WATSCO INC
Form 10-Q
August 07, 2009
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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, 2009

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

Coconut Grove, 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 x 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	x	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 x

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: 27,805,263 shares of Common stock ($.50 par value), excluding treasury shares of 6,322,650 and 3,999,958 shares of Class B common stock ($.50 par value), excluding treasury shares of 48,263, were outstanding as of August 5, 2009.

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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 FINANCIAL STATEMENTS

WATSCO, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)

(Unaudited)

	Quarter Ended June 30,		Six Months Ended June 30,	
	2009	**2008**	**2009**	**2008**
Revenues	**$ 404,971**	$ 509,822	**$ 696,314**	$ 890,221
Cost of sales	**303,986**	378,762	**521,095**	661,157
Gross profit	**100,985**	131,060	**175,219**	229,064
Selling, general and administrative expenses	**74,691**	88,734	**150,487**	173,912
Operating income	**26,294**	42,326	**24,732**	55,152
Interest expense, net	**344**	387	**672**	982
Income before income taxes	**25,950**	41,939	**24,060**	54,170
Income taxes	**9,668**	15,889	**8,950**	20,476
Net income	**$ 16,282**	$ 26,050	**$ 15,110**	$ 33,694
Earnings per share for Common and Class B common stock:				
Basic	**$ 0.57**	$ 0.92	**$ 0.53**	$ 1.20
Diluted	**$ 0.56**	$ 0.90	**$ 0.52**	$ 1.17

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, 2009 (Unaudited)	December 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 45,303**	$ 41,444
Accounts receivable, net	**176,429**	151,317
Inventories	**266,119**	250,914
Other current assets	**12,381**	13,028
Total current assets	**500,232**	456,703
Property and equipment, net	**22,538**	24,209
Goodwill	**219,810**	219,810
Other assets	**20,004**	15,339
	$ 762,584	$ 716,061
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Current portion of long-term obligations	**$ 230**	$ 268
Accounts payable	**106,070**	63,850
Accrued expenses and other current liabilities	**46,002**	43,706
Total current liabilities	**152,302**	107,824
Long-term obligations:		
Borrowings under revolving credit agreement	**20,000**	20,000
Other long-term obligations, net of current portion	**697**	783
Total long-term obligations	**20,697**	20,783
Deferred income taxes and other liabilities	**18,476**	16,794
Commitments and contingencies (Note 7)		
Shareholders equity:		
Common stock, $.50 par value	**15,557**	15,442
Class B common stock, $.50 par value	**1,977**	1,907
Paid-in capital	**294,078**	282,636
Accumulated other comprehensive loss, net of tax	**(965)**	(1,125)
Retained earnings	**374,887**	386,225
Treasury stock, at cost	**(114,425)**	(114,425)

Total shareholders equity		**571,109**		570,660
	$	**762,584**	$	716,061

See accompanying notes to condensed consolidated unaudited financial statements.

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WATSCO, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

Six Months Ended June 30, 2009 and 2008

(In thousands)

(Unaudited)

	2009	2008
Cash flows from operating activities:		
Net income	**$ 15,110**	$ 33,694
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**3,413**	3,569
Share-based compensation	**2,659**	3,368
Excess tax benefits from share-based compensation	**(3,711)**	(3,558)
Provision for doubtful accounts	**3,245**	1,533
Other, net	**1,332**	3,191
Changes in operating assets and liabilities:		
Accounts receivable	**(28,357)**	(53,007)
Inventories	**(15,205)**	(50,950)
Accounts payable and other liabilities	**48,174**	108,383
Other, net	**899**	755
Net cash provided by operating activities	**27,559**	46,978
Cash flows from investing activities:		
Capital expenditures	**(1,578)**	(1,766)
Proceeds from sale of property and equipment	**148**	101
Net cash used in investing activities	**(1,430)**	(1,665)
Cash flows from financing activities:		
Dividends on Common and Class B common stock	**(26,451)**	(23,897)
Costs related to amendment of revolving credit agreement (Note 8)	**(5,253)**	
Net repayments of other long-term obligations	**(124)**	(123)
Net repayments under revolving credit agreement		(30,700)
Excess tax benefits from share-based compensation	**3,711**	3,558
Net proceeds from issuances of common stock	**5,847**	2,288
Net cash used in financing activities	**(22,270)**	(48,874)
Net increase (decrease) in cash and cash equivalents	**3,859**	(3,561)
Cash and cash equivalents at beginning of period	**41,444**	9,405
Cash and cash equivalents at end of period	**$ 45,303**	$ 5,844

See accompanying notes to condensed consolidated unaudited financial statements.

WATSCO, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2009

(In thousands, except share and per share data)

(Unaudited)

1. BASIS OF PRESENTATION

Basis of Consolidation

The accompanying condensed consolidated balance sheet as of December 31, 2008, which has been derived from Watsco, Inc. and its subsidiaries (collectively, Watsco, which may be referred to as *we*, *us* or *our*) audited consolidated financial statements, and the June 30, 2009 unaudited interim condensed consolidated 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 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 financial statements herein. These statements should be read in conjunction with the consolidated financial statements and notes thereto included in the December 31, 2008 Annual Report on Form 10-K. All amounts, except share and per share data, are expressed in thousands of dollars.

The results of operations for the quarter and six months ended June 30, 2009, are not necessarily indicative of the results to be expected for the year ending December 31, 2009. 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 the severity or mildness of weather patterns during summer or winter selling seasons. Demand related to the residential central air conditioning replacement market is highest in the second and third quarters with demand for heating equipment usually highest in the fourth quarter. Demand related to the new construction sectors throughout most of the markets is fairly even during the year except for dependence on housing completions and related weather and economic conditions.

Use of Estimates

The preparation of condensed consolidated financial statements in conformity with U.S. generally accepted accounting principles 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 financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates include valuation reserves for accounts receivable, inventory and income taxes, reserves related to self-insurance programs and valuation of goodwill and indefinite life intangible assets. Actual results could differ from those estimates.

Accounting Changes

Business Combinations

We adopted Statement of Financial Accounting Standards (SFAS) No. 141R, Business Combinations, on January 1, 2009. SFAS No. 141R provides revised guidance for recognizing and measuring assets acquired and liabilities assumed in a business combination and requires, among other things, that acquisition-related costs in a business combination be expensed as incurred. SFAS No. 141R was effective for business combinations closing after January 1, 2009. In April 2009, the Financial Accounting Standards Board (FASB) issued Staff Position (FSP) 141R-1, Accounting for Assets Acquired and Liabilities Assumed in a Business Combination that Arise from Contingencies. FSP 141R-1 amends and clarifies SFAS No. 141R to address application issues associated with initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. FSP 141R-1 is effective for assets or liabilities arising from contingencies in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Approximately $1,300 of acquisition-related costs are included in selling, general and administrative expenses in our condensed consolidated unaudited statement of income for the six months ended June 30, 2009 as a result of the adoption of SFAS No. 141R.

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Earnings per Share

We adopted FASB FSP EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities, on January 1, 2009. This FSP provides that unvested share-based payment awards that contain non-forfeitable rights to dividends are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method described in SFAS No. 128, Earnings per Share. The two-class method of computing earnings per share is an earnings allocation formula that determines earnings per share for common stock and any participating securities according to dividends declared (whether paid or unpaid) and participation rights in undistributed earnings. Our non-vested (restricted) stock are considered participating securities since the share-based awards contain a non-forfeitable right to dividends irrespective of whether the awards ultimately vest. We adopted the provisions of FSP EITF 03-6-1 effective January 1, 2009 and computed earnings per share using the two-class method for all periods presented. See Note 2, Earnings per Share. The application of FSP EITF 03-6-1 reduced diluted earnings per share for our Common and Class B common stock by the following amounts for the quarters and six months ended June 30, 2009 and 2008:

	Quarter Ended June 30,		Six Months Ended June 30,	
	2009	**2008**	**2009**	**2008**
Diluted earnings per common share excluding effect of FSP EITF 03-6-1	**$ 0.58**	$ 0.94	**$ 0.54**	$ 1.22
Effect of FSP EITF 03-6-1	**$ 0.02**	$ 0.04	**$ 0.02**	$ 0.05
Diluted earnings per common share	**$ 0.56**	$ 0.90	**$ 0.52**	$ 1.17

Recently Adopted Accounting Standards

Noncontrolling Interests

We adopted SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements, an amendment of Accounting Research Bulletin No. 51, on January 1, 2009. The adoption of SFAS No. 160 did not have an impact on these condensed consolidated financial statements. See Note 8, Subsequent Events.

Fair Value Measurements

We adopted FSP No. SFAS 157-2, Effective Date of FASB Statement No. 157, which deferred the effective date of SFAS No. 157, Fair Value Measurements, for all nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed in financial statements at fair value on a recurring basis (at least annually). This standard did not have a material impact on our condensed consolidated financial statements. See Note 4, Fair Value Measurements.

In April 2009, the FASB issued FSP FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly. This FSP provides additional guidance on factors to consider in estimating fair value when there has been a significant decrease in market activity for a financial asset. FSP 157-4 is effective for interim and annual periods ending after June 15, 2009. The adoption of FSP 157-4 did not have a material impact on these condensed consolidated financial statements.

In April 2009, the FASB issued FSP FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments. This FSP amended SFAS No. 107, Disclosures about Fair Value of Financial Instruments, to require fair value disclosures in interim financial statements in order to provide more timely information about the effects of current market conditions on financial instruments. FSP FAS 107-1 and APB 28-1 is effective for interim and annual periods ending after June 15, 2009. The adoption of FSP FAS 107-1 and APB 28-1 did not have an impact on our condensed consolidated financial statements.

Other-Than-Temporary Impairments

In April 2009, the FASB issued FSP FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments. This FSP changes the method for determining whether an other-than-temporary impairment exists for debt securities and the amount of the impairment to be recorded in earnings. FSP FAS 115-2 and FAS 124-2 is effective for interim and annual periods ending after June 15, 2009.

The adoption of FSP FAS 115-2 and FAS 124-2 did not have a material impact on our condensed consolidated financial statements.

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Disclosures about Derivative Instruments and Hedging Activities

We adopted SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities an Amendment of FASB Statement No. 133, on January 1, 2009. The adoption of SFAS No. 161 did not change our accounting for derivative instruments and did not have a material impact on our condensed consolidated financial statements. See Note 3, Derivative Financial Instruments.

Subsequent Events

In May 2009, the FASB issued SFAS No. 165, Subsequent Events, which provides guidance on management s assessment of subsequent events and incorporates this guidance into accounting literature. SFAS No. 165 is effective prospectively for interim and annual periods ending after June 15, 2009. We adopted SFAS No. 165 as of June 30, 2009, which was the required effective date. We have evaluated subsequent events that require recognition and disclosure through the date of this filing. See Note 8, Subsequent Events.

Recently Issued Accounting Standards

Transfers of Financial Assets

In June 2009, the FASB issued SFAS No. 166, Accounting for Transfers of Financial Assets, which amends the derecognition guidance in SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. We will adopt SFAS No. 166 beginning January 1, 2010 and do not expect a material impact on our condensed consolidated financial statements.

Variable Interest Entities

In June 2009, the FASB issued SFAS No. 167, Amendments to FASB Interpretation No. 46R, which amends the consolidation guidance applicable to variable interest entities and affects the overall consolidation analysis under FIN No. 46R. We will adopt SFAS No. 167 beginning January 1, 2010 and are currently assessing the potential effect it will have on our condensed consolidated financial statements.

2. EARNINGS PER SHARE

We calculate earnings per share using the two-class method in accordance with SFAS No. 128, Earnings per Share, as clarified by EITF Issue No. 03-6, Participating Securities and the Two-Class Method under FASB Statement No. 128, Earnings per Share and FSP EITF 03-6-1.

Effective January 1, 2009, upon adoption of FSP EITF 03-6-1, basic earnings per common share for our Common and Class B common stock is computed by dividing the sum of distributed earnings to common shareholders and undistributed earnings allocated to common shareholders by the weighted-average number of shares of Common stock and Class B common stock outstanding for the period. In applying the two-class method, undistributed earnings are allocated to Common stock, Class B common stock and participating securities based on the weighted-average shares outstanding during the period.

Diluted earnings per share for our Common stock assumes the conversion of all of our Class B common stock (2,575,364 and 2,451,956 shares as of June 30, 2009 and 2008, respectively) into Common stock as of the beginning of the period and adjusts for the dilutive effects of outstanding stock options using the treasury stock method.

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The following table shows the calculation of basic and diluted earnings per common share for our Common and Class B common stock for the quarters and six months ended June 30, 2009 and 2008:

	Quarter Ended June 30,		Six Months Ended June 30,
	2009	2008	2009