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EDITED TRANSCRIPT

WSO - Q2 2017 Watsco Inc Earnings Call

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OVERVIEW:

Co. reported 1H17 sales of \$2.15b and EPS of \$2.80. 2Q17 sales were \$1.28b and EPS was \$2.07.



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CORPORATE PARTICIPANTS

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Albert H. Nahmad *Watsco, Inc. - Chairman and CEO*

Barry S. Logan *Watsco, Inc. - SVP, Secretary and Director*

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CONFERENCE CALL PARTICIPANTS

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David John Manthey *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Jeffrey David Hammond *KeyBanc Capital Markets Inc., Research Division - MD and Equity Research Analyst*

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Robert P. McCarthy *Stifel, Nicolaus & Company, Incorporated, Research Division - Senior Analyst*

Ryan James Merkel *William Blair & Company L.L.C., Research Division - Research Analyst*

William Kerr Steinwart *Stephens Inc., Research Division - Research Associate*

PRESENTATION

Operator

Good morning, and welcome to the Watsco Second Quarter 2017 Earnings Conference Call. (Operator Instructions) Please note this event is being recorded.

I would now like to turn the conference over to Albert Nahmad, Chairman and CEO. Please go ahead.

Albert H. Nahmad - Watsco, Inc. - Chairman and CEO

Good morning from hot and steamy Miami, and welcome to our second quarter conference call. This is Al Nahmad, Chairman and CEO. And with me is A.J. Nahmad, President; Paul Johnston, Executive Vice President; and Barry Logan, Senior Vice President.

And as I always do, let me start with the cautionary statement. This conference call has forward-looking statements as defined by SEC laws and regulations that are made pursuant to the safe harbor provisions of these various laws. Ultimate results may differ materially from the forward-looking statements.

Watsco achieved record second quarter results. This includes record sales, profits, earnings per share and expanded operating margins. Importantly, these results were achieved while we continue to make significant investments in our business. Sales growth was driven by strong demand for residential replacement equipment with comparable strength of commercial markets. Operating efficiency was achieved, even though we added over 150 new customer-facing employees over the last year. The additions were made to increase sales and service capacity in certain markets, and they contributed to second quarter results.

We are also very pleased with the recent purchase of 35% of Russell Sigler that was completed in June of this year. Sigler is the market leader in the Western U.S. with annual sales of approximately \$650 million. It is a wonderful family business with an incredible history and run by a great team of leaders and employees. Watsco will include its share of the Sigler earnings beginning in the third quarter. In addition, we have the exclusive right to purchase shares if and when any current Sigler owner wishes to sell shares in the future.



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Adoption of our technology continues. More customers are using our apps in e-commerce to gain speed and efficiency. More SKUs have been digitally mastered and added to our product information database, which has now over 600,000 SKUs. That's 600,000 SKUs. Given our progress today, we believe our e-commerce sales could reach \$1 billion this year.

Inventory turns have improved due to supply chain initiatives, with more progress expected to come. More of our locations have implemented our order fulfillment technology to complete and ship orders quicker and save customers time. More employees are using our data analytics to gain insight into operations. All said and done, our cultural change continues. Our technology spend continues at approximately \$23 million as we execute our long-term strategy to help our customers to make our network more efficient.

Now on to our results. For the quarter, sales increased 5% to a record \$1.28 billion. HVAC equipment sales increased 7%, including an 8% growth in the United States. Other HVAC products increased by 2%, and commercial refrigeration products increased 3%.

During the quarter, earnings per share increased 14% to a record \$2.07. Operating income grew 10% to a record \$129 million. Operating margins expanded 40 basis points to 10.1%. Gross margins improved 30 basis points, and SG&A as a percentage of sales increased -- I'm sorry, decreased 10%. Let me say that again. SG&A as a percentage of sales decreased 10 basis points.

Now for the first half, sales increased 4% to a record \$2.15 billion. HVAC equipment increased 5%. Other HVAC products grew 1%, and commercial refrigeration products increased 4%. For the first half, EPS or earnings per share increased over -- increased 10% to a record \$2.80, and operating income increased 6% to a record \$178 million. Operating margins expanded 20 basis points to 8.3%. Gross margins improved 20 basis points and SG&A as a percentage of sales was flat.

Moving on. Recently, we raised our annual dividend by 19% to \$5 per share. Our balance sheet remains conservative with a debt-to-EBITDA ratio of just over 1x. As always, the second half of the year will be a strong period for cash flow, and we believe operating cash flow will exceed next income -- net income for 2017.

With that, A.J., Paul, Barry and I will be happy to answer questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question comes from Matt Duncan of Stephens Inc.

William Kerr Steinwart - *Stephens Inc., Research Division - Research Associate*

This is actually Will on the call for Matt. AI, I wanted to start with the monthly sales growth progression through the quarter. You noted the 1Q to April was trending up in the double digits. But like you said, it's a relatively small contributor to the 2Q. So trying to get a better idea of what might have driven the late quarter slowdown.

Albert H. Nahmad - *Watsco, Inc. - Chairman and CEO*

Why is there a late quarter slowdown?

William Kerr Steinwart - *Stephens Inc., Research Division - Research Associate*

Well, you had mentioned that April was up in the double digits. And like I was saying -- and you had mentioned last...



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Albert H. Nahmad - Watsco, Inc. - Chairman and CEO

No, it's been a very strong quarter for us, best we've ever had. So I wouldn't call anything a slowdown.

William Kerr Steinwart - Stephens Inc., Research Division - Research Associate

There were no differences in trends from May or June, just maybe a difference in comparison from the prior year?

Albert H. Nahmad - Watsco, Inc. - Chairman and CEO

We don't get into that sort of thing. We just had a great quarter. And it's the best ever, made more money than ever before in 40-some years that I've been here. Great quarter.

William Kerr Steinwart - Stephens Inc., Research Division - Research Associate

Okay, Al. Can you talk a little bit more about the Russell Sigler business?

Albert H. Nahmad - Watsco, Inc. - Chairman and CEO

Yes, that's -- I'm so happy about that. It's such a great company, and they have such great culture. And we think that over time, we'll support them with technology when they ask for it and that we just can add capital if they need it. And just so positive about it, it's a big deal. And as I said earlier in the last conference call that we're looking to invest money, and this is just by far the most exciting one we've done since I said those comments.

Operator

The next question comes from Jeff Hammond of KeyBanc Capital Markets.

Jeffrey David Hammond - KeyBanc Capital Markets Inc., Research Division - MD and Equity Research Analyst

So Al, certainly a very good 2Q. How are you thinking about guidance? Is that kind of a third quarter event? Or is that something you want to kind of lay out at this point?

Albert H. Nahmad - Watsco, Inc. - Chairman and CEO

As you said, it will be a third quarter event. But we do think, Jeff, that it will be a record year in every respect.

Jeffrey David Hammond - KeyBanc Capital Markets Inc., Research Division - MD and Equity Research Analyst

Okay. And then just on a relative basis, it looks like your equipment was up 7 I think.

Albert H. Nahmad - Watsco, Inc. - Chairman and CEO

8 domestically, yes.



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Jeffrey David Hammond - KeyBanc Capital Markets Inc., Research Division - MD and Equity Research Analyst

Okay, 8 domestically. And then Carrier's kind of saying 11% for the quarter, Lennox was 14. I think the orders from Carrier were in the mid-teens. Can you just talk about maybe what the discrepancy might be on your equipment business versus some of these other guys?

Albert H. Nahmad - Watsco, Inc. - Chairman and CEO

Sure. Let's turn to Paul Johnston.

Paul Johnston - Watsco, Inc. - Executive Vice President

Yes. Obviously, there's always a difference between what OEMs report and what we report. Ours is purely movement -- not shipment or backlog. So that's one issue that is unusual about it. As it pertains to Lennox, we've got a different geographical footprint than they do. We tend to be much stronger in the Sunbelt. They have other regions like the Northeast and the Midwest where they have strength. They also have a different mix than a lot of the other manufacturers. We tend to be pretty strong on the replacement market and somewhat lighter -- much lighter on the residential new construction. So kind of an apples-and-oranges type look there, I think, if you're trying to compare us to them.

Jeffrey David Hammond - KeyBanc Capital Markets Inc., Research Division - MD and Equity Research Analyst

Okay. And then final question, I guess, a lot of discussion about Amazon and their impact on distribution. And can you just talk about where you see Amazon showing up in non-equipment, where you think there's risk or not risk on the equipment side? Maybe just a thought on how you think about the Amazon threat.

Albert H. Nahmad - Watsco, Inc. - Chairman and CEO

Well, I'm going to ask Paul and others to comment. But I can tell you that we do think that they're a force. They're the -- I mean the economy's never seen anything like it. However, we also think that we're a force in the size of our -- and density of our branch network and our technology that's supporting the contractor, which I think is unparalleled. There's no one else that has anything near that. So we keep our eyes on Amazon. And we also have our own e-commerce business, which as I said is going to reach we think \$1 billion and then it's going to go well beyond that. But I respect them, and we think that we constantly keep our eye on whatever threats come and also whatever opportunities come. But right now, we're not too concerned because of our enormous database, 600,000 SKUs that takes years to prepare, which is important. Because our contractors, when they go to our apps, can find out many things that they need to know to diagnose equipment that has been -- that needs maintenance or needs to be replaced. So we have a lot of edge in terms of technology and a lot of edge because of our density in branches. And convenience in the replacement market is -- that's a big thing, probably the most important thing. Paul, you want to add to that? Or A.J., you want to add to that?

Aaron J. Nahmad - Watsco, Inc. - President and Director

Yes, sure. I mean I think you spoke to what we're doing and what we're creating in terms of technology moats that provide some defense against Amazon or any other threat, really. And then the industry has some natural moats as well. I mean, this is not a DIY product. It's a technical sale that requires technical support. Our customers rely on our staff in the field to answer a lot of questions. We process hundreds of thousands of warranties every year. That's a giant product in terms of just the sheer size of the unit. So there's some natural moats that are some defense mechanisms. And then like you mentioned, we're doing a lot on the technology side to increase convenience, not only in the 600-or-so stores we have, but in how customers find the product they need and get that product ordered, get in and out of our stores quickly and get back to the customer. And lastly, the contractor doesn't necessarily know what he needs to buy until he shows up at your house that morning. So to have that density of our footprint and to have the tools to get that product quickly, that's a major asset.



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Albert H. Nahmad - Watsco, Inc. - Chairman and CEO

Don't forget we have brands -- global brands. I mean, Carrier is the inventor of air conditioning, and that's our brand forever wherever we operate. And we have Rheem. That's our brand. We have Goodman. So this is a brand-conscious industry and those are ours.

Paul Johnston - Watsco, Inc. - Executive Vice President

I think -- this is Paul. I think A.J. really put it well at the end there when he talked about you don't know what it takes to replace or repair a unit until you actually see the unit in the field. And that's a pretty unusual application for someone just to assume that they can do it all on e-com and have the unit delivered there, so big point.

Operator

Was there a follow-up, Mr. Hammond?

Jeffrey David Hammond - KeyBanc Capital Markets Inc., Research Division - MD and Equity Research Analyst

All set. Thanks, guys.

Operator

The next question comes from Paul Dircks of William Blair.

Ryan James Merkel - William Blair & Company L.L.C., Research Division - Research Analyst

This is actually Ryan Merkel on. So first question for me, it was nice to see the gross margin be -- you mentioned improved selling margins. But was this really driven by price and equipment mix to higher SEER?

Albert H. Nahmad - Watsco, Inc. - Chairman and CEO

Barry, you want to take that?

Barry S. Logan - Watsco, Inc. - SVP, Secretary and Director

Sure. Good morning, Ryan. Well, first on mix. There's very little difference in our margins relative to mix. That would be something that would be more volatile for the OEMs. But as a distributor, we tend to make the same markups across our portfolio, so that's not the answer. The answer is some inflation that will always help margin. And some of it is execution in the field to get more profit dollars as we're selling more.

Ryan James Merkel - William Blair & Company L.L.C., Research Division - Research Analyst

And then what about the mix shift to e-com? My understanding was that was a little bit higher gross margin. Is that happening?

Albert H. Nahmad - Watsco, Inc. - Chairman and CEO

That's not something we would disclose.



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Ryan James Merkel - *William Blair & Company L.L.C., Research Division - Research Analyst*

Okay. Maybe I'll just ask about July, just given the tough comparison there. Maybe you could just comment on how things are trending so far?

Albert H. Nahmad - *Watsco, Inc. - Chairman and CEO*

Why don't we just tell you about the quarter? Barry?

Barry S. Logan - *Watsco, Inc. - SVP, Secretary and Director*

Yes, Ryan. I mean, our outlook for the quarter is again very satisfying. We see growth and see some consistency. It is early in the quarter to make a complete read, but so far, so good.

Albert H. Nahmad - *Watsco, Inc. - Chairman and CEO*

Record year is what we expect.

Ryan James Merkel - *William Blair & Company L.L.C., Research Division - Research Analyst*

Fair enough, okay. I tried. And lastly, it seems that you're offering your technology to M&A candidates as a motivator to get them to sell their business or perhaps partner with you in a JV. So first, am I reading this correctly? And secondly, how is it going?

Albert H. Nahmad - *Watsco, Inc. - Chairman and CEO*

Yes, I think so, Ryan. How's it going? Well, I can't tell you all the reasons why the owners of Russell Sigler joined us, but I'm sure that this is one of them. And we are in the marketplace searching for more partners to share our technology, with either as an investor or as a merger. And I'm optimistic as hell about it.

Operator

The next question comes from David Manthey of Baird.

David John Manthey - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

First off, as it relates to Russell Sigler, when you look at the third quarter, you own 80% of the 35% or about 28% of it. And I'm just wondering if you can give us an idea of the magnitude of contribution in the third quarter based on seasonality and that percentage and so forth? The second part of this question, I guess, maybe if Ana's on or Barry, where in the P&L will that unconsolidated minority earnings reside?

Albert H. Nahmad - *Watsco, Inc. - Chairman and CEO*

Yes, I think the second part's a lot easier to answer than the first part because we're new to this. But go ahead, Barry or Ana, either one. Ana's not on, so it'd be Barry.



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Barry S. Logan - *Watsco, Inc. - SVP, Secretary and Director*

First, David, the second part, yes there'll be a line item that will be below EBIT, above interest expense that will show the income in Sigler. That's something we'll work through with our accountants, and -- but that's the early read, is a separate line item. It will be, as you said, 35% of their net income will be in that line item. Down below, there'll be a 20% allocation of those earnings to Carrier as minority interest. And in terms of magnitude and the actual calculation, the family has asked us not to disclose profitability for their competitive reasons. You can probably pick an average margin that's in your mind based on what you know about Watsco for 25 years and impute something against the \$650 million and seasonalize it very similar to what we have and come up with something.

David John Manthey - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Great, okay. And then, yes, I know that Watsco's very decentralized. But are there any what you call synergies relative to that acquisition? Or is it just a matter of making investments and trying to make that business more profitable? Just trying to understand how...

Albert H. Nahmad - *Watsco, Inc. - Chairman and CEO*

Yes, that's a great question. We have always taken the attitude that if we're going to be a partner with someone, especially a minority partner, we're going to do what they ask us for. We're going to provide whatever assistance they ask us for, and we'll wait and see what they want. We certainly can provide capital. We certainly can provide technology. Certainly can provide eventually equity in the parent to motivate further leaders. So ours is a wait-and-see attitude. We're a minority partner ready to help, and we'll do that with anybody that we do similar transactions with. We respect these great companies so much that it's not for us to tell them anything. It's for them to ask and evaluate what we have and then take what they want. It's the other way around.

Barry S. Logan - *Watsco, Inc. - SVP, Secretary and Director*

Yes, I would add something to that, that part of the success of Carrier Enterprise was sitting down with our partner every quarter and going through a strategic discussion about what's going on, how to help our partner, how to help our business. And a very similar culture will -- is going to be created with Sigler. Let's sit down every 90 days. We'll have a board meeting. We'll go through the story, go through the performance and again use that forum to really orchestrate what opportunities there are and what opportunities they see that they need help with.

Operator

The next question comes from Chris Dankert of Longbow Research.

Christopher M. Dankert - *Longbow Research LLC - Research Analyst*

I guess the first one, any commentary on pricing in the quarter? And have you seen those 3% to 6% increases that came through in the beginning of the year hold up?

Albert H. Nahmad - *Watsco, Inc. - Chairman and CEO*

Barry or Paul?

Paul Johnston - *Watsco, Inc. - Executive Vice President*

Yes, pricing is -- has held up throughout the year as I think we indicated in the first quarter call. And during the second quarter, we saw no deterioration at all from those prices. Price increases have held so far this year.



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Christopher M. Dankert - Longbow Research LLC - Research Analyst

Good to hear. And then I guess maybe just a second one, quick one for A.J. Any update on the adoption of BI across the sales force? Can we expect to see kind of everyone onboard with the system within the next 12 months or so?

Albert H. Nahmad - Watsco, Inc. - Chairman and CEO

God, I'd give him a big bonus if he can arrange that.

Aaron J. Nahmad - Watsco, Inc. - President and Director

Yes, BI adoption in our business is pretty mature. It's the first major technology program, the one we started with 5 years, 6 years ago. The tool is robust. Training and adoption is ongoing. The trick of BI is that it's infinite. The opportunity is to leverage this data, and we keep adding data sets. The opportunity to leverage this data is infinite. It can touch every part of the business. There's always new trends and patterns and anomalies that can be spotted, which create insight for not only salespeople, but marketers and warehouse folks and you name it. So it's an ever-evolving, ever-rich opportunity to be a better company. So it's going well.

Christopher M. Dankert - Longbow Research LLC - Research Analyst

Good. I guess, so is there still that same kind of spread between salesmen who are using it frequently and those who are slower to pick it up?

Aaron J. Nahmad - Watsco, Inc. - President and Director

There is. I mean, there's a noticeable performance improvement for those that use the technology, including BI. Our best performers are the ones that use it the most frequently.

Christopher M. Dankert - Longbow Research LLC - Research Analyst

Got it. And then I guess if I could sneak one last one in here. I mean you mentioned the goal is \$1 billion through e-commerce platform exiting this year. I guess any color on how much of that goes to the app versus some of the other digital channels you guys offer?

Aaron J. Nahmad - Watsco, Inc. - President and Director

Yes. Well, first, it's not the goal. \$1 billion is not the goal. That's the trend that we see right now, and the goal is well beyond that in the short, medium and long term. And as far as app versus online, that's not something that we break out.

Operator

The next question comes from Robert McCarthy of Stifel.

Robert P. McCarthy - Stifel, Nicolaus & Company, Incorporated, Research Division - Senior Analyst

I guess the context around the \$1 billion of sale on e-commerce, is there anything you can give us in terms of maybe staging it? What was the e-commerce business 2 years or 3 years ago? And how do we think about growth? Just some context historically around it.



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Albert H. Nahmad - *Watsco, Inc. - Chairman and CEO*

Go ahead, A.J.

Aaron J. Nahmad - *Watsco, Inc. - President and Director*

I would say as far as a trend, there's roughly -- this is not an exact number, but close to 80% to 100% growth year-over-year for the last 3 years -- in just about every metric referring to e-commerce.

Robert P. McCarthy - *Stifel, Nicolaus & Company, Incorporated, Research Division - Senior Analyst*

Interesting. And then I guess obviously, you've highlighted the spend you've been doing the last 12 months has been pretty consistent. I mean, given the strength we've seen, and we're going to get to the leverage in a second. But obviously, you're getting leverage because you're adding salespeople and then you're getting growth on that. Do you -- could we be seeing an opportunity for a step function higher in investment, given the fact that you've had a pretty good return so far in terms of what you've been doing? Or are you comfortable with this level of spend as we go into '18? How do we think about it?

Albert H. Nahmad - *Watsco, Inc. - Chairman and CEO*

A.J.?

Aaron J. Nahmad - *Watsco, Inc. - President and Director*

Yes, I would say both. I mean, we're comfortable with the level of spend. And then as there are more opportunities and we get comfortable and we do due diligence on different potential programs and projects to invest in, we'll invest. We do see return on these investments. We turn off programs that are not showing return or not just getting the traction that we want or hope for. So the answer is both. We're comfortable with the level of spend, and we will invest more if and when we see great opportunities to do so, which there are a handful. There are lots of things that we're not doing. I mean, we've only been at this for like I said, 5 years, 6 years. And we talk a lot about playing defense against doing too much. So the universe of opportunities in technology is a very broad umbrella term. It's people, process and technologies, being a better company, using the latest and greatest in people process and technology. There's a lot yet to come. And as far as what that means for our spend, that's TBD.

Robert P. McCarthy - *Stifel, Nicolaus & Company, Incorporated, Research Division - Senior Analyst*

Then finally on incremental margin. Obviously, a nice return to kind of the high-teens level, close to 20% and leverage on the SG&A line and obviously gross margin. How do we think about kind of refining that target over the next couple of years? Could we see consistently kind of a mid-teens incremental margin after this period of kind of spend and investment getting the return? And anything we should -- Barry, anything we should be thinking about or targeting there for incremental margins going forward?

Barry S. Logan - *Watsco, Inc. - SVP, Secretary and Director*

Well, I think if we look at 28 years, Rob, I think 25.5 years has been in that 15% to 20% range like this quarter. So the period of time where we were investing in technology, it interrupted that for -- that period of time for good reason. So long term going forward, I think the variables that drive pretty consistent incremental margin in that 15%, 20% range should be in place and continue.



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Operator

The next question comes from Robert Barry of Susquehanna.

Robert D. Barry - *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

So I think A.J. just mentioned you've been at the IT efforts for a few years now, 5 years or 6 years. Investors are curious when you think you might be able to quantify a margin benefit to the corporation as this IT gets deployed across the store base? You must already be seeing some impacts in a subset of stores where the efforts are more advanced.

Albert H. Nahmad - *Watsco, Inc. - Chairman and CEO*

A.J., you want to take that?

Aaron J. Nahmad - *Watsco, Inc. - President and Director*

Yes. I mean -- so we have a number of programs going on, right? We talked about e-commerce and the apps. We talked about various supply chain technologies. We talked about BI. And because of our decentralized model, some of these programs are more mature in one or several of the subsidiaries than others. For example, where we have -- where we invested in supply chain technology to help demand planning inventory optimization in that one subsidiary first, that subsidiary is out in front. And their inventory turns, which is a key metric in that program, are improving at a faster rate and have improved more so than everybody else's. So I don't -- so that's one example. In short, I don't want to put an expiration date or a timing on these things. These are long-term initiatives. It's all about being bigger, better, faster and more profitable over the long term. And that's what these programs are intended to do. These are platforms for our business leaders to have bigger, better, more profitable businesses. And that will play out over time.

Robert D. Barry - *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

Got you. In the quarter, did weather help or hurt?

Albert H. Nahmad - *Watsco, Inc. - Chairman and CEO*

All right. Barry or Paul, either one.

Barry S. Logan - *Watsco, Inc. - SVP, Secretary and Director*

Did it help or hurt? The answer is like probably.

Barry S. Logan - *Watsco, Inc. - SVP, Secretary and Director*

So Rob, I don't think...

Robert D. Barry - *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

It looked like it was cooler if you just look at the metric.



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Albert H. Nahmad - Watsco, Inc. - Chairman and CEO

Well, certainly global warming will help our business.

Barry S. Logan - Watsco, Inc. - SVP, Secretary and Director

Yes. I mean, Rob, I think we've answered it this way for a long time. I mean, 70%, 80% or more of our business is Sunbelt. The sun comes out. It shines. There's humidity. And the volatility of the weather should not be really ever an excuse or ever a risk. It's something that can impact a week or a month but shouldn't affect a year. And I don't think anything is peculiar this quarter.

Robert D. Barry - Susquehanna Financial Group, LLLP, Research Division - Senior Analyst

Got you. And then just to follow up on some of the M&A commentary. I mean bottom line versus a year ago, 6 months ago, are you more or less -- more, less or kind of neutral in terms of optimism around getting more M&A done?

Albert H. Nahmad - Watsco, Inc. - Chairman and CEO

I'll answer that. This is Al Nahmad. I'm more optimistic. We are out there. We think we have a lot to offer wonderful companies and we're out there and I'm optimistic. But I have to say that I'm going to keep the balance sheet conservative. I don't like leverage like some of our competitors are doing because leverage can eventually bite you. And our long-term strategy has always been a very strong balance sheet, and we'll continue that policy. But we're still going to make as big an acquisition as we can find.

Robert D. Barry - Susquehanna Financial Group, LLLP, Research Division - Senior Analyst

Got you. I mean, how would you define that? Like what's the threshold for where you would start to get concerned about the leverage?

Albert H. Nahmad - Watsco, Inc. - Chairman and CEO

Oh, I haven't put any math to it. I just don't like much debt, but I haven't put any math to it.

Robert D. Barry - Susquehanna Financial Group, LLLP, Research Division - Senior Analyst

Got you. Yes. Maybe just lastly, a more strategic question. As you look at the competitive landscape for the other equipment parts and supplies-type businesses in the portfolio, it seems like there's been stepped-up competition there. Home Depot and Lowe's getting more into pursuing pro growth. Wolseley has been investing specifically in HVAC. Just curious what your impression is of how the competitive landscape has been evolving in that part of your business?

Albert H. Nahmad - Watsco, Inc. - Chairman and CEO

Paul? Barry?

Paul Johnston - Watsco, Inc. - Executive Vice President

Yes, I really -- I don't think from a retail perspective, it's really been nipping at our heels as far as the aftermarket is concerned. The entire aftermarket business for parts is one that probably has a bigger impact on whether and consumer attitudes as well as the consumers ability to afford a



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replacement versus a repair. So I think it's way too early to make any predictions as far as what the -- what some of the so called new competitors are going to do to our aftermarket. To this date, there really hasn't been an impact.

Robert D. Barry - *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

Yes, so kind of steady as it goes? Okay.

Paul Johnston - *Watsco, Inc. - Executive Vice President*

Yes, and we obviously would react to anything.

Aaron J. Nahmad - *Watsco, Inc. - President and Director*

Sorry, this is A.J. I'll add to that is that my opinion is we don't do a good enough job on parts and supplies and that's a big opportunity for us. And we -- and our leaders know that and they are more focused than ever on changing that paradigm, which will be a good thing for the company.

Albert H. Nahmad - *Watsco, Inc. - Chairman and CEO*

Yes, A.J. has emphasized that side of the business with the operating companies and given them specific growth targets and monitoring that.

Operator

(Operator Instructions) The next question comes from Steve Tusa of JPMorgan.

Patrick Michael Baumann - *JP Morgan Chase & Co, Research Division - Analyst*

This is actually Pat Baumann on for Steve Tusa. Lots already been covered here. Just had a quick question on the sales growth, the 7% growth in HVAC equipment in the quarter. Just curious as to what you saw as it relates to growth by OEM and/or kind regionally. Carrier reported this morning 11% growth in resi HVAC. And I know they make up a large portion of your sales. I'm just trying to understand the disconnect there, while acknowledging obviously that 7% is a good number. Just trying to triangulate.

Albert H. Nahmad - *Watsco, Inc. - Chairman and CEO*

No, I understand that. Don't forget that Carrier is shipping to the distributors, whereas we're shipping to the contractor, which ends up in somebody's home or business and so there is a time lag there. Barry? Perhaps you can give him a more complete answer.

Barry S. Logan - *Watsco, Inc. - SVP, Secretary and Director*

Yes, we're not going to give specific OEM data to you in terms of growth rates. And as far as regional data, like I said earlier, we are much more proportionately large and significant in the Sunbelt of the U.S. The volatility of what weather can cause north of the Sunbelt can cause some of these swings. I don't know what their numbers are. I know what ours are. And we're seeing pretty good growth, pretty consistent growth across all of our Sunbelt markets and as importantly within our residential and our commercial business, where growth rates were very similar. So we like the consistency of that.



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Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Albert Nahmad for any closing remarks.

Albert H. Nahmad - *Watsco, Inc. - Chairman and CEO*

Thanks for listening, and thanks for following our company. We appreciate it. Look forward to talking to you at the next quarter. Bye.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

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