



Watsco, Inc. (WSO)

Updated February 13th, 2024 by Nathan Parsh

Key Metrics

Current Price:	\$389	5 Year CAGR Estimate:	11.7%	Market Cap:	\$14 B
Fair Value Price:	\$375	5 Year Growth Estimate:	10.0%	Ex-Dividend Date:	04/12/2024 ¹
% Fair Value:	104%	5 Year Valuation Multiple Estimate:	-0.7%	Dividend Payment Date:	04/26/2024 ²
Dividend Yield:	2.8%	5 Year Price Target	\$604	Years Of Dividend Growth:	11
Dividend Risk Score:	F	Retirement Suitability Score:	F	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 2023.

On February 13th, 2024, Watsco announced that it was increasing its annualized dividend 10.2% to \$10.80 per share, which extended the company's dividend growth streak to 11 consecutive years. The new dividend will be reflected in the April 2024 payment.

Also on February 13th, 2024, Watsco announced fourth quarter and full year earnings results for the period ending December 31st, 2023. Revenue grew 1.3% to \$1.6 billion, but this was \$40 million less than expected. GAAP earnings-per-share of \$2.06 compared unfavorably to \$3.55 in the prior year. For 2023, revenue grew slightly to a new record \$7.28 billion while GAAP earnings-per-share of \$13.67 compared to \$15.41 in the prior year.

As with prior quarters, the most recent quarter came on the heels of record setting results last year. For the quarter, HVAC equipment sales, which represented 69% of total sales, were consistent with the prior year. Other HVAC products, which contributed 27% of sales, fell by 6% while commercial refrigeration products, which accounted for 4% of sales, was lower by 3%. The operating margin contracted 200 basis points to 6.7%.

We expect earnings-per-share to of \$15.01 for 2024.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	\$4.32	\$4.90	\$5.15	\$5.54	\$6.49	\$6.50	\$7.01	\$10.78	\$15.41	\$13.67	\$15.01	\$24.17
DPS	\$2.00	\$2.80	\$3.60	\$4.60	\$5.60	\$6.40	\$6.93	\$7.63	\$8.55	\$9.80	\$10.80	\$17.39
Shares³	35	35	36	37	37	38	39	35	36	37	37	37

Watsco's earnings-per-share has increased 13.7% and 18.2% annually since 2014 and 2019, respectively. The company was able to accomplish this even as it increased its share count over the last decade. We believe 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 does not 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	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	22.6	24.8	26.3	27.5	26.3	24.7	28.1	29.0	29.2	31.3	25.9	25.0
Avg. Yld.	2.1%	2.3%	2.7%	3.0%	3.3%	4.0%	3.5%	2.4%	3.4%	2.3%	2.8%	2.9%

Shares of Watsco have increased \$35, or 9.9%, since our October 20th, 2023 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. 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 25.9, this implies a small headwind from multiple contraction. Reverting to our target valuation would be a 0.7% headwind to annual returns through 2029.

Safety, Quality, Competitive Advantage, & Recession Resiliency

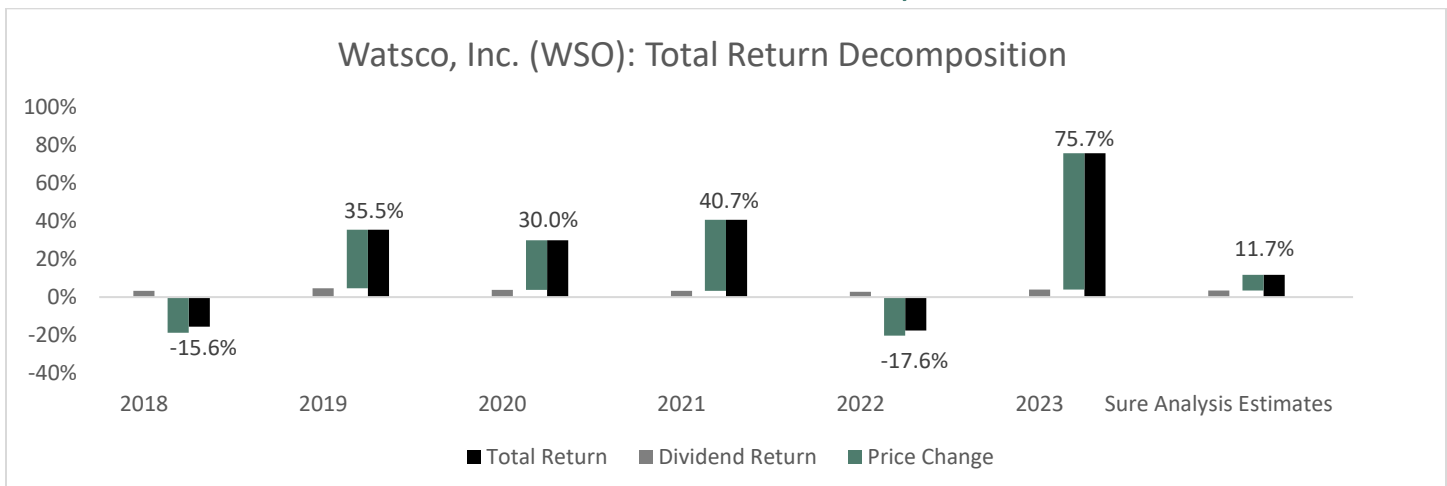
Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	46%	57%	70%	83%	86%	98%	99%	71%	55%	72%	72%	72%

As a medium-sized player in its industry, we do not 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. 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 11.7% annually through 2029, down from our prior estimate of 12.2%. Our projected return stems from a 10% earnings growth rate and a starting yield of 2.8%, offset by a small amount of multiple contraction. Watsco's business has experienced tremendous momentum over the last year. Earnings-per-share did decline in 2023, but this was off a record year for the business. We do expect that the company will return to growth in 2024. We have raised our five-year target price \$41 to \$604 due to earnings estimates for the year as well as 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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