Risk Factors Comparison 2024-02-13 to 2023-02-14 Form: 10-K

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In the ordinary course of our business, we face various strategic, operating, compliance and financial risks. These risks could have an impact on our business, financial condition, operating results and cash flows. The risks set forth below are not an exhaustive list of potential risks but reflect those that we believe to be material. You should carefully consider the risk factors set forth below and all other information contained in this Annual Report on Form 10- K, including the documents incorporated by reference, before making an investment decision regarding our common stock. If any of the events contemplated by the following risks were to actually occur, then our business, financial condition, or results of operations could be materially adversely affected. As a result, the trading price of our common stock could decline, and you may lose all or part of your investment. Economic and Industry Risks ■ The effects of global and regional economic conditions could have a material adverse effect on our business A decline in economic activity, such as a recession or economic downturn, in the U. S. and other regions in the world in which we do business, could **further** adversely affect consumer confidence and spending patterns which could result in decreased demand for the products we sell, a delay in purchases, increased price competition, slower adoption of energy- efficient water heaters and boilers, or high- quality water treatment products, which could negatively impact our profitability and cash flows. Such deterioration in economic conditions could arise from many factors or fears including public health crises, political instability or risk of government default. In addition, an increase in price levels generally or in particular industries (such as the inflation in steel prices in 2021 and the recent inflation in other material and logistics costs), could result in a consumer shift away from the products we offer, which could adversely affect our revenues and, at the same time, increase our costs. A deterioration in economic conditions also could negatively impact our vendors and customers, which could result in an increase in bad debt expense, customer and vendor bankruptcies, interruption or delay in supply of materials, or increased material prices, which could negatively impact our ability to distribute, market and sell our products and our financial condition, results of operations and cash flows. ■ The occurrence or threat of extraordinary events, including natural disasters, political disruptions, terrorist attacks, public health issues, and acts of war, could significantly disrupt production, or impact consumer spending As a global company with a large international footprint, we are subject to increased risk of damage or disruption to us and our employees, facilities, suppliers, distributors, or customers. Extraordinary events, including natural disasters, resulting from but not limited to climate change, political disruptions, terrorist attacks, public health issues, such as the COVID- 19 pandemic, and acts of war may disrupt our business and operations and impact our supply chain and access to necessary raw materials or could adversely affect the economy generally, resulting in a loss of sales and customers. Any of these disruptions or other extraordinary events outside of our control that impact our operations or the operations of our suppliers and key distributors could affect our business negatively, harming operating results ~~. The COVID- 19 pandemic continues to cause disruption to the global economy. We continue to monitor the pandemic, and while periodic local increases and decreases in COVID- 19 cases are likely, generally the restrictions due to and in response to the pandemic continue to relax in most locations. However, the COVID- 19 pandemic and efforts to manage it, including those by governmental authorities, could have a material adverse effect on our financial condition, results of operations and cash flows~~ . Natural disasters and extreme weather conditions may disrupt the productivity of our facilities. For example, two of our manufacturing plants are located within a floodplain that has experienced past flooding events. We also have other manufacturing facilities located in hurricane and earthquake zones. We maintain insurance coverage and have taken steps to mitigate these physical risks related to natural disasters and extreme weather conditions. **Although** ~~Pricing for our insurance program has remained at the prevailing market rate with no significant change in the current year' s premium rates from the prior year. Also, to mitigate the risk of flooding,~~ we **installed** ~~recently completed~~ an approximately 7, 000- foot- long berm, flood gates, and pumping stations around our Ashland City, Tennessee facility, our largest manufacturing facility **, to** ~~. Despite our mitigation~~ **mitigate** ~~efforts~~ **the risk of flooding** , there is still the potential for natural disasters and extreme weather conditions to disrupt the productivity of our facilities. Apart from the potential impact on our operations, these types of events also could negatively impact consumer spending in the impacted regions or depending on the severity, globally, which could materially and adversely affect our financial condition, results of operations and cash flows. ■ Our business could be adversely impacted by changes in consumer purchasing behavior, consumer preferences, technological changes, and market trends Consumer preferences for products and the methods in which they purchase products are constantly changing based on, among other factors, cost, performance, convenience, environmental and social concerns and perceptions. Consumer purchasing behavior may shift the product mix in the markets in which we participate or result in a shift to other distribution channels, for example e- commerce. Consumer preferences and broader trends, such as decarbonization and electrification efforts in response to climate change, may result in **reduced demand for gas or fossil fuel- powered products and** increased demand for higher efficiency products and / or more electric powered products. In addition, technologies are ever changing. Our ability to respond to these trends, timely transition our product portfolio, develop new and innovative products, and acquire and protect the necessary intellectual property rights is essential to our continued success, but cannot reasonably be assured. It is possible that we will not be able to develop new technologies, products or distribution channels, or do so on a timely basis, to align with consumer purchasing behavior and consumer preferences, which could materially and adversely affect our financial condition, results of operations and cash flows. ■ Our operations could be adversely impacted by material and component price volatility, as well as supplier concentration The market prices for certain materials and components we purchase, primarily steel, have been volatile. ~~We~~ **In recent years we** have also experienced inflation **-** related increases in our transportation **and other** costs. Significant increases in the cost of any of the key materials and components we purchase would increase our cost of doing business and ultimately could lead to lower operating earnings if we are not able to recover these cost increases through price increases to our customers. Historically, there has been a lag in our ability to recover increased material costs from customers, and that lag, could negatively impact our profitability. In some cases, we are dependent on a limited number of suppliers for some of the raw materials and components we require in the manufacturing of our products. A significant disruption or termination of the supply from one of these suppliers could delay sales or increase costs which could result in a material adverse effect on our financial condition, results of operations and cash flows. ■ Because we participate in markets that are highly competitive, our revenues and earnings could decline as we respond to competition We sell all of our products in highly competitive and evolving markets. We compete in each of our targeted markets based on product design, reliability, quality of products and services, advanced technologies, product performance, maintenance costs and price. Some of our competitors may have greater financial, marketing, manufacturing, research and development and distribution resources than we have; others may invest little in technology or product development but compete on price and the rapid replication of features, benefits, and technologies, and some are increasingly expanding beyond their existing manufacturing or geographic footprints. ~~In~~ **New technologies and new competitors have developed and continue to develop in certain markets in which we participate, such as gas tankless and heat pump technologies in** North America ~~, the gas tankless portion of the water heating market has for many years increased as a percentage of the overall market~~ . While we ~~have many gas tankless~~ **design and manufacture these and other** products, ~~our market share for gas tankless products is lower than our market share for the remainder of the water heating market. Further expansion of the gas tankless portion of the North America market, which~~ we ~~believe was approximately 11 percent of the residential market segment in 2022, could have an impact on our operating results. We~~ cannot assure that our products will continue to compete successfully with those of our **current** competitors **and** ~~. There could be~~ new market participants ~~that change the dynamics of those markets~~ and it is possible that we will not be able to retain our customer base or improve or maintain our profit margins on sales to our customers ~~, all~~ **. There is also increasing use** of **data analytics, machine learning, and artificial intelligence software,** which **our competitors may be able to use more effectively or implement more successfully than we are able to do. Failure to adapt to the evolving competitive environment** could materially and adversely affect our financial condition, results of operations and cash flows. ■ Because approximately 22 percent of our sales in ~~2022~~ **2023** were attributable to China, adverse economic conditions or changes in consumer behavior in China could impact our business Our sales in China ~~decreased~~ **increased** ~~five~~ **four** percent in local currency in **2023 compared to** 2022 ~~compared to 2021~~ . Our 2022 sales in China were impacted by lower consumer demand driven by COVID- 19 related disruptions. ~~Certain COVID- 19 restrictions were lifted at the end of 2022 but could return.~~ We derive a substantial portion of our sales in China from premium- tier products. Changes in consumer preferences and purchasing behaviors including preferences for e- commerce **and manufacturer emphasis on brand ecosystems and connectivity** , weakening consumer confidence and sentiment **,** as well as economic uncertainty, ~~socio- political~~ **sociopolitical and demographic** risks, **and** increased competition from Chinese- based companies ~~, and potential future COVID- 19 related impacts,~~ may prompt Chinese consumers to postpone purchases, choose lower- priced products or different alternatives, or lengthen the cycle of replacement purchases. Further deterioration in the Chinese economy may adversely affect our financial condition, results of operations and cash flows. Business, Operational, and Strategic Risks ■ We sell our products and operate outside the U. S., and to a lesser extent, rely on imports and exports, which may present additional risks to our business Approximately ~~34~~ **33** percent of our sales in ~~2022~~ **2023** were attributable to products sold outside of the U. S., primarily in China and Canada, and to a lesser extent in Europe and India. We also have operations and business relationships outside the U. S. that comprise a portion of our manufacturing, supply, and distribution. Approximately 5, ~~200~~ **000** of our 12, 000 employees as of December 31, ~~2022~~ **2023** were located in China. At December 31, ~~2022~~ **2023** , approximately $ ~~472~~ **292** million of cash and marketable securities were held by our foreign subsidiaries, substantially all of which were located in China. International operations generally are subject to various risks, including: political, religious, and economic instability; local labor market conditions; new or increased tariffs or other trade restrictions, or changes to trade agreements; the impact of foreign government regulations, actions or policies; the effects of income taxes; governmental expropriation; the changes or imposition of statutory restrictions which prohibit repatriation of cash; the imposition or increases in withholding and other taxes on remittances and other payments by foreign subsidiaries; labor relations problems; the imposition of environmental or employment laws, or other restrictions or actions by foreign governments; and differences in business practices. Unfavorable changes in the political, regulatory, or trade climate, diplomatic relations, or government policies, particularly in relation to countries where we have a presence, including Canada, China, India and Mexico, could have a material adverse effect on our financial condition, results of operations and cash flows or our ability to repatriate funds to the U. S. ■ A material loss, cancellation, reduction, or delay in purchases by one or more of our largest customers could harm our business Sales to our five largest customers represented approximately ~~39~~ **42** percent of our sales in ~~2022~~ **2023** . We expect that our customer concentration will continue for the foreseeable future. Our concentration of sales to a relatively small number of customers makes our relationships with each of these customers important to our business. We cannot assure that we will be able to retain our largest customers. Some of our customers may shift their purchases to our competitors in the future. Our customers may experience financial instability, affecting their ability to make or pay for future purchases. Further, a customer may be acquired by a customer of a competitor which could result in our loss of that customer. The loss of one or more of our largest customers, any material reduction or delay in sales to these customers, or our inability to successfully develop relationships with additional customers could have a material adverse effect on our financial position, results of operations and cash flows. ■ A portion of our business could be adversely affected by a ~~further~~ decline in North American new residential or commercial construction or a decline in replacement- related volume of water heaters and boilers, including a decline in demand for commercial spaces Residential new construction activity in North America and industry- wide replacement- related volume of water heaters had growth in ~~2020~~ **2023 after a** ~~and 2021, and then declined~~ - **decline** in 2022. New residential housing starts in the U. S. are projected to ~~decrease further~~ **be approximately flat** in **2024 compared to** 2023 ~~compared to 2022~~. Commercial construction activity in North America grew in **2023, although at a slower rate than** 2022 ~~and 2021 after declining in 2020~~. We believe that the significant majority of the markets we serve are for the replacement of existing products, and residential water heater replacement volume ~~was~~ **have been** strong ~~in 2022 and 2021~~. As a result of the COVID- 19 pandemic, businesses and commercial spaces have experienced and may experience in the future, fluctuation in demand and in occupancy that may reduce demand for our products, and commercial sectors, such as the restaurant and hospitality industries in which we have customers, may experience long- term shifts in consumer behavior which could negatively impact demand or capacity and may not return to pre- pandemic levels. In addition, the acceptance of remote work arrangements could negatively impact demand for commercial construction. Changes in the replacement volume and in the construction market in North America could negatively affect us. ■ An inability to adequately maintain our information systems and their security, as well as to protect data and other confidential information, could adversely affect our business and reputation In the ordinary course of business, we utilize information systems for day- to- day operations, to collect and store sensitive data and information, including our proprietary and regulated business information and personally identifiable information of our customers, suppliers and business partners, as well as personally identifiable information about our employees. Our information systems are susceptible to outages due to system failures, cybersecurity threats, failures on the part of third- party information system providers, natural disasters, power loss, telecommunications failures, viruses, fraud, theft, malicious actors or breaches of security. Like many companies, we, and some third parties upon which we rely, have experienced cybersecurity incidents and attacks on information technology networks and systems, products and services in the past but, to date, none have resulted in a material breach or had a material adverse impact on our financial condition, results of operations, or cash flows. We may experience ~~them~~ **such incidents and attacks** in the future, potentially with increasing frequency from increasingly sophisticated cyber threats. In addition, as a result of the COVID- 19 pandemic, remote work and remote access to our systems have increased, which may heighten these risks. ~~A~~ **Use of artificial intelligence software may also create risks from unintentional disclosure of proprietary, confidential, personal or otherwise sensitive information. Although we have a response plan in place in the event of a data breach and we have an active program to maintain and improve data security and address these risks and uncertainties by implementing and improving internal controls, security technologies, insurance programs, network and data center resiliency and recovery processes, a** successful attack in the future could result in operations failure or breach of security that could lead to disruptions of our business activities ~~,~~ **and** the loss or disclosure of both our and our customers' financial, product and other confidential information and could result in regulatory actions, **significant expense and** litigation and have a material adverse effect on our financial condition, results of operations and cash flows and our reputation ~~. We have a response plan in place in the event of a data breach and we have an active program to maintain and improve data security and address these risks and uncertainties by implementing and improving internal controls, security technologies, insurance programs, network and data center resiliency and recovery processes~~. ■ Our international operations are subject to risks related to foreign currencies We have a significant presence outside of the U. S., primarily in China and Canada and to a lesser extent Europe, Mexico, and India, and therefore, hold assets, including $ ~~377~~ **197** million of cash and marketable securities denominated in Chinese renminbi, incur liabilities, earn revenues and pay expenses in a variety of currencies other than the U. S. dollar. The financial statements of our foreign subsidiaries are translated into U. S. dollars in our consolidated financial statements. Furthermore, typically our products are priced in foreign countries in local currencies. As a result, we are subject to risks associated with operating in foreign countries, including fluctuations in currency exchange rates and interest rates, ~~hyperinflation in some foreign countries such as Turkey, where we currently have minor operations,~~ or global exchange rate instability or volatility that strengthens the U. S. dollar against foreign currencies. An increase in the value of the U. S. dollar relative to the local currencies of our foreign markets, **particularly** ~~as experienced globally~~ in **China** ~~the second half of 2022~~, has negatively affected our sales, profitability, and cash and cash equivalents balances and could have such effects in the future. In ~~2022~~ **2023**, the change in foreign currencies negatively impacted our sales and cash and cash equivalents by approximately $ ~~61~~ **56** million and $ ~~21~~ **13** million, respectively. In addition to currency translation risks, we incur a currency transaction risk whenever one of our subsidiaries enters into a purchase or sale transaction using a currency different from the operating subsidiaries' functional currency. The majority of our foreign currency transaction risk results from sales of our products in Canada, a portion of which we manufacture in the U. S **.**, and to a lesser extent from component purchases in Europe and India and payroll in Mexico. These risks may adversely impact our reported sales and profits in the future or negatively impact revenues and earnings translated from foreign currencies into U. S. dollars. ■ Our business may be adversely impacted by product defects Product defects can occur through our own product development, design and manufacturing processes or through our reliance on third parties for component design and manufacturing activities. We may incur various expenses related to product defects, including product warranty costs, product liability and recall or retrofit costs. While we maintain a reserve for product warranty costs based on certain estimates and our knowledge of current events and actions, our actual warranty costs may exceed our reserve, resulting in current period expenses and a need to increase our reserves for warranty charges. In addition, product defects and recalls may diminish the reputation of our brand. Further, our inability to cure a product defect could result in the failure of a product line or the temporary or permanent withdrawal from a product or market. Any of these events may have a material adverse impact on our financial condition, results of operations and cash flows. ■ Potential acquisitions could use a significant portion of our capital and we may not successfully integrate future acquisitions or operate them profitably or achieve strategic objectives We ~~acquired Giant, a Canada- based manufacturer of residential and commercial water heaters, on October 19, 2021, for $ 199 million subject to customary adjustments using a combination of cash and debt. We~~ will continue to evaluate potential acquisitions, and we could use a significant portion of our available capital to fund future acquisitions. We may not be able to successfully integrate ~~Giant or any~~ future acquired businesses or operate them profitably or accomplish our strategic objectives for those acquisitions. If we complete any future acquisitions in new geographies, our unfamiliarity with relevant regulations and market conditions may impact our ability to operate them profitably or achieve our strategic objectives for those acquisitions. Our level of indebtedness may increase in the future if we finance acquisitions with debt, which would cause us to incur additional interest expense and could increase our vulnerability to general adverse economic and industry conditions and limit our ability to service our debt or obtain additional financing. The impact of future acquisitions may have a material adverse effect on our financial condition, results of operations and cash flows. Legal, Regulatory, and Governance Risks ■ Changes in regulations or standards, such as those associated with climate change, could adversely affect our business Our products are subject to a wide variety of statutory, regulatory **, codes** and industry standards and requirements related to, among other items, energy and water efficiency, environmental emissions, labeling and safety. ~~We believe~~ **For example, the Department of Energy (DOE) has adopted a new efficiency rule for commercial water heaters that will take effect in 2026. In addition, there are proposed federal rule makings that would require** our **residential water heater product line to be more energy efficient as well as the establishment of a national drinking water standard regulating per- and poly- fluoroalkyl substances (PFAS), which could affect the demand for our water filtration** products **. There** are **also** ~~currently efficient, safe and environment- friendly. However,~~ a ~~limited~~ number of federal, foreign, state and local governments ~~are~~ adopting laws, regulations and codes in response to climate change that require a transition to non- fossil fuel based sources of energy production as well as significantly reducing or eliminating the on- site combustion of fossil fuels in the building sector, such as limiting or prohibiting the delivery of natural gas in new construction. ~~A~~ **We believe our products are currently efficient, safe and environment- friendly. However, a** significant change to regulatory **or code** requirements that promote a transition to alternative energy sources as a replacement for gas, or a significant shift in industry standards, could substantially increase manufacturing costs, capital expenditures, transportation costs and raw material costs **, alter distribution channels, attract new competitors** , impact the size and timing of demand for our products, affect the types of products we are able to offer or put us at a competitive disadvantage, any of which could harm our business and have a material adverse effect on our financial condition, results of operations and cash flow. ■ We are subject to U. S. and global laws and regulations covering our domestic and international operations that could adversely affect our business and results of operations Due to our global operations, we are subject to many laws governing international relations, including those that prohibit improper payments to government officials and restrict where we can do business, what information or products we can supply to certain countries and what information we can provide to a non- U. S. government, including but not limited to the Foreign Corrupt Practices Act and the U. S. Export Administration Act. Violations of these laws may result in criminal penalties or sanctions that could have a material adverse effect on our financial condition, results of operations and cash flows. ■ Our Environmental, Social, and Governance (ESG) commitments could result in additional costs, and our inability to achieve them could have an adverse impact on our reputation and performance We periodically communicate our strategies, commitments and targets related to ESG matters, including carbon emissions **, water usage** , diversity and inclusion, and human rights through the issuance of our ESG report. Although we intend to meet these strategies, commitments and targets and are committed to advancing sustainable innovations in our industry, we may be unable to achieve them due to impacts on resources, operational costs, and technological advancements. Failure to meet these sustainability requirements or targets could adversely impact our reputation as well as the demand for our products and adversely affect our business, financial condition and results of operations. In addition, standards and processes for measuring and reporting carbon emissions and other sustainability metrics may change over time, result in inconsistent data, or result in significant revisions to our strategies, commitments and targets, or our ability to achieve them. Any scrutiny of our carbon emissions or other sustainability disclosures or our failure to achieve related strategies, commitments and targets could negatively impact our reputation or performance. ■ Our results of operations may be negatively impacted by product liability lawsuits and claims Our products expose us to potential product liability risks that are inherent in the design, manufacture, sale and use of our products. While we currently maintain what we believe to be suitable product liability insurance, we cannot be certain that we will be able to maintain this insurance on acceptable terms, that this insurance will provide adequate protection against potential liabilities or that our insurance providers will be able to ultimately pay all insured losses. In addition, we self- insure a portion of product liability claims. A series of successful claims against us could materially and adversely affect our reputation and our financial condition, results of operations and cash flows. ■ We have significant goodwill and indefinite- lived intangible assets and an impairment of our goodwill or indefinite- lived intangible assets could cause a decline in our net worth Our total assets include significant goodwill and indefinite- lived intangible assets. Our goodwill results from our acquisitions, representing the excess of the purchase prices we paid over the fair value of the net tangible and intangible assets we acquired. We assess whether there have been impairments in the value of our goodwill or indefinite- lived intangible assets during the fourth quarter of each calendar year or sooner if triggering events warrant. If future operating performance at our businesses does not meet expectations, we may be required to reflect non- cash charges to operating results for goodwill or indefinite- lived intangible asset impairments. The recognition of an impairment of a significant portion of goodwill or indefinite- lived intangible assets would negatively affect our results of operations and total capitalization, the effect of which could be material. A significant reduction in our stockholders' equity due to an impairment of goodwill or indefinite- lived intangible assets may affect our ability to maintain the debt- to- capital ratio required under our existing debt arrangements. We have identified the valuation of goodwill and indefinite- lived intangible assets as a critical accounting policy. See " Management' s Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies — Goodwill and Indefinite- lived Intangible Assets " included in Item 7 of this Annual Report on Form 10- K. ■ Certain members of the founding family of our company and trusts for their benefit have the ability to influence all matters requiring stockholder approval We have two classes of common equity: our Common Stock and our Class A Common Stock. The holders of Common Stock currently are entitled, as a class, to elect only one- third of our Board of Directors. The holders of Class A Common Stock are entitled, as a class, to elect the remaining directors. Certain members of the founding family of our company and trusts for their benefit (Smith Family) have entered into a voting trust agreement with respect to shares of our Class A Common Stock and shares of our

Common Stock they own. As of December 31, ~~2022~~ **2023**, through the voting trust, these members of the Smith Family own approximately ~~65~~ **66**. ~~6~~ **2** percent of the total voting power of our outstanding shares of Class A Common Stock and Common Stock, taken together as a single class, and approximately 96. ~~8~~ **9** percent of the voting power of the outstanding shares of our Class A Common Stock, as a separate class. Due to the differences in the voting rights between shares of our Common Stock (one- tenth of one vote per share) and shares of our Class A Common Stock (one vote per share), the Smith Family voting trust is in a position to control to a large extent the outcome of matters requiring a stockholder vote, including the adoption of amendments to our certificate of incorporation or bylaws or approval of transactions involving a change of control. This ownership position may increase if other members of the Smith Family enter into the voting trust agreement, and the voting power relating to this ownership position may increase if shares of our Class A Common Stock held by stockholders who are not parties to the voting trust agreement are converted into shares of our Common Stock. The voting trust agreement provides that, in the event one of the parties to the voting trust agreement wants to withdraw from the trust or transfer any of its shares of our Class A Common Stock, such shares of our Class A Common Stock are automatically exchanged for shares of our Common Stock held by the trust to the extent available in the trust. In addition, the trust will have the right to purchase the shares of our Class A Common Stock and our Common Stock proposed to be withdrawn or transferred from the trust. As a result, the Smith Family members that are parties to the voting trust agreement have the ability to maintain their collective voting rights in our company even if certain members of the Smith Family decide to transfer their shares.