

WATSCO INC
Form 10-Q
August 09, 2016
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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 June 30, 2016**

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 August 5, 2016 was (i) 30,353,739 shares of Common stock, \$0.50 par value per share, excluding 6,322,650 treasury shares, and (ii) 5,117,336 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		Six Months Ended	
	June 30,		June 30,	
	2016	2015	2016	2015
Revenues	\$ 1,214,435	\$ 1,223,439	\$ 2,065,859	\$ 2,032,411
Cost of sales	922,574	928,194	1,561,551	1,532,941
Gross profit	291,861	295,245	504,308	499,470
Selling, general and administrative expenses	174,271	170,386	336,050	327,603
Operating income	117,590	124,859	168,258	171,867
Interest expense, net	1,054	1,630	2,040	3,007
Income before income taxes	116,536	123,229	166,218	168,860
Income taxes	35,112	38,988	50,620	53,319
Net income	81,424	84,241	115,598	115,541
Less: net income attributable to non-controlling interest	16,803	18,818	25,440	27,070
Net income attributable to Watsco, Inc.	\$ 64,621	\$ 65,423	\$ 90,158	\$ 88,471
Earnings per share for Common and Class B common stock:				
Basic	\$ 1.82	\$ 1.86	\$ 2.55	\$ 2.52
Diluted	\$ 1.82	\$ 1.85	\$ 2.54	\$ 2.51

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 June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net income	\$ 81,424	\$ 84,241	\$ 115,598	\$ 115,541
Other comprehensive income (loss), net of tax				
Foreign currency translation adjustment	1,193	2,972	14,886	(16,903)
Unrealized (loss) gain on cash flow hedging instruments	(1,082)	(241)	(1,875)	1,385
Reclassification of loss (gain) on cash flow hedging instruments into earnings	1,176	(997)	398	(1,134)
Unrealized (loss) gain on available-for-sale securities	(18)	14	(9)	21
Other comprehensive income (loss)	1,269	1,748	13,400	(16,631)
Comprehensive income	82,693	85,989	128,998	98,910
Less: comprehensive income attributable to non-controlling interest	17,300	19,516	30,640	20,332
Comprehensive income attributable to Watsco, Inc.	\$ 65,393	\$ 66,473	\$ 98,358	\$ 78,578

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)

	June 30, 2016 (Unaudited)	December 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 30,544	\$ 35,229
Accounts receivable, net	606,510	451,079
Inventories	749,333	673,967
Other current assets	20,438	20,990
Total current assets	1,406,825	1,181,265
Property and equipment, net	60,311	62,715
Goodwill	381,496	378,310
Intangible assets, net	165,537	160,481
Other assets	5,422	5,671
	\$ 2,019,591	\$ 1,788,442
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Current portion of other long-term obligations	\$ 195	\$ 184
Short-term borrowings	793	
Accounts payable	273,315	145,162
Accrued expenses and other current liabilities	132,246	124,955
Total current liabilities	406,549	270,301
Long-term obligations:		
Borrowings under revolving credit agreement	267,348	245,300
Other long-term obligations, net of current portion	443	514
Total long-term obligations	267,791	245,814
Deferred income taxes and other liabilities	72,011	68,606
Commitments and contingencies		
Watsco, Inc. shareholders equity:		
Common stock, \$0.50 par value	18,328	18,308
Class B common stock, \$0.50 par value	2,579	2,533
Preferred stock, \$0.50 par value		

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Paid-in capital	610,255	602,522
Accumulated other comprehensive loss, net of tax	(38,704)	(46,904)
Retained earnings	525,270	495,276
Treasury stock, at cost	(114,425)	(114,425)
Total Watsco, Inc. shareholders' equity	1,003,303	957,310
Non-controlling interest	269,937	246,411
Total shareholders' equity	1,273,240	1,203,721
	\$ 2,019,591	\$ 1,788,442

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)

	Six Months Ended June 30,	
	2016	2015
Cash flows from operating activities:		
Net income	\$ 115,598	\$ 115,541
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	10,043	9,409
Share-based compensation	5,474	5,840
Non-cash contribution to 401(k) plan	2,348	1,963
Deferred income tax provision	2,261	3,009
Provision for doubtful accounts	1,329	476
Gain on sale of property and equipment	(356)	(366)
Excess tax benefits from share-based compensation		(1,774)
Changes in operating assets and liabilities:		
Accounts receivable	(153,702)	(168,339)
Inventories	(72,370)	(124,477)
Accounts payable and other liabilities	130,840	84,894
Other, net	468	(303)
Net cash provided by (used in) operating activities	41,933	(74,127)
Cash flows from investing activities:		
Capital expenditures	(5,618)	(14,633)
Proceeds from sale of property and equipment	624	623
Net cash used in investing activities	(4,994)	(14,010)
Cash flows from financing activities:		
Dividends on Common and Class B common stock	(60,164)	(49,165)
Distributions to non-controlling interest	(7,114)	(3,654)
Net repayments of other long-term obligations	(60)	(83)
Excess tax benefits from share-based compensation		1,774
Proceeds from short-term borrowings	793	2,569
Net proceeds from issuances of common stock	2,842	3,235
Net proceeds under revolving credit agreement	22,025	131,146
Net cash (used in) provided by financing activities	(41,678)	85,822
Effect of foreign exchange rate changes on cash and cash equivalents	54	(281)

Net decrease in cash and cash equivalents	(4,685)	(2,596)
Cash and cash equivalents at beginning of period	35,229	24,447
Cash and cash equivalents at end of period	\$ 30,544	\$ 21,851

See accompanying notes to condensed consolidated unaudited financial statements.

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WATSCO, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS

June 30, 2016

(In thousands, except share and per share data)

1. BASIS OF PRESENTATION

Basis of Consolidation

Watsco, Inc. and its subsidiaries (collectively, Watsco, or 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 June 30, 2016 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 audited consolidated financial statements and notes thereto included in our 2015 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 six months ended June 30, 2016 are not necessarily indicative of the results to be expected for the year ending December 31, 2016. 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.

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 will adopt this guidance on January 1, 2018, and are currently evaluating the impact on our consolidated 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 consolidated financial statements.

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Leases

In February 2016, the FASB issued guidance on accounting for leases, which requires lessees to recognize most leases on their balance sheets for the rights and obligations created by those leases. The guidance requires enhanced disclosures regarding the amount, timing and uncertainty of cash flows arising from leases and will be effective for interim and annual periods beginning after December 15, 2018. Early adoption is permitted. The guidance requires the use of a modified retrospective approach. We are evaluating the impact of this guidance on our consolidated financial statements.

Presentation of Debt Issuance Costs

In April 2015, the FASB issued guidance that will require that 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 effective retrospectively for interim and annual reporting periods beginning after December 15, 2015. The adoption of this guidance did not have an impact on our consolidated financial statements.