

WATSCO INC  
Form 10-Q  
November 01, 2013

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**FORM 10-Q**

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the Quarterly Period Ended September 30, 2013**

**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  (Do not check if a smaller reporting company) 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 common stock outstanding as of October 28, 2013 was (i) 30,036,054 shares of Common stock, \$0.50 par value per share, excluding 6,322,650 treasury shares, and (ii) 4,685,473 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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**PART I. FINANCIAL INFORMATION**
**ITEM 1. CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS**

## 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,	
	2013	2012	2013	2012
Revenues	<b>\$ 1,081,893</b>	\$ 1,020,859	<b>\$ 2,915,978</b>	\$ 2,666,172
Cost of sales	<b>823,296</b>	778,354	<b>2,215,255</b>	2,034,570
Gross profit	<b>258,597</b>	242,505	<b>700,723</b>	631,602
Selling, general and administrative expenses	<b>163,142</b>	156,808	<b>469,629</b>	440,125
Operating income	<b>95,455</b>	85,697	<b>231,094</b>	191,477
Interest expense, net	<b>1,781</b>	1,185	<b>4,651</b>	3,423
Income before income taxes	<b>93,674</b>	84,512	<b>226,443</b>	188,054
Income taxes	<b>27,556</b>	24,981	<b>66,654</b>	54,129
Net income	<b>66,118</b>	59,531	<b>159,789</b>	133,925
Less: net income attributable to noncontrolling interest	<b>20,419</b>	18,526	<b>49,387</b>	45,350
Net income attributable to Watsco, Inc.	<b>\$ 45,699</b>	\$ 41,005	<b>\$ 110,402</b>	\$ 88,575
Earnings per share for Common and Class B common stock:				
Basic	<b>\$ 1.32</b>	\$ 1.19	<b>\$ 3.19</b>	\$ 2.62
Diluted	<b>\$ 1.32</b>	\$ 1.19	<b>\$ 3.18</b>	\$ 2.61

*See accompanying notes to condensed consolidated unaudited financial statements.*

## WATSCO, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED UNAUDITED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net income	<b>\$ 66,118</b>	\$ 59,531	<b>\$ 159,789</b>	\$ 133,925
Other comprehensive income (loss), net of tax				
Foreign currency translation adjustment	<b>5,073</b>	8,454	<b>(8,367)</b>	(212)
Unrealized gain on available-for-sale securities arising during the period	<b>18</b>	15	<b>15</b>	27
Other comprehensive income (loss)	<b>5,091</b>	8,469	<b>(8,352)</b>	(185)
Comprehensive income	<b>71,209</b>	68,000	<b>151,437</b>	133,740
Less: comprehensive income attributable to noncontrolling interest	<b>22,588</b>	22,249	<b>45,792</b>	45,247
Comprehensive income attributable to Watsco, Inc.	<b>\$ 48,621</b>	\$ 45,751	<b>\$ 105,645</b>	\$ 88,493

*See accompanying notes to condensed consolidated unaudited financial statements.*

WATSCO, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except per share data)

	September 30, 2013 (Unaudited)	December 31, 2012
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 29,229	\$ 73,770
Accounts receivable, net	466,340	377,655
Inventories	643,874	546,083
Other current assets	22,372	17,943
<b>Total current assets</b>	<b>1,161,815</b>	<b>1,015,451</b>
Property and equipment, net	44,891	42,842
Goodwill	394,746	397,262
Intangible assets, net	209,832	219,501
Other assets	6,749	6,999
	<b>\$ 1,818,033</b>	<b>\$ 1,682,055</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Current liabilities:		
Current portion of other long-term obligations	\$ 106	\$ 4
Accounts payable	198,277	184,957
Accrued expenses and other current liabilities	113,406	97,397
<b>Total current liabilities</b>	<b>311,789</b>	<b>282,358</b>
Long-term obligations:		
Borrowings under revolving credit agreement	284,800	316,182
Other long-term obligations, net of current portion	540	14
<b>Total long-term obligations</b>	<b>285,340</b>	<b>316,196</b>
Deferred income taxes and other liabilities	64,381	61,461
Commitments and contingencies		
Watsco, Inc. shareholders equity:		
Common stock, \$0.50 par value	18,166	18,131
Class B common stock, \$0.50 par value	2,368	2,315
Preferred stock, \$0.50 par value		
Paid-in capital	603,586	592,820
Accumulated other comprehensive loss, net of tax	(6,859)	(2,102)
Retained earnings	335,919	251,475

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Treasury stock, at cost	(114,425)	(114,425)
Total Watsco, Inc. shareholders equity	838,755	748,214
Noncontrolling interest	317,768	273,826
Total shareholders equity	1,156,523	1,022,040
	\$ 1,818,033	\$ 1,682,055

*See accompanying notes to condensed consolidated unaudited financial statements.*

## WATSCO, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED UNAUDITED STATEMENTS OF CASH FLOWS

Nine Months Ended September 30, 2013 and 2012

(In thousands)

	2013	2012
Cash flows from operating activities:		
Net income	<b>\$ 159,789</b>	\$ 133,925
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	<b>13,223</b>	11,276
Share-based compensation	<b>6,453</b>	5,609
Deferred income tax provision	<b>4,208</b>	4,743
Excess tax benefits from share-based compensation	<b>(590)</b>	(913)
Other, net	<b>1,510</b>	2,347
Changes in operating assets and liabilities, net of effects of acquisition:		
Accounts receivable	<b>(90,205)</b>	(81,793)
Inventories	<b>(99,655)</b>	(98,001)
Accounts payable and other liabilities	<b>60,278</b>	87,696
Other, net	<b>(3,828)</b>	(446)
Net cash provided by operating activities	<b>51,183</b>	64,443
Cash flows from investing activities:		
Capital expenditures	<b>(10,915)</b>	(9,228)
Business acquisition, net of cash acquired		(80,479)
Proceeds from sale of property and equipment	<b>222</b>	405
Net cash used in investing activities	<b>(10,693)</b>	(89,302)
Cash flows from financing activities:		
Distributions to noncontrolling interest	<b>(31,487)</b>	(16,003)
Net (repayments) proceeds under current revolving credit agreement	<b>(30,010)</b>	202,271
Dividends on Common and Class B common stock	<b>(25,958)</b>	(62,379)
Payment of fees related to revolving credit agreement	<b>(456)</b>	(2,072)
Purchase of additional ownership from noncontrolling interest		(51,881)
Net repayments under prior revolving credit agreements		(20,000)
Excess tax benefits from share-based compensation	<b>590</b>	913
Net proceeds from other long-term obligations	<b>628</b>	2
Net proceeds from issuances of common stock	<b>1,998</b>	3,977
Net cash (used in) provided by financing activities	<b>(84,695)</b>	54,828
Effect of foreign exchange rate changes on cash and cash equivalents	<b>(336)</b>	319
Net (decrease) increase in cash and cash equivalents	<b>(44,541)</b>	30,288



Cash and cash equivalents at beginning of period	<b>73,770</b>	15,673
Cash and cash equivalents at end of period	<b>\$ 29,229</b>	\$ 45,961
<b>Supplemental cash flow information:</b>		
Common stock issued for Carrier Enterprise III		\$ 93,250
<i>See accompanying notes to condensed consolidated unaudited financial statements.</i>		

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WATSCO, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS

September 30, 2013

(In thousands, except share and per share data)

## 1. BASIS OF PRESENTATION

### Basis of Consolidation

Watsco, Inc. and its subsidiaries (collectively, *Watsco*, which may be referred to as *we*, *us* or *our*) was incorporated in 1956 in Florida 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. The accompanying Watsco September 30, 2013 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, although 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 herein. These statements should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2012.

The condensed consolidated unaudited financial statements contained in this report include the accounts of Watsco and all of its wholly owned subsidiaries and include 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.

The results of operations for the quarter and nine months ended September 30, 2013 are not necessarily indicative of the results to be expected for the year ending December 31, 2013. 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 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 sectors throughout most of the markets is fairly consistent during the year, except for dependence on housing completions and related weather and economic conditions.

### Reclassifications

Certain reclassifications of prior year amounts have been made to conform to the 2013 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**

#### *Reporting Amounts Reclassified Out of Accumulated Other Comprehensive Income*

In February 2013, the Financial Accounting Standards Board ( FASB ) amended guidance that requires disclosure for amounts reclassified out of accumulated other comprehensive income ( AOCI ) by component. The amendments require the presentation of amounts reclassified out of AOCI by the respective line items of net income if the amount reclassified is required to be reclassified to net income in its entirety in the reporting period. For amounts that are not required to be reclassified in their entirety to net income, a cross-reference to other disclosures that provide additional detail about those amounts is required. This guidance is effective prospectively for interim and annual reporting periods beginning after December 15, 2012. The adoption of this guidance did not have an impact on our condensed consolidated unaudited financial statements.

#### *Presentation of Unrecognized Tax Benefits*

In July 2013, the FASB issued guidance that requires the presentation of an unrecognized tax benefit as a reduction to a deferred tax asset for a net operating loss carryforward rather than as a liability when the uncertain tax position would reduce the net operating loss under the tax law of the applicable jurisdiction and the entity intends to use the deferred tax asset for that purpose. This guidance is effective prospectively for interim and annual reporting periods beginning after December 15, 2013. 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,	
	2013	2012	2013	2012
<b>Basic Earnings per Share:</b>				
Net income attributable to Watsco, Inc. shareholders	\$ 45,699	\$ 41,005	\$ 110,402	\$ 88,575
Less: distributed and undistributed earnings allocated to non-vested (restricted) common stock	3,251	2,822	7,813	6,119