

WATSCO INC
Form 10-Q
November 05, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

x **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Quarterly Period Ended September 30, 2015**

or

.. **Transition Report Pursuant To Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Transition Period From _____ to _____**

Commission file number 1-5581

I.R.S. Employer Identification Number 59-0778222

WATSCO, INC.
(a Florida Corporation)

2665 South Bayshore Drive, Suite 901

Miami, Florida 33133

Telephone: (305) 714-4100

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES NO

The number of shares of each class of our common stock outstanding as of November 2, 2015 was (i) 30,249,084 shares of Common stock, \$0.50 par value per share, excluding 6,322,650 treasury shares, and (ii) 5,034,991 shares of Class B common stock, \$0.50 par value per share, excluding 48,263 treasury shares.

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WATSCO, INC. AND SUBSIDIARIES

QUARTERLY REPORT ON FORM 10-Q

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WATSCO, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED UNAUDITED STATEMENTS OF INCOME

(In thousands, except per share data)

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Revenues	\$ 1,177,012	\$ 1,134,999	\$ 3,209,423	\$ 3,067,753
Cost of sales	891,166	860,234	2,424,107	2,325,646
Gross profit	285,846	274,765	785,316	742,107
Selling, general and administrative expenses	175,166	169,527	502,769	488,336
Operating income	110,680	105,238	282,547	253,771
Interest expense, net	1,519	1,534	4,526	3,790
Income before income taxes	109,161	103,704	278,021	249,981
Income taxes	34,517	32,573	87,836	76,062
Net income	74,644	71,131	190,185	173,919
Less: net income attributable to non-controlling interest	16,676	16,670	43,746	46,604
Net income attributable to Watsco, Inc.	\$ 57,968	\$ 54,461	\$ 146,439	\$ 127,315
Earnings per share for Common and Class B common stock:				
Basic and diluted	\$ 1.64	\$ 1.56	\$ 4.16	\$ 3.64

See accompanying notes to condensed consolidated unaudited financial statements.

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WATSCO, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED UNAUDITED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net income	\$ 74,644	\$ 71,131	\$ 190,185	\$ 173,919
Other comprehensive loss, net of tax				
Foreign currency translation adjustment	(14,682)	(11,996)	(31,585)	(12,648)
Unrealized gain on cash flow hedging instruments	946		2,331	
Reclassification of gain on cash flow hedging instruments into earnings	(260)		(1,394)	
Unrealized (loss) gain on available-for-sale securities	(15)	(5)	6	(13)
Other comprehensive loss	(14,011)	(12,001)	(30,642)	(12,661)
Comprehensive income	60,633	59,130	159,543	161,258
Less: comprehensive income attributable to non-controlling interest	11,058	11,723	31,390	41,350
Comprehensive income attributable to Watsco, Inc.	\$ 49,575	\$ 47,407	\$ 128,153	\$ 119,908

See accompanying notes to condensed consolidated unaudited financial statements.

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WATSCO, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except per share data)

	September 30, 2015 (Unaudited)	December 31, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 28,505	\$ 24,447
Accounts receivable, net	510,004	434,234
Inventories	751,944	677,990
Other current assets	24,041	20,664
Total current assets	1,314,494	1,157,335
Property and equipment, net	63,297	53,480
Goodwill	379,985	387,311
Intangible assets, net	165,753	186,476
Other assets	5,930	6,465
	\$ 1,929,459	\$ 1,791,067
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Current portion of other long-term obligations	\$ 182	\$ 169
Short-term borrowings	2,353	
Accounts payable	200,641	173,360
Accrued expenses and other current liabilities	127,861	113,493
Total current liabilities	331,037	287,022
Long-term obligations:		
Borrowings under revolving credit agreement	304,941	303,199
Other long-term obligations, net of current portion	561	686
Total long-term obligations	305,502	303,885
Deferred income taxes and other liabilities	71,355	68,121
Commitments and contingencies		
Watsco, Inc. shareholders' equity:		
Common stock, \$0.50 par value	18,283	18,222
Class B common stock, \$0.50 par value	2,540	2,467

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Preferred stock, \$0.50 par value		
Paid-in capital	597,519	580,564
Accumulated other comprehensive loss, net of tax	(42,033)	(23,747)
Retained earnings	493,478	420,879
Treasury stock, at cost	(114,425)	(114,425)
Total Watsco, Inc. shareholders' equity	955,362	883,960
Non-controlling interest	266,203	248,079
Total shareholders' equity	1,221,565	1,132,039
	\$ 1,929,459	\$ 1,791,067

See accompanying notes to condensed consolidated unaudited financial statements.

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WATSCO, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED UNAUDITED STATEMENTS OF CASH FLOWS

(In thousands)

	Nine Months Ended September 30,	
	2015	2014
Cash flows from operating activities:		
Net income	\$ 190,185	\$ 173,919
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	14,216	13,348
Share-based compensation	8,862	7,850
Deferred income tax provision	5,634	4,989
Non-cash contribution to 401(k) plan	1,963	1,759
Provision for doubtful accounts	1,305	1,375
Excess tax benefits from share-based compensation	(1,983)	(1,576)
Gain on sale of property and equipment	(420)	(149)
Changes in operating assets and liabilities:		
Accounts receivable	(82,792)	(106,890)
Inventories	(80,165)	(149,085)
Accounts payable and other liabilities	45,358	99,175
Other, net	(2,405)	(2,996)
Net cash provided by operating activities	99,758	41,719
Cash flows from investing activities:		
Capital expenditures	(20,593)	(9,234)
Proceeds from sale of property and equipment	686	332
Net cash used in investing activities	(19,907)	(8,902)
Cash flows from financing activities:		
Dividends on Common and Class B common stock	(73,840)	(48,884)
Distributions to non-controlling interest	(13,266)	(25,817)
Net proceeds from other long-term obligations	(112)	276
Purchase of additional ownership from non-controlling interest		(87,735)
Payment of fees related to revolving credit agreement		(381)
Excess tax benefits from share-based compensation	1,983	1,576
Proceeds from short-term borrowings	2,353	
Net proceeds under revolving credit agreement	3,327	122,943
Net proceeds from issuances of common stock	4,528	2,604
Net cash used in financing activities	(75,027)	(35,418)

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Effect of foreign exchange rate changes on cash and cash equivalents	(766)	(186)
Net increase (decrease) in cash and cash equivalents	4,058	(2,787)
Cash and cash equivalents at beginning of period	24,447	19,478
Cash and cash equivalents at end of period	\$ 28,505	\$ 16,691

See accompanying notes to condensed consolidated unaudited financial statements.

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WATSCO, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS

September 30, 2015

(In thousands, except share and per share data)

1. BASIS OF PRESENTATION

Basis of Consolidation

Watsco, Inc. (collectively with its subsidiaries, Watsco, we, us or our) was incorporated in Florida in 1956 and is the largest distributor of air conditioning, heating and refrigeration equipment and related parts and supplies (HVAC/R) in the HVAC/R distribution industry in North America. The accompanying September 30, 2015 interim condensed consolidated unaudited financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures normally included in the annual financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP) have been condensed or omitted pursuant to those rules and regulations, but we believe the disclosures made are adequate to make the information presented not misleading. In the opinion of management, all adjustments, consisting of normal and recurring adjustments, necessary for a fair presentation have been included in the condensed consolidated unaudited financial statements included herein. These statements should be read in conjunction with the consolidated financial statements and notes thereto included in our 2014 Annual Report on Form 10-K.

The condensed consolidated unaudited financial statements contained in this report include the accounts of Watsco, all of its wholly owned subsidiaries and the accounts of three joint ventures with Carrier Corporation (Carrier), in each of which Watsco maintains a controlling interest. All significant intercompany balances and transactions have been eliminated in consolidation.

The results of operations for the quarter and nine months ended September 30, 2015 are not necessarily indicative of the results to be expected for the year ending December 31, 2015. Sales of residential central air conditioners, heating equipment and parts and supplies are seasonal. Furthermore, results of operations can be impacted favorably or unfavorably based on weather patterns, primarily during the Summer and Winter selling seasons. Demand related to the residential central air conditioning replacement market is typically highest in the second and third quarters, and demand for heating equipment is usually highest in the fourth quarter. Demand related to the new construction market is fairly consistent during the year, subject to weather and economic conditions, including their effect on the number of housing completions.

Reclassifications

Certain reclassifications of prior year amounts have been made to conform to the 2015 presentation. These reclassifications had no effect on net income or earnings per share as previously reported.

Use of Estimates

The preparation of condensed consolidated unaudited financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and

disclosure of contingent assets and liabilities at the date of the condensed consolidated unaudited financial statements and the reported amounts of revenues and expenses for the reporting period. Significant estimates include valuation reserves for accounts receivable, inventories and income taxes, reserves related to self-insurance programs and the valuation of goodwill and indefinite lived intangible assets. While we believe that these estimates are reasonable, actual results could differ from such estimates.

New Accounting Standards

Revenue Recognition

In May 2014, the Financial Accounting Standards Board (the FASB) issued a standard on revenue recognition that provides a single, comprehensive revenue recognition model for all contracts with customers. The standard is principle-based and provides a five-step model to determine the measurement of revenue and timing of when it is recognized. The core principle is that a company will recognize revenue to reflect the transfer of goods or services to customers at an amount that the company expects to be entitled to in exchange for those goods or services. In July 2015, the FASB deferred the effective date of this standard by one year. As a result, this standard is effective for our interim and annual reporting periods beginning after December 15, 2017, with early adoption permitted for annual reporting periods beginning after December 15, 2016. We are currently evaluating the impact on our condensed consolidated unaudited financial statements.

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In April 2015, the FASB issued guidance that will require debt issuance costs related to a recognized debt liability be presented on the balance sheet as a direct deduction from the carrying amount of that debt liability, rather than as an asset. This guidance is to be applied retrospectively and will be effective for interim and annual reporting periods beginning after December 15, 2015. We do not expect the adoption of this guidance to have a material impact on our condensed consolidated unaudited financial statements.

Measurement of Inventory

In July 2015, the FASB issued guidance that simplifies the measurement of inventory by replacing the lower of cost or market test with a lower of cost and net realizable value test. The guidance applies to all inventory that is measured using first-in, first-out or average cost methods. This guidance must be applied prospectively and will be effective for interim and annual reporting periods beginning after December 15, 2016. We do not expect the adoption of this guidance to have a material impact on our condensed consolidated unaudited financial statements.

2. EARNINGS PER SHARE

The following table presents the calculation of basic and diluted earnings per common share for our Common and Class B common stock:

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Basic Earnings per Share:				
Net income attributable to Watsco, Inc. shareholders	\$ 57,968	\$ 54,461	\$ 146,439	\$ 127,315
Less: distributed and undistributed earnings allocated to non-vested restricted common stock	4,595	4,106	11,513	9,644
Earnings allocated to Watsco, Inc. shareholders	\$ 53,373	\$ 50,355	\$ 134,926	\$ 117,671
Weighted-average common shares outstanding - Basic	32,458,906	32,330,888	32,421,350	32,292,559
Basic earnings per share for Common and Class B common stock	\$ 1.64	\$ 1.56	\$ 4.16	\$ 3.64
Allocation of earnings for Basic:				
Common stock	\$ 48,893	\$ 46,138	\$ 123,588	\$ 107,804
Class B common stock	4,480	4,217	11,338	