



Watsco, Inc. (WSO)

Updated February 24th, 2023 by Nathan Parsh

Key Metrics

Current Price:	\$300	5 Year CAGR Estimate:	15.3%	Market Cap:	\$11 B
Fair Value Price:	\$338	5 Year Growth Estimate:	10.0%	Ex-Dividend Date:	04/13/2023 ¹
% Fair Value:	89%	5 Year Valuation Multiple Estimate:	2.4%	Dividend Payment Date:	04/28/2023 ²
Dividend Yield:	3.3%	5 Year Price Target	\$545	Years Of Dividend Growth:	10
Dividend Risk Score:	F	Retirement Suitability Score:	D	Rating:	Buy

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 more than \$7 billion in 2022.

On October 20th, 2022, Watsco increased its quarterly dividend 11% to \$2.45 beginning in January of 2023, which extended the company's dividend growth streak to 10 consecutive years.

On February 16th, 2023, Watsco reported fourth quarter and full year earnings results for the period ending December 31st, 2022. Revenue grew 4.6% to a fourth quarter record \$1.58 billion, but this was \$30 million below estimates. Record GAAP earnings-per-share of \$3.55 compared favorably to \$2.02 in the prior year, which was \$1.43 more than expected. For the year, revenue grew 16% to a record \$7.27 billion while GAAP earnings-per-share of \$15.41 compared to \$10.78. Full year EPS results were a new record for the company.

Record top-line growth was led by comparable sales growth of 14% for the year. For the quarter, HVAC equipment sales, which represented 67% of total sales, increased 2%. Other HVAC products, which contributed 29% of sales, improved 6% while commercial refrigeration products, which accounted for 4% of sales, was up 19%. The operating margin expanded 60 basis points to a record 8.7%.

We expect earnings-per-share to slightly decline to \$13.53 in 2023 following a record year.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	\$3.68	\$4.32	\$4.90	\$5.15	\$5.54	\$6.49	\$6.50	\$7.01	\$10.78	\$15.41	\$13.53	\$21.79
DPS	\$1.15	\$2.00	\$2.80	\$3.60	\$4.60	\$5.60	\$6.40	\$6.93	\$7.63	\$8.55	\$9.80	\$15.78
Shares³	35	35	35	36	37	37	38	39	35	36	36	36

Watsco's earnings-per-share has increased 15.8% and 17.2% since 2013 and 2018, respectively. 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.

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.

¹ Estimated ex-dividend date

² Estimated dividend payment date

³ Share count in millions

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	23.8	22.6	24.8	26.3	27.5	26.3	24.7	28.1	29.0	29.2	22.2	25.0
Avg. Yld.	1.3%	2.1%	2.3%	2.7%	3.0%	3.3%	4.0%	3.5%	2.4%	3.4%	3.3%	2.9%

Shares of Watsco have increased \$58, or 24.0%, since our October 20th, 2022 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, recent record setting results, and growth expectations going forward. With shares trading at a price-to-earnings ratio of 22.2, this implies a tailwind from multiple expansion. Reverting to our target valuation would add 2.4% to annual returns through 2028.

Safety, Quality, Competitive Advantage, & Recession Resiliency

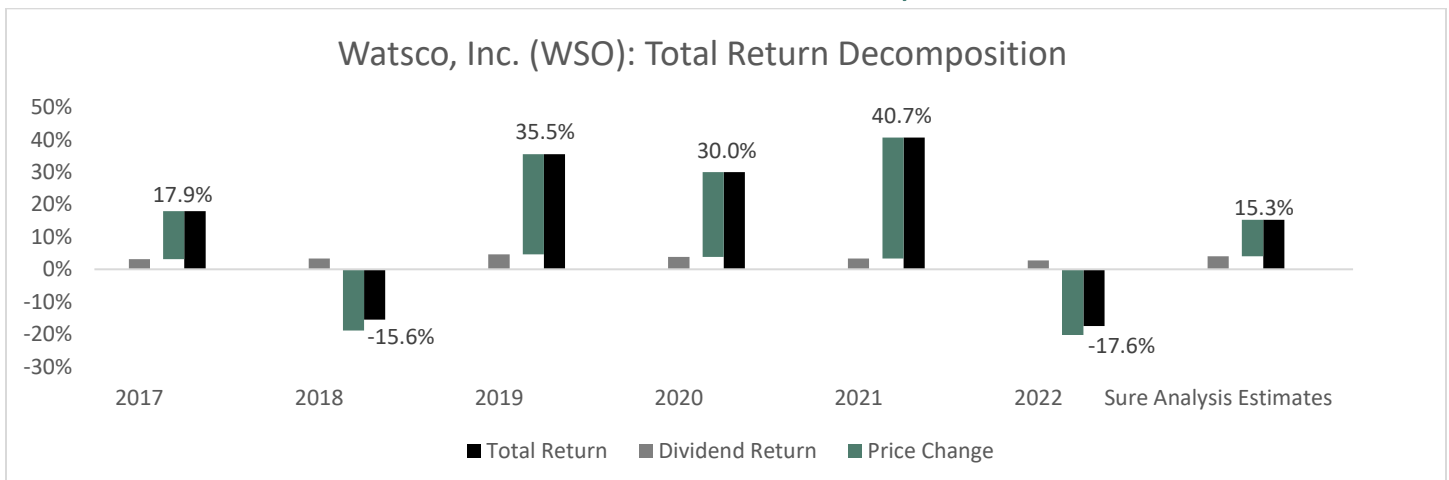
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	31%	46%	57%	70%	83%	86%	98%	99%	71%	55%	72%	72%

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 15.3% annually through 2028, down from our prior estimate of 21.5%. Our projected return stems from a 10% earnings growth rate, a starting yield of 3.3%, and a small contribution from multiple expansion. Watsco's business has experienced tremendous momentum over the last year. We do expect that earnings-per-share will decline in 2023, but find that there is still the potential for double-digit returns over the next five years. We have lowered our five-year target price \$36 to \$545 due to earnings estimates for the year, but maintain our buy rating on shares of Watsco due to projected returns.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	3,743	3,945	4,113	4,221	4,342	4,547	4,770	5,055	6,280	7,274
Gross Profit	899	956	1,007	1,035	1,066	1,120	1,157	1,223	1,668	2,030
Gross Margin	24.0%	24.2%	24.5%	24.5%	24.5%	24.6%	24.3%	24.2%	26.6%	27.9%
SG&A Exp.	628	651	671	689	716	757	800	833	1,058	1,221
Depr. & Amort.	18	18	19	20	22	22	25	26	28	32
Operating Profit	271	306	337	346	350	363	357	390	609	809
Op. Margin	7.2%	7.8%	8.2%	8.2%	8.1%	8.0%	7.5%	7.7%	9.7%	11.1%
Net Profit	128	151	173	183	208	243	246	270	419	601
Net Margin	3.4%	3.8%	4.2%	4.3%	4.8%	5.3%	5.2%	5.3%	6.7%	8.3%
Free Cash Flow	136	123	199	238	289	153	318	518	324	536
Income Tax	78	92	105	106	90	73	67	77	129	126

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	1,670	1,791	1,788	1,875	2,047	2,161	2,556	2,484	3,086	3,488
Cash & Equivalents	19	24	35	56	80	83	74	146	118	148
Acc. Receivable	400	434	451	476	478	502	534	535	698	747
Inventories	583	678	674	685	761	837	921	781	1,115	1,370
Goodwill & Int.	596	574	539	538	544	540	583	582	621	606
Total Liabilities	542	659	585	623	496	559	841	705	1,088	1,240
Accounts Payable	141	173	145	185	230	200	240	252	364	456
Long-Term Debt	231	304	246	236	22	136	225	72	174	147
Total Equity	840	884	957	1,006	1,298	1,348	1,435	1,487	1,665	1,889
LTD/E Ratio	0.27	0.34	0.26	0.23	0.02	0.10	0.16	0.05	0.10	0.08

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	7.6%	8.7%	9.7%	10.0%	10.6%	11.5%	10.4%	10.7%	15.0%	18.3%
Return on Equity	16.1%	17.6%	18.8%	18.6%	18.1%	18.4%	17.7%	18.5%	26.6%	33.8%
ROIC	9.5%	10.8%	12.0%	12.4%	13.6%	14.7%	13.4%	14.2%	20.8%	26.3%
Shares Out.	35	35	35	36	37	37	38	39	35	36
Revenue/Share	116.04	121.90	126.64	129.40	132.12	132.27	137.57	143.81	177.29	203.86
FCF/Share	4.21	3.82	6.13	7.30	8.78	4.46	9.17	14.74	9.15	15.03

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

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