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

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**FORM 10-Q**

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**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

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**WATSCO, INC.**  
(a Florida Corporation)

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2665 South Bayshore Drive, Suite 901  
Miami, Florida 33133  
Telephone: (305) 714-4100

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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

TABLE OF CONTENTS

	<u>Page No.</u>
<b>PART I. FINANCIAL INFORMATION</b>	3
Item 1. <a href="#">Condensed Consolidated Unaudited Financial Statements</a>	3
<a href="#">Condensed Consolidated Unaudited Statements of Income – Quarter and Six Months Ended June 30, 2016 and 2015</a>	3
<a href="#">Condensed Consolidated Unaudited Statements of Comprehensive Income – Quarter and Six Months Ended June 30, 2016 and 2015</a>	4
<a href="#">Condensed Consolidated Balance Sheets – June 30, 2016 (Unaudited) and December 31, 2015</a>	5
<a href="#">Condensed Consolidated Unaudited Statements of Cash Flows – Six Months Ended June 30, 2016 and 2015</a>	6
<a href="#">Notes to Condensed Consolidated Unaudited Financial Statements</a>	7
Item 2. <a href="#">Management’s Discussion and Analysis of Financial Condition and Results of Operations</a>	15
Item 3. <a href="#">Quantitative and Qualitative Disclosures about Market Risk</a>	20
Item 4. <a href="#">Controls and Procedures</a>	20
<b>PART II. OTHER INFORMATION</b>	
Item 1. <a href="#">Legal Proceedings</a>	21
Item 1A. <a href="#">Risk Factors</a>	21
Item 6. <a href="#">Exhibits</a>	21
<a href="#">SIGNATURE</a>	22
<a href="#">EXHIBITS</a>	

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

See accompanying notes to condensed consolidated unaudited financial statements.

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

See accompanying notes to condensed consolidated unaudited financial statements.

WATSCO, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(In thousands, except per share data)

	June 30, 2016 (Unaudited)	December 31, 2015
<b>ASSETS</b>		
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	<u>1,406,825</u>	<u>1,181,265</u>
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
	<u>\$2,019,591</u>	<u>\$1,788,442</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
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	<u>406,549</u>	<u>270,301</u>
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	<u>267,791</u>	<u>245,814</u>
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	—	—
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	<u>1,003,303</u>	<u>957,310</u>
Non-controlling interest	269,937	246,411
Total shareholders' equity	<u>1,273,240</u>	<u>1,203,721</u>
	<u>\$2,019,591</u>	<u>\$1,788,442</u>

See accompanying notes to condensed consolidated unaudited financial statements.

[Table of Contents](#)

WATSCO, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED UNAUDITED STATEMENTS OF CASH FLOWS  
(In thousands)

	Six Months Ended June 30,	
	2016	2015
<b>Cash flows from operating activities:</b>		
Net income	<b>\$ 115,598</b>	\$ 115,541
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	<b>10,043</b>	9,409
Share-based compensation	<b>5,474</b>	5,840
Non-cash contribution to 401(k) plan	<b>2,348</b>	1,963
Deferred income tax provision	<b>2,261</b>	3,009
Provision for doubtful accounts	<b>1,329</b>	476
Gain on sale of property and equipment	<b>(356)</b>	(366)
Excess tax benefits from share-based compensation	<b>—</b>	(1,774)
Changes in operating assets and liabilities:		
Accounts receivable	<b>(153,702)</b>	(168,339)
Inventories	<b>(72,370)</b>	(124,477)
Accounts payable and other liabilities	<b>130,840</b>	84,894
Other, net	<b>468</b>	(303)
Net cash provided by (used in) operating activities	<b>41,933</b>	(74,127)
<b>Cash flows from investing activities:</b>		
Capital expenditures	<b>(5,618)</b>	(14,633)
Proceeds from sale of property and equipment	<b>624</b>	623
Net cash used in investing activities	<b>(4,994)</b>	(14,010)
<b>Cash flows from financing activities:</b>		
Dividends on Common and Class B common stock	<b>(60,164)</b>	(49,165)
Distributions to non-controlling interest	<b>(7,114)</b>	(3,654)
Net repayments of other long-term obligations	<b>(60)</b>	(83)
Excess tax benefits from share-based compensation	<b>—</b>	1,774
Proceeds from short-term borrowings	<b>793</b>	2,569
Net proceeds from issuances of common stock	<b>2,842</b>	3,235
Net proceeds under revolving credit agreement	<b>22,025</b>	131,146
Net cash (used in) provided by financing activities	<b>(41,678)</b>	85,822
Effect of foreign exchange rate changes on cash and cash equivalents	<b>54</b>	(281)
Net decrease in cash and cash equivalents	<b>(4,685)</b>	(2,596)
Cash and cash equivalents at beginning of period	<b>35,229</b>	24,447
Cash and cash equivalents at end of period	<b>\$ 30,544</b>	\$ 21,851

See accompanying notes to condensed consolidated unaudited financial statements.

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.

## [Table of Contents](#)

### *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.

### *Share-Based Payments*

In March 2016, the FASB issued amended guidance related to employee share-based payment accounting. The guidance requires that all income tax effects of awards to be recognized in the income statement when the awards vest or are settled. The guidance also requires presentation of excess tax benefits as an operating activity on the statement of cash flows rather than as a financing activity. The guidance increases the amount companies can withhold to cover income taxes on awards without triggering liability classification for shares used to satisfy statutory income tax withholding obligations and requires application of a modified retrospective transition method. The amended guidance will be effective for interim and annual periods beginning after December 15, 2016; early adoption is permitted if all provisions are adopted in the same period.

We elected to early adopt the amended guidance during the quarter ended June 30, 2016, which required us to reflect any adjustments as of January 1, 2016, the beginning of the annual period that includes the interim period of adoption. The primary impact of adoption was the recognition of excess tax benefits in our provision for income taxes rather than paid-in capital for all periods in 2016. We elected to apply the presentation requirements for cash flows related to excess tax benefits prospectively. The accounting for income taxes and minimum statutory withholding tax requirements had no impact to retained earnings as of January 1, 2016, where the cumulative effect of these changes are required to be recorded. We have elected to continue to estimate forfeitures expected to occur to determine the amount of compensation cost to be recognized in each period.

Adoption of the amended guidance resulted in the recognition of excess tax benefits in our provision for income taxes rather than paid-in capital of \$2,307 for the quarter and six months ended June 30, 2016 and impacted our previously reported quarterly results for March 31, 2016 as follows:

<u>Quarter Ended March 31, 2016</u>	<u>As Reported</u>	<u>As Adjusted</u>
<b>Income Statement:</b>		
Income taxes	\$ 15,508	\$ 14,654
Net income	\$ 34,174	\$ 35,028
Diluted earnings per share	\$ 0.71	\$ 0.74
Diluted weighted-average common shares outstanding	32,537,225	32,546,314
<b>Balance Sheet:</b>		
Paid-in capital	\$ 610,285	\$ 609,431
<b>Cash Flow Statement:</b>		
Net cash provided by operating activities	\$ 41,852	\$ 42,706
Net cash used in financing activities	\$ (41,638)	\$ (42,492)

## 2. EARNINGS PER SHARE

The following table presents the calculation of basic and diluted earnings per share for our Common and Class B common stock:

	Quarter Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
<b>Basic Earnings per Share:</b>				
Net income attributable to Watsco, Inc. shareholders	\$ 64,621	\$ 65,423	\$ 90,158	\$ 88,471
Less: distributed and undistributed earnings allocated to non-vested restricted common stock	5,254	5,183	7,304	6,922
Earnings allocated to Watsco, Inc. shareholders	\$ 59,367	\$ 60,240	\$ 82,854	\$ 81,549
Weighted-average common shares outstanding – Basic	32,574,901	32,427,088	32,543,354	32,402,262
Basic earnings per share for Common and Class B common stock	\$ 1.82	\$ 1.86	\$ 2.55	\$ 2.52
Allocation of earnings for Basic:				
Common stock	\$ 54,411	\$ 55,179	\$ 75,930	\$ 74,692
Class B common stock	4,956	5,061	6,924	6,857
	\$ 59,367	\$ 60,240	\$ 82,854	\$ 81,549
<b>Diluted Earnings per Share:</b>				
Net income attributable to Watsco, Inc. shareholders	\$ 64,621	\$ 65,423	\$ 90,158	\$ 88,471
Less: distributed and undistributed earnings allocated to non-vested restricted common stock	5,251	5,179	7,302	6,917
Earnings allocated to Watsco, Inc. shareholders	\$ 59,370	\$ 60,244	\$ 82,856	\$ 81,554
Weighted-average common shares outstanding – Basic	32,574,901	32,427,088	32,543,354	32,402,262
Effect of dilutive stock options	31,435	50,174	32,972	52,036
Weighted-average common shares outstanding – Diluted	32,606,336	32,477,262	32,576,326	32,454,298
Diluted earnings per share for Common and Class B common stock	\$ 1.82	\$ 1.85	\$ 2.54	\$ 2.51
Anti-dilutive stock options not included above	714	2,363	16,363	54,535

Diluted earnings per share for our Common stock assumes the conversion of all of our Class B common stock into Common stock as of the beginning of the fiscal year; therefore, no allocation of earnings to Class B common stock is required. At June 30, 2016 and 2015, our outstanding Class B common stock was convertible into 2,719,495 and 2,724,464 shares of our Common stock, respectively.

## 3. OTHER COMPREHENSIVE INCOME (LOSS)

Other comprehensive income (loss) consists of the foreign currency translation adjustment associated with our Canadian operations' use of the Canadian dollar as its functional currency and changes in the unrealized (losses) gains on cash flow hedging instruments and available-for-sale securities. The tax effects allocated to each component of other comprehensive income (loss) were as follows:

## Table of Contents

	Quarter Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Foreign currency translation adjustment	\$ 1,193	\$ 2,972	\$14,886	\$(16,903)
Unrealized (loss) gain on cash flow hedging instruments	(1,483)	(329)	(2,569)	1,898
Income tax benefit (expense)	401	88	694	(513)
Unrealized (loss) gain on cash flow hedging instruments, net of tax	(1,082)	(241)	(1,875)	1,385
Reclassification of loss (gain) on cash flow hedging instruments into earnings	1,611	(1,366)	545	(1,554)
Income tax (benefit) expense	(435)	369	(147)	420
Reclassification of loss (gain) on cash flow hedging instruments into earnings, net of tax	1,176	(997)	398	(1,134)
Unrealized (loss) gain on available-for-sale securities	(28)	23	(15)	34
Income tax benefit (expense)	10	(9)	6	(13)
Unrealized (loss) gain on available-for-sale securities, net of tax	(18)	14	(9)	21
Other comprehensive income (loss)	\$ 1,269	\$ 1,748	\$13,400	\$(16,631)

The changes in each component of accumulated other comprehensive loss, net of tax, were as follows:

Six Months Ended June 30,	2016	2015
Foreign currency translation adjustment:		
Beginning balance	\$ (47,204)	\$ (23,623)
Current period other comprehensive income (loss)	9,095	(10,065)
Ending balance	\$ (38,109)	\$ (33,688)
Cash flow hedging instruments:		
Beginning balance	\$ 600	\$ 168
Current period other comprehensive (loss) income	(1,125)	831
Less reclassification adjustment	239	(680)
Ending balance	\$ (286)	\$ 319
Available-for-sale securities:		
Beginning balance	\$ (300)	\$ (292)
Current period other comprehensive (loss) income	(9)	21
Ending balance	\$ (309)	\$ (271)
Accumulated other comprehensive loss, net of tax	\$ (38,704)	\$ (33,640)

## 4. DERIVATIVES

We enter into foreign currency forward contracts to offset the earnings impact that foreign exchange rate fluctuations would otherwise have had on certain monetary liabilities that are denominated in nonfunctional currencies.

### Cash Flow Hedging Instruments

We enter into foreign currency forward contracts that are designated as cash flow hedges. The settlement of these derivatives results in reclassifications from accumulated other comprehensive income (loss) to earnings for the period in which the settlement of these instruments occurs. The maximum period for which we hedge our cash flow using these instruments is 12 months. Accordingly, at June 30, 2016, all of our open foreign currency forward contracts had maturities of one year or less. The total notional value of our foreign currency exchange contracts designated as cash flow hedges at June 30, 2016 was \$29,100, and such contracts have varying terms expiring through December 2016.

## [Table of Contents](#)

The impact from foreign exchange derivative instruments designated as cash flow hedges was as follows:

	Quarter Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
(Loss) gain recorded in accumulated other comprehensive loss	<b>\$(1,483)</b>	\$ (329)	<b>\$(2,569)</b>	\$1,898
(Loss) gain reclassified from accumulated other comprehensive loss into earnings	<b>\$(1,611)</b>	\$1,366	<b>\$ (545)</b>	\$1,554

At June 30, 2016, we expected an estimated \$654 pre-tax loss to be reclassified into earnings to reflect the fixed prices obtained from foreign exchange hedging within the next 12 months.

### Derivatives Not Designated as Hedging Instruments

We have also entered into foreign currency forward contracts that are either not designated as hedges or did not qualify for hedge accounting. These derivative instruments were effective economic hedges for all of the periods presented. The fair value gains and losses on these contracts are recognized in earnings as a component of selling, general and administrative expenses. The total notional value of our foreign currency exchange contract not designated as a hedging instrument at June 30, 2016 was approximately \$5,000, and such contract expired in July 2016.

We recognized losses of \$(33) and \$(89) from foreign currency forward contracts not designated as hedging instruments in our condensed consolidated unaudited statements of income for the quarters ended June 30, 2016 and 2015, respectively. We recognized a (loss) gain of \$(464) and \$1,294 from foreign currency forward contracts not designated as hedging instruments in our condensed consolidated unaudited statements of income for the six months ended June 30, 2016 and 2015, respectively.

The following table summarizes the fair value of derivative instruments, which consist solely of foreign currency forward contracts, included in other current assets and accrued expenses and other current liabilities in our condensed consolidated unaudited balance sheets. See Note 5.

	Asset Derivatives	
	June 30, 2016	December 31, 2015
Derivatives designated as hedging instruments	<b>\$ 200</b>	\$ 923
Derivatives not designated as hedging instruments	<b>74</b>	326
Total asset derivative instruments	<b>\$ 274</b>	\$ 1,249

  

	Liability Derivatives	
	June 30, 2016	December 31, 2015
Derivatives designated as hedging instruments	<b>\$ 649</b>	\$ 3
Derivatives not designated as hedging instruments	<b>—</b>	4
Total liability derivative instruments	<b>\$ 649</b>	\$ 7

## [Table of Contents](#)

### 5. FAIR VALUE MEASUREMENTS

The following tables present our assets and liabilities carried at fair value that are measured on a recurring basis:

	Balance Sheet Location	Total	Fair Value Measurements at June 30, 2016 Using		
			Level 1	Level 2	Level 3
<b>Assets:</b>					
Available-for-sale securities	Other assets	\$239	\$ 239	—	—
Derivative financial instruments	Other current assets	\$274	—	\$ 274	—
<b>Liabilities:</b>					
Derivative financial instruments	Accrued expenses and other current liabilities	\$649	—	\$ 649	—

	Balance Sheet Location	Total	Fair Value Measurements at December 31, 2015 Using		
			Level 1	Level 2	Level 3
<b>Assets:</b>					
Available-for-sale securities	Other assets	\$ 254	\$ 254	—	—
Derivative financial instruments	Other current assets	\$1,249	—	\$1,249	—
<b>Liabilities:</b>					
Derivative financial instruments	Accrued expenses and other current liabilities	\$ 7	—	\$ 7	—

The following is a description of the valuation techniques used for these assets and liabilities, as well as the level of input used to measure fair value:

*Available-for-sale securities* – the investments are exchange-traded equity securities. Fair values for these investments are based on closing stock prices from active markets and are therefore classified within Level 1 of the fair value hierarchy.

*Derivative financial instruments* – these derivatives are foreign currency forward contracts. See Note 4. Fair value is based on observable market inputs, such as forward rates in active markets; therefore, we classify these derivatives within Level 2 of the valuation hierarchy.

There were no transfers in or out of Level 1 and Level 2 during the six months ended June 30, 2016.

### 6. DEBT

We maintain an unsecured, syndicated revolving credit agreement that provides for borrowings of up to \$600,000. Borrowings are used to fund seasonal working capital needs and for other general corporate purposes, including acquisitions, dividends (if and as declared by our Board of Directors), capital expenditures, stock repurchases and issuances of letters of credit. The revolving credit agreement matures on July 1, 2019. At June 30, 2016 and December 31, 2015, \$267,348 and \$245,300, respectively, were outstanding under the revolving credit agreement. The revolving credit agreement contains customary affirmative and negative covenants, including financial covenants with respect to consolidated leverage and interest coverage ratios, and other customary restrictions. We believe we were in compliance with all covenants at June 30, 2016.

At June 30, 2016, \$793 of short-term borrowings were outstanding under a credit line established by our Mexican subsidiary. This line of credit has a one-year term, maturing on June 14, 2017, is non-committed and provides for borrowings of up to approximately \$4,000 (MXN \$75,000) for general corporate purposes. No short-term borrowings were outstanding under this credit line at December 31, 2015.

### 7. SHAREHOLDERS' EQUITY

#### Common Stock Dividends

We paid cash dividends of \$0.85, \$0.70, \$1.70 and \$1.40 per share of Common stock and Class B common stock during the quarters and six months ended June 30, 2016 and 2015, respectively.

## [Table of Contents](#)

### **Non-Vested Restricted Stock**

During the quarters ended June 30, 2016 and 2015, we granted 24,500 and 19,000 shares of non-vested restricted stock, respectively. During the six months ended June 30, 2016 and 2015, we granted 112,178 and 171,979 shares of non-vested restricted stock, respectively.

During the quarter ended June 30, 2016, an aggregate of 20,195 shares of Common and Class B common stock with an aggregate fair market value of \$2,603 were withheld as payment in lieu of cash to satisfy tax withholding obligations in connection with the vesting of non-vested restricted stock. During the six months ended June 30, 2016, an aggregate of 27,477 shares of Common and Class B common stock with an aggregate fair market value of \$3,548 were withheld as payment in lieu of cash to satisfy tax withholding obligations in connection with the vesting of non-vested restricted stock. During the quarter and six months ended June 30, 2015, 7,206 shares of Common stock with an aggregate fair market value of \$889 were withheld as payment in lieu of cash to satisfy tax withholding obligations in connection with the vesting of non-vested restricted stock. These shares were retired upon delivery.

### **Exercise of Stock Options**

During the quarters ended June 30, 2016 and 2015, 7,500 and 41,000 stock options, respectively, were exercised for a combination of Common and Class B common stock. During the six months ended June 30, 2016 and 2015, 34,500 and 66,200 stock options, respectively, were exercised for a combination of Common and Class B common stock. Cash received from common stock issued as a result of stock options exercised during the quarters and six months ended June 30, 2016 and 2015, was \$454, \$1,579, \$2,258 and \$2,682, respectively.

During the quarter ended June 30, 2015, 10,133 shares of Class B common stock with an aggregate fair market value of \$1,288 were withheld as payment in lieu of cash for stock option exercises and related tax withholdings. During the six months ended June 30, 2015, 14,760 shares of Class B common stock with an aggregate fair market value of \$1,837 were withheld as payment in lieu of cash for stock option exercises and related tax withholdings. These shares were retired upon delivery.

### **Employee Stock Purchase Plan**

During the quarters ended June 30, 2016 and 2015, 2,203 and 2,300 shares of Common stock were issued under our employee stock purchase plan, for which we received net proceeds of \$287 and \$275, respectively. During the six months ended June 30, 2016 and 2015, 4,831 and 4,969 shares of Common stock were issued under our employee stock purchase plan for which we received net proceeds of \$584 and \$553, respectively.

### **401(k) Plan**

During the six months ended June 30, 2016 and 2015, we issued 20,045 and 18,343 shares of Common stock, respectively, to our profit sharing retirement plan, representing the Common stock discretionary matching contributions of \$2,348 and \$1,963, respectively.

### **Non-controlling Interest**

Of our three joint ventures with Carrier, we have an 80% controlling interest in one and a 60% controlling interest in each of the other two, while Carrier has either a 20% or 40% non-controlling interest in such joint ventures, as applicable. The following table reconciles shareholders' equity attributable to Carrier's non-controlling interest:

Non-controlling interest at December 31, 2015	\$246,411
Net income attributable to non-controlling interest	25,440
Distributions to non-controlling interest	(7,114)
Foreign currency translation adjustment	5,791
Loss recorded in accumulated other comprehensive loss	(750)
Loss reclassified from accumulated other comprehensive loss into earnings	159
Non-controlling interest at June 30, 2016	<u>\$269,937</u>

## **8. COMMITMENTS AND CONTINGENCIES**

### **Litigation, Claims and Assessments**

In December 2015, a purported Watsco shareholder, Nelson Gaskins, filed a derivative lawsuit in the U.S. District Court for the Southern District of Florida against Watsco's Board of Directors. The Company is a nominal defendant. The lawsuit alleges breach of fiduciary duties regarding CEO incentive compensation and seeks to recover alleged excessive incentive compensation and unspecified damages. The defendants believe the claims are entirely without merit and intend to vigorously defend against them.

## [Table of Contents](#)

While we cannot predict the outcome of this litigation, we believe the ultimate outcome of this matter will not have a material effect on our financial condition or results of operations.

We are also involved in other litigation incidental to the operation of our business. We vigorously defend all matters in which we or our subsidiaries are named defendants and, for insurable losses, maintain significant levels of insurance to protect against adverse judgments, claims or assessments that may affect us. Although the adequacy of existing insurance coverage and the outcome of any legal proceedings cannot be predicted with certainty, based on the current information available, we do not believe the ultimate liability associated with any known claims or litigation will have a material adverse effect on our financial condition or results of operations.

### **Self-Insurance**

Self-insurance reserves are maintained relative to company-wide casualty insurance and health benefit programs. The level of exposure from catastrophic events is limited by the purchase of stop-loss and aggregate liability reinsurance coverage. When estimating the self-insurance liabilities and related reserves, management considers a number of factors, which include historical claims experience, demographic factors, severity factors and valuations provided by independent third-party actuaries. Management reviews its assumptions with its independent third-party actuaries to evaluate whether the self-insurance reserves are adequate. If actual claims or adverse development of loss reserves occur and exceed these estimates, additional reserves may be required. Reserves in the amounts of \$4,060 and \$3,214 at June 30, 2016 and December 31, 2015, respectively, were established related to such programs and are included in accrued expenses and other current liabilities in our condensed consolidated unaudited balance sheets.

### **Purchase Obligations**

At June 30, 2016, we were obligated under a non-cancelable purchase order with one of our key suppliers for goods aggregating approximately \$129,000.

## **9. RELATED PARTY TRANSACTIONS**

Purchases from Carrier and its affiliates comprised 62% and 64% of all inventory purchases made during the quarters ended June 30, 2016 and 2015, respectively. Purchases from Carrier and its affiliates comprised 62% of all inventory purchases made during both the six months ended June 30, 2016 and 2015. At June 30, 2016 and December 31, 2015, approximately \$101,000 and \$85,000, respectively, was payable to Carrier and its affiliates, net of receivables. Our joint ventures with Carrier also sell HVAC products to Carrier and its affiliates. Revenues in our condensed consolidated unaudited statements of income for the quarters and six months ended June 30, 2016 and 2015 included approximately \$17,000, \$21,000, \$29,000 and \$29,000, respectively, of sales to Carrier and its affiliates. We believe these transactions are conducted at arm's-length in the ordinary course of business.

## **10. SUBSEQUENT EVENT**

On July 18, 2016, our Board of Directors approved an increase to the quarterly cash dividend per share of Common and Class B common stock to \$1.05 per share from \$0.85 per share, beginning with the dividend that will be paid in October 2016.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Forward-Looking Statements

This Quarterly Report on Form 10-Q contains or incorporates by reference statements that are not historical in nature and that are intended to be, and are hereby identified as, "forward-looking statements" as defined in the Private Securities Litigation Reform Act of 1995. Statements which are not historical in nature, including the words "anticipate," "estimate," "could," "should," "may," "plan," "seek," "expect," "believe," "intend," "target," "will," "project," "focused," "outlook" and variations of these words and negatives thereof and similar expressions are intended to identify forward-looking statements, including statements regarding, among others, (i) economic conditions, (ii) business and acquisition strategies, (iii) potential acquisitions and/or joint ventures, (iv) financing plans and (v) industry, demographic and other trends affecting our financial condition or results of operations. These forward-looking statements are based on management's current expectations, are not guarantees of future performance and are subject to a number of risks, uncertainties and changes in circumstances, certain of which are beyond our control. Actual results could differ materially from these forward-looking statements as a result of several factors, including, but not limited to:

- general economic conditions;
- competitive factors within the HVAC/R industry;
- effects of supplier concentration;
- fluctuations in certain commodity costs;
- consumer spending;
- consumer debt levels;
- new housing starts and completions;
- capital spending in the commercial construction market;
- access to liquidity needed for operations;
- seasonal nature of product sales;
- weather conditions;
- insurance coverage risks;
- federal, state and local regulations impacting our industry and products;
- prevailing interest rates;
- foreign currency exchange rate fluctuations;
- international political risk;
- cybersecurity risk; and
- the continued viability of our business strategy.

We believe these forward-looking statements are reasonable; however, you should not place undue reliance on any forward-looking statements, which are based on current expectations. For additional information regarding other important factors that may affect our operations and could cause actual results to vary materially from those anticipated in the forward-looking statements, please see the discussion included in Item 1A "Risk Factors" of our Annual Report on Form 10-K for the year ended December 31, 2015, as well as the other documents and reports that we file with the SEC. Forward-looking statements speak only as of the date the statements were made. We assume no obligation to update forward-looking information or the discussion of such risks and uncertainties to reflect actual results, changes in assumptions or changes in other factors affecting forward-looking information, except as required by applicable law. We qualify any and all of our forward-looking statements by these cautionary factors.

The following information should be read in conjunction with the condensed consolidated unaudited financial statements, including the notes thereto, included under Part I, Item 1 of this Quarterly Report on Form 10-Q. In addition, reference should be made to our audited consolidated financial statements and notes thereto and related Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended December 31, 2015.

### Company Overview

Watsco, Inc. was incorporated in Florida in 1956, and, together with its subsidiaries (collectively, "Watsco," or "we," "us" or "our") 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. At June 30, 2016, we operated from 563 locations in 37 U.S. States, Canada, Mexico and Puerto Rico with additional market coverage on an export basis to portions of Latin America and the Caribbean.

## [Table of Contents](#)

Revenues primarily consist of sales of air conditioning, heating and refrigeration equipment and related parts and supplies. Selling, general and administrative expenses primarily consist of selling expenses, the largest components of which are salaries, commissions and marketing expenses that are variable and correlate to changes in sales. Other significant selling, general and administrative expenses relate to the operation of warehouse facilities, including a fleet of trucks and forklifts and facility rent, which expenses are payable mostly under non-cancelable operating leases.

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.

### **Joint Ventures with Carrier Corporation**

In 2009, we formed a joint venture with Carrier Corporation (“Carrier”), which we refer to as Carrier Enterprise I, in which Carrier contributed 95 of its company-owned locations in 13 Sun Belt states and Puerto Rico and its export division in Miami, Florida, and we contributed 15 locations that distributed Carrier products. In July 2012, we exercised our option to acquire an additional 10% ownership interest in Carrier Enterprise I, which increased our ownership interest to 70%; and, on July 1, 2014, we exercised our last remaining option to acquire an additional 10% ownership interest in Carrier Enterprise I, which increased our controlling interest in Carrier Enterprise I to 80%. Neither we nor Carrier has any remaining options to purchase additional ownership interests in Carrier Enterprise I or any of our other joint ventures with Carrier, which are described below.

In 2011, we formed a second joint venture with Carrier and completed two additional transactions. In April 2011, Carrier contributed 28 of its company-owned locations in eight Northeast U.S. States, and we contributed 14 locations in the Northeast U.S. In July 2011, we purchased Carrier’s distribution operations in Mexico, which included seven locations. Collectively, the Northeast locations and the Mexico operations are referred to as Carrier Enterprise II. We have a 60% controlling interest in Carrier Enterprise II, and Carrier has a 40% non-controlling interest.

In 2012, we formed a third joint venture, which we refer to as Carrier Enterprise III, with UTC Canada Corporation, referred to as UTC Canada, an affiliate of Carrier. Carrier contributed 35 of its company-owned locations in Canada to Carrier Enterprise III. We have a 60% controlling interest in Carrier Enterprise III, and UTC Canada has a 40% non-controlling interest.

### **Critical Accounting Policies**

Management’s discussion and analysis of financial condition and results of operations is based upon the condensed consolidated unaudited financial statements included in this Quarterly Report on Form 10-Q, which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the condensed consolidated unaudited financial statements and the reported amount of revenues and expenses during the reporting period. Actual results may differ from these estimates under different assumptions or conditions. At least quarterly, management reevaluates its judgments and estimates, which are based on historical experience, current trends and various other assumptions that are believed to be reasonable under the circumstances.

Our critical accounting policies are included in our 2015 Annual Report on Form 10-K as filed on February 29, 2016. We believe that there have been no significant changes during the quarter ended June 30, 2016 to the critical accounting policies disclosed in our Annual Report on Form 10-K for the year ended December 31, 2015.

### **New Accounting Standards**

Refer to Note 1 to our condensed consolidated unaudited financial statements included in this Quarterly Report on Form 10-Q for a discussion of new accounting standards.

### **Results of Operations**

The following table summarizes information derived from our condensed consolidated unaudited statements of income, expressed as a percentage of revenues, for the quarters and six months ended June 30, 2016 and 2015:

## [Table of Contents](#)

	Quarter Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Revenues	<b>100.0%</b>	100.0%	<b>100.0%</b>	100.0%
Cost of sales	<b>76.0</b>	75.9	<b>75.6</b>	75.4
Gross profit	<b>24.0</b>	24.1	<b>24.4</b>	24.6
Selling, general and administrative expenses	<b>14.3</b>	13.9	<b>16.3</b>	16.1
Operating income	<b>9.7</b>	10.2	<b>8.1</b>	8.5
Interest expense, net	<b>0.1</b>	0.1	<b>0.1</b>	0.2
Income before income taxes	<b>9.6</b>	10.1	<b>8.0</b>	8.3
Income taxes	<b>2.9</b>	3.2	<b>2.5</b>	2.6
Net income	<b>6.7</b>	6.9	<b>5.6</b>	5.7
Less: net income attributable to non-controlling interest	<b>1.4</b>	1.5	<b>1.2</b>	1.3
Net income attributable to Watsco, Inc.	<b>5.3%</b>	5.4%	<b>4.4%</b>	4.4%

Note: Due to rounding, percentages may not add up to 100.

In the following narratives, computations and disclosure information referring to “same-store basis” exclude the effects of locations acquired or locations opened or closed during the immediately preceding 12 months unless they are within close geographical proximity to existing locations. At June 30, 2016 and 2015, 15 and 34 locations, respectively, were excluded from “same-store basis” information. The table below summarizes the changes in our locations for the 12 months ended June 30, 2016:

	Number of Locations
June 30, 2015	566
Opened	5
Closed	(5)
December 31, 2015	566
Opened	1
Closed	(4)
June 30, 2016	<b>563</b>

### Second Quarter of 2016 Compared to Second Quarter of 2015

#### Revenues

Revenues for the second quarter of 2016 decreased \$9.0 million, or 1%, including \$0.5 million from locations opened during the preceding 12 months, offset by \$6.2 million from locations closed. On a same-store basis, revenues decreased \$3.3 million as compared to the same period in 2015, reflecting a 1% decrease in sales of HVAC equipment (67% of sales), a 3% decrease in sales of other HVAC products (28% of sales) and an 8% increase in sales of commercial refrigeration products (5% of sales). The decline in revenues reflects lower demand for residential HVAC equipment.

#### Gross Profit

Gross profit for the second quarter of 2016 decreased \$3.4 million, or 1%, primarily as a result of decreased revenues. Gross profit margin for the quarter ended June 30, 2016 declined 10 basis-points to 24.0% versus 24.1%.

#### Selling, General and Administrative Expenses

Selling, general and administrative expenses for the second quarter of 2016 increased \$3.9 million, or 2%. Selling, general and administrative expenses as a percentage of revenues for the quarter ended June 30, 2016 increased to 14.3% versus 13.9% for the same period in 2015. On a same-store basis, selling, general and administrative expenses increased 3% as compared to the same period in 2015. The increase in selling, general and administrative expenses was primarily due to our inability to leverage fixed operating costs as compared to 2015 and included \$1.0 million of additional costs for 2016 in excess of 2015 for ongoing technology initiatives.

#### Interest Expense, Net

Net interest expense for the second quarter of 2016 decreased \$0.6 million, or 35%, primarily as a result of a decrease in average outstanding borrowings, partially offset by a higher effective interest rate for the 2016 period as compared to the same period in 2015.

## [Table of Contents](#)

### *Income Taxes*

Income taxes decreased to \$35.1 million for the second quarter of 2016 as compared to \$39.0 million for the second quarter of 2015 and are a composite of the income taxes attributable to our wholly owned operations and income taxes attributable to the Carrier joint ventures, which are primarily taxed as partnerships for income tax purposes. The effective income tax rates attributable to us were 34.7% and 36.8% for the quarters ended June 30, 2016 and 2015, respectively. The decrease was primarily due to a \$2.3 million benefit from the adoption of new accounting guidance related to share-based compensation. See Note 1 to our condensed consolidated unaudited financial statements contained in this Quarterly Report on Form 10-Q.

### *Net Income Attributable to Watsco, Inc.*

Net income attributable to Watsco for the second quarter of 2016 decreased \$0.8 million, or 1%, compared to the same period in 2015. The decrease was primarily driven by lower revenues, reduced profit margins, higher selling, general and administrative expenses as a percentage of revenues, lower interest expense and reduced income taxes as discussed above.

## **First Half of 2016 Compared to First Half of 2015**

### *Revenues*

Revenues for the first half of 2016 increased \$33.4 million, or 2%, including \$0.9 million from locations opened during the preceding 12 months, offset by \$11.9 million from locations closed. On a same-store basis, revenues increased \$44.4 million, or 2%, as compared to the same period in 2015, reflecting a 2% increase in sales of HVAC equipment (66% of sales), flat sales of other HVAC products (29% of sales) and a 7% increase in sales of commercial refrigeration products (5% of sales). The increase in same-store revenues was primarily due to demand for residential HVAC equipment.

### *Gross Profit*

Gross profit for the first half of 2016 increased \$4.8 million, or 1%, primarily as a result of increased revenues. Gross profit margin for the six months ended June 30, 2016 declined 20 basis-points to 24.4% versus 24.6%, primarily due to lower realized gross margins for residential HVAC equipment.

### *Selling, General and Administrative Expenses*

Selling, general and administrative expenses for the first half of 2016 increased \$8.4 million, or 3%, primarily due to increased revenues. Selling, general and administrative expenses as a percentage of revenues for the six months ended June 30, 2016 increased to 16.3% versus 16.1% for the same period in 2015. Selling, general and administrative expenses included \$2.5 million of additional costs for 2016 in excess of 2015 for ongoing technology initiatives. On a same-store basis, selling, general and administrative expenses increased 3% as compared to the same period in 2015.

### *Interest Expense, Net*

Net interest expense for the first half of 2016 decreased \$1.0 million, or 32%, primarily as a result of a decrease in average outstanding borrowings, partially offset by a higher effective interest rate for the 2016 period as compared to the same period in 2015.

### *Income Taxes*

Income taxes decreased to \$50.6 million for the first half of 2016 as compared to \$53.3 million for the first half of 2015 and are a composite of the income taxes attributable to our wholly owned operations and income taxes attributable to the Carrier joint ventures, which are primarily taxed as partnerships for income tax purposes. The effective income tax rates attributable to us were 35.4% and 37.0% for the six months ended June 30, 2016 and 2015, respectively. The decrease was primarily due to the aforementioned \$2.3 million benefit from the adoption of new accounting guidance related to share-based compensation. See Note 1 to our condensed consolidated unaudited financial statements contained in this Quarterly Report on Form 10-Q.

### *Net Income Attributable to Watsco, Inc.*

Net income attributable to Watsco for the first half of 2016 increased \$1.7 million, or 2%, compared to the same period in 2015. The increase was primarily driven by higher revenues as discussed above.

**Liquidity and Capital Resources**

We assess our liquidity in terms of our ability to generate cash to execute our business strategy and fund operating and investing activities, taking into consideration the seasonal demand for HVAC/R products, which peaks in the months of May through August. Significant factors that could affect our liquidity include the following:

## Table of Contents

- cash needed to fund our business (primarily working capital requirements);
- borrowing capacity under our bank line of credit;
- the ability to attract long-term capital with satisfactory terms;
- acquisitions, including joint ventures;
- dividend payments;
- capital expenditures; and
- the timing and extent of common stock repurchases.

### Sources and Uses of Cash

We rely on cash flows from operations and borrowing capacity under our revolving credit agreement to fund seasonal working capital needs and for other general corporate purposes, including dividend payments, if and as declared by our Board of Directors, capital expenditures, business acquisitions and development of our long-term operating and technology strategies.

As of June 30, 2016, we had \$30.5 million of cash and cash equivalents, of which, \$20.3 million was held by foreign subsidiaries. The repatriation of cash balances from our foreign subsidiaries could have adverse tax consequences or be subject to capital controls; however, these balances are generally available without legal restrictions to fund ordinary business operations of our foreign subsidiaries.

We believe that our operating cash flows, cash on hand and funds available for borrowing under our line of credit will be sufficient to meet our liquidity needs in the foreseeable future. However, there can be no assurance that our current sources of available funds will be sufficient to meet our cash requirements.

Our access to funds under our line of credit depends on the ability of the syndicate banks to meet their respective funding commitments. Disruptions in the credit and capital markets could adversely affect our ability to draw on our line of credit and may also adversely affect the determination of interest rates, particularly rates based on LIBOR, which is one of the base rates under our line of credit. Disruptions in the credit and capital markets could also result in increased borrowing costs and/or reduced borrowing capacity under our line of credit.

### Working Capital

Working capital increased to \$1.0 billion at June 30, 2016 from \$911.0 million at December 31, 2015, reflecting higher levels of accounts receivable and inventories, primarily due to the seasonality of our business.

### Cash Flows

The following table summarizes our cash flow activity for the six months ended June 30, 2016 and 2015:

	2016	2015	Change
Cash flows provided by (used in) operating activities	\$ 41.9	\$(74.1)	\$ 116.0
Cash flows used in investing activities	\$ (5.0)	\$(14.0)	\$ 9.0
Cash flows (used in) provided by financing activities	\$(41.7)	\$ 85.8	\$(127.5)

The individual items contributing to cash flow changes for the periods presented are detailed in the condensed consolidated unaudited statements of cash flows contained in this Quarterly Report on Form 10-Q.

### Operating Activities

Net cash provided by operating activities was higher primarily due to a lower seasonal build-up of inventory as well as lower inventory as a result of the transition to new regional efficiency standards in 2015 and the timing of payments for accrued expenses in 2016.

### Investing Activities

Net cash used in investing activities was lower due to the purchase of owned space for expansion of our corporate headquarters in 2015.

### Financing Activities

Net cash used in financing activities was higher due to increases in repayments of borrowings under our revolving credit agreement, dividends paid and distributions to the noncontrolling interest in 2016.

## [Table of Contents](#)

### Revolving Credit Agreement

We maintain an unsecured, syndicated revolving credit agreement that provides for borrowings of up to \$600.0 million. Borrowings are used to fund seasonal working capital needs and for other general corporate purposes, including acquisitions, dividends (if and as declared by our Board of Directors), capital expenditures, stock repurchases and issuances of letters of credit. The revolving credit agreement matures on July 1, 2019. At June 30, 2016 and December 31, 2015, \$267.3 million and \$245.3 million were outstanding under the revolving credit agreement, respectively. The revolving credit agreement contains customary affirmative and negative covenants, including financial covenants with respect to consolidated leverage and interest coverage ratios, and other customary restrictions. We believe we were in compliance with all covenants at June 30, 2016.

### Short-Term Debt

At June 30, 2016, \$0.8 million of short-term borrowings were outstanding under a credit line established by our Mexican subsidiary. This line of credit has a one-year term, maturing on June 14, 2017, is non-committed and provides for borrowings of up to approximately \$4.0 million (MXN \$75.0 million) for general corporate purposes. No short-term borrowings were outstanding under this credit line at December 31, 2015.

### Acquisitions

We continually evaluate potential acquisitions and/or joint ventures and routinely hold discussions with a number of acquisition candidates. Should suitable acquisition opportunities arise that would require additional financing, we believe our financial position and earnings history provide a sufficient basis for us to either obtain additional debt financing at competitive rates and on reasonable terms or raise capital through the issuance of equity securities.

### Common Stock Dividends

We paid cash dividends of \$1.70 and \$1.40 per share of Common stock and Class B common stock during the six months ended June 30, 2016 and 2015, respectively. On July 1, 2016, our Board of Directors declared a regular quarterly cash dividend of \$0.85 per share of Common and Class B common stock that was paid on July 29, 2016 to shareholders of record as of July 15, 2016. On July 18, 2016, our Board of Directors approved an increase to the quarterly cash dividend rate to \$1.05 per share from \$0.85 per share of Common and Class B common stock, beginning with the dividend that will be paid in October 2016. Future dividends and/or changes in dividend rates will be at the sole discretion of the Board of Directors and will depend upon such factors as cash flow generated by operations, profitability, financial condition, cash requirements, future prospects and other factors deemed relevant by our Board of Directors.

### Company Share Repurchase Program

In September 1999, our Board of Directors authorized the repurchase, at management's discretion, of up to 7,500,000 shares of common stock in the open market or via private transactions. Shares repurchased under the program are accounted for using the cost method and result in a reduction of shareholders' equity. No shares were repurchased during the quarters ended June 30, 2016 or 2015. In aggregate, 6,370,913 shares of Common and Class B common stock have been repurchased at a cost of \$114.4 million since the inception of the program. At June 30, 2016, there were 1,129,087 shares remaining authorized for repurchase under the program.

## **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

There have been no material changes to the information regarding market risk provided in Item 7A, Quantitative and Qualitative Disclosures about Market Risk, of our Annual Report on Form 10-K for the year ended December 31, 2015.

## **ITEM 4. CONTROLS AND PROCEDURES**

### **Evaluation of Disclosure Controls and Procedures**

We maintain disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended ("the Exchange Act")) that are, among other things, designed to ensure that information required to be disclosed by us under the Exchange Act is accumulated and communicated to management, including our Chief Executive Officer ("CEO"), Senior Vice President ("SVP") and Chief Financial Officer ("CFO"), to allow for timely decisions regarding required disclosure and appropriate SEC filings.

Our management, with the participation of our CEO, SVP and CFO, evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report, and, based on that evaluation, our CEO, SVP and CFO concluded that our disclosure controls and procedures were effective, at a reasonable assurance level, at and as of such date.

## Changes in Internal Control over Financial Reporting

We are continuously seeking to improve the efficiency and effectiveness of our operations and of our internal controls. This results in refinements to processes throughout the Company. However, there were no changes in internal controls over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended June 30, 2016, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

Information with respect to this item may be found in Note 8 to our condensed consolidated unaudited financial statements contained in this Quarterly Report on Form 10-Q under the caption "Litigation, Claims and Assessments," which information is incorporated by reference in this Item 1 of Part II of this Quarterly Report on Form 10-Q.

### ITEM 1A. RISK FACTORS

Information about risk factors for the quarter ended June 30, 2016 does not differ materially from that set forth in Part I, Item 1A, of our Annual Report on Form 10-K for the year ended December 31, 2015.

### ITEM 6. EXHIBITS

- 31.1 # Certification of Chief Executive Officer pursuant to Securities Exchange Act Rules 13a- 15(e) and 15d-15(e) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 # Certification of Senior Vice President pursuant to Securities Exchange Act Rules 13a-15(e) and 15d-15(e) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.3 # Certification of Chief Financial Officer pursuant to Securities Exchange Act Rules 13a- 15(e) and 15d-15(e) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 + Certification of Chief Executive Officer, Senior Vice President and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes- Oxley Act of 2002.
- 101.INS # XBRL Instance Document.
- 101.SCH # XBRL Taxonomy Extension Schema Document.
- 101.CAL # XBRL Taxonomy Extension Calculation Linkbase Document.
- 101.DEF # XBRL Taxonomy Extension Definition Linkbase Document.
- 101.LAB # XBRL Taxonomy Extension Label Linkbase Document.
- 101.PRE # XBRL Taxonomy Extension Presentation Linkbase Document.

# filed herewith.

+ furnished herewith.

**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

WATSCO, INC.

\_\_\_\_\_  
(Registrant)

August 9, 2016

By: /s/ Ana M. Menendez

Ana M. Menendez

Chief Financial Officer

(on behalf of the Registrant and as Principal Financial Officer)

**INDEX TO EXHIBITS**

<u>Exhibit No.</u>	<u>Exhibit Description</u>
31.1 #	Certification of Chief Executive Officer pursuant to Securities Exchange Act Rules 13a- 15(e) and 15d-15(e) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2 #	Certification of Senior Vice President pursuant to Securities Exchange Act Rules 13a-15(e) and 15d-15(e) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.3 #	Certification of Chief Financial Officer pursuant to Securities Exchange Act Rules 13a- 15(e) and 15d-15(e) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1 +	Certification of Chief Executive Officer, Senior Vice President and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes- Oxley Act of 2002.
101.INS #	XBRL Instance Document.
101.SCH #	XBRL Taxonomy Extension Schema Document.
101.CAL #	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF #	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB #	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE #	XBRL Taxonomy Extension Presentation Linkbase Document.

# filed herewith.

+ furnished herewith.

## CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Albert H. Nahmad, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Watsco, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 9, 2016

/s/ Albert H. Nahmad

Albert H. Nahmad  
Chief Executive Officer

## CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Barry S. Logan, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Watsco, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 9, 2016

/s/ Barry S. Logan

Barry S. Logan  
Senior Vice President

## CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Ana M. Menendez, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Watsco, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 9, 2016

/s/ Ana M. Menendez

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Ana M. Menendez  
Chief Financial Officer

## CERTIFICATION PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q of Watsco, Inc. ("Watsco") for the quarter and six months ended June 30, 2016 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Albert H. Nahmad, as Chief Executive Officer of Watsco, Barry S. Logan, as Senior Vice President of Watsco and Ana M. Menendez, as Chief Financial Officer of Watsco, each hereby certifies, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that, to our knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Watsco.

/s/ Albert H. Nahmad

Albert H. Nahmad  
Chief Executive Officer  
August 9, 2016

/s/ Barry S. Logan

Barry S. Logan  
Senior Vice President  
August 9, 2016

/s/ Ana M. Menendez

Ana M. Menendez  
Chief Financial Officer  
August 9, 2016

A signed original of this written statement required by Section 906 has been provided to Watsco and will be retained by Watsco and furnished to the Securities and Exchange Commission or its staff upon request.

This certification accompanies the Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes-Oxley Act of 2002, be deemed filed by Watsco for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.