



Watsco, Inc. (WSO)

Updated October 21st, 2021 by Nathan Parsh

Key Metrics

Current Price:	\$290	5 Year CAGR Estimate:	10.0%	Market Cap:	\$10 B
Fair Value Price:	\$257	5 Year Growth Estimate:	10.0%	Ex-Dividend Date:	10/14/2021
% Fair Value:	113%	5 Year Valuation Multiple Estimate:	-2.4%	Dividend Payment Date:	10/29/2021
Dividend Yield:	2.7%	5 Year Price Target	\$414	Years Of Dividend Growth:	8
Dividend Risk Score:	F	Retirement Suitability Score:	D	Last Dividend Increase:	9.9%

Overview & Current Events

Watsco sells heating, ventilation and air condition equipment to customers in the U.S., Puerto Rico, Canada and Mexico. The company's products include residential and commercial air condition as well as gas, electric and oil furnaces. Watsco also provides parts such as compressors, evaporator coils, ductworks, thermostats and insulation materials. The company generated revenue of just over \$5 billion in 2020.

On 10/20/2021, Watsco reported third quarter earnings results for the period ending 9/30/2021. The company generated revenue of \$1.79 billion, \$40 million below analysts' estimates, but this was a 16.2% increase from the prior year. GAAP earnings-per-share of \$3.62 compared favorably to earnings-per-share of \$2.76 in the prior year and was \$0.06 higher than expected.

Revenue and earnings-per-share were once again a new quarterly record driven by same-store sales growth of 8% year-over-year. HVAC equipment sales, which represented 69% of total sales, grew 7%. Other HVAC products, which contributed 27% of sales, grew 12% while commercial refrigeration products, which accounted for 4% of sales, was up 27%. The operating margin expanded 140 basis points to 11.6% while operating income grew 32% to a company record \$207 million. Year-to-date, revenue has increased 22% to nearly \$4.77 billion and earnings-per-share has improved 50% to \$8.75, both records for the company.

Analysts now expect Watsco to earn \$10.29 per share in 2021, up from \$10.12 previously. This would be a 47% increase from the prior year and a new record if achieved.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	\$2.74	\$3.03	\$3.68	\$4.32	\$4.90	\$5.15	\$5.54	\$6.49	\$6.50	\$7.01	\$10.29	\$16.57
DPS	\$2.23	\$2.48	\$1.15	\$2.00	\$2.80	\$3.60	\$4.60	\$5.60	\$6.40	\$6.93	\$7.80	\$12.56
Shares¹	33	35	35	35	35	36	37	37	38	39	35	35

Watsco has grown earnings-per-share at a double-digit rate over both the last five- and 10-year periods of time. The company was able to accomplish this even as it increased its share count over the last decade. We feel an expected earnings-per-share growth rate of 10% is an appropriate starting place given Watsco's earnings history.

Watsco increased its dividend almost 10% for the 4/30/2021 payment date. The company did cut its dividend by more than half in 2013, but has raised its every year since. However, the dividend increase doesn't often follow a predictable schedule. Sometimes the dividend is raised after four consecutive payments, sometimes after two consecutive payments.

Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	23.1	23.9	23.8	22.6	24.8	26.3	27.5	26.3	24.7	28.1	28.2	25.0
Avg. Yld.	3.5%	3.4%	1.3%	2.1%	2.3%	2.7%	3.0%	3.3%	4.0%	3.5%	2.7%	3.0%

¹ Share count in millions

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Shares of Watsco are up marginally since our 9/6/2021 report. The stock has traded with a premium multiple for much of the last 10 years, as the average price-earnings ratio is more than 25 over this period of time. We feel that this is an appropriate starting point for our target valuation for the stock given the historical earnings multiple and growth expectations going forward. With shares trading at a price-to-earnings ratio of 28.2, this implies a slight headwind from multiple reversion. Reverting to our target valuation would reduce annual returns by 2.4% through 2026.

Safety, Quality, Competitive Advantage, & Recession Resiliency

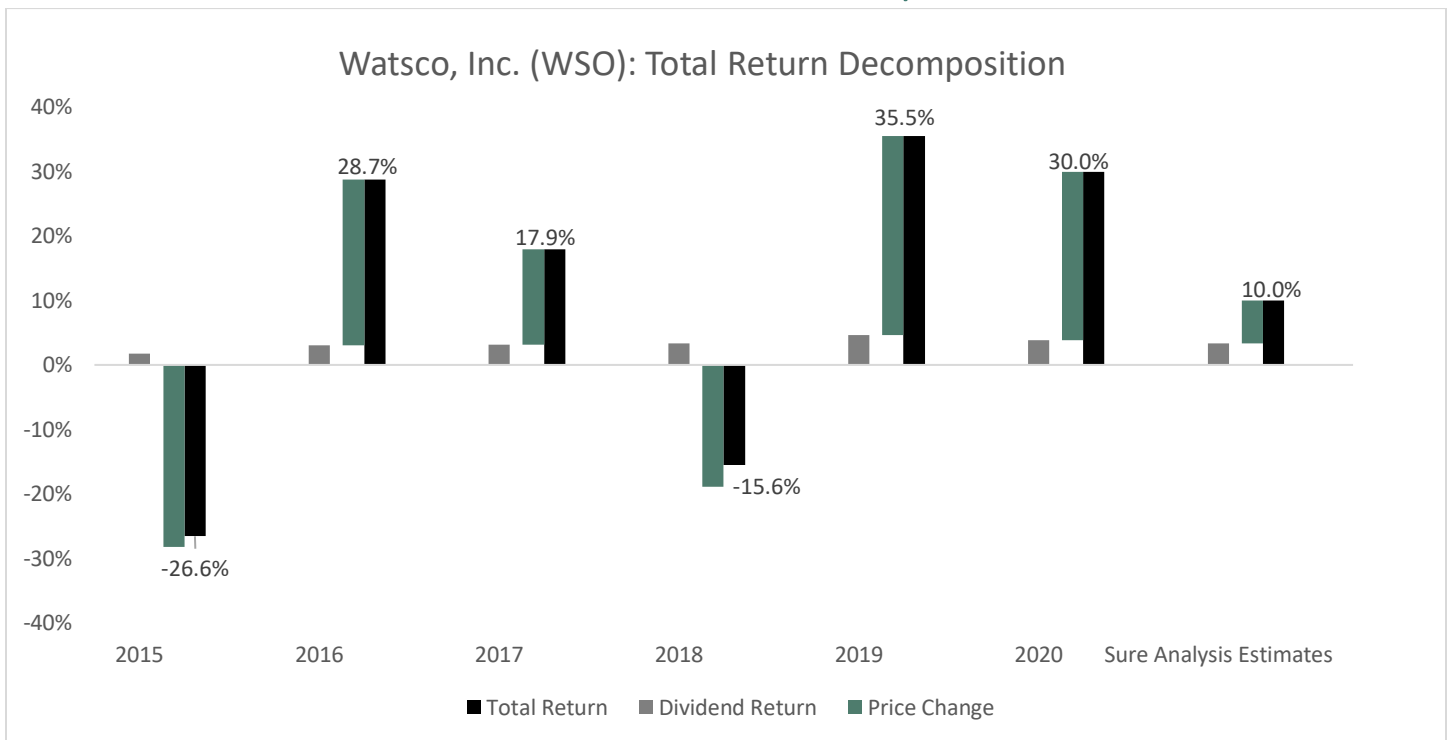
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	81%	82%	31%	46%	57%	70%	83%	86%	98%	99%	76%	76%

As a medium-sized player in its industry, we don't feel that Watsco has significant competitive advantages, though the company rebounded sharply from the last recession. Like many companies in the industry, Watsco was not immune to the impact of the last recession. The company reported earnings-per-share of \$2.43, \$2.18 and \$1.40 for 2007, 2008 and 2009, respectively. This resulted in a 42% decline over this period of time. However, the company followed this up with earnings-per-share growth the very next year, a trend that has continued every year since. While we believe that the next recession could have an equally painful impact on the company, Watsco is likely to see an improvement in business following the next economic downturn.

Final Thoughts & Recommendation

Watsco is expected to return 10% annually through 2026, up from our prior estimate of 9.8%. Our projected return stems from a 10% earnings growth rate and a starting yield of 2.7% that is partially offset by a low single-digit headwind from multiple compression. Watsco continues to produce new records for nearly every metric, both on a quarterly and year-to-date basis. We have raised our 2026 price target by \$6 to \$414 and reiterate our buy rating on the stock.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	2,978	3,432	3,743	3,945	4,113	4,221	4,342	4,547	4,770	5,055
Gross Profit	728	814	899	956	1,007	1,035	1,066	1,120	1,157	1,223
Gross Margin	24.5%	23.7%	24.0%	24.2%	24.5%	24.5%	24.5%	24.6%	24.3%	24.2%
SG&A Exp.	529	589	628	651	671	689	716	757	800	833
Depr. & Amort.	12	16	18	18	19	20	22	22	25	26
Operating Profit	199	225	271	306	337	346	354	363	357	390
Op. Margin	6.7%	6.6%	7.2%	7.8%	8.2%	8.2%	8.2%	8.0%	7.5%	7.7%
Net Profit	90	103	128	151	173	183	208	243	246	270
Net Margin	3.0%	3.0%	3.4%	3.8%	4.2%	4.3%	4.8%	5.3%	5.2%	5.3%
Free Cash Flow	48	161	136	123	199	238	289	153	318	518
Income Tax	57	63	78	92	105	106	90	73	67	77

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	1,268	1,682	1,670	1,791	1,788	1,875	2,047	2,161	2,556	2,484
Cash & Equivalents	16	74	19	24	35	56	80	83	74	146
Acc. Receivable	328	378	400	434	451	476	478	502	534	535
Inventories	465	546	583	678	674	685	761	837	921	781
Goodwill & Int.	395	617	596	574	539	538	544	540	583	582
Total Liabilities	266	660	542	659	585	623	496	559	841	705
Accounts Payable	127	185	141	173	145	185	230	200	240	252
Long-Term Debt	20	316	231	304	246	236	22	136	156	-
Total Equity	803	748	840	884	957	1,006	1,298	1,348	1,435	1,487
D/E Ratio	0.02	0.42	0.27	0.34	0.26	0.23	0.02	0.10	0.11	-

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	7.2%	7.0%	7.6%	8.7%	9.7%	10.0%	10.6%	11.5%	10.4%	10.7%
Return on Equity	11.5%	13.3%	16.1%	17.6%	18.8%	18.6%	18.1%	18.4%	17.7%	18.5%
ROIC	9.2%	8.8%	9.5%	10.8%	12.0%	12.4%	13.6%	14.7%	13.6%	14.8%
Shares Out.	33	35	35	35	35	36	37	37	38	39
Revenue/Share	96.83	108.10	116.04	121.90	126.64	129.40	132.12	132.27	137.57	143.81
FCF/Share	1.55	5.07	4.21	3.82	6.13	7.30	8.78	4.46	9.17	14.74

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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