as well as drawings under the facility, are classified as long-term debt. At June 30, 2014, we had available borrowing capacity of \$197.5 million under this facility. We believe the combination of available borrowing capacity and operating cash flow will provide sufficient funds to finance our existing operations for the foreseeable future.

Our total debt increased \$58.5 million from \$191.9 million at December 31, 2013 to \$250.4 million at June 30, 2014. Our leverage, as measured by the ratio of total debt to total capitalization, was 15.6 percent at June 30, 2014, compared with 12.6 percent at December 31, 2013.



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Our pension plan continues to meet all funding requirements under ERISA regulations. We are not required to make contributions to the plan in 2014.

In July 2013, our board of directors approved a stock repurchase program authorizing the purchase of 2,000,000 shares of our common stock. On April 7, 2014 our board of directors approved adding an additional 1,500,000 shares of common stock to the existing discretionary share repurchase authority. During the first half of 2014, we repurchased 1,280,200 shares at a total cost of \$60.8 million. A total of approximately 1,373,000 shares remained of the existing repurchase authority at June 30, 2014. Depending on factors such as stock price, working capital requirements and alternative investment opportunities, we expect to repurchase one million of the remainder of the authorized shares in 2014 and spend an aggregate of approximately \$110 million in 2014 for share repurchases.

On July 7, 2014, our board of directors declared a regular cash dividend of \$.15 per share on our common stock and Class A common stock. The dividend is payable on August 15, 2014 to shareholders of record on July 31, 2014.

**Non-GAAP Financial Information**

We provide non-GAAP measures (adjusted earnings, adjusted earnings per share (EPS) and adjusted segment operating earnings) that exclude certain items as well as non-operating pension costs consisting of interest cost, expected returns on assets, amortization of actuarial gains (losses) and curtailments.

We believe that the measures of adjusted earnings, adjusted EPS and adjusted segment operating earnings provide useful information to investors about our operating performance and allow management and our investors to compare our performance period over period.

**Table of Contents****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 EPS to adjusted earnings (non-GAAP) and adjusted EPS (non-GAAP):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
<b>Net Earnings (GAAP)</b>	\$ 57.3	\$ 42.1	\$ 104.0	\$ 81.1
Non-operating pension costs, before tax	5.0	4.8	9.8	9.6
Tax effect of non-operating pension costs	(2.0)	(1.8)	(3.8)	(3.6)
Restructuring and impairment expenses, before tax		4.2		16.9
Tax effect of restructuring and impairment expenses		(1.1)		(4.3)
Settlement income, before tax				(11.0)
Tax effect of settlement income				4.2
<b>Adjusted Earnings</b>	\$ 60.3	\$ 48.2	\$ 110.0	\$ 92.9
<b>Diluted EPS (GAAP)</b>	\$ 0.63	\$ 0.45	\$ 1.14	\$ 0.87
Non-operating pension costs per diluted share, before tax	0.05	0.05	0.10	0.10
Tax effect of non-operating pension costs per diluted share	(0.02)	(0.02)	(0.04)	(0.04)
Restructuring and impairment expenses per diluted share, before tax		0.05		0.19
Tax effect of restructuring and impairment expense per diluted share		(0.01)		(0.05)
Settlement income per diluted share, before tax				(0.12)
Tax effect of settlement income per diluted share				0.05
<b>Adjusted EPS</b>	\$ 0.66	\$ 0.52	\$ 1.20	\$ 1.00

Table of Contents**A. O. SMITH CORPORATION****Adjusted Segment Operating Earnings****(dollars in millions)****(unaudited)**

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
<b>Segment Operating Earnings (GAAP)</b>				
North America	\$ 63.2	\$ 55.0	\$ 118.5	\$ 109.1
Rest of World	29.3	22.4	54.4	40.7
<b>Total Segment Operating Earnings (GAAP)</b>	<b>\$ 92.5</b>	<b>\$ 77.4</b>	<b>\$ 172.9</b>	<b>\$ 149.8</b>
<b>Adjustments</b>				
North America	\$ 3.9	\$ 7.8	\$ 7.7	\$ 13.0
Rest of World				
<b>Total Adjustments</b>	<b>\$ 3.9</b>	<b>\$ 7.8</b>	<b>\$ 7.7</b>	<b>\$ 13.0</b>
<b>Adjusted Segment Operating Earnings</b>				
North America	\$ 67.1	\$ 62.8	\$ 126.2	\$ 122.1
Rest of World	29.3	22.4	54.4	40.7
<b>Total Adjusted Segment Operating Earnings</b>	<b>\$ 96.4</b>	<b>\$ 85.2</b>	<b>\$ 180.6</b>	<b>\$ 162.8</b>

Additional information:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
<b>Adjustments: North America Segment</b>				
Non-operating pension costs	\$ 3.9	\$ 3.6	\$ 7.7	\$ 7.1
Restructuring and impairment expenses		4.2		16.9
Settlement income				(11.0)
<b>Total North America Segment Adjustments</b>	<b>\$ 3.9</b>	<b>\$ 7.8</b>	<b>\$ 7.7</b>	<b>\$ 13.0</b>



**Table of Contents****A. O. SMITH CORPORATION****Adjusted 2014 EPS Guidance and Adjusted 2013 EPS****(unaudited)**

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

	2014 Guidance	2013
<b>Diluted EPS (GAAP)</b>	\$2.20 - 2.26	\$ 1.83
Non-operating pension costs per diluted share	0.14	0.13
Settlement income per diluted share		(0.07)
Restructuring and impairment expenses per diluted share		0.17
<b>Adjusted EPS</b>	<b>\$2.34 - 2.40</b>	<b>\$ 2.06</b>

**Critical Accounting Policies**

The preparation of our consolidated financial statements is in conformity with accounting principles generally accepted in the U.S. which 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 critical accounting policies that we believe could have the most significant effect on our reported results or require complex judgment by management are contained in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, of our Annual Report on Form 10-K for the year ended December 31, 2013. We believe that as of June 30, 2014 there has been no material change to this information.

**Recent Accounting Pronouncements**

In May 2014, the Financial Accounting Standards Board issued Accounting Standards Codification (ASC) 606-10, *Revenue from Contracts with Customers* (issued under Accounting Standards Update No. 2014-09).

ASC 606-10 will replace all existing revenue recognition guidance when effective. ASC 606-10 is effective for the year beginning January 1, 2017. We are in the process of determining whether the adoption of ASC 606-10 will have an impact on our consolidated financial condition, results of operations or cash flows.

**ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

As is more fully described in our Annual Report on Form 10-K for the year ended December 31, 2013, we are exposed to various types of market risks, including currency and certain commodity risks. Our quantitative and qualitative disclosures about market risk have not materially changed since that report was filed. We monitor our currency and commodity risks on a continuous basis and generally enter into forward and futures contracts to minimize these exposures. The majority of the contracts are for periods of less than one year. Our company does not engage in speculation in our derivative strategies. It is important to note that gains and losses from our forward and

futures contract activities are offset by changes in the underlying costs of the transactions being hedged.

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### **ITEM 4 - CONTROLS AND PROCEDURES**

#### **Evaluation of disclosure controls and procedures**

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (Exchange Act). Based upon their evaluation of these disclosure controls and procedures, the principal executive officer and principal financial officer concluded that the disclosure controls and procedures were effective as of June 30, 2014 to ensure that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time period specified in the SEC rules and forms, and to ensure that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is accumulated and communicated to the Company's management, including its principal executive and principal financial officers, as appropriate, to allow timely decisions regarding disclosure.

#### **Changes in internal control over financial reporting**

There have been no significant changes in our internal control over financial reporting during the quarter ended June 30, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

#### **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, guidance or words of similar meaning. All statements regarding 2015 outlook are forward-looking statements. 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: uncertain costs, savings and timeframes associated with the implementation of the new enterprise resource planning system; potential weakening in the high efficiency boiler segment in the U.S.; the ability to execute our acquisition strategy; significant volatility in raw material prices; competitive pressures on the company's businesses; inability to implement pricing actions; instability in the company's replacement markets; strength or duration of any recoveries in U.S. residential or commercial construction; a further slowdown in the growth of the Chinese economy; foreign currency fluctuations; and adverse general economic conditions and capital market deterioration.

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.

**Table of Contents****PART II - OTHER INFORMATION****ITEM 1 - LEGAL PROCEEDINGS**

There have been no material changes in the legal and environmental matters discussed in Part 1, Item 3 and Note 15 of the Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2013.

**ITEM 2 - UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

On July 8, 2013, our board of directors approved a stock repurchase program authorizing the purchase of 2,000,000 shares of our common stock. On April 7, 2014, our board of directors approved adding 1,500,000 shares of common stock to the existing discretionary share repurchase authority. Under the share repurchase program, the company's common stock may be purchased 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 the second quarter of 2014, we repurchased 834,408 shares at an average price of \$47.35 per share and at a total cost of \$39.5 million. As of June 30, 2014, there were 1,372,576 shares remaining on the repurchase authorization.

**ISSUER PURCHASES OF EQUITY SECURITIES**

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number of Shares that may yet be Purchased Under the Plans or Programs
April 1 - April 30, 2014	358,759	\$ 46.03	358,759	1,848,225
May 1 - May 31, 2014	306,827	47.59	306,827	1,541,398
June 1 - June 30, 2014	168,822	49.72	168,822	1,372,576

**ITEM 5 - OTHER INFORMATION**

None.

**ITEM 6 - EXHIBITS**

Refer to the Exhibit Index on page 31 of this report.



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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has authorized this report to be signed on its behalf by the undersigned.

**A. O. SMITH CORPORATION**

August 5, 2014

/s/ Daniel L. Kempken  
Daniel L. Kempken  
Vice President and Controller

August 5, 2014

/s/ John J. Kita  
John J. Kita  
Executive Vice President  
and Chief Financial Officer

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**INDEX TO EXHIBITS**

Exhibit Number	Description
10.1	Summary of Directors Compensation
31.1	Certification of Periodic Report by the Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.
31.2	Certification of Periodic Report by the Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.
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 Quarterly Report on Form 10-Q for the six months ended June 30, 2014 are filed herewith, formatted in XBRL (Extensive Business Reporting Language): (i) the Condensed Consolidated Statements of Earnings for the three and six months ended June 30, 2014 and 2013, (ii) the Condensed Consolidated Statements of Comprehensive Earnings for the three and six months ended June 30, 2014 and 2013, (iii) the Condensed Consolidated Balance Sheets as of June 30, 2014, and December 31, 2013, (iv) the Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2014 and 2013 (v) the Notes to Condensed Consolidated Financial Statements