



Water Heater Marketplace

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A.O. Smith Corporation

- Water Heaters and Electric Motors
 - 2007 Sales: \$2.3B
- Water Products Division
 - 2007 Sales: \$1.4B
 - Water Heater Market Leader in U.S. & Canada
 - Residential & Commercial
 - Plumbing Wholesale & Retail
 - Strong Position in China
 - \$150M; Since 1996;
 - Growth ~ 30% / Year
 - Small operation in Europe
 - Entering India



U.S. Residential Water Heater Market

- 9 million units
- 50% Gas; 50% Electric
- 50% Retail; 50% Wholesale
 - Retail = more electric (more DIY)
 - Wholesale = more Gas (more DIFM)
- 80% Replacement; 20% New Const.
- 65% Emergency; 35% “Planned”
 - Most “planned” = fear of failure

U.S. Residential Water Heater Market

- Heavily Commoditized
 - A. O. Smith: over 4000 skus
 - Heavily concentrated in
 - Minimum efficiency 40 & 50 Gallon (gas)
- Large, relatively low value
 - Fills the truck
 - Takes up warehouse & “shelf” space
 - Plumbing Contractor carries only one
 - Heavy, difficult to install

U.S. Residential Water Heater Market

- Obstacles and inertia in both channels
 - Retail & Plumbing Wholesale
 - Highly Competitive: Low margins
 - Profitability dependent on “turns”
 - Velocity is critical
 - Channels respond to demand
 - Don't drive it

U.S. Residential Water Heater Market

- Consumer not engaged
 - Doesn't interact with water heater
 - Doesn't understand it
 - Doesn't know what it costs to run it
 - Can't replace it easily
 - Scared of gas
 - Scared of water
 - A mystery



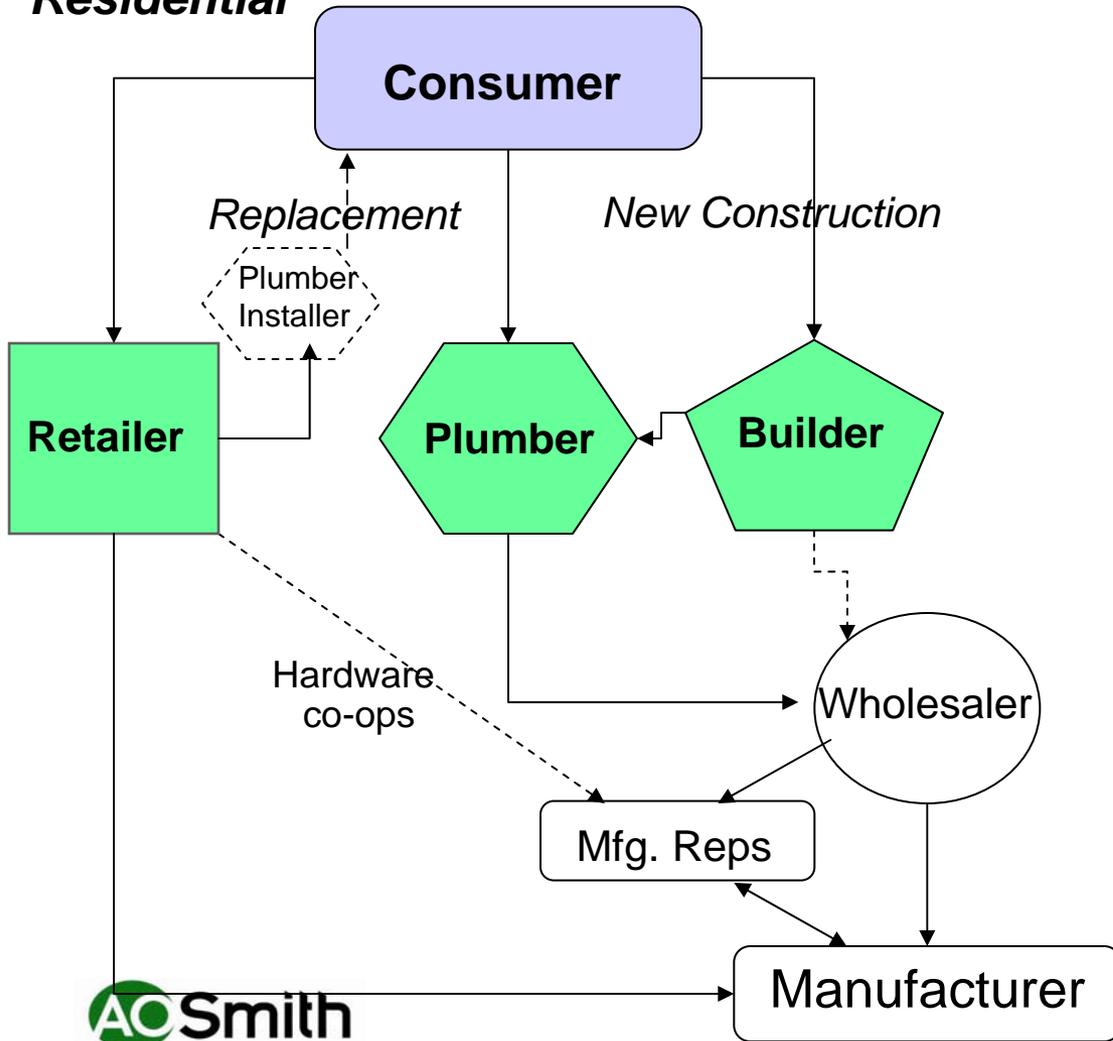
Market Research

Summary of Research Findings

- Decision Makers: **Plumbing Contractors, Builders, Property Managers, Home Owners, Specifying engineers (influencers)**
- Defined eight distinct purchasing segments
- Plumbing Contractors **remain loyal to Wholesale Channel (91%)**
- Plumbers desire to offer good, better, best options (71%)
- New Paradigm: Consumer (Home Owner) “Pull”
 - Proactive Residential Replacement = **37%**
 - Home Owners driving Tankless Growth
 - Consumers (today) choose channel / outlet first; then brand

Purchase Process

Residential



Engage the Consumer

Incentivize the decision maker / influencer

Facilitate distribution availability



Innovation

Energy
Efficiency

Industry
Leader

A.O. Smith Vertex

- Unlimited hot water
- High efficiency water heating (90% TE)
- High output in small footprint (123 gal 1st hr)
- Latest technology
- Electronic control
- Innovative Appearance



The case for higher value products



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GM\$

Plumbing Industry Evolution



1946

\$1089



2006

Plumbing Industry Evolution



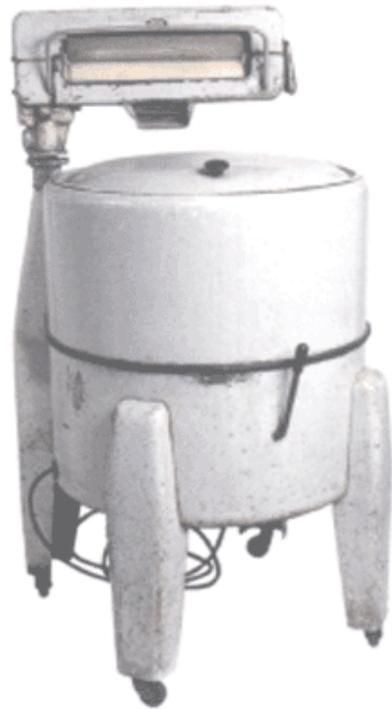
1946

\$3900



2006

Plumbing Industry Evolution



1946

\$2500



2006

Water Heater Evolution



1946

\$212



2006



Innovation has a name.