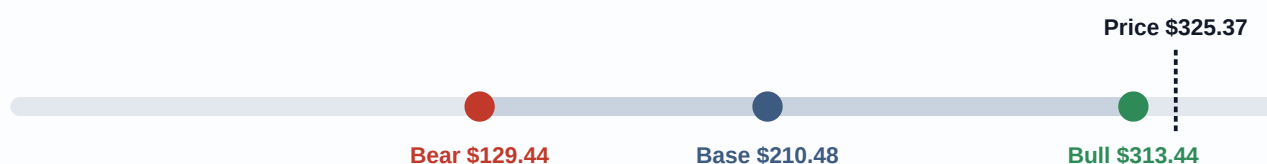


Initiated 2026-09-24 · Price \$325.37 (as of 2026-09-23, Robinhood quote) · Mkt cap \$13.42bn (both share classes) · Industrials / HVAC distribution · Model: verified

Rating: Sell — Conviction: Medium

Watsco is a well-run distributor whose earnings have gone backwards for three straight years while its multiple has not moved: 27.9x trailing earnings against a ten-year average of 28.5x, as though FY2025's 5% same-store decline and 18% drop in residential ducted unit volume had not happened. The dividend was just raised 10% to a level above reported earnings per share, so nothing compounds inside the business. Every case in the model — including the bull case, at today's 18x multiple — values the equity at or below the current price.

MODEL VALUE RANGE VS PRICE



Business overview

Watsco is the largest North American distributor of HVAC and refrigeration equipment and parts, with 695 locations across 43 states, Canada, Mexico and Puerto Rico. FY2025 revenue of \$7.24bn was 67% HVAC equipment, 29% other HVAC products and 4% commercial refrigeration. Roughly 53% runs through four joint ventures with Carrier in which Watsco holds 60–80% and consolidates the whole, with Carrier's 20–40% carried as non-controlling interest. Three variables drive earnings: replacement unit volume on the aging US installed base, gross margin per unit — which regulation-driven OEM price increases can flatter or starve — and operating expense leverage over the branch network. Carrier is both the source of 62% of purchases and the minority partner: unusual counterparty concentration on both sides.

Bull case

- Two deferred years should produce a catch-up cycle** — FY2025 same-store sales fell 5% with ducted residential unit volume down 18%; installed systems do not stop aging because a homeowner postponed. Management said organic growth was running 4–5% through 2026-07-28 against +1.2% in H1. Plays out if unit demand keeps normalising. *Model: rev_growth*
- The margin decline is a comparison, not a break** — management attributed ~130bp of Q2 2026's 180bp gross-margin decline to lapping prior-year OEM pricing around the A2L refrigerant changeover. Volume recovery over a fixed 695-branch cost base restores operating margin without anything new having to work. *Model: ebitda_margin*
- The A2L inventory position is a cash spring** — inventory held flat at ~\$1.39bn while revenue fell \$379mm, pushing operating working capital to 25.3% of revenue against a 23.8% five-year average. Normalising the dual-refrigerant stock releases cash. *Model: nwc_pct_rev*
- The balance sheet is completely unencumbered** — net cash of \$464.2mm, zero funded debt and a \$600mm undrawn revolver to 2028, in a fragmented industry, with the standing option to buy in Carrier's JV minority. Plays out if capital is deployed rather than

distributed. *Model: FY0 net cash (`market.cash`) enters value directly; deployment (`share_change` , `capital_return_pct`) moves EPS and net cash only*

Bear case

- The top line broke and has not mended** — revenue fell 5.0% in FY2025 and operating income has declined three consecutive years, from FY2022's \$831.6mm to FY2025's \$720.3mm. H1 2026 revenue is up only 1.2%; Q2 diluted EPS fell to \$4.00 from \$4.52. Plays out if replacement stays deferred. *Model: rev_growth*
- Gross margin is handing back the regulatory windfall** — Q2 2026 gross margin was 27.5% against 29.3%. The 2025 OEM price increases flattered margin; competing for volume in a flat market is the opposite condition. Plays out if OEM pricing stays quiet while distributors chase units. *Model: ebitda_margin*
- The dividend now exceeds reported earnings** — \$13.20 declared per share against FY2025 diluted EPS of \$12.25, a 108% payout raised 10% into a down earnings year, alongside distributions to the JV minority and a share count drifting up with stock compensation and equity-funded deals. There is no buyback, and a 52-year dividend record makes a cut a last resort — so the constraint binds on reinvestment instead. *Model: not in the value range — the payout moves net cash only; the value case rests on the operating drivers (see model note)*
- Working capital absorbed the shortfall and has not given it back** — operating NWC has risen every year since FY2022 and now sits at a five-year high as a share of revenue. Plays out if the inventory position proves structural rather than transitional. *Model: nwc_pct_rev*

Valuation & balance sheet

Metric (definition)	Current	Own history (range or 5y avg)	Peers	Source, as-of
Forward P/E (consensus NTM EPS)	26.3x	10y avg ~28.5x; range 16.1x (Dec 2022) – 38.9x (Mar 2025)	Pool Corp ~16.6x	stockanalysis.com / fullratio.com, 2026-09-24
EV/EBITDA (trailing: EV \$12.63bn / TTM EBITDA \$701.1mm)	18.0x	10y median ~16.9x; range ~10.9x–27.5x	n/a (unverified)	stockanalysis.com / gurufocus.com, 2026-09-24
FCF yield (TTM FCF \$697.1mm / market cap)	5.2% on the \$13.42bn two-class cap	n/a (unverified)	n/a (unverified)	stockanalysis.com, 2026-09-24
Dividend payout (\$13.20 declared / FY2025 diluted EPS \$12.25)	108%	\$11.70 paid in FY2025, \$10.55 in FY2024	n/a (unverified)	10-K exhibit 13 / Q2 2026 call, 2026-09-24

Model-implied value range (from `model-summary.json` ; generic module, Gordon-growth DCF and exit-EV/EBITDA DCF, midpoints): Bear \$129.44 · Base \$210.48 · Bull \$313.44 per share, i.e. implied returns of –60.2% / –35.3% / –3.7% vs \$325.37. *These ranges show how the bull and bear drivers translate into value; they are not price targets.* Nothing floors at zero — the company is net cash — so every figure is informative. The market price sits above the entire range: even the bull driver set, which gives Watsco a catch-up replacement cycle, 12% EBITDA margins by FY2030 and an 18x exit multiple equal to what it trades at today, does not get back to \$325.37. That is the rating.

Where this could be wrong, largest first. The non-controlling interest: `other_claims` is an analyst estimate of \$1,359mm — 15x the NCI's FY2025 earnings of \$90.6mm — rather than the \$478.8mm book carrying value, because Carrier's JV stakes earn a normal return on historical cost. Using book would add ~\$21 per share to every case, taking Base to about –29% and Bull to roughly breakeven; it would not change the call, and every 5x is worth ~\$11 per share. Next, the exit multiple: base uses 15.0x against a 16.9x ten-year median and 18.0x today, below both because the median was earned while operating income was rising — raise it to 18x and Base still does not reach the current price. Then the 9.5% WACC on a 1.04 beta, not aggressive but arguably generous to a 52-year dividend payer. One trap to note: the module runs EPS on consolidated net income and deducts minority claims from value rather than earnings, so Base Y1 EPS of \$13.71 sits ~\$2.20 above the attributable basis behind the reported \$12.25 and the market's 27.9x. The DCF values are unaffected; don't compare that EPS line to the quoted multiple.

Balance sheet: net cash — \$464.2mm of cash and short-term investments against zero funded debt, net leverage –0.61x FY2025 EBITDA, coverage not meaningful. The \$600mm syndicated unsecured revolver was undrawn at both 2025-12-31 and 2026-06-30 and matures 2028-03-16, the only material maturity in the structure. Operating lease liabilities of \$467.8mm across 695 leased branches are

deliberately *not* capitalised as debt, because EBITDA here is already after rent and capitalising them without adding rent back would double-count. Ratings: n/a (unverified) — unsurprising for a company with no funded debt.

Model note: tier `full`, status `built`, verification `verified` (all 3,187 formula cells recalculated in LibreOffice and matched). One unverified input by design — `market.other_claims`, the NCI valuation above — and no assumptions without basis. All 14 scenarios consistency `OK`. Conventions: `historicals.ebitda` is consolidated GAAP operating income plus D&A from two EDGAR endpoints; operating NWC is receivables plus inventories less payables; per-share figures use 41.252mm shares, both classes from the 10-Q cover, because aggregator pages showing 38.59mm and a \$12.56bn market cap count Common only. Generator note (2026-09-24): in this module `share_change`, `capital_return_pct` and `cost_of_debt` move EPS and the net-cash path only, and `peer_pe` feeds a cross-check only; none changes the value range, so bull/bear tags no longer cite them. Scenario deltas were rebuilt after `multiple_pct` shocks were extended to the Gordon method (previously they moved only the exit-multiple half), and EPS now uses average diluted shares.

Scenario stress test

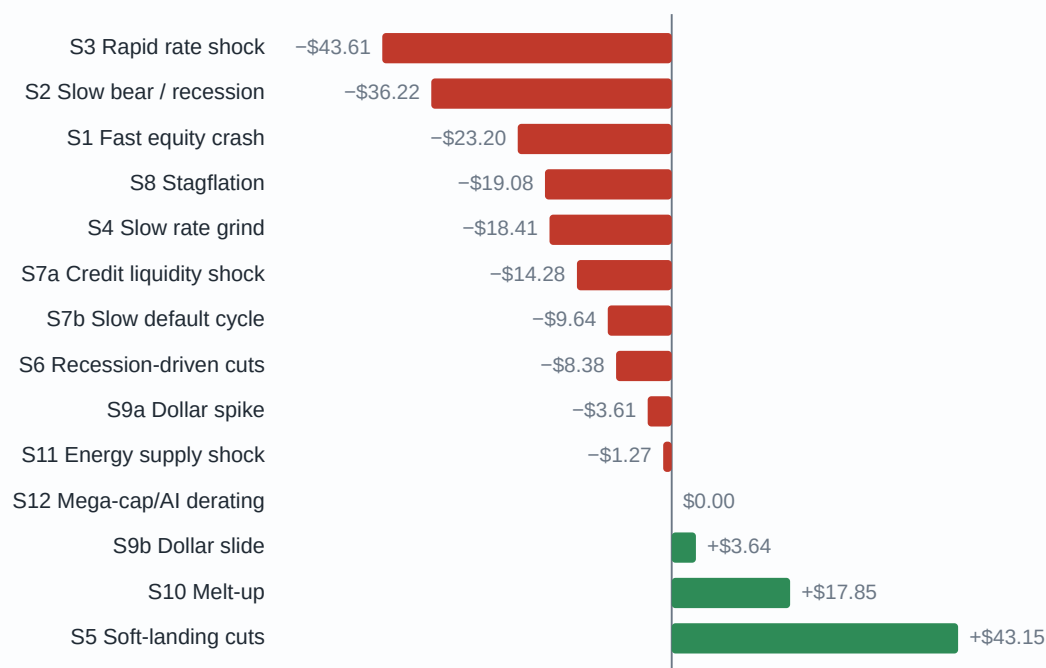
Reasoned from the bull/bear drivers above. The model column comes from the scenario overlays (Base case + shock).

Scenario	Effect	Mechanism	Magnitude	Model Δ value vs Base (\$/sh)
S1 Fast equity crash	−	De-rating with the tape on a 1.04 beta — milder than a high-beta name, but from a full multiple	Med	−\$23.20
S2 Slow bear / recession	−	Households repair instead of replace and trade down in efficiency tier; FY2025 showed an 18% unit decline without a recession	High	−\$36.22
S3 Rapid rate shock	−	Financing cost on a \$10–15k system replacement plus new-construction attach; higher yields on the cash pile soften but do not offset it	High	−\$43.61
S4 Slow rate grind	−	Same channel, grinding; net cash earns more as the discount rate rises against it	Med	−\$18.41
S5 Soft-landing cuts	+	Housing turnover and financing both improve, releasing two years of deferred replacement — the cleanest positive case	High	+\$43.15
S6 Recession-driven cuts	−	Volume loss plus a lower yield on the cash pile; rate relief does not restore a deferred replacement decision	Low	−\$8.38
S7a Credit liquidity shock	−	No funding channel at all — net cash, undrawn revolver to 2028 — so purely a multiple event	Low	−\$14.28
S7b Slow default cycle	−	Trade credit to small contractors: \$796mm of receivables is where a contractor default cycle lands	Low	−\$9.64
S8 Stagflation	±	Genuinely two-sided — a distributor passes OEM price increases through and grows revenue dollars on inflation, exactly as the A2L increases did in 2025, but volume slows and the discount rate rises. The model nets it negative	Med	−\$19.08
S9a Dollar spike	−	Carrier Enterprise II (Mexico) and III (Canada) translate lower; non-US is a modest share of the footprint	Low	−\$3.61
S9b Dollar slide	+	Mirror of S9a: translation tailwind on the Canadian and Mexican operations	Low	+\$3.64
S10 Melt-up	+	Re-rates with risk appetite, but from a multiple already at its ten-year average, so there is less room than most	Low	+\$17.85
S11 Energy supply shock	−	Fuel and freight across a 695-branch delivery network, partly offset over time as higher electricity bills pull forward efficiency-driven replacement	Low	−\$1.27
S12 Mega-cap/AI derating	0	No material effect, not modeled — no mega-cap or AI linkage	—	\$0.00

Magnitude labels re-ranked 2026-09-25 to match the model's dollar deltas (skill 3a-v-b item 7; the 2026-09-24 generator fix enlarged multiple-shock rows): S6 Med → Low.

Two of the four scenarios currently live or on watch are meaningful negatives here (S3, S8), and S8 is the one row where the mechanism genuinely cuts both ways. **Currently active/on watch per the playbook:** S3 partially active (price leg met, pace legs short); S8, S10 and S11 on watch, S11 escalated after the 2026-09-19/20 Saudi/Houthi events.

MODEL VALUE CHANGE VS BASE, BY SCENARIO



What would change the call

Upgrades if: unit volumes — not revenue dollars — grow for two consecutive quarters with gross margin at or above 28%, meaning the bull case is arriving rather than hoped for; or the price falls toward the Base midpoint; or dividend growth is slowed below earnings growth and the retained cash visibly funds acquisitions or a JV buy-in. **Downgrades further if:** gross margin falls below 27% for two consecutive quarters; or the payout exceeds 120% of attributable EPS; or organic growth returns to flat after the 4–5% mid-2026 run-rate.

Watch items

- **W1:** Q3 2026 unit volumes and gross margin — whether the 4–5% organic run-rate through late July held through the quarter — Q3 2026 earnings release, late October 2026 — *Model: rev_growth, ebitda_margin*
- **W2:** FY2026 dividends declared against FY2026 diluted EPS — whether the payout ratio rises above the 108% implied by the current rate — FY2026 10-K, February 2027 — *Model: capital_return_pct*
- **W3:** Year-end 2026 inventory and operating NWC as a share of revenue against FY2025's 25.3% — FY2026 10-K balance sheet, February 2027 — *Model: nwc_pct_rev*
- **W4:** Any change in the Carrier relationship — a JV ownership change, a buy-in of the minority, or a shift in the 62% purchase concentration — 8-K or the FY2026 10-K, whenever it occurs — *Model: other_claims (market fact), rev_growth*

Sources

- SEC EDGAR XBRL companyconcept — WSO revenue, operating income, D&A, receivables, inventories, payables, capex, NCI income (FY2021–FY2025 10-K values) — <https://data.sec.gov/api/xbrl/companyconcept/CIK0000105016/us-gaap/Revenues.json> — accessed 2026-09-24

- Watsco, Inc. Form 10-Q for the quarter ended 2026-06-30 (filed 2026-08-07) — <https://www.sec.gov/Archives/edgar/data/0000105016/000119312526340204/wso-20260630.htm> — accessed 2026-09-24
- Watsco, Inc. FY2025 Form 10-K, financial-statements exhibit 13 (filed 2026-02-27) — <https://www.sec.gov/Archives/edgar/data/105016/000119312526082486/wso-ex13.htm> — accessed 2026-09-24
- Watsco, Inc. FY2025 Form 10-K main document — <https://www.sec.gov/Archives/edgar/data/105016/000119312526082486/wso-20251231.htm> — accessed 2026-09-24
- Watsco (WSO) Q2 2026 earnings call transcript — <https://seekingalpha.com/article/4927276-watsco-inc-wso-q2-2026-earnings-call-transcript> — accessed 2026-09-24
- Watsco (WSO) statistics and valuation — <https://stockanalysis.com/stocks/wso/statistics/> — accessed 2026-09-24
- Watsco (WSO) quote — <https://robinhood.com/us/en/stocks/WSO/> — accessed 2026-09-24
- Watsco (WSO) P/E ratio history — <https://fullratio.com/stocks/nyse-wso/pe-ratio> — accessed 2026-09-24
- Watsco EV-to-EBITDA history — <https://www.gurufocus.com/term/enterprise-value-to-ebitda/WSO> — accessed 2026-09-24

Independent single-name research. Directional characterization, not a price target, execution instruction, or portfolio recommendation.