

A WORLD OF COMFORT AND CONVENIENCE

Our long-term success depends upon delivering sustained superior performance.

About the cover: Whether it's a hot shower, a relaxing whirlpool bath, or your warm and inviting home, A. O. Smith products help provide "a world of comfort and convenience."

Letter to the Shareholders

While "historic" is a term that tends to be overused, 2006 definitely was a memorable year of accomplishment for A. O. Smith and its employees. We achieved our financial objectives with record-setting sales, profits, and earnings per share and exceeded \$2 billion in sales for the first time in our history. In April, the company successfully concluded the largest acquisition in its history with the purchase of GSW Inc. Our water heater operation in China continued its impressive growth, generating sales of more than \$120 million – a 40 percent year-over-year increase – and solidifying A. O. Smith's position as the number two water heater brand in that country.

This is not to say that everything went our way in 2006. Our operating units continued to struggle with unrelenting high prices for raw materials, most notably copper and steel. Freight costs, influenced by record-setting oil prices, also created challenges. During the third and fourth quarters, the slowdown in the U. S. housing market impacted a number of our electric motor markets and, to a lesser extent, the residential water heater market segment. While these were certainly issues that consumed a great deal of time and effort, the positives far out-weighed the negatives in terms of A. O. Smith's overall 2006 performance.

Water Products. At nearly \$1.3 billion in sales, our Water Products unit is now North America's largest manufacturer and marketer of residential and commercial water heaters. Our legacy business grew approximately eight percent last year due to improvements in the commercial and residential markets, and record-setting performance in China; while the GSW acquisition contributed more than \$360 million in sales. Water Products' operating profit improved 54 percent in 2006. The GSW acquisition, China, and ongoing improvements in our operations contributed to the record profits. Water Products' operating margin of 9.7 percent improved over the prior year as well.



Letter to the Shareholders [continued]

China remains an important part of our growth strategy, and to meet customer demand, we completed the first phase of a major expansion of the Nanjing plant at the end of last year. With the completion of the second phase, scheduled for the second quarter of 2007, we will more than double our capacity in China.

The April addition of GSW, which is made up of the American Water Heater Company in the U. S. and GSW Water Heating in Canada, does more than just increase the size of the business. In residential water heating, our company now enjoys a better balance between the wholesale and retail channels of distribution, and we have gained an important new retail customer in Lowe's®, the fastest-growing company in the home improvement industry. The addition of GSW significantly strengthens our presence in the Canadian residential water heater market and broadens access to the Canadian commercial market. Our Water Products team has done an outstanding job of integrating GSW into our business, and we are enthused about the future benefits that will result from this combination.

Electrical Products. The Electrical Products unit achieved record sales of \$906 million in 2006. We secured new business from a number of heating and air conditioning (HAC) customers and continued to see growth in the

distribution (replacement motor) market segment. Electrical Products also benefited from a full year of sales from the Yueyang hermetic motor operation in China. Yueyang, which makes large hermetic motors and high-voltage products for commercial air conditioning applications, complements our existing commercial hermetic operations in Suzhou and gives us a sizable presence in the fast-growing Asian market. Operating profit increased \$6 million, the result of lower restructuring charges and improved pricing, partially offset by lower unit volumes. Operating margin of 5.3 percent, while better than the prior year, is still not acceptable and will be the focus of our attention in 2007.

The electric motor industry presents significant challenges due to increased global competition, customer consolidation, and high material and freight costs. We continued to refine our global manufacturing footprint throughout the year, announcing the transfer of production and closing of the McMinnville, Tennessee, and Taizhou, China, plants and the transfer of manufacturing from the Tipp City, Ohio facility.

Optimizing the Core. Over the last 10 years, A. O. Smith has concentrated on growing the size and scale of its Water Products and Electrical Products divisions. Our emphasis this year will be on optimizing the business: reducing cost, streamlining processes, and eliminating waste. When you

examine the company's returns, it becomes clear that we are nowhere near our true profit potential, and the best means to achieve that potential is by addressing the issues that prevent us from operating as efficiently as we should. Optimizing the core in 2007 will involve actions such as reducing Selling, General, and Administrative (SG&A) and fixed overhead costs, eliminating multiple product designs and rationalizing components, consolidating multiple SKUs, continued emphasis on working capital management, and upgrading or replacing information systems to promote agility and customer service.

The outlook for 2007 and beyond is positive. As I indicated in last year's letter, A. O. Smith must keep the commitments it makes to its customers, employees, and shareholders. Our 2006 performance was certainly a step in the right direction, but our long-term success depends upon delivering sustained superior performance – continually improving as individuals and as a company. I know I speak for everyone at A. O. Smith when I say that we are excited about our company and the opportunities we see in 2007 and beyond.

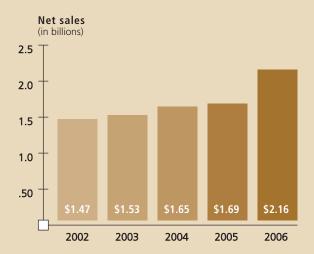
Paul W. Jones

Chairman and Chief Executive Officer

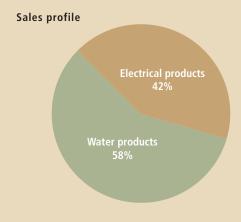
Vision Statement

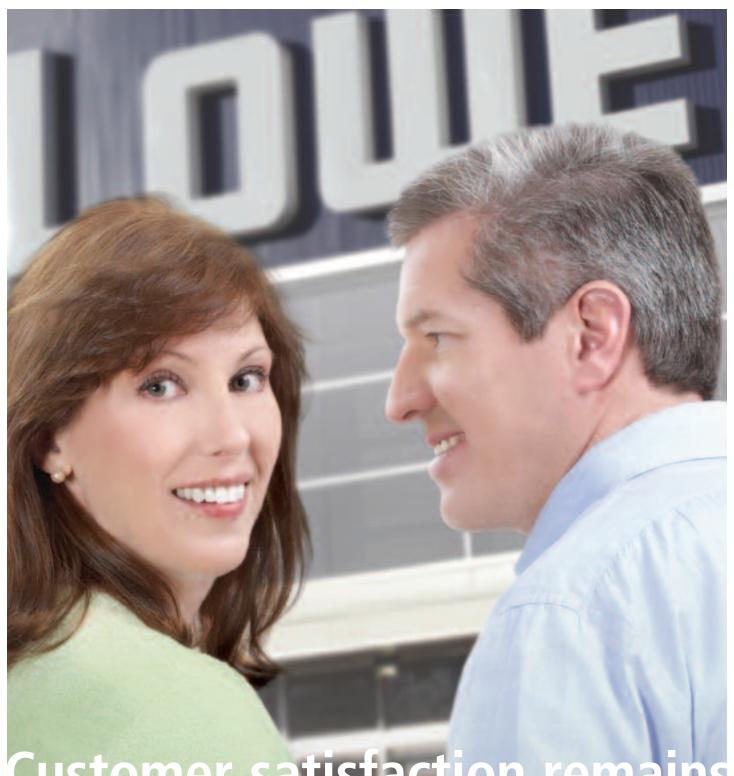
To be the global leader in applying innovative technology and energy-efficent solutions that provide comfort and convenience to life.

- Delivering water solutions for your home and business
- Powering everyday electrical products
- Creating extraordinary value for stakeholders









Customer satisfaction remains the overriding objective of our company.

At a time when consumers are becoming more brand conscious, A. O. Smith enjoys some of the best-known brands in our industries.

The power of the brand

A brand is a promise; it often evokes an emotional response from the customer. A company must constantly strive to make good on its promises and deliver the value proposition associated with the product. At a time when consumers are becoming more brand conscious, A. O. Smith enjoys the competitive advantage of a portfolio of some of the best-known names in our industries.

As our traditional markets evolve, A. O. Smith has taken actions to enhance the power of its brands. Research shows, for example, that as consumers invest more time and money in their homes, they are beginning to associate the water heater with other "white goods." Unlike the past, consumers often are buying a new unit before the old heater wears out, seeking more features, better efficiency, or the latest technology. Last year's GSW acquisition has significantly strengthened our position in the retail channel to take

advantage of these trends and provided us with a well-known water heater brand, Whirlpool®, to go along with our existing Maytag®, Kenmore®, and Reliance® lines. These brands not only enhance our presence in the retail channel, they enable us to partner with new customers such as Lowe's®, one of the fastest-growing companies in the home improvement industry.

Similar trends are taking place in the distribution segment of the electric motor market. A. O. Smith is the "national brand" in the catalogs of many of the leaders in the replacement motor market, testimony to our reputation with the professionals in those industries. "Powered by A.O. Smith" is also widely recognized as the leading brand in the pool and spa industry, and many homeowners are beginning to request the A. O. Smith brand by name, either as a replacement motor or when purchasing a new air conditioner or furnace.







The growing middle class worldwide is beginning to demand products and services that we take for granted such as hot water, home heating and cooling.

Creating a global reputation for excellence

People's desire for comfort and convenience is universal. As the number of middle class consumers worldwide grows, they are beginning to demand the products and services that we in the U.S. take for granted such as hot water, home heating and cooling. The action is taking place in red-hot growth markets such as China and India. In China, for example, demand for residential water heaters has been growing at double-digit rates for more than five years. Success in these wide-open markets is not guaranteed; it takes the ability to "localize" strategies to suit the unique characteristics of each country.

For A. O. Smith, the template derives from our major successes in China. We certainly were not the first U. S. company to do business in China, but in less than 10 years, we have grown from a minimal presence to becoming the number two residential water heater brand with market share approaching 20 percent.

The strategy involved successfully executing the basics of brand building: products specifically designed for Chinese consumers; productive manufacturing operations; partnerships with the best customers (including China's version of the "big box" retailers); knowledgeable and committed local management; and aggressive, targeted marketing.

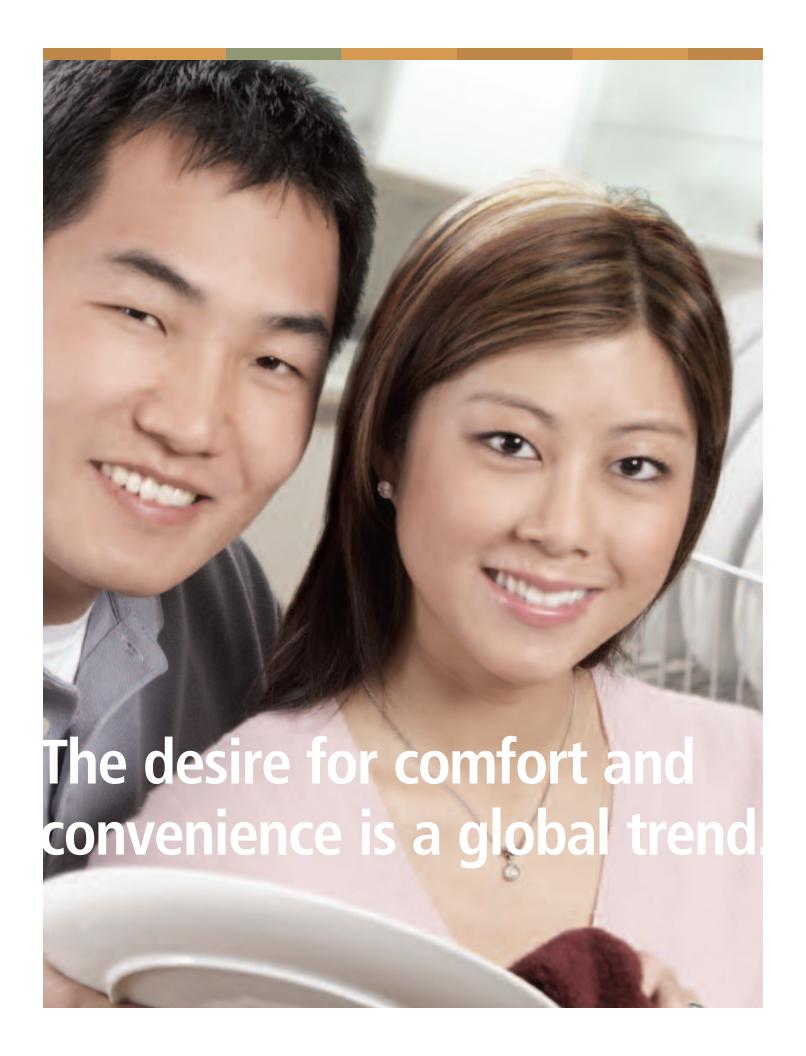
We continue to leverage the brand, introducing new water heating products for the residential and commercial market in China and extending into new in-home durable goods including water-softening and filtration equipment. Our growing electric motor operations in China are looking at ways to take advantage of the strong A. O. Smith brand.

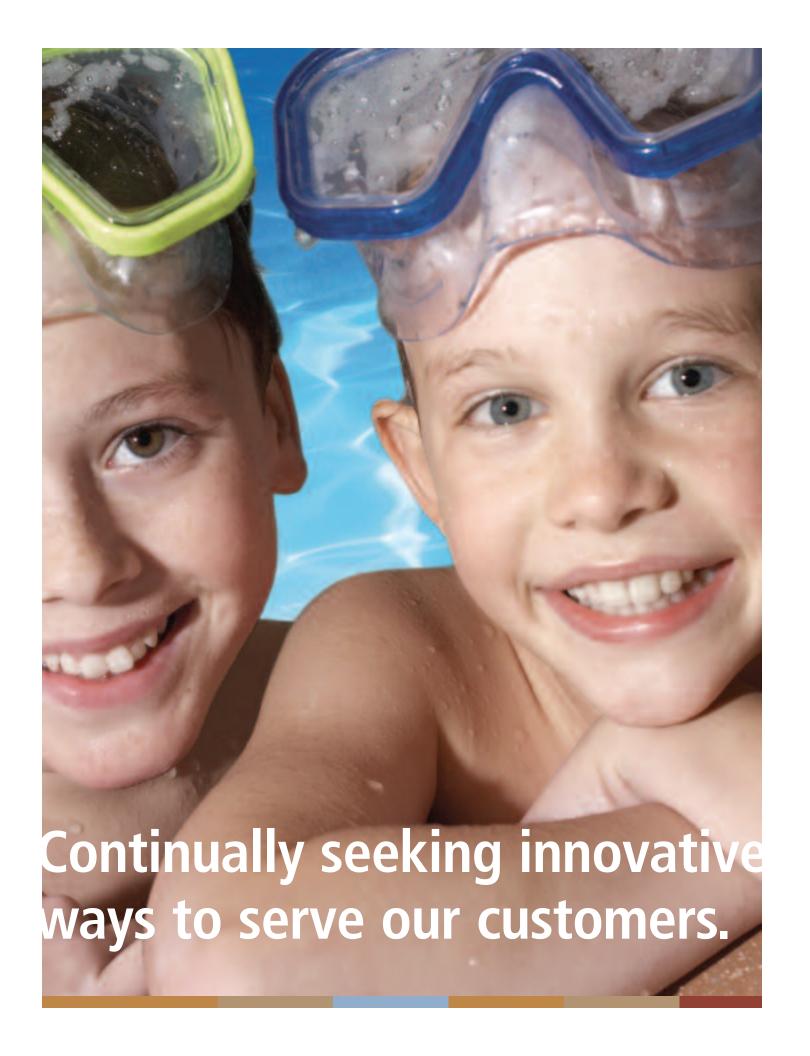
A. O. Smith plans to use this success formula in other emerging markets around the world.











Technology leadership is a global initiative and having first-rate engineering is just the beginning. Speed to market is essential to success.

Great ideas have powerful consequences

The companies that will survive – and thrive – in the 21st Century are those that can consistently bring innovative products and services to market. Technology leadership is rapidly becoming a global initiative. Over the last two years, A. O. Smith has opened three engineering centers in Asia to support its global product engineering operations, with a fourth scheduled to come on line in 2007. These engineering centers of excellence are collaborating on a number of water heating and motor projects, with some of their initial work debuting later this year.

Having first-rate engineering, however, is not enough. Speed to market is essential. New processes, designed to quickly identify the best projects from the dozens of new product ideas formulated each year, will enable us to streamline the time it takes to move from the lab to the market. These processes make the best use of limited resources by allowing engineers to invest time and money in the most promising new technologies.

To be the global leader in applying innovative technology requires more than robust engineering resources; it requires the ability to anticipate – and act upon – the changing needs of our water heater and electric motor markets. One of the compelling trends today is energy efficiency. A. O. Smith has more than 30 years of experience in designing high-efficiency products; the original Conservationist® water heater and electric motors were first introduced in 1976. Of more recent vintage are the Cyclone®, the first ultra-high-efficiency commercial water heater, the Vertex™ line of 90 percent efficiency residential water heaters, and our extensive line of high-efficiency motors for heating and cooling applications. Using electronic controls and interfaces, our engineers are finding ways to coax greater efficiency from products and systems, and a number of new high-efficiency motors and water heaters will reach the





market in 2007.



The evolving distribution channel requires partnership approaches based on a blend of products, technical expertise, and customer support.

Partners who extend our reach

Wholesale distribution remains an important market channel for A. O. Smith. It's generally acknowledged that approximately 80 percent of the demand for residential and commercial water heating is driven by replacement applications. A similar percentage of residential heating and air conditioning sales is the result of replacement demand. This makes the plumbers, HVAC contractors, and other professionals who install this equipment critical channel partners for us.

But as with other markets, wholesale distribution is evolving to meet changing customer demands and new competitors. The traditional wholesaler-supplier relationship no longer suffices. A. O. Smith has responded to these needs and, in the process, has forged strong partnerships with the leading companies in the distribution channel.

The partnership is the result of a unique blend of products, technical expertise, and customer support. We have developed programs to help our distributor partners

analyze market data and identify sales opportunities in their regions. We have collaborated with wholesalers to optimize inventories and improve logistics to better manage cost while maintaining high service levels. Utilizing the resources of our field sales engineers, we provide extensive on-site training for distributor sales staff and counter personnel, not only enhancing their product knowledge but improving their sales capabilities.

A. O. Smith is also one of the leaders in offering technical support to wholesale customers. Plumbing professionals, architects, and specifying engineers take advantage of the water heater installation, maintenance, and trouble-shooting courses offered at our Customer Care Center, the only facility of its kind in the industry. The A. O. Smith Professional Contractors Association and State Preferred

Contractor Association are further evidence of our ongoing support for the industry.









Board of Directors



Ronald D. Brown 3,4 Chairman, President and Chief Executive Officer Milacron Inc. Elected to board in 2001



Paul W. Jones 2 Chairman and Chief Executive Officer Elected to board in 2004



Mark D. Smith 1 **Business Manager** Strattec Security Corporation Elected to board in 2001





Paul W. Jones

Corporate Officers

Terry M. Murphy **Executive Vice President** and Chief Financial Officer

Christopher L. Mapes Executive Vice President

Ronald E. Massa **Executive Vice President**

Ajita G. Rajendra Executive Vice President

Randall S. Bednar Senior Vice President Information Technology

Dr. Charles J. Bishop Senior Vice President Corporate Technology

Michael J. Cole Senior Vice President – Asia

John J. Kita Senior Vice President, Corporate Finance and Controller

Mark A. Petrarca Senior Vice President Human Resources and Public Affairs

Steve W. Rettler Senior Vice President **Business Development**

W. David Romoser Senior Vice President General Counsel and Secretary

Patricia K. Ackerman Vice President and Treasurer

Kenneth J. Maciolek Vice President Associate General Counsel and Assistant Secretary

Karen K. Duke **Assistant Secretary**



William F. Buehler 3,4 Retired Vice Chairman-Board of Directors Xerox Corporation Elected to board in 1998



Robert J. O'Toole 2 Retired Chairman and Chief Executive Officer Elected to board in 1986



Idelle K. Wolf President Barnes Distribution Elected to board in 2005



William P. Greubel 3,4 Executive Director and Chairman Wabash National Corporation Elected to board in 2006



Bruce M. Smith 2,4 Chairman, President and Chief Executive Officer Smith Investment Company Elected to board in 1995



Gene C. Wulf Senior Vice President and Chief Financial Officer Bemis Company, Inc. Elected to board in 2003

Director Emeritus

Lloyd B. Smith Retired Chairman Flected to board in 1945

- 1 Audit Committee
- 2 Investment Policy Committee (Employee Benefit Trust Fund)
- 3 Nominating and Governance Committee
- 4 Personnel and Compensation Committee

Company Securities and Operating Companies



A.O. Smith Corporation's Common Stock is listed on the New York Stock Exchange under the trading symbol AOS.

Corporate Data

World Headquarters

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Investor Relations

Analyst inquiries should be directed to: Craig Watson Vice President of Investor Relations (414) 359-4009 cwatson@aosmith.com

Independent Registered Public Accounting Firm

Ernst & Young LLP 875 East Wisconsin Avenue Milwaukee, WI 53202

Registrar, Stock Transfer Agent, Dividend Reinvestment Agent (for both classes of stock)

Wells Fargo Bank, N.A. Shareowner Services[™] 161 N. Concord Exchange Street South St. Paul, MN 55075 (800) 468-9716 www.wellsfargo.com/ shareownerservices

Annual Meeting

The 2007 annual meeting of shareholders will be held on April 9, 2007, at the A.O. Smith Water Products Company 500 Tennessee Waltz Parkway Ashland City, TN

Divisions

Electrical Products Company

Christopher L. Mapes, President

Tipp City, OH (Headquarters) Acuña, Mexico Budapest, Hungary Changzhou, China Gainsborough, England Juarez, Mexico LaVergne, TN Mebane, NC McMinnville, TN Monterrey, Mexico Mt. Sterling, KY Scottsville, KY Shenzhen, China Suzhou, China Winchester, KY Yueyang, China

Water Products Company

Ajita G. Rajendra, President

Ashland City, TN (Headquarters)
Charlotte, NC
Cookeville, TN
El Paso, TX
Fergus, Ontario
Florence, KY
Franklin, TN
Johnson City, TN
Juarez, Mexico
Knoxville, TN
McBee, SC
Nanjing, China
Renton, WA
Stratford, Canada
Veldhoven, The Netherlands

Certifications

The company has filed as exhibits to its Annual Report on Form 10-K for the fiscal year ended December 31, 2006, the certifications of its Chairman and Chief Executive Officer and Executive Vice President and Chief Financial Officer required by Section 302 of the Sarbanes-Oxley Act. The company submitted to the New York Stock Exchange during 2006 the Annual CEO Certification required by Section 303A.12(a) of the New York Stock Exchange Listed Company Manual.

