

A. O. Smith: What Should It Do With Its China Platform?

Internal ID: S&F-STR-012

Topic: Platform Strategy, Capital Allocation, Customer Strategy

Industry: Building Products

Source: Strategy & Finance

Publication date: 5 October 2026

License: Not specified

Decision date: 30 July 2026

Information cutoff: 30 July 2026, end of day

For decades, A. O. Smith had built a substantial water-heater and water-treatment business in China. The company reported roughly 8,700 points of sale, about 4,200 employees in China, and nearly 30 years of operating presence. Yet demand had weakened. In its second-quarter 2026 filing, AOS reported China third-party sales down 28% in local currency and forecast a low-double-digit local-currency decline for the full year. Its strategic assessment, started in 2025, remained open. Management said it was considering strategic partnerships and “other alternatives,” while also emphasizing the market’s long-term prospects. The company had not disclosed a transaction, partner, or exit plan. [C1, MD&A p. 20; C3, Item 1 p. 4 and Item 1A p. 8]

The board must decide what analysis and commitment should come next. The choices below are constructed for this case; they are not disclosed management proposals.

The decision

Choose one immediate path for the China assessment:

1. **Continue assessing the owned platform with explicit gates.** Define the evidence needed to justify continued investment, restructuring, or a later change in direction.
2. **Negotiate one specified partner path.** Decide whether to explore an equity joint venture or a non-equity commercial arrangement, and define the control, investment, and customer responsibilities each would require.
3. **Prepare partial or full exit analysis.** Build a decision-quality view of proceeds, obligations, and transition effects. Exit is an analyst-proposed option; AOS has not said it is pursuing one.

The immediate choice is about the assessment and commitment path. Any later change to the operating footprint-retaining, restructuring, or transferring activities-would be contingent implementation, not a separate set of options to cross-product. A commercial partner contract does not itself change ownership. A transfer or redeployment case would require a named recipient and credible economics.

What should AOS do next, and what evidence would cause you to change course?

A material business with deteriorating results

China generated \$689.5 million of reported sales in 2025, about 18% of AOS's consolidated revenue, compared with \$791.9 million in 2024 and \$835.1 million in 2023. The company separately reported a 12% local-currency decline in 2025. For the second quarter of 2026, reported China sales were \$152.4 million versus \$192.3 million a year earlier; first-half sales were \$314.8 million versus \$379.5 million. The local-currency decline in Q2 was 28%. Reported-dollar and local-currency comparisons are different measures. Management attributed the Q2 decline to continued weak consumer demand and the end of government appliance subsidies. [C1, Note 2 p. 9 and MD&A p. 20; C3, Item 1A p. 8 and Note 2 p. 38]

China's results are not separately reported as operating income, cash flow, or investment. Instead, AOS reports a Rest of World segment that combines China, India, and Europe. Q2 Rest of World revenue was \$194.9 million versus \$240.1 million; segment margin was 5.2%, down from 10.5%. First-half margin was 5.7%, compared with 9.6%. Management said lower China sales were the principal factor in the margin decline, partly offset by spending controls, and forecast a 6-7% Rest of World margin for 2026. These figures help establish the pressure on the broader region, but they do not reveal China's standalone profitability. [C1, MD&A pp. 20, 22-23]

There is counterevidence to a simple "exit" conclusion. Rest of World margin was 8.7% in 2025, compared with 7.0% reported in 2024. The 2024 number included \$11.3 million of China severance and restructuring costs; excluding those charges, the 2024 margin was 8.3%. Thus, the reported margin increase was 170 basis points, while the adjusted comparison was 40 basis points. Management attributed the 2025 improvement primarily to prior restructuring and other cost savings despite lower China sales. The segment still mixes three geographies, so neither comparison is a China margin. [C3, MD&A p. 22 and Note 5 p. 40]

What is the platform worth?

AOS describes a long-standing China operation selling residential and commercial water heaters and water-treatment products. Its filing identifies Haier/Casarte, Midea/COLMO, and Rinnai among competitors in water heaters; in water treatment it identifies Angel, Haier/Casarte, Midea/COLMO, and Truliva. The company's disclosure does not establish relative market share, product performance, or competitor economics. Its approximately 8,700 points of sale include about 3,800 retail outlets and 1,400 exclusive outlets. The filing also reports about 4,200 China employees out of 11,500 company-wide. These are indicators of a meaningful footprint, not evidence of its productivity, avoidable cost, transferability, or sale value. [C3, Item 1 p. 4; Item 1A pp. 8-9]

One possible channel issue is changing. AOS stopped using a third-party provider to finance distributor working capital in December 2025; outstanding balances were expected to amortize during 2026, with no new loans. The filing does not say that the change caused the sales decline or quantify its effect. The board would need to test whether distributor inventory, financing, or sell-through has changed before treating it as an explanation. [C3, Note 15 p. 52]

The company is also reallocating capital elsewhere. In North America, AOS recognized a \$22.6 million charge in Q2 for a water-treatment restructuring plan. It estimated net plan costs of about \$20 million after anticipated asset-sale proceeds and projected annual savings of \$6-8 million beginning in 2027. These are three distinct measures: a recognized charge, estimated net plan cost, and future annual savings. They are not evidence of available China exit proceeds or redeployment benefits. [C1, Note 4 p. 10 and MD&A pp. 20-21; C2]

Other capital-allocation indicators provide context, not a proof of constraint. AOS raised its 2026 repurchase target by \$200 million to \$300 million after repurchasing \$162.4 million in the first half. At June 30, cash was \$181.3 million and debt was \$637.5 million. Management expected boilers to grow 6-8% for the year, but Q2 boiler sales growth of 21% partly reflected price carryover and seasonal pre-buy ahead of price increases. These facts do not show that North American capacity is scarce or that money or people released in China could earn a specific return elsewhere. [C1, MD&A pp. 20, 23-25; C2]

The information the board does not yet have

Public filings do not provide China-only contribution or profit, cash flow, capital spending, working capital, product margins, plant utilization, shared-cost allocation, or the cost of operating the platform. They do not identify a partner, a proposed ownership share, valuation, governance rights, or a transaction timetable. Nor do they quantify sale proceeds, taxes, employee obligations, regulatory approvals, stranded costs, customer disruption, or the value of any recipient operation that might absorb assets or capabilities. The decision therefore cannot be settled by applying the Rest of World margin to China or by assuming an exit releases a known amount of cash.

The competitive context establishes that AOS faces named local and international competitors in China, but the public evidence does not support a relative market-position conclusion. The board must decide which company-specific information to request, how to learn it, and which commitments to defer until it is available.

Your assignment

Advise AOS's board on the immediate path for its China assessment. In your recommendation:

- Compare the three paths and state the assumptions that distinguish them.
- Identify the customer, channel, operating, ownership, and control questions that matter.
- Specify a small set of evidence gates, including what result would lead you to continue, negotiate, or prepare an exit analysis.
- Explain the opportunity cost without inventing North American capacity bottlenecks or redeployment synergies.
- Identify the China-only financial and transaction information needed before ranking alternatives.

Exhibit 1. China sales and regional operating signals

Measure	Current period	Comparison
China reported sales, 2025	\$689.5m	\$791.9m in 2024; \$835.1m in 2023
China local-currency sales change, 2025	–12%	Management-reported
China reported sales, Q2 2026	\$152.4m	\$192.3m in Q2 2025
China local-currency sales change, Q2 2026	–28%	Management-reported
China reported sales, H1 2026	\$314.8m	\$379.5m in H1 2025
Rest of World margin, Q2 2026	5.2%	10.5% in Q2 2025
Rest of World margin, H1 2026	5.7%	9.6% in H1 2025
Rest of World margin, FY2025	8.7%	7.0% reported / 8.3% adjusted in FY2024

Sources: AOS Q2 2026 Form 10-Q, Note 2 and MD&A; AOS 2025 Form 10-K, Note 2 and MD&A. China local-currency rates are not the same as reported-dollar changes. Rest of World includes China, India, and Europe. The 2024 adjusted comparator excludes \$11.3m of China severance/restructuring costs; it is not a China-only margin.

Exhibit 2. China footprint and disclosed unknowns

Disclosed item	At or near cutoff	Interpretation limit
Operating presence	About 30 years	Does not establish future advantage or exit cost
Points of sale	About 8,700, including ~3,800 retail and ~1,400 exclusive outlets	Does not establish active outlets, sell-through, or productivity
Employees	About 4,200 of 11,500 company-wide	Does not identify cost, transferability, or obligations
Competitors named by AOS	Haier/Casarte, Midea/COLMO, Rinnai; water-treatment competitors also include Angel and Truliva	No share, pricing, or performance comparison disclosed
China-only economics	Not disclosed in reviewed filings	No China-specific profit, cash flow, margin, capex, or utilization
Partner or transaction terms	Not disclosed	No counterparties, valuation, governance, proceeds, or exit cost

Source: AOS 2025 Form 10-K, Item 1 p. 4 and Item 1A pp. 8-9; reviewed 2026 Q2 filings. “Not disclosed” describes the reviewed public sources, not necessarily information available inside AOS.

Exhibit 3. Immediate paths for the assessment

Path	Near-term action	What must be learned before a larger commitment
Continue owned-platform assessment with gates	Request a China-only baseline and define a time-bounded test of controllable contribution, channel health, and required investment	Whether the operation can cover avoidable costs and needed investment under plausible demand; what thresholds change the decision
Negotiate one specified partner path	Identify a counterparty and clarify whether the proposal is an equity/JV change or a non-equity commercial contract	Partner capability, investment, control rights, customer/channel access, brand and product responsibilities, economics, and termination/buyout terms
Prepare partial/full exit analysis	Develop proceeds, obligations, transition, and stranded-cost analyses without committing to transact	Net proceeds after tax and obligations; customer, employee, supplier, and channel effects; which assets/capabilities have a named recipient, if any

Analyst-constructed classroom alternatives; AOS disclosed partnerships and “other alternatives,” but no exit plan or partner proposal. Operating-footprint changes are contingent implementation under a selected path.

Primary sources available by the cutoff

- [AOS Q2 2026 Form 10-Q, filed 30 July 2026.](#)
- [AOS Q2 2026 earnings release, 30 July 2026.](#)
- [AOS 2025 Form 10-K, filed 10 February 2026.](#)