



Watsco, Inc. (WSO)

Updated April 24th, 2024 by Nathan Parsh

Key Metrics

Current Price:	\$439	5 Year CAGR Estimate:	8.2%	Market Cap:	\$15 B
Fair Value Price:	\$359	5 Year Growth Estimate:	10.0%	Ex-Dividend Date:	04/12/2024
% Fair Value:	122%	5 Year Valuation Multiple Estimate:	-4.0%	Dividend Payment Date:	04/30/2024
Dividend Yield:	2.5%	5 Year Price Target	\$578	Years Of Dividend Growth:	11
Dividend Risk Score:	F	Retirement Suitability Score:	F	Rating:	Hold

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 is the largest distributor in a highly fragmented North American HVAC/R space. Watsco 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 is be reflected in the April 30th, 2024 payment.

On April 24th, 2024, Watsco reported first quarter earnings results for the period ending March 31st, 2024. Revenue improved 0.6% to \$1.56 billion, but this was \$40 million below estimates. GAAP earnings-per-share of \$2.17 compared unfavorably to \$3.83 in the prior year and was \$0.10 less than expected.

As with prior quarters, the most recent quarter faces tough comparisons. For the quarter, HVAC equipment sales, which represented 68% of total sales, were down 1% year-over-year. Other HVAC products, which contributed 28% of sales, decreased 6% while commercial refrigeration products, which accounted for 4% of sales, were higher by 2%. The operating margin contracted 250 basis points to 8.1%. The company produced record cash flow of \$104 million during the period. Management mentioned that it is seeing higher end-market demand as the summer selling season approaches.

We expect earnings-per-share to of \$14.35 for 2024, down from \$15.01 previously.

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	\$14.35	\$23.11
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
Shares¹	35	35	36	37	37	38	39	35	36	37	37	37

Watsco's earnings-per-share has increased 13.7% and 17.2% 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 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	30.6	25.0
Avg. Yld.	2.1%	2.3%	2.7%	3.0%	3.3%	4.0%	3.5%	2.4%	3.4%	2.3%	2.5%	3.0%

Shares of Watsco have increased \$50, or 12.9%, since our February 13th, 2024 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 30.6, this implies a headwind from multiple contraction. Reverting to our target valuation would reduce annual returns by 4.0% annually.

Safety, Quality, Competitive Advantage, & Recession Resiliency

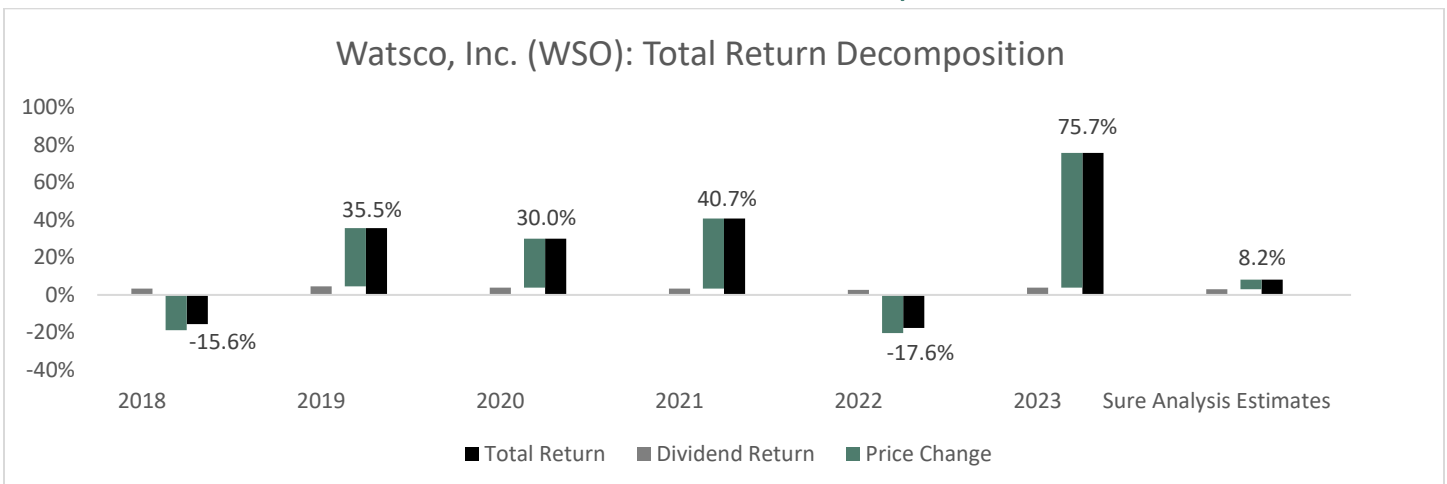
Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	46%	57%	70%	83%	86%	98%	99%	71%	55%	72%	75%	75%

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 8.2% annually through 2029, down from our prior estimate of 11.7%. Our projected return stems from a 10% earnings growth rate and a starting yield of 2.5%, offset by a mid-single-digit headwind from multiple contraction. Watsco's business experienced tremendous momentum over the last few years, which makes the comparable periods difficult. We do expect that the company will return to growth in 2024, albeit at a lower rate that previously forecasted. We have lowered our five-year target price \$26 to \$578 due to revised earnings estimates for the year and now rate shares of Watsco as a hold due to projected returns.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	3,945	4,113	4,221	4,342	4,547	4,770	5,055	6,280	7,274	7,284
Gross Profit	956	1,007	1,035	1,066	1,120	1,157	1,223	1,668	2,030	1,992
Gross Margin	24.2%	24.5%	24.5%	24.5%	24.6%	24.3%	24.2%	26.6%	27.9%	27.4%
SG&A Exp.	651	671	689	716	757	800	833	1,058	1,221	1,224
Depr. & Amort.	18	19	20	22	22	25	26	28	32	35
Operating Profit	306	337	346	350	363	357	390	609	809	769
Op. Margin	7.8%	8.2%	8.2%	8.1%	8.0%	7.5%	7.7%	9.7%	11.1%	10.6%
Net Profit	151	173	183	208	243	246	270	419	601	536
Net Margin	3.8%	4.2%	4.3%	4.8%	5.3%	5.2%	5.3%	6.7%	8.3%	7.4%
Free Cash Flow	123	199	238	289	153	318	518	324	536	526
Income Tax	92	105	106	90	73	67	77	129	126	156

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	1,791	1,788	1,875	2,047	2,161	2,556	2,484	3,086	3,488	3,729
Cash & Equivalents	24	35	56	80	83	74	146	118	148	210
Acc. Receivable	434	451	476	478	502	534	535	698	747	798
Inventories	678	674	685	761	837	921	781	1,115	1,370	1,347
Goodwill & Int.	574	539	538	544	540	583	582	621	606	675
Total Liabilities	659	585	623	496	559	841	705	1,088	1,240	1,113
Accounts Payable	173	145	185	230	200	240	252	364	456	369
Long-Term Debt	304	246	236	22	136	225	72	174	147	116
Total Equity	884	957	1,006	1,298	1,348	1,435	1,487	1,665	1,889	2,230
LTD/E Ratio	0.34	0.26	0.23	0.02	0.10	0.16	0.05	0.10	0.08	0.05

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	8.7%	9.7%	10.0%	10.6%	11.5%	10.4%	10.7%	15.0%	18.3%	14.9%
Return on Equity	13.4%	14.8%	14.9%	14.9%	15.4%	14.8%	15.4%	22.2%	28.3%	22.1%
ROIC	10.8%	12.0%	12.4%	13.6%	14.7%	13.4%	14.2%	20.8%	26.3%	20.9%
Shares Out.	35	35	36	37	37	38	39	35	36	37
Revenue/Share	121.90	126.64	129.40	132.12	132.27	137.57	143.81	177.29	203.86	199.38
FCF/Share	3.82	6.13	7.30	8.78	4.46	9.17	14.74	9.15	15.03	14.41

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

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