

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

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**FORM 10-K**

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**Annual Report Pursuant to Section 13 or 15(d) of the Securities and Exchange Act of 1934**

For the Fiscal Year Ended December 31, 2008

**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

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**watsco**

**WATSCO, INC.**

(Exact name of registrant as specified in its charter)

**FLORIDA**  
(State or other jurisdiction of  
incorporation or organization)

**59-0778222**  
(I.R.S. Employer  
Identification No.)

**2665 South Bayshore Drive, Suite 901, Coconut Grove, FL 33133**

(Address of principal executive offices, including zip code)

**(305) 714-4100**

(Registrant's telephone number, including area code)

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**Securities registered pursuant to Section 12(b) of the Act:**

<small>Title of each class</small>	<small>Name of each exchange on which registered</small>
<b>Common stock, \$.50 par value</b>	<b>New York Stock Exchange</b>
<b>Class B common stock, \$.50 par value</b>	<b>American Stock Exchange</b>

**Securities registered pursuant to section 12(g) of the Act: None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES  NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES  NO

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 and 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 Act). YES  NO

The aggregate market value of the registrant's voting stock (common stock) held by non-affiliates of the registrant as of June 30, 2008, the last business day of the registrant's most recently completed second fiscal quarter, was approximately \$1,015 million, based on the closing sale price of the registrant's common stock on that date. For purposes of determining this number all executive officers and directors of the registrant as of June 30, 2008 are considered to be affiliates of the registrant. This number is provided only for the purposes of this report on Form 10-K and does not represent an admission by either the registrant or any such person as to the status of such person.

The number of shares of common stock outstanding as of February 24, 2009 was 24,566,631 shares of Common stock, excluding treasury shares of 6,322,650, and 3,923,511 shares of Class B common stock, excluding treasury shares of 48,263.

#### **DOCUMENTS INCORPORATED BY REFERENCE**

Certain information required by Parts I and II is incorporated by reference from the Annual Report to Shareholders for the year ended December 31, 2008, attached hereto as Exhibit 13. The information required by Part III (Items 10, 11, 12, 13 and 14) will be incorporated by reference from the Registrant's definitive proxy statement (to be filed pursuant to Regulation 14A).

WATSCO, INC. AND SUBSIDIARIES

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Index to Annual Report  
on Form 10-K  
Year Ended December 31, 2008

	<u>Page</u>
<a href="#">PART I</a>	
Item 1. <a href="#">Business</a>	3
Item 1A. <a href="#">Risk Factors</a>	8
Item 1B. <a href="#">Unresolved Staff Comments</a>	11
Item 2. <a href="#">Properties</a>	11
Item 3. <a href="#">Legal Proceedings</a>	11
Item 4. <a href="#">Submission of Matters to a Vote of Security Holders</a>	11
<a href="#">PART II</a>	
Item 5. <a href="#">Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</a>	11
Item 6. <a href="#">Selected Financial Data</a>	13
Item 7. <a href="#">Management’s Discussion and Analysis of Financial Condition and Results of Operations</a>	13
Item 7A. <a href="#">Quantitative and Qualitative Disclosures about Market Risk</a>	13
Item 8. <a href="#">Financial Statements and Supplementary Data</a>	13
Item 9. <a href="#">Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</a>	14
Item 9A. <a href="#">Controls and Procedures</a>	14
Item 9B. <a href="#">Other Information</a>	14
<a href="#">PART III</a>	14
<a href="#">PART IV</a>	
Item 15. <a href="#">Exhibits and Financial Statement Schedules</a>	14
<a href="#">SIGNATURES</a>	18

## PART I

### ITEM 1. BUSINESS

#### General

Watsco, Inc. and its subsidiaries (collectively, “Watsco”, which may be referred to as *we*, *us* or *our*) was incorporated in 1956 and is the largest independent distributor of air conditioning, heating, and refrigeration equipment and related parts and supplies (“HVAC/R”) in the United States. At December 31, 2008 we operated from 417 locations in 34 states serving over 40,000 contractors and dealers who service the replacement and new construction markets. Our revenues in HVAC/R distribution have increased from \$64 million in 1989 to \$1.7 billion in 2008 via a strategy of acquiring companies with established market positions and subsequently building revenue and profit through a combination of adding locations, products, services and other initiatives.

Our principal executive office is located at 2665 South Bayshore Drive, Suite 901, Coconut Grove, Florida 33133, and our telephone number is (305) 714-4100. Our website address on the Internet is [www.watsco.com](http://www.watsco.com) and e-mails may be sent to [info@watsco.com](mailto:info@watsco.com).

#### Residential Central Air Conditioning, Heating and Refrigeration Industry

The HVAC/R distribution industry is highly fragmented with over 1,300 distribution companies. The industry is well-established having its primary period of growth during the post-World War II era with the advent of affordable central air conditioning and heating systems for residential applications.

Based on data published by the Air Conditioning, Heating and Refrigeration Institute (“AHRI”) and other available data, we estimate the market for residential central air conditioning, heating and refrigeration equipment and related parts and supplies in the United States is approximately \$26 billion. Residential central air conditioners are manufactured primarily by seven major companies that together account for approximately 90% of all units shipped in the United States each year. These companies are: Carrier Corporation (“Carrier”), a subsidiary of United Technologies Corporation, Goodman Manufacturing Company, L.P. (“Goodman”), a subsidiary of Goodman Global, Inc., Rheem Manufacturing Company (“Rheem”), Trane Inc. (“Trane”), a subsidiary of Ingersoll-Rand Company Limited, York International Corporation (“York”), a subsidiary of Johnson Controls, Inc., Lennox International, Inc. (“Lennox”) and Nordyne Corporation (“Nordyne”), a subsidiary of Nortek Corporation. These manufacturers distribute their products through a combination of factory-owned and independent distributors who, in turn, supply the equipment and related parts and supplies to contractors and dealers nationwide that sell to and install the products for the consumer and other end-users.

Residential central air conditioning and heating equipment is sold to both the replacement and the new construction markets. The replacement side of the market has increased in size relative to the total market over the past several years as a result of the aging of the installed base of residential central air conditioners and furnaces, the introduction of new higher energy efficient models, the remodeling and expansion of existing homes, the addition of central air conditioning to homes that previously had only heating products and the consumers’ overall unwillingness to live without air conditioning or heating products. According to industry data published by the AHRI, over 120 million central air conditioning units and furnaces have been installed in the United States in the past 20 years. Many of these installed units have reached the end of their useful lives, thus providing a growing and stable replacement market. The mechanical life of central air conditioning and furnaces varies by geographical region due to usage and is estimated to range from 8 to 20 years.

We also sell products to the refrigeration market. Such products include condensing units, compressors, evaporators, valves, refrigerant, walk-in coolers and ice machines for industrial and commercial applications. We distribute products manufactured by Copeland Compressor Corporation, a subsidiary of Emerson Electric Co. (“Emerson”), E. I. Du Pont De Nemours and Company (“DuPont”), Mueller Industries, Inc., Lennox and The Manitowoc Company, Inc. (“Manitowoc”).

#### Business Strategy

We have a “buy and build” strategy that has produced substantial long-term growth in sales and profits. The “buy” component of the strategy focuses on acquiring existing market leaders either by expanding into new geographic areas or gaining additional market share in existing markets. We employ a disciplined and conservative approach that seeks opportunities that fit well-defined financial and strategic criteria. The “build” component of the strategy focuses on implementing a growth culture at acquired companies, by adding products and locations to better serve our customers, exchanging ideas and business concepts amongst the executive management teams and investing in new technologies. Newly acquired businesses have access to our capital resources and established vendor relationships to provide their customers with an expanded array of product lines on favorable terms and conditions with an intensified commitment to service.

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## [Table of Contents](#)

### Strategy in Existing Markets

Our strategy for growth in existing markets focuses on customer service and product expansion to satisfy the needs of the higher growth, higher margin replacement market, where customers generally demand immediate, convenient and reliable service. In response to this need, our focus is to (i) offer a broad range of product lines, including the necessary equipment, parts and supplies to enable a contractor to install or repair a central air conditioner, furnace or refrigeration system, (ii) maintain a strong density of warehouse locations for increased customer convenience, (iii) maintain well-stocked inventories to ensure that customer orders are filled in a timely manner, (iv) provide a high degree of technical expertise at the point of sale and (v) develop and implement technology to further enhance customer service capabilities. We believe these concepts provide a competitive advantage over smaller, less-capitalized competitors who are unable to commit resources to open and maintain additional locations, implement technological business solutions, provide the same range of products, maintain the same inventory levels or attract the wide range of expertise that is required to support a diverse product offering. In some geographic areas we believe we have a competitive advantage over factory-operated distributor networks who typically do not maintain as diversified inventories of parts and supplies and whose fewer number of warehouse locations make it more difficult to meet the time-sensitive demands of the replacement market.

In addition to the replacement market, we sell to the new construction market, including both traditional site-built homes and manufactured housing. We believe our reputation for reliable, high-quality service and relationships with contractors, who may serve both the replacement and new construction markets, allow us to compete effectively in these markets.

### Acquisition Strategy

Our acquisition strategy is focused on acquiring businesses that complement our current presence in existing markets or establish a presence in new markets. Since 1989, we have acquired 53 HVAC/R distribution businesses, three of which currently operate as primary operating subsidiaries. The other smaller distributors acquired have been integrated into or are under the management of the primary operating subsidiaries. We continue to pursue additional strategic acquisitions to allow further penetration in existing markets and expand into new geographic markets.

### Product Line Expansion

We actively seek new or expanded territories of distribution from the key equipment suppliers. Significant relationships currently exist with Rheem, Carrier, Nordyne, Goodman, Trane and Lennox. We continually evaluate new parts and supply products to support equipment sales and further enhance service to our customers. The initiative includes increasing the product offering with existing vendors and identifying new product opportunities through traditional and non-traditional supply channels. We have also introduced private-label products as a means to obtain market share and grow revenues. We believe that the private-label brand products complement the existing offerings at the selected locations based on their particular market position, price-point and customer needs.

### Operating Philosophy

Our subsidiaries operate in a manner that recognizes the long-term relationships established between the distributors and their customers. Typically, the identity and culture of acquired businesses continue by retaining their historical trade-name, management team and sales organization, and by continuing the product brand-name offerings. We believe this strategy builds on the value of the acquired operations by creating additional sales opportunities and is an attractive exit strategy for the existing ownership of the long-standing distribution companies targeted for acquisition.

A specialized functional support staff is maintained at our corporate headquarters to support the subsidiaries' strategies for growth in their respective markets. Such functional support includes specialists in finance, accounting, product procurement, treasury and working capital management, tax planning, risk management and safety. Certain general and administrative expenses are targeted for cost savings by leveraging the overall business volume and improving operating efficiencies.

### Technology

Our technology initiatives include: (i) implementation of effective point-of-sale systems that allow timely and effective customer service, including up-to-date pricing, credit checks, credit card processing and inventory availability, (ii) enabling connectivity with our suppliers and by our customers to the relevant components of our subsidiaries' business software and (iii) developing our website, ACDoctor.com, that educates consumers about energy efficient HVAC solutions, financial incentives related to the installation of energy efficient systems and connecting them with high quality contractors.

## DESCRIPTION OF BUSINESS

### Products

We sell an expansive line of products and maintain a diverse mix of inventory to meet our customers' immediate needs and seek to provide products a contractor would generally require when installing or repairing a central air conditioner, furnace or refrigeration system on short notice. The cooling capacity of air conditioning units is measured in tons. One ton of cooling capacity is equivalent to 12,000 BTUs and is generally adequate to air condition approximately 500 square feet of residential space. The products we distribute consist of: (i) equipment, including residential central air conditioners ranging from 1- 1/2 to 5 tons, light commercial air conditioners ranging up to 20 tons, gas, electric and oil furnaces ranging from 50,000 to 150,000 BTUs, commercial air conditioning and heating equipment and systems ranging from 5 to 25 tons, and other specialized equipment, (ii) parts, including replacement compressors, evaporator coils, motors and other component parts and (iii) supplies, including thermostats, insulation material, refrigerants, ductwork, grills, registers, sheet metal, tools, copper tubing, concrete pads, tape, adhesives and other ancillary supplies.

Sales of HVAC equipment accounted for 44% and 45% of our revenues for the years ended December 31, 2008 and 2007, respectively. Sales of other HVAC products (currently sourced from over 600 vendors) comprised 43% and 44% of our revenues for the years ended December 31, 2008 and 2007, respectively. Sales of commercial refrigeration products accounted for 13% and 11% of our revenues for the years ended December 31, 2008 and 2007, respectively.

### Distribution and Sales

At December 31, 2008, we operated from 417 locations, a vast majority of which are located in regions that we believe have favorable demographic trends. We maintain large inventories at each warehouse location, which is accomplished by transporting inventory between locations daily and either directly delivering products to customers using one of our 714 trucks or by making products available for pick-up at the location nearest to the customer. Watsco has approximately 450 commissioned salespeople, averaging 11 years or more of experience in the HVAC/R distribution industry.

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[Table of Contents](#)

Markets

The table below identifies the number of locations by state as of December 31, 2008:

Florida	83
Texas	76
California	41
Georgia	38
North Carolina	27
South Carolina	23
Tennessee	19
Louisiana	15
Mississippi	11
Virginia	11
Alabama	9
Arizona	8
Missouri	8
Kansas	6
Massachusetts	6
Arkansas	5
Colorado	3
Oklahoma	3
Iowa	2
Kentucky	2
Maine	2
Nebraska	2
Nevada	2
New Hampshire	2
New Mexico	2
New York	2
South Dakota	2
Connecticut	1
Illinois	1
Maryland	1
New Jersey	1
North Dakota	1
Rhode Island	1
Vermont	1
<b>TOTAL</b>	<b>417</b>

Customers and Customer Service

We currently serve over 40,000 contractors and dealers who service the replacement and new construction markets for residential and light commercial central air conditioning, heating and refrigeration systems. No single customer in 2008, 2007 or 2006 represented more than 1% of consolidated revenues. We focus on providing products where and when the customer needs them, technical support by phone or on site as required, and quick and efficient service at our locations. Increased customer convenience is also provided through e-commerce, which allows customers to access information on-line 24 hours a day, seven days a week to search for desired products, verify inventory availability, obtain pricing, place orders, check order status, schedule pickup or delivery times and make payments. We believe we compete successfully with other distributors primarily on the basis of an experienced sales organization, strong service support, high quality reputation and broad product lines.

Key Suppliers

Significant relationships are maintained with Rheem, Carrier, Nordyne, Goodman, Trane, Emerson, Manitowoc, DuPont and Lennox, each a leading manufacturer of HVAC/R products in the United States. Each manufacturer has a well-established reputation of producing high-quality, competitively priced products. The manufacturers' current product offerings, quality, serviceability and brand-name recognition allow us to operate favorably relative to our competitors. To maintain brand-name recognition, the manufacturers of air conditioning and heating equipment provide national advertising and participate with us in cooperative

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## [Table of Contents](#)

advertising programs and promotional incentives that are targeted to both contractors and end-users. We estimate that the replacement market for air conditioning products currently accounts for approximately 80% of industry sales in the United States and is expected to increase as units installed in the past 20 years wear out and get replaced or updated to more energy-efficient models as well as the significant decline in sales to the new construction market.

Approximately 48%, 48% and 47% of purchases in 2008, 2007 and 2006, respectively, were made from the seven key HVAC/R equipment suppliers. The largest supplier accounted for 16%, 17% and 17% of all purchases made in each of the years ended 2008, 2007 and 2006, respectively. A significant interruption in the delivery of these products could impair our ability to continue to maintain current inventory levels and could adversely affect our financial results. Future financial results are also materially dependent upon the continued market acceptance of these manufacturers' products and their ability to continue to manufacture products that comply with laws relating to environmental and efficiency standards. See "Business Risk Factors" in Item 1A. We believe that sales of other complementary equipment products and continued emphasis to expand sales of parts and supplies are mitigating factors against such risks.

### Distribution Agreements

Distribution agreements have been executed with several of our key suppliers, either on an exclusive or non-exclusive basis, for terms generally ranging from one to ten years. Certain of the distribution agreements contain provisions that restrict or limit the sale of competitive products in the markets served. Other than the markets where such restrictions and limitations may apply, we may distribute other manufacturers' lines of air conditioning or heating equipment.

### Seasonality

Sales of residential central air conditioners, heating equipment and parts and supplies have historically been seasonal. See "Business Risk Factors" in Item 1A.

### Competition

We operate in highly competitive environments. See "Business Risk Factors" in Item 1A.

### **Employees**

There were approximately 3,100 employees as of December 31, 2008, substantially all of which are non-union employees. Most of these employees are employed on a full-time basis, and relations with employees are good.

### **Order Backlog**

Order backlog is not a material aspect of the business and no material portion of the business is subject to government contracts.

### **Government Regulations, Environmental and Health and Safety Matters**

Our industry and business are subject to federal, state and local laws and regulations relating to the generation, storage, handling, emission, transportation and discharge of materials into the environment. These include laws and regulations implementing the Clean Air Act, relating to minimum energy efficiency standards of HVAC systems and the production, servicing and disposal of certain ozone-depleting refrigerants used in such systems, including those established at the Montreal Protocol in 1992 concerning the phase-out of the production of CFC-based refrigerants on January 1, 2010 for use in new equipment. We are also subject to regulations concerning the transport of hazardous materials, including regulations adopted pursuant to the Motor Carrier Safety Act of 1990. Our operations are also subject to health and safety requirements including the Occupational, Safety and Health Act (OSHA). Management believes that the business is operated in substantial compliance with all applicable federal, state and local provisions relating to the protection of the environment, transport of hazardous materials and health and safety requirements.

Our industry and business was also subject to a Department of Energy mandate that required, effective January 23, 2006, that our key equipment suppliers manufacture products with a higher standard of energy efficiency. Prior to January 23, 2006, the minimum standard for energy efficiency as measured by industry guidelines was 10 SEER (seasonal energy efficiency rating, the metric used to measure energy efficiency). On the effective date, the new standard increased the minimum allowed efficiency to 13 SEER (a 30% improvement in efficiency). The transition of products to the new standard took place during 2006, as 13 SEER products were introduced and became fully available to consumers.

### **Non-U.S. Operations**

All of our operations are within the United States. We do not have any international operations. Products are sold on an export-only basis to portions of Latin America and the Caribbean Basin and export sales are less than 1% of total revenues.



## ADDITIONAL INFORMATION

### Filings with the Securities and Exchange Commission

As a public company, we regularly file reports and proxy statements with the Securities and Exchange Commission (“SEC”). These reports are required by the Securities Exchange Act of 1934 and include, but are not limited to:

- annual reports on Form 10-K;
- quarterly reports on Form 10-Q;
- current reports on Form 8-K; and
- proxy statements on Schedule 14A.

The public may read and copy any of the materials we file with the SEC at the SEC’s Public Reference Room at 100 F. Street N.E., Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site at [www.sec.gov](http://www.sec.gov) that contains the reports, proxy and information statements, and other information that we file electronically.

### Website Access to Reports

We make available, free of charge, access to our SEC filings as soon as reasonably practicable after such materials are electronically filed with or furnished to the SEC through our website at [www.watsco.com](http://www.watsco.com). Other reports filed with the SEC under the Securities Exchange Act of 1934, as amended, are also available including the proxy statements and reports filed by officers and directors under Section 16(a) of that Act. These reports may be found on the website by selecting the option entitled “SEC FILINGS” under the “INVESTOR RELATIONS” section of the website. The information contained on our website is not incorporated by reference into this Annual Report on Form 10-K.

### Corporate Governance

An “Employee Code of Business Ethics and Conduct” is maintained that is applicable to all employees and additionally a “Code of Conduct for Senior Executives” that is applicable to members of the Board of Directors, executive officers and senior operating and financial personnel. These codes require continued observance of high ethical standards such as honesty, integrity and compliance with laws. These codes are publicly available on the website by selecting the option entitled “CODE OF CONDUCT” under the “CAREERS” area of the website. These materials may also be requested in print by writing to Watsco, Inc., Investor Relations, 2665 South Bayshore Drive, Suite 901, Coconut Grove, FL 33133.

## ITEM 1A. RISK FACTORS

### **Business Risk Factors**

#### Continuing Decline in Economic Conditions

The global and U.S. economy is currently experiencing a significant contraction, with an almost unprecedented lack of availability of business and consumer credit. We rely on the capital markets as well as the credit markets to meet our financial commitments and short-term liquidity needs if internal funds are not available from our operations. Long-term disruptions in the capital and credit market, similar to those that have been experienced during 2008 and are currently being experienced in 2009, could result from uncertainty, changing or increased regulation, reduced alternatives or failures of significant financial institutions and could adversely affect our access to liquidity needed for our business. Any disruption could require us to take measures to conserve cash until the markets stabilize or until alternative credit arrangements or other funding for our business needs can be arranged. Such measures could include reducing or eliminating dividend payments, deferring capital expenditures and reducing or eliminating discretionary uses of cash.

The decline in economic conditions could have an adverse effect on our business. Continued capital and credit market disruptions could cause broader economic downturns, which may lead to lower demand for our products and increased incidence of customers’ inability to pay their accounts. Further, bankruptcies or similar events by customers may cause us to incur bad debt expense at levels higher than historically experienced. Also, our suppliers may potentially be impacted causing disruption or delay of product availability. These events would adversely impact our results of operations, cash flows and financial position. Additionally, if financial institutions that have extended credit commitments to us are adversely affected by the conditions of the capital and credit markets, they may become unable to fund borrowings under their credit commitments to us, which could have an adverse impact on our financial condition and our ability to borrow funds, if needed, for working capital, acquisitions, capital expenditures and other corporate purposes.

#### Supplier Concentration

We maintain distribution agreements with our key equipment suppliers, either on an exclusive or non-exclusive basis, for terms generally ranging from one to ten years. Certain of the distribution agreements contain provisions that restrict or limit the sale of competitive

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## Table of Contents

products in the markets served. Other than the markets where such restrictions and limitations may apply, we may distribute other manufacturers' lines of air conditioning or heating equipment. Purchases from the seven key equipment suppliers comprised 48% of all purchases made in 2008, with the largest supplier accounting for 16% of all purchases. Any significant interruption by the manufacturers or a termination of a distribution agreement could temporarily disrupt the operations of certain subsidiaries. Future results of operations are also materially dependent upon the continued market acceptance of these manufacturers' products and their ability to continue to manufacture products that comply with laws relating to environmental and efficiency standards.

### Risks Inherent in Acquisitions

As part of our strategy, we intend to pursue additional acquisitions of complementary businesses. If we complete future acquisitions, we may be required to incur or assume additional debt and/or issue additional shares of our common stock as consideration, which will dilute our existing stockholders' ownership interest and may affect our results of operations. Growth through acquisitions involves a number of risks, including the following:

- the ability to identify and consummate complementary acquisition candidates;
- the successful operation and/or integration of acquired companies in an effective manner;
- diversion of management's attention from other daily functions;
- issuance by us of equity securities that would dilute ownership of our existing stockholders;
- incurrence and/or assumption of significant debt and contingent liabilities; and
- possible loss of key employees and/or customer relationships of the acquired companies.

### Competition

We operate in highly competitive environments. We compete with a number of distributors and also with several air conditioning and heating equipment manufacturers that distribute a significant portion of their products through their own distribution organizations in certain markets. Competition within any given geographic market is based upon product availability, customer service, price and quality. Competitive pressures or other factors could cause our products or services to lose market acceptance or result in significant price erosion, all of which would have a material adverse effect on profitability.

### Seasonality

Sales of residential central air conditioners, heating equipment and parts and supplies have historically been seasonal. Furthermore, profitability can be impacted favorably or unfavorably based on the severity or mildness of weather patterns during summer or winter selling seasons. Demand related to the residential central air conditioning replacement market is highest in the second and third quarters with demand for heating equipment usually highest in the fourth quarter. Demand related to the new construction sectors throughout most of the markets is fairly even during the year except for dependence on housing completions and related weather and economic conditions.

### Dependence on Key Personnel

We are highly dependent on the skills, experience and services of key personnel. The loss of key personnel could have a material adverse effect on our business, operating results or financial condition. Our potential growth and expansion are expected to place increased demands on our management skills and resources. Therefore, our success also depends upon our ability to recruit, hire, train and retain additional skilled and experienced management personnel. Employment and retention of qualified personnel is important due to the competitive nature of our industry.

## **General Risk Factors**

### Goodwill and Intangibles

At December 31, 2008, goodwill and intangibles represented approximately 32% of total assets. Goodwill and indefinite life intangibles are no longer amortized and are subject to impairment testing at least annually using a fair value based approach. The identification and measurement of impairment involves the estimation of the fair value of the reporting unit. Accounting for impairment contains uncertainty because management must use judgment in determining appropriate assumptions to be used in the measurement of fair value. The estimates of fair value of the reporting unit are based on the best information available as of the date of the assessment and incorporate management assumptions about expected future cash flows and contemplate other valuation techniques. Future cash flows can be affected by changes in the industry, the continued declining economic environment or market conditions.

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## Table of Contents

The recoverability of goodwill and indefinite life intangibles is evaluated at least annually and when events or changes in circumstances indicate that the carrying amount of goodwill and indefinite life intangibles may not be recoverable. Although no impairment has been recorded to date, there can be no assurances that future impairments will not occur.

### Risks Related to Insurance Coverage

We carry general liability, comprehensive property damage, workers' compensation and other insurance coverage that management considers adequate for the protection of its assets and operations. There can be no assurance, however, that the coverage limits of such policies will be adequate to cover losses and expenses for lawsuits brought or which may be brought against us. A loss in excess of insurance coverage could have a material adverse effect on our financial position and/or profitability. Certain self-insurance risks for casualty insurance programs and health benefits are retained and reserves are established based on claims filed and estimates of claims incurred but not yet reported. Assurance cannot be provided that actual claims will not exceed present estimates. Exposure to catastrophic losses has been limited by maintaining excess and aggregate liability coverage and implementing loss control programs.

### Control by Existing Shareholder

As of December 31, 2008, Albert H. Nahmad, our Chairman and Chief Executive Officer, and a limited partnership controlled by him, collectively had beneficial ownership of approximately 58% of the combined voting power of the outstanding Common stock and Class B common stock. Based on Mr. Nahmad's stock ownership and the stock ownership of the limited partnership controlled by him, Mr. Nahmad has the voting power to elect all but three members of the nine-person Board of Directors and to control most corporate actions requiring shareholder approval.

### Information about Forward-Looking Statements

This Form 10-K 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, including statements regarding, among other items, (i) business and acquisition strategies, (ii) potential acquisitions, (iii) financing plans and (iv) industry, demographic and other trends affecting our financial condition or results of operations. These forward-looking statements are based largely on management's current expectations and are subject to a number of risks, uncertainties and changes in circumstances, certain of which are beyond their control.

Actual results could differ materially from these forward-looking statements as a result of several factors, including:

- general economic conditions;
- effects of supplier concentration;
- competitive factors within the HVAC/R industry;
- 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;
- prevailing interest rates; and
- the continued viability of our business strategy.

In light of these uncertainties, there can be no assurance that the forward-looking information contained herein will be realized or, even if substantially realized, that the information will have the expected consequences or effects on Watsco or its business or operations. A discussion of certain of these risks and uncertainties that could cause actual results to differ materially from those predicted in such forward-looking statements is included in our Annual Report to Shareholders for the fiscal year ended December 31, 2008 in the section captioned "Management's Discussion and Analysis of Financial Condition and Results of Operations," which section has been incorporated in the Form 10-K by reference. Forward-looking statements speak only as of the date the statement was made. Watsco assumes 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.

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[Table of Contents](#)

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

**ITEM 2. PROPERTIES**

Our main properties include warehousing and distribution facilities, trucks and administrative office space.

Warehousing and Distribution Facilities

At December 31, 2008, we operated 417 warehousing and distribution facilities across 34 states in the United States having approximately 9.1 million square feet of space in the aggregate of which approximately 8.7 million square feet is leased. The majority of these leases are for terms of three to five years. We believe that our facilities are generally sufficient to meet our present operating needs.

Trucks

At December 31, 2008, we operated 714 ground transport vehicles, including delivery and pick-up trucks, vans and tractors. Of this number, 471 trucks were leased and the rest were owned. We believe that the present size of our truck fleet is adequate to support our operations.

Administrative Facility

Senior management and a functional support staff are located at our corporate headquarters in Coconut Grove, Florida in approximately 6,000 square feet of owned space.

Capital Expenditures

During 2008, our capital expenditures were \$4.0 million.

**ITEM 3. LEGAL PROCEEDINGS**

In November 2007, one of our subsidiaries was named in a complaint filed in the Circuit Court of the Seventh Judicial Circuit, in and for, Volusia County, Florida, brought by CODISCO, Inc. and CODISCO International, Inc. ("CODISCO"), an existing landlord of facilities leased by our subsidiary. CODISCO alleged that eleven former and existing leased premises were not properly maintained and that our subsidiary failed to perform the necessary repairs breaching the lease agreements. During January 2009, an Order of Joint Stipulation for Voluntary Dismissal with Prejudice regarding this complaint was granted.

We are 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 or 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 impact to our financial condition or results of operations.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

No matters were submitted to a vote of security holders during the fourth quarter of the year ended December 31, 2008.

**PART II**

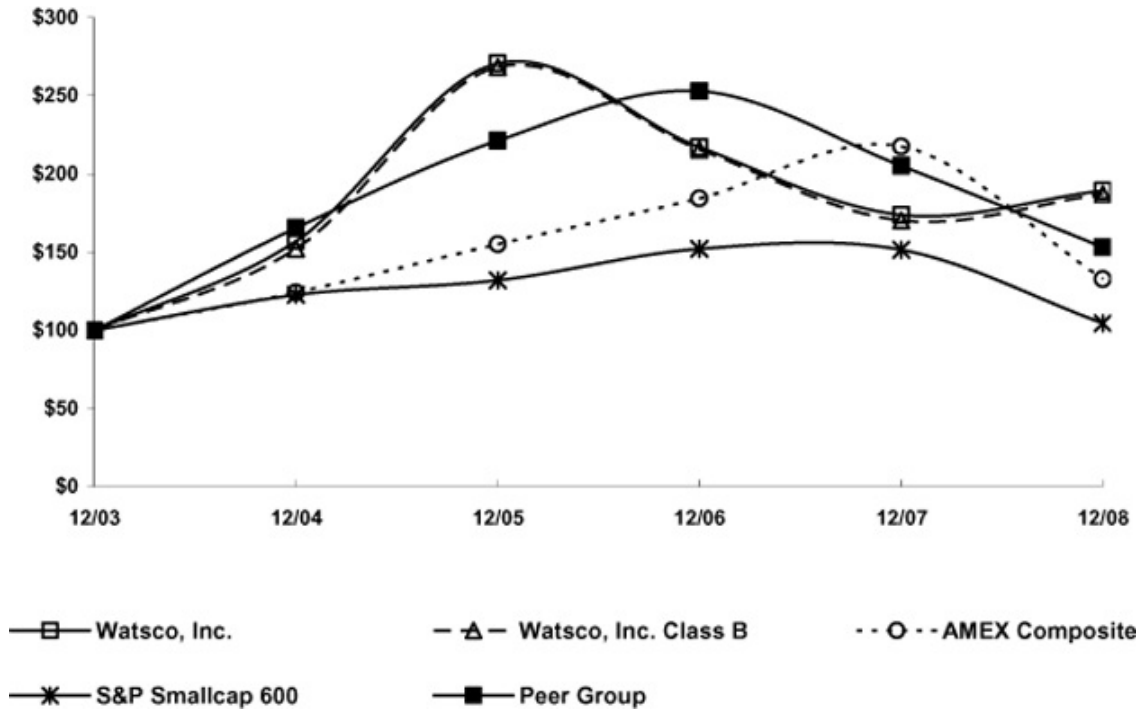
**ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

Page 43 of the 2008 Annual Report contains "Information on Common Stock," which identifies the market on which our common stocks are being traded and contains the high and low sales prices and dividend information for the years ended December 31, 2008 and 2007, and is incorporated herein by reference.

**Performance Graph**

The following graph compares the cumulative five-year total return attained by shareholders on our Common stock and Class B common stock relative to the cumulative total returns of the AMEX Composite index, the S&P SmallCap 600 index and a customized peer group of companies, which are: Beacon Roofing Supply, Inc., Interline Brands, Inc., Lennox International Inc., Pool Corp and WESCO International, Inc. An investment of \$100 (with reinvestment of all dividends) is assumed to have been made in our common stock, in each index and in the peer group on 12/31/03 and its relative performance is tracked through 12/31/08.

**COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN\***  
**Among Watsco, Inc., the AMEX Composite Index, the S&P SmallCap 600 Index and**  
**a Peer Group**



	12/03	12/04	12/05	12/06	12/07	12/08
Watsco, Inc.	100.00	157.14	270.78	217.14	173.85	189.41
Watsco, Inc. Class B	100.00	152.15	268.41	215.57	170.19	187.23
AMEX Composite	100.00	124.13	155.00	184.30	217.52	132.72
S&P SmallCap 600	100.00	122.65	132.07	152.04	151.58	104.48
Peer Group	100.00	165.34	221.42	253.08	205.27	152.99

\* The stock price performance included in this graph is not necessarily indicative of future stock price performance.

[Table of Contents](#)

**Purchases of Equity Securities by the Issuer and Affiliated Purchasers**

The following table provides information for the quarter ended December 31, 2008 with respect to any purchase made by or on behalf of Watsco or any affiliated purchaser of shares of any class of Watsco equity securities:

<u>Period</u>	<u>Issuer Purchases of Equity Securities</u>			<u>Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs (at end of period)(1)</u>
	<u>Total Number of Shares Purchased</u>	<u>Average Price Paid per Share</u>	<u>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</u>	
October 1 – 31, 2008	70,400	\$ 44.66	70,400	1,129,087
November 1 – 30, 2008	—	—	—	—
December 1 – 31, 2008	—	—	—	—
Total	70,400	\$ 44.66	70,400	1,129,087

- (1) Our Board of Directors has authorized the repurchase (originally adopted in September 1999), at management's discretion, of 7.5 million shares of common stock to be repurchased in the open market or via private transactions. Through December 31, 2008, 6.4 million shares of Common and Class B common stock have been repurchased at a cost of \$114.4 million since the inception of the program. The remaining 1.1 million shares authorized for repurchase are subject to certain restrictions included in our debt agreement.

**Recent Sales of Unregistered Securities**

No sales of unregistered securities were made during the fourth quarter of the year ended December 31, 2008.

**Dividends**

Cash dividends of \$1.75 per share, \$1.31 per share and \$0.95 per share of Common stock and Class B common stock were paid in 2008, 2007 and 2006, respectively. Future dividends will be at the sole discretion of the Board of Directors and will depend upon such factors as profitability, financial condition, cash requirements, restrictions existing under our debt agreement, future prospects and other factors deemed relevant by our Board of Directors.

**ITEM 6. SELECTED FINANCIAL DATA**

Page 44 of the 2008 Annual Report contains "Selected Consolidated Financial Data" and is incorporated herein by reference.

**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

Pages 10 through 17 of the 2008 Annual Report contain "Management's Discussion and Analysis of Financial Condition and Results of Operations" and are incorporated herein by reference.

**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Page 16 of the 2008 Annual Report contains "Quantitative and Qualitative Disclosures about Market Risk" and is incorporated herein by reference.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

Pages 21 through 41 of the 2008 Annual Report contain the 2008 and 2007 Consolidated Balance Sheets and other consolidated financial statements for the years ended December 31, 2008, 2007 and 2006, together with the report thereon of Grant Thornton LLP dated February 27, 2009, and is incorporated herein by reference.

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[Table of Contents](#)

Page 42 of the 2008 Annual Report contains “Selected Quarterly Financial Data” for 2008 and 2007 and is incorporated herein by reference.

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

There were no disagreements with accountants on accounting or financial disclosures during the last three fiscal years.

**ITEM 9A. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures**

We performed an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. This evaluation was performed under the supervision and with the participation of management, including our Chief Executive Officer, Senior Vice President and Chief Financial Officer. Based upon that evaluation, our Chief Executive Officer, Senior Vice President and Chief Financial Officer concluded that our disclosure controls and procedures are effective. Disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934 is accumulated and communicated to management, including our Chief Executive Officer, Senior Vice President and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure and are effective to provide reasonable assurance that such information is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms.

**Management’s Report on Internal Control over Financial Reporting**

Pages 18 and 19 of the 2008 Annual Report contain “Management’s Report on Internal Control over Financial Reporting” and the report thereon of Grant Thornton LLP dated February 27, 2009, and is incorporated herein by reference .

**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 have been 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 December 31, 2008, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**ITEM 9B. OTHER INFORMATION**

None.

**PART III**

This part of Form 10-K, which includes Items 10 through 14, is omitted because we will file definitive proxy material pursuant to Regulation 14A not more than 120 days after the close of our year-end, which proxy material will include the information required by Items 10 through 14 and is incorporated herein by reference.

**PART IV**

**ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

	<u>Page No. in Annual Report</u>
(1) Consolidated Financial Statements (incorporated by reference from the 2008 Annual Report of Watsco, Inc.):	
<a href="#">Management’s Report on Internal Control Over Financial Reporting</a>	18
<a href="#">Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting – Grant Thornton LLP</a>	19
<a href="#">Report of Independent Registered Public Accounting Firm on the Financial Statements – Grant Thornton LLP</a>	20
<a href="#">Consolidated Statements of Income for the years ended December 31, 2008, 2007 and 2006</a>	21
<a href="#">Consolidated Balance Sheets as of December 31, 2008 and 2007</a>	22
<a href="#">Consolidated Statements of Shareholders’ Equity for the years ended December 31, 2008, 2007 and 2006</a>	23

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[Table of Contents](#)

	<u>Page No. in Annual Report</u>
<a href="#">Consolidated Statements of Cash Flows for the years ended December 31, 2008, 2007 and 2006</a>	24
<a href="#">Notes to Consolidated Financial Statements</a>	25-41
<a href="#">Selected Quarterly Financial Data (Unaudited)</a>	42
	<u>Page No. in Form 10-K</u>
(2) Consolidated Financial Statement Schedule for the three years ended December 31, 2008, 2007 and 2006	
<a href="#">Report of Independent Registered Public Accounting Firm on Schedule – Grant Thornton LLP</a>	S-1
<a href="#">Schedule II Valuation and Qualifying Accounts</a>	S-2
All other schedules have been omitted since the required information is not present, or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the consolidated financial statements or notes thereto.	
(3) Exhibits: The following list of exhibits includes exhibits submitted with this Form 10-K as filed with the SEC and those incorporated by reference to other filings.	
3.1 Watsco’s Amended and Restated Articles of Incorporation (filed as Exhibit 3.1 to the Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2001 and incorporated herein by reference).	
3.2 Watsco’s Bylaws (filed as Exhibit 3.2 to the Annual Report on Form 10-K for the fiscal year ended January 31, 1985 and incorporated herein by reference).	
4.1 Specimen form of Class B Common Stock Certificate (filed as Exhibit 4.6 to the Registration Statement on Form S-1 (No. 33-56646) and incorporated herein by reference).	
4.2 Specimen form of Common Stock Certificate (filed as Exhibit 4.4 to the Annual Report on Form 10-K for the fiscal year ended December 31, 1994 and incorporated herein by reference).	
10.1 Watsco, Inc. Amended and Restated 1991 Stock Option Plan (filed as Exhibit 4.23 to the Registration Statement on Form S-8 (333-82011) and incorporated herein by reference). +	
10.2 Watsco, Inc. Amended and Restated Profit Sharing Retirement Plan and Trust Agreement dated October 21, 1994 (filed as Exhibit 10.25 to the Annual Report on Form 10-K for the year ended December 31, 1994 and incorporated herein by reference). +	
10.3 Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.20 to the Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1996 and incorporated herein by reference). +*	
10.4 First Amendment dated January 1, 2001 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.13 to the Annual Report on Form 10-K for the year ended December 31, 2000 and incorporated herein by reference). +*	
10.5 Second Amendment dated January 1, 2002 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.15 to the Annual Report on Form 10-K for the year ended December 31, 2001 and incorporated herein by reference). +*	
10.6 Third Amendment dated January 1, 2003 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.11 to the Annual Report on Form 10-K for the year ended December 31, 2002 and incorporated herein by reference). +*	



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[Table of Contents](#)

- 10.7 Fourth Amendment dated January 1, 2004 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.1 to the Quarterly Report on Form 10-Q for the period ended March 31, 2004 and incorporated herein by reference). +\*
- 10.8 Revolving Credit Agreement dated as of December 10, 2004 among Watsco, Inc., as borrower, the Lenders from Time to Time Party and SunTrust Bank as administrative agent (filed as Exhibit 10.1 to the Current Report on Form 8-K on December 16, 2004 and incorporated herein by reference).
- 10.9 Second Amended and Restated \$125 million Private Shelf Agreement dated as of December 10, 2004 by and among Watsco, Inc. and the Prudential Insurance Company of America (filed as Exhibit 10.14 to the Annual Report on Form 10-K for the year ended December 31, 2004 and incorporated herein by reference).
- 10.10 Fifth Amendment dated January 1, 2005 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.1 to the Quarterly Report on Form 10-Q for the period ended March 31, 2005 and incorporated herein by reference). +\*
- 10.11 Amendment No. 1 to Revolving Credit Agreement dated as of December 1, 2005 among Watsco, Inc., as borrower, the Lenders from Time to Time Party and SunTrust Bank as administrative agent (filed as Exhibit 10.13 to the Annual Report on Form 10-K for the year ended December 31, 2005 and incorporated herein by reference).
- 10.12 Amendment to the Watsco, Inc. Profit Sharing Retirement Plan and Trust dated January 1, 2006 (filed as Exhibit 10.15 to the Annual Report on Form 10-K for the year ended December 31, 2005 and incorporated herein by reference). +
- 10.13 Sixth Amendment dated January 1, 2006 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.16 to the Annual Report on Form 10-K for the year ended December 31, 2005 and incorporated herein by reference). +\*
- 10.14 Watsco, Inc. 2001 Incentive Compensation Plan (filed as Exhibit I to the Definitive Proxy Statement for the year ended December 31, 2005 and incorporated herein by reference). +
- 10.15 Seventh Amendment dated January 1, 2007 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.18 to the Annual Report on Form 10-K for the year ended December 31, 2006 and incorporated herein by reference). +\*
- 10.16 Third Amended and Restated 1996 Qualified Employee Stock Purchase Plan dated February 27, 2007 (filed as Exhibit 1 to the Definitive Proxy Statement for the year ended December 31, 2006 and incorporated herein by reference). +
- 10.17 Revolving Credit Agreement, dated as of August 3, 2007, by and among Watsco, Inc., as Borrower, the Lenders From Time to Time Party Thereto, Bank of America, N.A., as Administrative Agent (filed as Exhibit 10.1 to the Current Report on Form 8-K on August 6, 2007 and incorporated herein by reference).
- 10.18 Eighth Amendment dated January 1, 2008 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.1 to the Quarterly Report on Form 10-Q for the period ended March 31, 2008 and incorporated herein by reference). +\*
- 10.19 Ninth Amendment dated December 10, 2008 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad. #+\*
- 13 2008 Annual Report to Shareholders (with the exception of the information incorporated by reference into Items 1, 5, 6, 7 and 8 of this Form 10-K, the 2008 Annual Report to Shareholders is provided solely for the information of the SEC and is not deemed “filed” as part of this Form 10-K). #
- 14.1 Watsco, Inc. Employee Code of Business Ethics and Conduct (filed as Appendix C to the Definitive Proxy Statement on Schedule 14A for the year ended December 31, 2002).
- 14.2 Watsco, Inc. Code of Conduct for Senior Executives (filed as Appendix D to the Definitive Proxy Statement on Schedule 14A for the year ended December 31, 2002).
- 21 Subsidiaries of the Registrant. #
- 23.1 Consent of Independent Registered Public Accounting Firm – Grant Thornton LLP. #

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[Table of Contents](#)

- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. #
- 31.2 Certification of Senior Vice President pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. #
- 31.3 Certification of Chief Financial Officer 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 Section 906 of the Sarbanes-Oxley Act of 2002. #

Note to Exhibits:

- # Submitted electronically herewith
- + Compensation plan or arrangement
- \* Management contract

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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.

February 27, 2009

By: /s/ Albert H. Nahmad  
Albert H. Nahmad, President

February 27, 2009

By: /s/ Ana M. Menendez  
Ana M. Menendez, Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

<u>SIGNATURE</u>	<u>TITLE</u>	<u>DATE</u>
<u>/S/ ALBERT H. NAHMAD</u> <b>Albert H. Nahmad</b>	Chairman of the Board and Chief Executive Officer (principal executive officer)	February 27, 2009
<u>/S/ BARRY S. LOGAN</u> <b>Barry S. Logan</b>	Senior Vice President	February 27, 2009
<u>/S/ ANA M. MENENDEZ</u> <b>Ana M. Menendez</b>	Chief Financial Officer (principal accounting officer and principal financial officer)	February 27, 2009
<u>/S/ CESAR L. ALVAREZ</u> <b>Cesar L. Alvarez</b>	Director	February 27, 2009
<u>/S/ ROBERT L. BERNER III</u> <b>Robert L. Berner III</b>	Director	February 27, 2009
<u>/S/ DENISE DICKINS</u> <b>Denise Dickins</b>	Director	February 27, 2009
<u>/S/ FREDERICK H. JOSEPH</u> <b>Frederick H. Joseph</b>	Director	February 27, 2009
<u>/S/ PAUL F. MANLEY</u> <b>Paul F. Manley</b>	Director	February 27, 2009
<u>/S/ BOB L. MOSS</u> <b>Bob L. Moss</b>	Director	February 27, 2009
<u>/S/ GEORGE P. SAPE</u> <b>George P. Sape</b>	Director	February 27, 2009
<u>/S/ GARY L. TAPELLA</u> <b>Gary L. Tapella</b>	Director	February 27, 2009

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Shareholders of  
Watsco, Inc.

We have audited in accordance with the standards of the Public Company Accounting Oversight Board (United States) the consolidated financial statements of Watsco, Inc. and subsidiaries (the "Company") referred to in our report dated February 27, 2009, which is included in the 2008 Annual Report of Watsco, Inc. and incorporated by reference in Item 15 (1) of this Form 10-K. Our audits of the basic consolidated financial statements included the financial statement schedule listed in the index appearing under Item 15 (2), which is the responsibility of the Company's management. In our opinion, this financial statement schedule when considered in relation to the consolidated basic financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

/s/ GRANT THORNTON LLP

Miami, Florida  
February 27, 2009

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[Table of Contents](#)

WATSCO, INC. AND SUBSIDIARIES  
SCHEDULE II-VALUATION AND QUALIFYING ACCOUNTS  
For the Years Ended December 31, 2008, 2007 and 2006  
(In thousands)

**Allowance for Doubtful Accounts:**

BALANCE, December 31, 2005	\$ 2,844
Additions charged to costs and expenses	3,484
Write-offs, net	<u>(3,252)</u>
BALANCE, December 31, 2006	3,076
Additions charged to costs and expenses	3,086
Write-offs, net	<u>(1,019)</u>
BALANCE, December 31, 2007	5,143
Additions charged to costs and expenses	3,816
Write-offs, net	<u>(5,018)</u>
BALANCE, December 31, 2008	<u>\$ 3,941</u>

**Exhibit Index**

<u>Exhibit Number</u>	<u>Description</u>
10.19	Ninth Amendment dated December 10, 2008 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad.
13	2008 Annual Report to Shareholders (with the exception of the information incorporated by reference into Items 1, 5, 6, 7 and 8 of this Form 10-K, the 2008 Annual Report to Shareholders is provided solely for the information of the SEC and is not deemed “filed” as part of this Form 10-K).
21	Subsidiaries of the Registrant.
23.1	Consent of Independent Registered Public Accounting Firm – Grant Thornton LLP.
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Senior Vice President pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.3	Certification of Chief Financial Officer 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 Section 906 of the Sarbanes-Oxley Act of 2002.

**NINTH AMENDMENT  
TO  
EMPLOYMENT AGREEMENT**

This Ninth Amendment to Employment Agreement is made and entered into effective as of December 10, 2008, by and between **WATSCO, INC.**, a Florida corporation (hereinafter called the "Company"), and **ALBERT H. NAHMAD** (hereinafter called the "Employee").

**RECITALS**

**WHEREAS**, the Company and the Employee entered into an Employment Agreement effective as of January 31, 1996 (the "Employment Agreement") pursuant to which the Employee renders certain services to the Company; and

**WHEREAS**, the Compensation Committee of the Company's Board of Directors amended the Employment Agreement effective as of January 1, 2001, January 1, 2002, January 1, 2003, January 1, 2004, January 1, 2005, January 1, 2006, January 1, 2007 and January 1, 2008; and

**WHEREAS**, the Company and the Employee now desire to amend the Employment Agreement to make certain modifications thereunder.

**NOW, THEREFORE**, in consideration of the mutual promises and covenants set forth in this Ninth Amendment, and other good and valuable consideration, the parties to this Ninth Amendment agree as follows:

1. All capitalized terms in this Ninth Amendment shall have the same meaning as in the Employment Agreement, unless otherwise specified.
2. Section 6 of the Employment Agreement is hereby amended to read as follows:

**"6. EXPENSE REIMBURSEMENT.**

Upon submission of proper proof of payment by Employee, the Company will reimburse him for all reasonable expenditures for business travel or entertainment made by him in the course of and pursuant to the business of the Company, and reimbursements of any amounts that may be taxable to Employee are to be made prior to the end of the year following the year in which the expenses are incurred."

3. Paragraph B of Section III to Exhibit A of the Employment Agreement is hereby amended to read as follows:

***"B. Payment of Performance Based Compensation.*** Performance Based Compensation shall be paid to the Executive on or before the March 15<sup>th</sup> that immediately follows the end of the year for which it is payable and the Compensation Committee shall certify that the performance goals have been met prior to such payment."

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4. All other terms and conditions of the Employment Agreement shall remain the same.

**IN WITNESS WHEREOF**, the parties have caused this Ninth Amendment to be duly executed effective as of the day and year first above written.

**COMPANY:**

WATSCO, INC.

By: /s/ Barry S. Logan

Barry S. Logan, Senior Vice President

**EMPLOYEE:**

/s/ Albert H. Nahmad

Albert H. Nahmad



**WATSCO, INC. AND SUBSIDIARIES**  
**SELECTED CONSOLIDATED FINANCIAL DATA \***

*Years Ended December 31,*

*(In thousands, except per share data)*

	2008	2007 (1)	2006 (2)	2005	2004
<b>OPERATIONS</b>					
Revenues	\$ 1,700,237	\$ 1,758,022	\$ 1,771,214	\$ 1,658,249	\$ 1,294,715
Gross profit	441,994	446,985	457,270	418,479	333,619
Operating income	98,608	111,154	135,394	117,283	84,094
Net income from continuing operations	60,369	67,489	82,233	70,528	49,370
(Loss) income from discontinued operations, net of income taxes	—	(1,912)	131	(509)	(1,265)
Net income	<u>\$ 60,369</u>	<u>\$ 65,577</u>	<u>\$ 82,364</u>	<u>\$ 70,019</u>	<u>\$ 48,105</u>

**SHARE AND PER SHARE DATA**

Diluted earnings per share for Common and Class B common stock (3):

Net income from continuing operations	\$ 2.18	\$ 2.43	\$ 2.95	\$ 2.54	\$ 1.83
Net (loss) income from discontinued operations	—	(0.07)	—	(0.02)	(0.05)
Net income	<u>\$ 2.18</u>	<u>\$ 2.36</u>	<u>\$ 2.96</u>	<u>\$ 2.52</u>	<u>\$ 1.79</u>

Cash dividends declared and paid per share:

Common stock	\$ 1.75	\$ 1.31	\$ 0.95	\$ 0.62	\$ 0.38
Class B common stock	\$ 1.75	\$ 1.31	\$ 0.95	\$ 0.62	\$ 0.38

Weighted-average Common and Class B common shares and equivalent

shares used to calculate diluted earnings per share	27,736	27,824	27,829	27,769	26,931
Common stock outstanding	<u>28,326</u>	<u>27,969</u>	<u>27,833</u>	<u>27,463</u>	<u>26,855</u>

**BALANCE SHEET INFORMATION**

Total assets	\$ 716,061	\$ 750,113	\$ 710,368	\$ 677,884	\$ 607,209
Long-term obligations	20,783	55,042	30,118	40,189	50,155
Shareholders' equity	<u>570,660</u>	<u>549,957</u>	<u>516,386</u>	<u>450,650</u>	<u>402,738</u>

\* On July 19, 2007, we divested of our non-core staffing unit. All amounts related to this operation are restated as discontinued operations for all periods presented consistent with the 2007 presentation.

- (1) Effective January 1, 2007, we adopted the provisions of Financial Accounting Standards Board Interpretation No. 48, "Accounting for Uncertainty in Income Taxes."
- (2) Effective January 1, 2006, the provisions of Statement of Financial Accounting Standards No. 123R, "Share-Based Payment," were adopted using the modified prospective transition method.
- (3) Earnings per Common and Class B common share are calculated on an individual basis and, because of rounding, the summation of earnings from continuing operations and earnings (loss) from discontinued operations may not equal the amount calculated for earnings as a whole.

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**WATSCO, INC. AND SUBSIDIARIES**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS OF**  
**FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following information should be read in conjunction with the information contained in Item 1A, "Risk Factors" and the consolidated financial statements included under Item 8, "Financial Statements and Supplementary Data" of this Annual Report on Form 10-K.

**Company Overview**

Watsco, Inc. and its subsidiaries (collectively, "Watsco," which may be referred to as *we*, *us* or *our*) was incorporated in 1956 and is the largest independent distributor of air conditioning, heating and refrigeration equipment and related parts and supplies ("HVAC/R") in the United States. We operate from 417 locations in 34 states at December 31, 2008.

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 tend to be variable in nature 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 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 the severity or mildness of weather patterns during summer or winter selling seasons. Demand related to the residential central air conditioning replacement market is highest in the second and third quarters with demand for heating equipment usually highest in the fourth quarter. Demand related to the new construction sectors throughout most of the markets is fairly even during the year except for dependence on housing completions and related weather and economic conditions.

**Critical Accounting Policies**

Management's discussion and analysis of financial condition and results of operations is based upon the consolidated financial statements, 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 consolidated 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 significant accounting policies are discussed in Note 1 to the consolidated financial statements. Management believes that the following accounting policies include a higher degree of judgment and/or complexity and, thus, are considered to be critical accounting policies. Management has discussed the development and selection of critical accounting policies with the Audit Committee of the Board of Directors and the Audit Committee has reviewed the disclosures relating to them.

**Allowance for Doubtful Accounts**

An allowance for doubtful accounts is maintained for estimated losses resulting from the inability of customers to make required payments. Accounting for doubtful accounts contains uncertainty because management must use judgment to assess the collectability of these accounts. When preparing these estimates, management considers a number of factors, including the aging of a customer's account, past transactions with customers, creditworthiness of specific customers, historical trends and other information. Our business is seasonal and our customers' businesses are also seasonal. Sales are lowest during the first and fourth quarters and past due accounts receivable balances as a percentage of total trade receivables generally increase during these quarters. We review our accounts receivable reserve policy periodically, reflecting current risks, trends and changes in industry conditions.

The allowance for doubtful accounts was \$3.9 million and \$5.1 million at December 31, 2008 and 2007, respectively, a decrease of \$1.2 million. The decrease from December 31, 2007 is primarily due to the decrease in net sales coupled with an improvement in the

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underlying quality of our accounts receivable portfolio at December 31, 2008. Accounts receivable balances greater than 90 days past due as a percent of accounts receivable at December 31, 2008 decreased to 3.4% compared to 3.7% at December 31, 2007. This decrease is attributable to lower net sales and an increase in write-offs. Accounts receivable net write-offs as a percent of sales increased for the year ended December 31, 2008 to .3% compared to .06% for the year ended December 31, 2007. This was primarily the result of higher write-offs and bad debt expense in 2008.

Although we believe the allowance for doubtful accounts is sufficient, the continuing declining economic conditions could lead to further deterioration in the financial condition of customers, resulting in an impairment of their ability to make payments and additional allowances may be required that could materially impact our consolidated results of operations. Concentrations of credit risk with respect to accounts receivable are limited due to the large number of customers comprising the customer base and their dispersion across many different geographical regions. We also have access to a credit insurance program which is used as an additional means to mitigate credit risk.

#### Inventory Valuation

Inventories consist of air conditioning, heating and refrigeration equipment and related parts and supplies and are valued at the lower of cost or market on a weighted-average cost basis. As part of the valuation process, inventory reserves are established to state excess, slow-moving and damaged inventories at their estimated net realizable value. The valuation process for excess, slow-moving and damaged inventory contains uncertainty because management must use judgment to estimate when the inventory will be sold and the quantities and prices at which the inventory will be sold in the normal course of business. Inventory reserve policies are periodically reviewed, reflecting current risks, trends and changes in industry conditions. A reserve for estimated inventory shrinkage is also maintained and reflects the results of cycle count programs and physical inventories. When preparing these estimates, management considers historical results, inventory levels and current operating trends.

Inventory reserves of \$5.0 million and \$6.3 million at December 31, 2008 and 2007, respectively, have been established. The decrease in inventory reserves is primarily due to reduced levels of excess and slow-moving inventory on hand at December 31, 2008 compared to December 31, 2007, which is attributed to improved inventory management. Inventory reserves are affected by a number of factors, including general economic conditions and other factors affecting demand as well as the effectiveness of the inventory management process for controlling inventory shrinkage. In the event the estimates differ from actual results, inventory-related reserves may be adjusted and could materially impact the consolidated results of operations.

#### Valuation of Goodwill and Indefinite Life Intangible Assets

The recoverability of goodwill and indefinite life intangibles is evaluated at least annually and when events or changes in circumstances indicate that the carrying amount of goodwill and indefinite life intangibles may not be recoverable. The identification and measurement of goodwill impairment involves the estimation of the fair value of our reporting unit and contains uncertainty because management must use judgment in determining appropriate assumptions to be used in the measurement of fair value. Indefinite life intangibles not subject to amortization are assessed for impairment by comparing the fair value of the intangible asset to its carrying amount to determine if a write-down to fair value is required. The estimates of fair value of the reporting unit and indefinite life intangibles are based on the best information available as of the date of the assessment and incorporate management assumptions about expected future cash flows and contemplate other valuation techniques. Future cash flows can be affected by changes in the industry, the continuing declining economic environment or market conditions.

On January 1, 2009, the annual impairment tests were performed and it was determined there was no impairment. No factors have developed since the last impairment tests that would indicate that the carrying value of goodwill and indefinite life intangibles may not be recoverable. The carrying amount of goodwill and intangibles at December 31, 2008 was \$230.5 million. Although no impairment has been recorded to date, there can be no assurances that future impairments will not occur. An adjustment to the carrying value of goodwill and intangibles could materially impact the consolidated results of operations.

#### Self-Insurance Reserves

Self-insurance reserves are maintained for company-wide casualty insurance programs and for one subsidiary's health benefit program. 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 occurs and exceed these estimates, additional reserves may be required that could materially impact the consolidated results of operations. The estimation process contains uncertainty since management must use judgment to estimate the ultimate cost that will be incurred to settle reported claims and unreported claims for incidents incurred but not reported as of the balance sheet date. Reserves in the amount of \$3.9 million and \$4.6 million at December 31, 2008 and 2007, respectively, were established related to such insurance programs. The decrease in the self-insurance reserves reflects the settlement (close-out) of the 2003 policy year with our carrier as well as an improvement in the frequency and severity of claims experience during 2008.

#### Income Taxes

Income taxes are accounted for under the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial reporting basis and the tax basis of assets and liabilities at enacted tax rates expected to be in effect when such amounts are recovered or settled. The use of estimates by management is required to determine income tax expense, deferred tax assets and any related valuation allowance and deferred tax liabilities. The valuation allowance is based on estimates of future taxable income by jurisdiction in which the deferred tax assets will be recoverable. These estimates can be affected by a number of factors, including possible tax audits or general economic conditions or competitive pressures that could affect future taxable income. Although management believes that the estimates are reasonable, the deferred tax asset and any related valuation allowance will need to be adjusted if management's estimates of future taxable income differ from actual taxable income. An adjustment to the deferred tax asset and any related valuation allowance could materially impact the consolidated results of operations. At December 31, 2008 and 2007, there was no valuation allowance recorded.

#### Discontinued Operations

During June 2007, our Board of Directors approved and we executed an agreement to sell the stock of our non-core staffing unit, Dunhill Staffing Systems, Inc. ("Dunhill"). The transaction closed on July 19, 2007. The amounts related to this operation are presented as discontinued operations in our consolidated statements of income and our consolidated statements of cash flows for all periods presented. See Note 13 to the consolidated financial statements for further information.

#### Results of Operations

The following table summarizes information derived from the consolidated statements of income expressed as a percentage of revenues for the years ended December 31, 2008, 2007 and 2006:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Revenues	100.0%	100.0%	100.0%
Cost of sales	<u>74.0</u>	<u>74.6</u>	<u>74.2</u>
Gross profit	26.0	25.4	25.8
Selling, general and administrative expenses	<u>20.2</u>	<u>19.1</u>	<u>18.2</u>
Operating income	5.8	6.3	7.6
Interest expense, net	<u>0.1</u>	<u>0.2</u>	<u>0.2</u>
Income from continuing operations before income taxes	5.7	6.1	7.4
Income taxes	<u>2.1</u>	<u>2.3</u>	<u>2.8</u>
Net income from continuing operations	3.6	3.8	4.6
(Loss) income from discontinued operations, net of income taxes	<u>—</u>	<u>(0.1)</u>	<u>0.1</u>
Net income	<u>3.6%</u>	<u>3.7%</u>	<u>4.7%</u>

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The following narratives include the results of operations for businesses acquired during 2007 and 2006. The operating results of the acquisitions have been included in the consolidated results beginning on their respective dates of acquisition. The proforma effect of acquisitions, excluding ACR Group, Inc. (“ACR”), was not deemed significant on either an individual or an aggregate basis in the related acquisition year. There were no businesses acquired during 2008. 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 prior twelve months unless they are within close geographical proximity to existing locations. Additionally, the following narratives include the results of operations of our continuing operations only and exclude the results of our discontinued operation, Dunhill.

## **2008 Compared to 2007**

### Revenues

Revenues in 2008 decreased \$57.8 million, or 3%, as compared to 2007, including a \$133.4 million contribution from locations acquired and opened during the last 12 months, offset by \$13.6 million from closed locations. On a same-store basis, revenues declined \$177.6 million, or 10.2%, over 2007 and reflected a decline of 10% in sales of HVAC equipment, an 11% decline in sales of other HVAC products and a 5% decline in sales of refrigeration products. Revenues in 2008 were impacted by significantly lower demand in the new construction market.

### Gross Profit

Gross profit in 2008 decreased \$5.0 million, or 1%, as compared to 2007. Gross profit margin improved 60 basis-points to 26.0% in 2008 from 25.4% in 2007 and improved 70 basis-points on a same-store basis. The expansion of gross profit margin is primarily due to increased sales of high-efficiency air conditioning systems, an improved sales mix to the repair and replacement market and execution on gross profit margin enhancement initiatives.

### Selling, General and Administrative Expenses

Selling, general and administrative expenses in 2008 increased \$7.6 million, or 2%, over 2007. Selling, general and administrative expenses as a percent of revenues increased to 20.2% in 2008 from 19.1% in 2007 primarily as a result of lower same-store revenues and the relative inefficiency of fixed operating costs following a decline in revenues. On a same-store basis, including locations closed during 2008, selling, general and administrative expenses decreased 6% compared to 2007 primarily due to decreases in selling expenses related to our decreased revenues, other cost reductions and efficiency initiatives including facility rationalization and headcount reductions and lower incentive-based compensation as a result of our decreased revenues.

### Interest Expense, Net

Net interest expense in 2008 decreased \$1.2 million, or 36%, compared to 2007, primarily due to a 24% decrease in average outstanding borrowings and a lower effective interest rate.

### Income Taxes

The effective tax rate was 37.5% in 2008 and 2007.

### Net Income from Continuing Operations

Net income from continuing operations for 2008 decreased \$7.1 million, or 11%, compared to 2007. The decrease in net income from continuing operations was primarily a result of lower revenues.

## **2007 Compared to 2006**

### Revenues

Revenues in 2007 decreased \$13.2 million, or 1%, as compared to 2006, including a \$121.2 million contribution from locations acquired and opened during the last 12 months, offset by \$.5 million from closed locations. On a same-store basis, revenues declined \$133.9 million, or 7.6%, over 2006 and reflected a decline of 5% in sales of HVAC equipment and an 11% decrease in the sale of other HVAC products, primarily related to a decline in sales to the new construction market, partially offset by a 10% increase in sales of refrigeration products.

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### Gross Profit

Gross profit in 2007 decreased \$10.3 million, or 2%, as compared to 2006, primarily as a result of decreased revenues. Gross profit margin declined 40 basis-points to 25.4% in 2007 from 25.8% in 2006, resulting from a shift in sales mix to a higher proportion of lower-margin HVAC equipment, lower margins on copper-based products that are sensitive to changes in commodity prices and generally more competitive pricing conditions.

### Selling, General and Administrative Expenses

Selling, general and administrative expenses in 2007 increased \$14.0 million, or 4%, over 2006. Selling, general and administrative expenses as a percent of revenues increased to 19.1% in 2007 from 18.2% in 2006 primarily as a result of lower same-store revenues and the relative inefficiency of fixed operating costs following a decline in revenues. On a same-store basis, selling, general and administrative expenses decreased 4% compared to 2006 primarily due to decreases in selling expenses related to our decreased revenues and lower incentive-based compensation.

### Interest Expense, Net

Net interest expense in 2007 decreased \$.6 million, or 17%, compared to 2006, primarily due to a 9% decrease in average outstanding borrowings and a lower effective interest rate.

### Income Taxes

The effective tax rate was 37.5% in 2007 and 2006.

### Net Income from Continuing Operations

Net income from continuing operations for 2007 decreased \$14.7 million, or 18%, compared to 2006. The decrease in net income from continuing operations was primarily driven by the lower revenues and lower gross profit margin 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 of HVAC/R products, which peak in the months of May through August. Significant factors which could affect our liquidity include the following:

- cash flows generated from operating activities;
- the adequacy of available bank lines of credit;
- the ability to attract long-term capital with satisfactory terms;
- acquisitions;
- dividend payments;
- the timing and extent of common stock repurchases; and
- capital expenditures.

We rely on cash flows from operations and our line of credit to fund seasonal working capital needs, financial commitments and short-term liquidity needs, including funds necessary for business acquisitions. Disruptions in the capital and credit markets, such as has been experienced during 2008, could adversely affect our ability to draw on our line of credit. Our access to funds under the line of credit is dependent on the ability of the banks to meet their funding commitments. Recent disruptions in capital and credit markets have also affected the determination of interest rates for borrowers, particularly rates based on LIBOR, as is our line of credit. Continued disruptions in these markets and their affect on interest rates could result in increased borrowing costs under our line of credit. We believe that, at present, cash flows from operations combined with those available under our line of credit are sufficient to satisfy our current liquidity needs, including our anticipated dividend payments and capital expenditures.

### Overview

Cash flows provided by operating activities supply us with a significant source of liquidity. Our cash flows from operating activities of continuing operations were \$113.5 million in 2008 compared to \$106.8 million in 2007. The increase in operating cash flows resulted primarily from lower reductions in accounts payable and other liabilities in 2008 compared to 2007, partially offset by lower reductions in inventories in 2008 compared to 2007.

Net cash used in investing activities of continuing operations decreased to \$3.7 million in 2008 from \$108.0 million in 2007. The decrease is primarily due to businesses acquired in 2007 for cash consideration of \$109.0 million and a \$2.1 million decrease in capital expenditures, partially offset by \$3.3 million in proceeds from the 2007 sale of Dunhill and \$3.3 million in net proceeds from the sale of marketable securities realized in 2007.

Net cash used in financing activities increased to \$77.8 million in 2008 from \$24.9 million in 2007. The increase is primarily attributable to \$48.0 million of net debt repayments and an increase of \$12.6 million in dividends paid partially offset by a reduction of \$4.6 million of stock repurchases in 2008.

Working capital decreased to \$348.9 million at December 31, 2008 from \$359.8 million at December 31, 2007.

#### Revolving Credit Agreement

We maintain a bank-syndicated, unsecured revolving credit agreement that provides for borrowings of up to \$300.0 million. Borrowings are used to fund seasonal working capital needs and for other general corporate purposes, including acquisitions, dividends, stock repurchases and issuances of letters of credit. The credit facility matures in August 2012. At December 31, 2008 and 2007, \$20.0 million and \$54.0 million, respectively, were outstanding under the revolving credit agreement.

The revolving credit agreement contains customary affirmative and negative covenants including two financial covenants with respect to consolidated leverage and interest coverage ratios and limits capital expenditures, dividends and share repurchases in addition to other restrictions. We were in compliance with all covenants and financial ratios at December 31, 2008.

#### Contractual Obligations and Off-Balance Sheet Arrangements

As of December 31, 2008, our significant contractual obligations were as follows (in millions):

Contractual Obligations	Payments due by Period						
	2009	2010	2011	2012	2013	Thereafter	Total
Non-cancelable operating lease obligations	\$ 46.3	\$ 36.7	\$ 26.9	\$ 18.7	\$ 12.1	\$ 14.7	\$ 155.4
Minimum royalty payments	1.0	1.0	1.0	—	—	—	3.0
Other debt	0.3	0.2	0.1	0.1	—	0.4	1.1
Total Contractual Obligations	\$ 47.6	\$ 37.9	\$ 28.0	\$ 18.8	\$ 12.1	\$ 15.1	\$ 159.5

Commercial obligations outstanding at December 31, 2008 under the revolving credit agreement consist of borrowings totaling \$20.0 million and standby letters of credit totaling \$4.6 million. Borrowings under the revolving credit agreement at December 31, 2008 had revolving maturities of 30 days and letters of credit had varying terms expiring through January 2010.

Standby letters of credit are primarily used as collateral under self-insurance programs and are not expected to result in any material losses or obligation as the obligations under the programs will be met in the ordinary course of business. Accordingly, the estimated fair value of these instruments is zero at December 31, 2008. See Note 10 to the consolidated financial statements for further information.

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## Company Share Repurchase Program

In September 1999, our Board of Directors authorized the repurchase, at management's discretion, of 7.5 million 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. Repurchases totaled 105,600 shares at a cost of \$4.8 million in 2008, 231,100 shares at a cost of \$9.4 million in 2007 and 243,600 shares at a cost of \$15.3 million in 2006. In aggregate, 6.4 million shares of Common stock and Class B common stock have been repurchased at a cost of \$114.4 million since the inception of the program. The remaining 1.1 million shares authorized for repurchase are subject to certain restrictions included in our debt agreement.

## Common Stock Dividends

Cash dividends of \$1.75 per share, \$1.31 per share and \$0.95 per share of Common stock and Class B common stock were paid in 2008, 2007 and 2006, respectively. In February 2009, the Board of Directors approved an increase to the quarterly cash dividend rate to \$0.48 per share from \$0.45 per share of Common and Class B common stock beginning with the next regular scheduled dividend declaration in April 2009. Future dividends and/or dividend rate increases will be at the sole discretion of the Board of Directors and will depend upon such factors as profitability, financial condition, cash requirements, restrictions under our debt agreement, future prospects and other factors deemed relevant by our Board of Directors.

## Capital Resources

We believe we have adequate availability of capital from operations and our current credit facility to fund working capital requirements and support the development of our short-term and long-term operating strategies. As of December 31, 2008, we had \$41.4 million of cash and cash equivalents and \$275.4 million of additional borrowing capacity under the revolving credit agreement to fund present operations and anticipated growth, including expansion in our current and targeted market areas. Potential acquisitions are continually evaluated and discussions are conducted with a number of acquisition candidates. Should suitable acquisition opportunities or working capital needs arise that would require additional financing, we believe our financial position and earnings history provide a sufficient base for obtaining additional financing resources at competitive rates and terms or gives us the ability to raise funds through the issuance of equity securities.

## Quantitative and Qualitative Disclosures about Market Risk

The primary market risk exposure for Watsco is interest rate risk. The objective in managing the exposure to interest rate changes is to limit the impact of interest rate changes on earnings and cash flows and to lower our overall borrowing costs. To achieve this objective, interest rate swaps are used to manage net exposure to interest rate changes to our borrowings. These swaps are entered into with financial institutions with investment grade credit ratings, thereby minimizing the risk of credit loss. All items described are non-trading. See Notes 1 and 10 to the consolidated financial statements for further information.

Interest rate swap agreements reduce the exposure to market risks from changing interest rates under our revolving credit agreement. Under the swap agreements, we agree to exchange, at specified intervals, the difference between fixed and variable interest amounts calculated by reference to a notional principal amount. Any differences paid or received on interest rate swap agreements are recognized as adjustments to interest expense over the life of each swap, thereby adjusting the effective interest rate on the underlying obligation. Financial instruments are not held for trading purposes. Derivatives used for hedging purposes must be designated as, and effective as, a hedge of the identified risk exposure at the inception of the contract. Accordingly, changes in the fair value of the derivative contract must be highly correlated with changes in the fair value of the underlying hedged item at inception of the hedge and over the life of the hedge contract.

At December 31, 2008 and 2007, two interest rate swap agreements were in effect with notional amounts of \$10.0 million each, to manage the net exposure to interest rate changes related to \$20.0 million of borrowings under our revolving credit agreement. One swap agreement matures in October 2009 and exchanges the variable rate of 30-day LIBOR to a fixed interest rate of 5.04%. The other swap agreement matures in October 2011 and exchanges the variable rate of 30-day LIBOR to a fixed interest rate of 5.07%. The interest rate swaps were effective as cash flow hedges and no charge to earnings was required in 2008 and 2007.



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We were party to an interest rate swap agreement with a notional amount of \$30.0 million, which matured on October 9, 2007, that was designated as a cash flow hedge and effectively exchanged the variable rate of 90-day LIBOR to a fixed interest rate of 6.25%. During 2007 and 2006, the hedging relationship was determined to be highly effective in achieving offsetting changes in cash flows.

The negative fair value of the derivative financial instruments was \$1.3 million and \$.6 million at December 31, 2008 and 2007, respectively, and is included, net of accrued interest, in deferred income taxes and other liabilities in the consolidated balance sheets.

At December 31, 2008 and 2007, our exposure to interest rate changes was limited to variable rate lease payments which are indexed to one month LIBOR. To assess our exposure to changes in interest rates, we performed a sensitivity analysis to determine the impact to earnings associated with an immediate 100 basis-point fluctuation from one month LIBOR. Based on the results of this simulation, as of December 31, 2008 and 2007, net income would decrease or increase by approximately \$.1 million on an annual basis if there were an immediate 100 basis-point increase or decrease, respectively, in one month LIBOR. Recent disruptions in the capital and credit markets have also affected the determination of interest rates for LIBOR-based borrowers. Continued disruptions in these markets and their affect on interest rates could result in increased borrowings than our sensitivity analysis determined. This information constitutes a “forward-looking statement” and actual results may differ significantly based on actual borrowings and interest rates.

#### **Recent Accounting Pronouncements**

Refer to Note 1, “Summary of Significant Accounting Policies—Recently Adopted Accounting Standards,” in the notes to consolidated financial statements for a discussion surrounding the adoption of these accounting standards.

#### **Information about Forward-Looking Statements**

This Annual Report 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, including statements regarding, among other items, (i) economic conditions, (ii) business and acquisition strategies, (iii) potential acquisitions, (iv) financing plans and (v) industry, demographic and other trends affecting our financial condition or results of operations. These forward-looking statements are based largely on management’s current expectations and are subject to a number of risks, uncertainties and changes in circumstances, certain of which are beyond their control.

Actual results could differ materially from these forward-looking statements as a result of several factors, including:

- general economic conditions;
- effects of supplier concentration;
- competitive factors within the HVAC/R industry;
- 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;
- prevailing interest rates; and
- the continued viability of our business strategy.

In light of these uncertainties, there can be no assurance that the forward-looking information contained herein will be realized or, even if substantially realized, that the information will have the expected consequences to or effects on Watsco or its business or operations. A discussion of certain of these risks and uncertainties that could cause actual results to differ materially from those predicted in such forward-looking statements is included in our Annual Report to Shareholders for the fiscal year ended December 31, 2008 in the section captioned “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” which section has been incorporated in the Form 10-K by reference. Forward-looking statements speak only as of the date the statement was 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.

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**Corporate Governance**

On June 26, 2008, Watsco submitted to the New York Stock Exchange (“NYSE”) the annual Chief Executive Officer Certification required under Section 303A 12(a) of the NYSE Listed Company Manual. In addition, Watsco filed with the Securities and Exchange Commission the certifications required under Section 302 of the Sarbanes-Oxley Act of 2002 as Exhibits 31.1, 31.2 and 31.3 to its Annual Report on Form 10-K for the year ended December 31, 2008.

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**WATSCO, INC. AND SUBSIDIARIES**  
**MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f). Our internal control system was designed to provide reasonable assurance to our management and Board of Directors regarding the reliability of financial reporting and the preparation and fair presentation of our published consolidated financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective may not prevent or detect misstatements and can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and with the participation of our management, including our Chief Executive Officer, Senior Vice President and Chief Financial Officer, we conducted an assessment of the effectiveness of our internal control over financial reporting as of December 31, 2008. The assessment was based on criteria established in the framework *Internal Control — Integrated Framework*, issued by the Committee of Sponsoring Organizations (“COSO”) of the Treadway Commission. Based on this assessment under the COSO framework, our management concluded that our internal control over financial reporting was effective as of December 31, 2008. The effectiveness of our internal control over financial reporting as of December 31, 2008 has been audited by Grant Thornton LLP, an independent registered public accounting firm, as stated in their report that is included herein.

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## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders of  
Watsco, Inc.

We have audited Watsco, Inc. (a Florida Corporation) and subsidiaries' (the "Company") internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Watsco, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on Watsco, Inc. and subsidiaries' internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. In our opinion, Watsco, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control—Integrated Framework* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Watsco, Inc. and subsidiaries as of December 31, 2008 and 2007, and the related consolidated statements of income, cash flows, and shareholders' equity for each of the three years in the period ended December 31, 2008 and our report dated February 27, 2009 expressed an unqualified opinion on those financial statements.

/s/ GRANT THORNTON LLP

Miami, Florida  
February 27, 2009

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Shareholders of  
Watsco, Inc.

We have audited the accompanying consolidated balance sheets of Watsco, Inc. (a Florida Corporation) and subsidiaries (the “Company”) as of December 31, 2008 and 2007, and the related consolidated statements of income, cash flows, and shareholders’ equity for each of the three years in the period ended December 31, 2008. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Watsco, Inc. and subsidiaries as of December 31, 2008 and 2007, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2008 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Notes 1 and 5 to the consolidated financial statements, the Company adopted Financial Accounting Standards Board Interpretation No. 48, “Accounting for Uncertainty in Income Taxes” on January 1, 2007. As discussed in Notes 1 and 6 to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards No. 123R “Share-Based Payment” on January 1, 2006.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Watsco, Inc. and subsidiaries’ internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated February 27, 2009 expressed an unqualified opinion thereon.

/s/ GRANT THORNTON LLP

Miami, Florida  
February 27, 2009

**WATSCO, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME**

<i>(In thousands, except per share data)</i>	Years Ended December 31,		
	2008	2007	2006
Revenues	\$ 1,700,237	\$ 1,758,022	\$ 1,771,214
Cost of sales	1,258,243	1,311,037	1,313,944
Gross profit	441,994	446,985	457,270
Selling, general and administrative expenses	343,386	335,831	321,876
Operating income	98,608	111,154	135,394
Interest expense, net	2,018	3,172	3,821
Income from continuing operations before income taxes	96,590	107,982	131,573
Income taxes	36,221	40,493	49,340
Net income from continuing operations	60,369	67,489	82,233
(Loss) income from discontinued operations, net of income taxes (Note 13)	—	(1,912)	131
Net income	<u>\$ 60,369</u>	<u>\$ 65,577</u>	<u>\$ 82,364</u>
Basic earnings per share for Common and Class B common stock (1):			
Net income from continuing operations	\$ 2.28	\$ 2.57	\$ 3.14
Net (loss) income from discontinued operations	—	(0.07)	0.01
Net income	<u>\$ 2.28</u>	<u>\$ 2.49</u>	<u>\$ 3.15</u>
Diluted earnings per share for Common and Class B common stock (1):			
Net income from continuing operations	\$ 2.18	\$ 2.43	\$ 2.95
Net (loss) income from discontinued operations	—	(0.07)	—
Net income	<u>\$ 2.18</u>	<u>\$ 2.36</u>	<u>\$ 2.96</u>
Weighted-average Common and Class B common shares and equivalent shares used to calculate earnings per share:			
Basic	26,453	26,297	26,150
Diluted	<u>27,736</u>	<u>27,824</u>	<u>27,829</u>

*The accompanying notes to consolidated financial statements are an integral part of these statements.*

- (1) Earnings per Common and Class B common share are calculated on an individual basis and, because of rounding, the summation of earnings from continuing operations and earnings (loss) from discontinued operations may not equal the amount calculated for earnings as a whole.

**WATSCO, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**

<i>(In thousands, except share and per share data)</i>	<b>December 31,</b>	
	<b>2008</b>	<b>2007</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 41,444	\$ 9,405
Accounts receivable, net	151,317	178,415
Inventories	250,914	288,149
Other current assets	13,028	13,203
<b>Total current assets</b>	<b>456,703</b>	<b>489,172</b>
Property and equipment, net	24,209	26,904
Goodwill	219,810	217,129
Other assets	15,339	16,908
	<b>\$ 716,061</b>	<b>\$ 750,113</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Current portion of long-term obligations	\$ 268	\$ 275
Accounts payable	63,850	88,596
Accrued expenses and other current liabilities	43,706	40,493
<b>Total current liabilities</b>	<b>107,824</b>	<b>129,364</b>
Long-term obligations:		
Borrowings under revolving credit agreement	20,000	54,000
Other long-term obligations, net of current portion	783	1,042
<b>Total long-term obligations</b>	<b>20,783</b>	<b>55,042</b>
Deferred income taxes and other liabilities	16,794	15,750
Commitments and contingencies (Notes 10 and 12)		
Shareholders' equity:		
Common stock, \$0.50 par value, 60,000,000 shares authorized; 30,882,931 and 30,513,096 shares issued in 2008 and 2007, respectively	15,442	15,256
Class B common stock, \$0.50 par value, 10,000,000 shares authorized; 3,813,620 and 3,721,687 shares issued in 2008 and 2007, respectively	1,907	1,861
Paid-in capital	282,636	267,669
Accumulated other comprehensive loss, net of tax	(1,125)	(431)
Retained earnings	386,225	375,207
Treasury stock, at cost, 6,370,913 and 6,265,313 shares of Common and Class B common stock in 2008 and 2007, respectively	(114,425)	(109,605)
<b>Total shareholders' equity</b>	<b>570,660</b>	<b>549,957</b>
	<b>\$ 716,061</b>	<b>\$ 750,113</b>

*The accompanying notes to consolidated financial statements are an integral part of these statements.*

**WATSCO, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**

<i>(In thousands, except share and per share data)</i>	Common Stock and Class B Common Stock Shares	Common Stock and Class B Common Stock Amount	Paid-In Capital	Deferred Compensation on Non-Vested Stock	Accumulated Other Comprehensive Loss	Retained Earnings	Treasury Stock	Total
<b>Balance at December 31, 2005</b>	<b>27,462,832</b>	<b>\$ 16,627</b>	<b>\$ 264,903</b>	<b>\$ (35,894)</b>	<b>\$ (478)</b>	<b>\$ 290,383</b>	<b>\$ (84,891)</b>	<b>\$ 450,650</b>
Net income						82,364		82,364
Changes in unrealized gains and losses on available-for-sale securities and a derivative instrument, net of income taxes					352			352
Comprehensive income								82,716
Retirement of common stock	(150,086)	(75)	(10,488)					(10,563)
Common stock contribution to 401(k) plan	19,055	10	1,130					1,140
Stock issuances from exercise of stock options and employee stock purchase plan	460,144	230	8,143					8,373
Excess tax benefit from share-based compensation			8,371					8,371
Issuances of non-vested (restricted) shares of common stock	287,359	144	12,235					12,379
Forfeitures of non-vested (restricted) shares of common stock	(2,873)	(2)	2					—
Share-based compensation Adoption of SFAS No. 123R, "Share-Based Payment"			5,020	(35,894)	35,894			5,020
Cash dividends declared on Common and Class B common stock, \$0.95 per share						(26,372)		(26,372)
Purchase of treasury stock	(243,600)						(15,328)	(15,328)
<b>Balance at December 31, 2006</b>	<b>27,832,831</b>	<b>16,934</b>	<b>253,422</b>	<b>—</b>	<b>(126)</b>	<b>346,375</b>	<b>(100,219)</b>	<b>516,386</b>
Net income						65,577		65,577
Changes in unrealized gains and losses on available-for-sale securities and derivative instruments, net of income taxes					(305)			(305)
Comprehensive income								65,272
Retirement of common stock	(17,291)	(9)	(893)					(902)
Common stock contribution to 401(k) plan	27,111	14	1,265					1,279
Stock issuances from exercise of stock options and employee stock purchase plan	268,652	133	4,488					4,621
Excess tax benefit from share-based compensation			3,462					3,462
Issuances of non-vested (restricted) shares of common stock	91,255	46	(46)					—
Forfeitures of non-vested (restricted) shares of common stock	(1,988)	(1)	1					—
Share-based compensation			5,970					5,970



<i>(In thousands, except share and per share data)</i>	Common Stock and Class B Common Stock Shares	Common Stock and Class B Common Stock Amount	Paid-In Capital	Deferred Compensation on Non-Vested Stock	Accumulated Other Comprehensive Loss	Retained Earnings	Treasury Stock	Total
Cash dividends declared on Common and Class B common stock, \$1.31 per share						(36,745)		(36,745)
Purchase of treasury stock	(231,100)						(9,386)	(9,386)
<b>Balance at December 31, 2007</b>	<b>27,969,470</b>	<b>17,117</b>	<b>267,669</b>	<b>—</b>	<b>(431)</b>	<b>375,207</b>	<b>(109,605)</b>	<b>549,957</b>
Net income						60,369		60,369
Changes in unrealized gains and losses on available-for-sale securities and derivative instruments, net of income taxes					(694)			(694)
Comprehensive income								<u>59,675</u>
Retirement of common stock	(261,014)	(131)	(9,798)					(9,929)
Common stock contribution to 401(k) plan	33,986	17	1,232					1,249
Stock issuances from exercise of stock options and employee stock purchase plan	643,796	323	12,344					12,667
Excess tax benefit from share-based compensation			4,758					4,758
Issuances of non-vested (restricted) shares of common stock	45,000	23	(23)					—
Share-based compensation			6,454					6,454
Cash dividends declared on Common and Class B common stock, \$1.75 per share						(49,351)		(49,351)
Purchase of treasury stock	(105,600)						(4,820)	(4,820)
<b>Balance at December 31, 2008</b>	<b>28,325,638</b>	<b>\$ 17,349</b>	<b>\$282,636</b>	<b>—</b>	<b>\$ (1,125)</b>	<b>\$386,225</b>	<b>\$(114,425)</b>	<b>\$ 570,660</b>

*The accompanying notes to consolidated financial statements are an integral part of these statements.*

**WATSCO, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

<i>(In thousands)</i>	Years Ended December 31,		
	2008	2007	2006
<b>Cash flows from operating activities:</b>			
Net income	\$ 60,369	\$ 65,577	\$ 82,364
Loss (income) from discontinued operations, net of income taxes	—	1,912	(131)
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	7,071	6,420	5,786
Share-based compensation	6,454	5,970	5,020
Provision for doubtful accounts	3,816	3,086	3,484
Gain on sale of property and equipment	(170)	(23)	(199)
Gain on sale of available-for-sale securities	—	(1,299)	—
Deferred income tax provision	447	4,117	(659)
Non-cash contribution for 401(k) plan	1,249	1,279	1,140
Excess tax benefits from share-based compensation	(4,758)	(3,462)	(8,371)
Changes in operating assets and liabilities, net of effects of acquisitions:			
Accounts receivable	23,416	23,519	10,181
Inventories	37,153	46,416	(18,026)
Accounts payable and other liabilities	(23,020)	(48,390)	(10,193)
Other, net	1,446	1,649	(2,057)
Net cash provided by operating activities of continuing operations	113,473	106,771	68,339
Net cash provided by operating activities of discontinued operations	—	1,227	202
Net cash provided by operating activities	113,473	107,998	68,541
<b>Cash flows from investing activities:</b>			
Capital expenditures	(3,973)	(6,071)	(9,883)
Purchases of available-for-sale securities	—	(5,240)	(2,847)
Proceeds from sale of discontinued operations	—	3,342	—
Proceeds from sale of available-for-sale securities	—	8,551	—
Business acquisitions, net of cash acquired	76	(108,972)	(9,889)
Proceeds from sale of property and equipment	226	428	448
Net cash used in investing activities of continuing operations	(3,671)	(107,962)	(22,171)
Net cash used in investing activities of discontinued operations	—	(38)	(109)
Net cash used in investing activities	(3,671)	(108,000)	(22,280)
<b>Cash flows from financing activities:</b>			
Dividends on Common and Class B common stock	(49,351)	(36,745)	(26,372)
Net (repayments) proceeds under current revolving credit agreement	(34,000)	54,000	—
Purchase of treasury stock	(4,820)	(9,386)	(15,328)
Net (repayments) proceeds from other long-term obligations	(266)	81	(64)
Net repayment under prior revolving credit agreement	—	(30,000)	—
Repayment of long-term notes	—	(10,000)	(10,000)
Payment of current revolving credit agreement costs	—	(476)	—
Excess tax benefits from share-based compensation	4,758	3,462	8,371
Net proceeds from issuances of common stock	5,916	4,131	3,822
Net cash used in financing activities	(77,763)	(24,933)	(39,571)
Net increase (decrease) in cash and cash equivalents	32,039	(24,935)	6,690
Cash and cash equivalents at beginning of year	9,405	34,340	27,650
Cash and cash equivalents at end of year	\$ 41,444	\$ 9,405	\$ 34,340

*The accompanying notes to consolidated financial statements are an integral part of these statements.*

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**WATSCO, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
*(In thousands, except share data)*

**1. Summary of Significant Accounting Policies**

Nature of Operations

Watsco, Inc. and its subsidiaries (collectively, "Watsco", which may be referred to as *we, us* or *our*) is the largest independent distributor of air conditioning, heating and refrigeration equipment and related parts and supplies ("HVAC/R") in the United States. At December 31, 2008, we operated from 417 locations in 34 states.

Financial Statement Presentation

On July 19, 2007, we divested of our non-core staffing unit (see Note 13). All amounts related to this operation are restated as discontinued operations for all periods presented consistent with the 2007 presentation.

Basis of Consolidation

The consolidated financial statements include the accounts of Watsco and all of its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated.

Use of Estimates

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

Cash Equivalents

All highly liquid instruments purchased with original maturities of three months or less are considered to be cash equivalents.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable primarily consists of trade receivables due from customers. Our customers are primarily independent contractors and dealers who service the replacement and new construction markets for residential and light commercial central air conditioning, heating and refrigeration systems. We routinely grant credit to customers to facilitate revenue growth and maintain branch locations for product sales and distribution. When determining whether to grant or increase credit, management considers a number of factors, which include creditworthiness, customer payment history, historical experience with the customer and other information. Consistent with industry practices, we normally require payment from our customers within 30 to 45 days. We record our trade receivables at the invoiced amount less an allowance for doubtful accounts. An allowance for doubtful accounts is maintained for estimated losses resulting from the inability of customers to make required payments. When preparing these estimates, we consider a number of factors, including the aging of a customer's account, past transactions with customers, creditworthiness of specific customers, historical trends and other information. We typically do not require our customers to provide collateral. Accounts receivable reserve policies are reviewed periodically, reflecting current risks, trends and changes in industry conditions. The past due status of an account is determined based on stated payment terms. Upon determination that an account is uncollectible, we write off the receivable balance. At December 31, 2008 and 2007, the allowance for doubtful accounts totaled \$3,941 and \$5,143, respectively. Although we believe the allowance is sufficient, the continuing declining economic conditions could lead to further deterioration in the financial condition of our customers, resulting in an impairment of their ability to make payments and additional allowances may be required.

Inventories

Inventories consist of air conditioning, heating and refrigeration equipment and related parts and supplies and are valued at the lower of cost or market on a weighted-average cost basis. As part of the valuation process, inventory reserves are established to state excess,

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slow-moving and damaged inventories at their estimated net realizable value. Inventory reserve policies are reviewed periodically, reflecting current risks, trends and changes in industry conditions. A reserve for estimated inventory shrinkage is also maintained to consider inventory shortages determined from cycle counts and physical inventories. At December 31, 2008 and 2007, inventory reserves totaled \$5,009 and \$6,268, respectively.

#### Vendor Rebates

We account for vendor rebates in accordance with Emerging Issues Task Force (“EITF”) Issue No. 02-16, “Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor.” We have arrangements with several vendors that provide rebates payable to us when we achieve any of a number of measures, generally related to the volume level of purchases. We account for such rebates as a reduction of inventory until we sell the product, at which time such rebates are reflected as a reduction of cost of sales in our consolidated statements of income. Throughout the year, we estimate the amount of the rebate based on our estimate of purchases to date relative to the purchase levels that mark our progress toward earning the rebates. We continually revise these estimates of earned vendor rebates based on actual purchase levels. At December 31, 2008 and 2007, we have \$4,416 and \$4,692, respectively, of rebates recorded as a reduction of inventory. Substantially all vendor rebate receivables are collected within three months immediately following the end of the year.

#### Marketable Securities

Investments in marketable equity securities of \$279 and \$732 at December 31, 2008 and 2007, respectively, are included in other assets in our consolidated balance sheets and are classified as available-for-sale. These equity securities are recorded at market using the specific identification method with unrealized holding losses, net of deferred taxes, reported in accumulated other comprehensive loss (“OCL”) within shareholders’ equity. Dividend and interest income are recognized in the statement of income when earned. At December 31, 2008 and 2007, \$347 and \$65 of unrealized losses, net of deferred tax benefits of \$208 and \$38, respectively, was included in accumulated OCL.

#### Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization of property and equipment is computed using the straight-line method. Buildings and improvements are depreciated or amortized over estimated useful lives ranging from 3-40 years. Leasehold improvements are amortized over the shorter of the respective lease terms or estimated useful lives. Estimated useful lives for other depreciable assets range from 3-7 years. Depreciation and amortization expense related to property and equipment amounted to \$6,612, \$6,196 and \$5,725 for the years ended December 31, 2008, 2007 and 2006, respectively.

#### Goodwill and Intangible Assets

Goodwill is recorded when the purchase price paid for an acquisition exceeds the estimated fair value of the net identified tangible and intangible assets acquired. In accordance with Statement of Financial Accounting Standards (“SFAS”) No. 142, “Goodwill and Other Intangible Assets,” an annual impairment review is performed, or more frequently if indicators of potential impairment exist, to determine if the carrying value of the recorded goodwill is impaired. The impairment review process compares the fair value of the reporting unit in which goodwill resides to its carrying value. If the fair value of the reporting unit is less than its carrying value, an impairment loss is recorded to the extent that the implied fair value of goodwill (as defined under SFAS No. 142) within the reporting unit is less than its carrying value (see Note 8).

Intangible assets primarily consist of the value of trade names and trademarks, customer relationships and non-compete agreements. Indefinite life intangibles not subject to amortization are assessed for impairment at least annually, or more frequently if events or changes in circumstances indicate they may be impaired, by comparing the fair value of the intangible asset to its carrying amount to determine if a write-down to fair value is required. Intangible assets with finite lives are amortized using the straight-line method over their respective estimated useful lives, which range from 4 to 15 years. Amortization expense related to intangible assets amounted to \$459, \$224 and \$61 for the years ended December 31, 2008, 2007 and 2006, respectively. Based on the current amount of finite lived intangible assets, we estimate amortization expense to be approximately \$400 for each of the next five years (see Note 8).

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### Impairment of Long-Lived Assets Other than Goodwill

Long-lived assets, including intangible assets with finite lives, are tested for recoverability when events or changes in circumstances indicate that the carrying amount of assets may not be recoverable. In accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," recoverability is evaluated by determining whether the amortization of the balance over its remaining life can be recovered through undiscounted future operating cash flows. The amount of impairment if any, is measured based on projected discounted cash flows using a discount rate reflecting the average cost of funds and compared to the asset's carrying value. As of December 31, 2008, there were no such events or circumstances.

### Revenue Recognition

Revenue is recognized in accordance with Securities and Exchange Commission Staff Accounting Bulletin ("SAB") No. 104, "Revenue Recognition" (which superseded SAB No. 101, "Revenue Recognition in Financial Statements," as amended by SAB 101A and 101B). Revenue primarily consists of sales of air conditioning, heating and refrigeration equipment and related parts and supplies and is recorded when shipment of products or delivery of services has occurred. Assessment of collection is based on a number of factors, including past transactions, creditworthiness of customers, historical trends and other information. Substantially all customer returns relate to products that are returned under warranty obligations underwritten by manufacturers, effectively mitigating our risk of loss for customer returns. Taxes collected from our customers and remitted to governmental authorities are presented in our consolidated statements of income on a net basis.

### Advertising Costs

Advertising costs are expensed as incurred. Advertising expense amounted to \$5,841, \$6,314 and \$6,050 for the years ended December 31, 2008, 2007 and 2006, respectively.

### Shipping and Handling

Shipping and handling costs associated with inbound freight are capitalized to inventories and relieved through cost of sales as inventories are sold. Shipping and handling costs associated with the delivery of products is included in selling, general and administrative expenses. Shipping and handling costs included in selling, general and administrative expenses amounted to \$6,444, \$6,747 and \$6,914 for the years ended December 31, 2008, 2007 and 2006, respectively.

### Share-Based Compensation

We account for share-based compensation in accordance with the recognition and measurement provisions of SFAS No. 123R, "Share-Based Payment," and related interpretations. See Note 6 for information on our share-based compensation plans.

### Income Taxes

We record federal and state income taxes currently payable, as well as deferred taxes due to temporary differences between reporting income and expenses for financial statement purposes versus tax purposes. Deferred tax assets and liabilities reflect the temporary differences between the financial statement and income tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect of a change in tax rates is recognized as income or expense in the period that includes the enactment date. Watsco and its eligible subsidiaries file a consolidated United States federal income tax return. As income tax returns are generally not filed until well after the closing process for the December 31 financial statements is complete, the amounts recorded at December 31 reflect estimates of what the final amounts will be when the actual income tax returns are filed for that calendar year. In addition, estimates are often required with respect to, among other things, the appropriate state income tax rates to use in the various states that Watsco and its subsidiaries are required to file, the potential utilization of operating loss carryforwards and valuation allowances required, if any, for tax assets that may not be realizable in the future.

In accordance with Financial Accounting Standards Board ("FASB") Interpretation ("FIN") No. 48, "Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109," we recognize the financial statement benefit of a tax position only after determining that the relevant tax authority would more likely than not sustain the position following an audit. For tax positions

meeting the “more-likely-than-not” threshold, the amount recognized in the financial statements is the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement with the relevant tax authority.

#### Earnings per Share

We calculate earnings per share using the two-class method in accordance with SFAS No. 128, “Earnings per Share,” as clarified by EITF Issue No. 03-6, “Participating Securities and the Two-Class Method under FASB Statement No. 128, Earnings per Share.” EITF Issue No. 03-6 requires the income per share for each class of common stock to be calculated assuming 100% of our earnings are distributed as dividends to each class of common stock based on their respective dividend rights, even though we do not anticipate distributing 100% of our earnings as dividends. The effective result of EITF Issue No. 03-6 is that the calculation of earnings per share for each class of our common stock yields the same basic and diluted earnings per share.

Basic earnings per share for our Common and Class B common stock is computed by dividing net income allocated to Common stock and Class B common stock by the weighted-average number of shares of Common stock and Class B common stock outstanding, respectively. Non-vested (restricted) stock is not included in the computation of basic earnings per share until the securities vest. Diluted earnings per share for our Common stock assume the conversion of all Class B common stock into Common stock and adjust for the dilutive effects of outstanding stock options and shares of non-vested (restricted) stock using the treasury stock method.

For the basic earnings per share calculation, net income available to shareholders is allocated among our two classes of common stock: Common stock and Class B common stock. The allocation among each class is based upon the two-class method on a one-for-one per share basis. The following table shows how net income is allocated using this method:

<u>Years Ended December 31,</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Net income available to shareholders	\$60,369	\$65,577	\$82,364
Allocation of net income for Basic:			
Common stock	\$54,811	\$59,733	\$74,891
Class B common stock	5,558	5,844	7,473
	<u>\$60,369</u>	<u>\$65,577</u>	<u>\$82,364</u>

The diluted earnings per share calculation assumes the conversion of all of our Class B common stock into Common stock as of the beginning of the year, so no allocation of earnings to Class B common stock is required.

The following summarizes the weighted-average number of Common and Class B common shares outstanding during the year and is used to calculate earnings per share of Common and Class B common stock including the potentially dilutive impact of stock options and non-vested (restricted) stock, calculated using the treasury stock method, as included in the calculation of diluted weighted-average shares:

<u>Years Ended December 31,</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Weighted-average Common and Class B common shares outstanding for basic earnings per share	<u>26,453,167</u>	<u>26,296,555</u>	<u>26,149,676</u>
Weighted-average Common shares outstanding for basic earnings per share	24,017,621	23,952,942	23,776,968
Diluted shares resulting from:			
Stock options	568,560	842,063	1,009,739
Non-vested (restricted) stock	714,772	685,378	669,723
Effect of assuming conversion of Class B common shares into Common stock	<u>2,435,546</u>	<u>2,343,613</u>	<u>2,372,708</u>
Shares for diluted earnings per share	<u>27,736,499</u>	<u>27,823,996</u>	<u>27,829,138</u>

Diluted earnings per share excluded 261,015, 219,640 and 153,500 shares for the years ended December 31, 2008, 2007 and 2006, respectively, related to stock options with an exercise price per share greater than the average market value, resulting in an

anti-dilutive effect on diluted earnings per share. In addition, 338,765, 331,987 and 284,486 shares for the years ended December 31, 2008, 2007 and 2006, respectively, related to non-vested (restricted) stock were considered anti-dilutive and excluded from the earnings per share calculation.

#### Derivative Instruments

We apply the provisions of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," which establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. All derivatives, whether designated in hedging relationships or not, are required to be recorded on the balance sheet at fair value. If the derivative is designated as a fair value hedge, the changes in the fair value of the derivative and of the hedged item attributable to the hedged risk are recognized in earnings. If the derivative is designated as a cash flow hedge, the effective portions of changes in the fair value of the derivative are recorded in OCL and are recognized in the income statement when the hedged item affects earnings. Ineffective portions of changes in the fair value of cash flow hedges are recognized in earnings. See Note 10 for further information regarding hedging activities.

#### Comprehensive Income

Comprehensive income consists of net income and changes in the unrealized (losses) gains on available-for-sale securities and the effective portion of cash flow hedges as further discussed in Note 10. The components of comprehensive income are as follows:

<u>Years Ended December 31,</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Net income	\$ 60,369	\$65,577	\$ 82,364
Changes in unrealized losses on derivative instruments, net of income tax (benefit) expense of \$(248), \$(137) and \$205, respectively	(411)	(230)	342
Changes in unrealized (losses) gains on available-for-sale securities arising during the period, net of income tax (benefit) expense of \$(170), \$218 and \$6, respectively	(283)	361	10
Reclassification adjustment for securities gains and losses on a derivative instrument realized in net income, net of income tax expense of \$0, \$262 and \$0, respectively	—	(436)	—
Comprehensive income	<u>\$59,675</u>	<u>\$65,272</u>	<u>\$82,716</u>

#### Recently Adopted Accounting Standards

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities." SFAS No. 159 allows entities the option to measure eligible financial instruments at fair value as of specified dates. Unrealized gains and losses on items for which the fair value option has been elected will be recognized in earnings at each subsequent reporting date. The provisions of SFAS No. 159 were effective for us beginning January 1, 2008. Upon adoption, we did not elect the fair value option for any items that were not already required to be measured at fair value in accordance with U.S. generally accepted accounting principles. As such, there was no impact on our consolidated financial statements upon adoption of SFAS No. 159.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." This standard defines fair value, establishes a framework for measuring fair value and expands disclosure about fair value measurements. SFAS No. 157, as originally issued, was effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. However, on February 12, 2008, the FASB issued Staff Position ("FSP") No. SFAS 157-2, which deferred the effective date of SFAS No. 157 for one year, as it relates to nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed in financial statements at fair value on a recurring basis (at least annually). The provisions of SFAS No. 157 as they relate to financial assets and liabilities were effective for us beginning January 1, 2008. Upon adoption, there was no material impact on our consolidated financial statements. We are currently assessing the potential effect of SFAS No. 157 for our nonfinancial assets and liabilities on our consolidated financial statements.

In October 2008, the FASB issued FSP No. SFAS 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active," which amended SFAS No. 157 to illustrate key considerations in determining the fair value of a financial asset in an inactive market. This FSP was effective for us beginning with the fourth quarter 2008 and did not have a material impact on our consolidated financial statements.

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## Recently Issued Accounting Standards

In June 2008, the FASB issued FSP EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities." FSP EITF 03-6-1 requires that non-vested share-based payment awards that contain nonforfeitable rights to dividends be considered participating securities and included in the computation of earnings per share pursuant to the two-class method. This FSP is effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2008. Upon adoption, all prior period earnings per share data presented in financial statements after the effective date shall be adjusted retrospectively to conform to the provisions of this FSP. FSP EITF 03-6-1 is effective for us retroactively in the first quarter ending March 31, 2009. We do not expect the adoption of FSP EITF 03-6-1 to have an impact on our consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities – an Amendment of FASB Statement No. 133," which requires enhanced disclosures about an entity's derivative and hedging activities. In addition to disclosing the fair values of derivative instruments and their gains and losses in a tabular format, entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under Statement No. 133 and its related interpretations and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. We will adopt SFAS No. 161 beginning January 1, 2009 and do not expect a material impact on our consolidated financial statements. SFAS No. 161 does not change the accounting for derivative instruments.

In December 2007, the FASB issued SFAS No. 141R, "Business Combinations." SFAS No. 141R requires an acquirer to measure the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquiree at their fair values on the acquisition date, with goodwill being the excess value over the net identifiable assets acquired. SFAS No. 141R significantly changes the accounting for business combinations in a number of areas including the treatment of contingent consideration, transaction costs, in-process research and development and restructuring costs. In addition, under SFAS No. 141R, changes in an acquired entity's deferred tax assets and uncertain tax positions after the measurement period will impact income tax expense. SFAS No. 141R is effective for fiscal years beginning after December 15, 2008 with early application prohibited. We will adopt SFAS No. 141R beginning January 1, 2009 and will change our accounting treatment for business combinations on a prospective basis.

In December 2007, the FASB also issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements," an amendment of Accounting Research Bulletin No. 51. This standard clarifies that a noncontrolling interest in a subsidiary should be reported as equity in the consolidated financial statements. The calculation of earnings per share will continue to be based on income amounts attributable to the parent. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008 with early application prohibited. We will adopt SFAS No. 160 beginning January 1, 2009 and do not expect a material impact on our consolidated financial statements.

## Reclassifications

Certain reclassifications of prior year amounts have been made to conform to the 2008 presentation. These reclassifications had no effect on net income or earnings per share as previously reported.

## 2. Supplier Concentration

We have seven key suppliers of HVAC/R equipment products. Purchases from these seven suppliers comprised 48%, 48% and 47% of all purchases made in 2008, 2007 and 2006, respectively; with the largest supplier accounting for 16%, 17% and 17% of all purchases made in each of the years ended December 31, 2008, 2007 and 2006. Any significant interruption by the suppliers or a termination of a distribution agreement could disrupt the operations of certain subsidiaries.



### 3. Property and Equipment

Property and equipment, net, consists of:

<u>December 31,</u>	<u>2008</u>	<u>2007</u>
Land	\$ 1,106	\$ 1,106
Buildings and improvements	24,447	24,109
Machinery, vehicles and equipment	28,615	29,025
Furniture and fixtures	17,374	18,004
	<u>71,542</u>	<u>72,244</u>
Less: accumulated depreciation and amortization	(47,333)	(45,340)
	<u>\$ 24,209</u>	<u>\$ 26,904</u>

### 4. Long-Term Obligations

#### Revolving Credit Agreement and Long-Term Notes

We maintain a bank-syndicated, unsecured revolving credit agreement that provides for borrowings of up to \$300,000. Borrowings are used for general corporate purposes, including seasonal working capital needs, dividends, stock repurchases, acquisitions and issuance of letters of credit. Included in the facility are a \$25,000 swingline subfacility and a \$50,000 letter of credit subfacility. Borrowings bear interest at primarily LIBOR-based rates plus a spread which ranges from 37.5 to 112.5 basis-points depending upon our ratio of total debt to EBITDA (LIBOR plus 37.5 basis-points at December 31, 2008). We pay a variable commitment fee on the unused portion of the commitment, ranging from 7.5 to 20 basis-points (7.5 basis-points at December 31, 2008). Alternatively, we may elect to have borrowings bear interest at the Prime Rate or the Federal Funds Rate plus our spread. The credit facility matures in August 2012. At December 31, 2008 and 2007, \$20,000 and \$54,000, respectively, were outstanding under the revolving credit agreement.

The \$300,000 unsecured revolving credit agreement contains customary affirmative and negative covenants including two financial covenants with respect to consolidated leverage and interest coverage ratios and limits capital expenditures, dividends and share repurchases in addition to other restrictions. We were in compliance with all covenants and financial ratios at December 31, 2008.

A \$125,000 unsecured private placement shelf facility was also maintained as a source of long-term borrowings through December 10, 2007. This uncommitted shelf facility provided fixed-rate financing as a complement to the variable rate borrowings available under the revolving credit agreement.

#### Other Long-Term Obligations

Other long-term obligations, net of current portion, of \$783 and \$1,042 at December 31, 2008 and 2007, respectively, relate to a mortgage loan and capital leases on equipment. Interest rates on other debt range from 1.0% to 11.1% and mature at varying dates through 2020. Annual maturities of other long-term obligations for the years subsequent to December 31, 2008 are as follows:

2009	\$ 268
2010	163
2011	90
2012	56
2013	47
Thereafter	427
	<u>\$1,051</u>

Total cash payments for interest were \$2,299, \$4,557 and \$4,345 for the years ended December 31, 2008, 2007 and 2006, respectively.

## 5. Income Taxes

The components of income tax expense from continuing operations are as follows:

<u>Years Ended December 31,</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Federal	\$ 32,493	\$ 37,387	\$ 45,399
State	3,728	3,106	3,941
	<u>\$36,221</u>	<u>\$ 40,493</u>	<u>\$ 49,340</u>
Current	\$ 35,774	\$36,376	\$49,999
Deferred	447	4,117	(659)
	<u>\$36,221</u>	<u>\$ 40,493</u>	<u>\$ 49,340</u>

Following is a reconciliation of the effective income tax rate:

<u>Years Ended December 31,</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Federal statutory rate	35.0%	35.0%	35.0%
State income taxes, net of federal benefit and other	2.5	2.5	2.5
	<u>37.5%</u>	<u>37.5%</u>	<u>37.5%</u>

The following is a summary of the significant components of our current and long-term deferred tax assets and liabilities:

<u>December 31,</u>	<u>2008</u>	<u>2007</u>
Current deferred tax assets:		
Allowance for doubtful accounts	\$ 1,626	\$ 1,922
Capitalized inventory costs and inventory reserves	3,074	1,167
Self-insurance reserves	1,452	1,944
Other current deferred tax assets	1,168	1,672
Total current deferred tax assets (1)	<u>7,320</u>	<u>6,705</u>
Long-term deferred tax assets (liabilities):		
Deductible goodwill	(25,503)	(22,680)
Net operating loss carryforwards	492	597
Unrealized loss on derivative instruments	483	236
Depreciation	1,287	1,296
Share-based compensation	8,289	6,397
Other long-term net deferred tax assets	238	83
Total net long-term deferred tax liabilities	<u>(14,714)</u>	<u>(14,071)</u>
Net deferred tax liabilities	<u>\$ (7,394)</u>	<u>\$ (7,366)</u>

- (1) Current deferred tax assets of \$7,320 and \$6,705 have been included in the consolidated balance sheets in other current assets at December 31, 2008 and 2007, respectively.

SFAS No. 109, "Accounting for Income Taxes," requires a valuation allowance to reduce the deferred tax assets reported if, based on the weight of the evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Management has determined that no valuation allowance was necessary at December 31, 2008 to reduce the deferred tax assets to the amount that will more likely than not be realized. At December 31, 2008, there were state net operating loss carryforwards of \$13,504, which expire in varying amounts from 2009 through 2028. These amounts are available to offset future taxable income. There were no federal net operating loss carryforwards at December 31, 2008.

We are subject to U.S. federal income tax and income tax of multiple state jurisdictions. We are open to tax audits in the various jurisdictions until the respective statutes of limitations expire. In June 2008, the Internal Revenue Service finalized an examination of

our federal income tax returns for the 2004 and 2005 tax years. The adjustments resulting from this examination did not have a material effect on our consolidated financial position, results of operations or cash flows. We are no longer subject to U.S. federal tax examinations for tax years prior to 2005. For the majority of states, we are no longer subject to tax examinations for tax years prior to 2004. In connection with our adoption of FIN No. 48, we analyzed the filing positions in the federal and all state jurisdictions where we are required to file income tax returns, as well as all open tax years in these jurisdictions. There was no material impact on our consolidated financial statements upon adoption of FIN No. 48 on January 1, 2007.

As of December 31, 2008 and 2007, the total amount of gross unrecognized tax benefits (excluding the federal benefit received from state positions) was \$2,296 and \$2,173, respectively. Of these totals, \$1,803 and \$1,723, respectively, (net of the federal benefit received from state positions) represent the amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate. Our continuing practice is to recognize penalties within selling, general and administrative expenses and interest related to income tax matters in income tax expense in the consolidated statements of income. As of December 31, 2008 and 2007, the cumulative amount of estimated accrued interest and penalties resulting from such unrecognized tax benefits was \$362 and \$217, respectively, and is included in accrued expenses and other current liabilities in the accompanying consolidated balance sheets.

The change in gross unrecognized tax benefits during 2008 and 2007 is as follows:

Gross balance at January 1, 2007	\$ 894
Additions based on tax positions related to the current year	1,226
Additions for tax positions of prior years	303
Reductions for tax positions of prior years	(250)
Gross balance at December 31, 2007	2,173
Additions based on tax positions related to the current year	256
Additions for tax positions of prior years	69
Reductions for tax positions of prior years	(202)
Gross balance at December 31, 2008	<u>\$2,296</u>

Total cash payments, net of refunds, for income taxes were \$25,270, \$32,329 and \$47,961 for the years ended December 31, 2008, 2007 and 2006, respectively.

## 6. Share-Based Compensation and Benefit Plans

### Share-Based Compensation Plans

We have two share-based compensation plans for employees. The 2001 Incentive Compensation Plan (the "2001 Plan") provides for the award of a broad variety of share-based compensation alternatives such as non-qualified stock options, incentive stock options, non-vested (restricted) stock, performance awards, dividend equivalents, deferred stock and stock appreciation rights at no less than 100% of the market price on the date the award is granted. To date, awards under the 2001 Plan consist of non-qualified stock options and non-vested (restricted) stock. Under the 2001 Plan, awards for an aggregate of 3,000,000 shares of Common and Class B common stock may be granted. A total of 1,573,630 shares of Common stock, net of cancellations and 1,044,811 shares of Class B common stock, net of cancellations have been awarded under the 2001 Plan as of December 31, 2008. There were 381,559 shares of common stock reserved for future grants as of December 31, 2008 under the 2001 Plan. There are 773,775 options of common stock outstanding under the 2001 Plan at December 31, 2008. Options under the 2001 Plan vest over two to five years of service and have contractual terms of five to ten years.

Awards of non-vested (restricted) stock, which are granted at no cost to the employee, vest upon attainment of a certain age, generally the employee's respective retirement age. Vesting may be accelerated in certain circumstances prior to the original vesting date.

We also maintain the 1991 Stock Option Plan (the "1991 Plan"), which expired during 2001; therefore, no additional options may be granted. There are 611,125 options of common stock outstanding under the 1991 Plan at December 31, 2008. Options under the 1991 Plan vest over two to five years of service and have contractual terms of ten years.

A summary of stock option activity under the 2001 Plan and 1991 Plan as of December 31, 2008, and changes during 2008, is as follows:

	Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Options outstanding at January 1, 2008	1,970,908	\$ 20.37		
Granted	53,500	40.54		
Exercised	(627,308)	19.11		
Forfeited	(9,600)	36.36		
Expired	(2,600)	19.89		
Options outstanding at December 31, 2008	<u>1,384,900</u>	<u>\$ 21.79</u>	<u>2.03</u>	<u>\$26,722</u>
Options exercisable at December 31, 2008	<u>1,129,365</u>	<u>\$ 16.28</u>	<u>1.86</u>	<u>\$26,360</u>

The weighted-average grant date fair value of stock options granted during 2008, 2007 and 2006 was \$7.06, \$11.07 and \$14.99, respectively. The total intrinsic value of stock options exercised during 2008, 2007 and 2006 was \$11,986, \$3,841 and \$22,390, respectively. The fair value of stock options that vested during 2008, 2007 and 2006 was \$2,158, \$1,120 and \$497, respectively.

A summary of non-vested (restricted) stock issued as of December 31, 2008, and changes during 2008, is shown below:

	Shares	Weighted-Average Grant Date Fair Value
Non-vested (restricted) stock outstanding at January 1, 2008	1,755,999	\$ 29.77
Granted	45,000	43.04
Vested	(13,830)	50.93
Forfeited	—	—
Non-vested (restricted) stock outstanding at December 31, 2008	<u>1,787,169</u>	<u>\$ 29.94</u>

The weighted-average grant date fair value of non-vested (restricted) stock granted during 2008, 2007 and 2006 was \$43.04, \$52.34 and \$67.94, respectively. The fair value of stock vested during 2008 and 2007 was \$704 and \$128, respectively. No non-vested (restricted) stock vested during 2006.

#### Share-Based Compensation Fair Value Assumptions

The fair value of each stock option award is estimated on the date of grant using the Black-Scholes option pricing valuation model based on the weighted-average assumptions noted in the table below. The fair value of each stock option award, which is subject to graded vesting, is expensed, net of estimated forfeitures, on a straight-line basis over the requisite service period for each separately vesting portion of the stock option. We use historical data to estimate stock option forfeitures within the valuation model. All of the awards granted during 2008 meet the definition of “plain vanilla” options, as defined in SAB No. 107. The expected term of stock option awards granted represents the period of time that stock option awards granted are expected to be outstanding and was calculated using the simplified method for plain vanilla options. We will continue to use the simplified method until we have the historical data necessary to provide a reasonable estimate of expected life, in accordance with SAB No. 107, as amended by SAB No. 110. The risk-free rate for periods within the contractual life of the stock option award is based on the yield curve of a zero-coupon U.S. Treasury bond on the date the stock option award is granted with a maturity equal to the expected term of the stock option award. Expected volatility is based on historical volatility of our stock.

The weighted-average assumptions relating to the valuation of our stock options were as follows:

<u>Years Ended December 31,</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Expected term in years	4.25	4.25	4.25
Risk-free interest rate	2.13%	4.38%	4.91%
Expected volatility	27.33%	24.29%	24.08%
Expected dividend yield	3.40%	2.26%	1.35%

#### Share-Based Compensation Expense

Share-based compensation expense is included in selling, general and administrative expenses in our consolidated statements of income. The following table provides information on share-based compensation expense and tax benefits recognized:

<u>Years Ended December 31,</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Share-based compensation expense	\$ 6,454	\$ 5,970	\$ 5,020
Income tax benefit	(2,420)	(2,239)	(1,883)
Share-based compensation expense, net of tax	<u>\$ 4,034</u>	<u>\$ 3,731</u>	<u>\$ 3,137</u>

Cash received from Common stock issued as a result of stock options exercised during 2008, 2007 and 2006, was \$5,235, \$3,351 and \$2,214, respectively. During 2008, 2007 and 2006, 261,014 shares of Common and Class B common stock with an aggregate market value of \$9,929, 17,291 shares of Common stock with an aggregate market value of \$902 and 150,086 shares of Common stock with an aggregate market value of \$10,563, respectively, were delivered as payment in lieu of cash for stock option exercises and related tax withholdings. Upon delivery these shares were retired. The tax benefit realized for the tax deductions from share-based compensation plans totaled \$5,095, \$3,542 and \$8,396, for the years ended December 31, 2008, 2007 and 2006, respectively.

At December 31, 2008, there was \$642 of unrecognized share-based compensation expense related to stock options granted under the 2001 Plan, which is expected to be recognized over a weighted-average period of 1.5 years. At December 31, 2008, there was \$34,471 of unrecognized share-based compensation expense related to non-vested (restricted) stock, which is expected to be recognized over a weighted-average period of 9.6 years. In the event that vesting is accelerated for any circumstance, as defined in the related agreements, the remaining unrecognized share-based compensation expense would be immediately recognized as a charge to earnings. Approximately \$23,000 of the unrecognized share-based compensation for shares of non-vested stock is related to awards granted to our Chief Executive Officer that vest in approximately 10 years upon his attainment of age 78.

#### Employee Stock Purchase Plan

The Watsco, Inc. Amended and Restated 1996 Qualified Employee Stock Purchase Plan (the "Watsco ESPP") provides for up to 1,000,000 shares of Common stock to be available for purchase by our full-time employees with at least 90 days of service. The plan allows participating employees to purchase, through payroll deductions or lump-sum contribution, shares of Common stock at specified times subject to certain restrictions. Effective January 1, 2006, the Watsco ESPP was amended to change the discount that employees can purchase shares of our Common stock to 5% of the fair market value and to remove certain restrictions. Prior to the amendment, employees could purchase shares of our Common stock at 85% of the fair market value. During 2008, 2007 and 2006, employees purchased 9,058, 11,059 and 28,232 shares of Common stock at an average price of \$39.81, \$47.39 and \$48.88 per share, respectively. Cash dividends received by the Watsco ESPP were reinvested in Common stock and resulted in additional shares issued in the amount of 7,430, 5,355 and 4,162 for the years ended December 31, 2008, 2007 and 2006, respectively. We received net proceeds of \$681, \$780 and \$1,608, respectively, during 2008, 2007 and 2006, for shares of Watsco Common stock issued under the Watsco ESPP. At December 31, 2008, 101,423 shares remained available for purchase under the plan.

#### 401(k) Plan

We have a profit sharing retirement plan for our employees that is qualified under Section 401(k) of the Internal Revenue Code. Annual matching contributions are made based on a percentage of eligible employee compensation deferrals. The contribution is made in cash or by the issuance of Common stock to the plan on behalf of our employees. For the years ended December 31, 2008, 2007 and 2006, the aggregate contribution required to the plan was \$1,249, \$1,279 and \$1,140, respectively. This contribution is made during the first quarter of the subsequent year.

## 7. Acquisitions

In August 2007, we acquired all of the assets and assumed all of the liabilities of ACR Group, Inc. ("ACR"), one of the nation's largest distributors of air conditioning and heating products with 54 locations in Florida, Texas, California, Georgia, Tennessee, Arizona, Colorado, Louisiana, Nevada, and New Mexico, for \$108,332 in cash, including acquisition costs and net of cash acquired. Based on a third-party valuation, the purchase price, including acquisition costs, resulted in the recognition of \$67,361 in goodwill and other intangible assets, which is not deductible for tax purposes. The fair values of the assets acquired and liabilities assumed for the acquisition is as follows:

Accounts receivable	\$ 27,493
Inventories	43,883
Property and equipment	6,256
Goodwill	60,811
Intangibles	6,550
Current and other assets	6,454
Accounts payable and accrued expenses	(38,579)
Other long-term liabilities	(4,536)
Cash used in acquisition, net of cash acquired	<u>\$ 108,332</u>

The unaudited proforma financial information combining our results of operations with the operations of ACR as if the acquisition had occurred on January 1, 2006 is as follows:

<u>Years ended December 31,</u>	<u>2007</u>	<u>2006</u>
Revenues	\$ 1,893,218	\$ 2,011,609
Net income from continuing operations	\$ 67,989	\$ 85,221
Basic earnings per share for Common and Class B common stock:		
Net income from continuing operations	\$ 2.59	\$ 3.26
Diluted earnings per share for Common and Class B common stock:		
Net income from continuing operations	\$ 2.44	\$ 3.06

This unaudited proforma financial information is presented for informational purposes only. The unaudited proforma financial information from the beginning of the periods presented until the acquisition date includes adjustments to record income taxes at our effective tax rate, interest expense on borrowings incurred to acquire the business and does not include adjustments to remove certain corporate expenses of ACR, which may not be incurred in future periods, adjustments for depreciation and amortization, or synergies (primarily related to improved gross profit and lower general and administrative expenses) that may be realized subsequent to the acquisition date. The unaudited proforma financial information may not necessarily reflect our future results of operations or what the results of operations would have been had we owned and operated ACR as of the beginning of the periods presented.

In July 2007, one of our subsidiaries acquired substantially all of the assets and assumed certain liabilities of a wholesale distributor of air conditioning and heating products operating from one location in Gonzales, Louisiana. The purchase price of the acquisition included a cash payment of \$467, net of cash acquired.

In December 2006, one of our subsidiaries completed the acquisition of a distributor of air conditioning and heating products with 10 locations in Nebraska, Missouri and Kansas. The purchase price of the acquisition included a cash payment of \$5,190.

In October 2006, one of our subsidiaries completed the acquisition of a wholesale distributor of refrigeration equipment with eight locations in Tennessee, Mississippi and Arkansas. The purchase price of the acquisition included a cash payment of \$3,705, net of cash acquired.

In March 2006, one of our subsidiaries completed the acquisition of a refrigeration equipment distributor with locations in Birmingham and Montgomery, Alabama for cash consideration of \$798, net of cash acquired.

In February 2006, one of our subsidiaries completed the purchase of the net assets and business of a wholesale distributor of air conditioning and heating products operating from a single location in Kansas City, Missouri for cash consideration of \$293, net of cash acquired.

The results of operations of these locations have been included in the consolidated financial statements from their respective dates of acquisition. The proforma effect of these acquisitions was not deemed significant on either an individual or aggregate basis to the consolidated financial statements for the years ended December 31, 2008, 2007 and 2006.

## 8. Goodwill and Intangibles

The recoverability of goodwill and indefinite life intangibles is evaluated at least annually and when events or changes in circumstances indicate that the carrying amount of goodwill and indefinite life intangibles may not be recoverable. The identification and measurement of impairment involves the estimation of the fair value of the reporting unit and indefinite life intangibles and contains uncertainty because management must use judgment in determining appropriate assumptions to be used in the measurement of fair value. The estimate of fair value of the reporting unit is based on the best information available as of the date of the assessment and incorporates management's assumptions about expected future cash flows and contemplates other valuation techniques. Future cash flows can be affected by changes in the industry, the continuing declining economic environment or market conditions.

On January 1, 2009, the annual impairment test was performed and it was determined there was no impairment. No factors have developed since the last impairment test that would indicate that the carrying value of goodwill and indefinite life intangibles may not be recoverable. The carrying amount of goodwill and intangibles at December 31, 2008 was \$230,468. Although no impairment has been recorded to date, there can be no assurances that future impairments will not occur. An adjustment to the carrying value of goodwill and intangibles could materially impact the consolidated results of operations.

The changes in the carrying amount of goodwill are as follows:

Balance at December 31, 2006	\$157,558
Acquired goodwill	59,571
Balance at December 31, 2007	217,129
Purchase price adjustments, net	2,681
Balance at December 31, 2008	<u>\$ 219,810</u>

Intangible assets, net, included in other assets in the consolidated balance sheets consist of:

<u>December 31,</u>	<u>2008</u>	<u>2007</u>
Unamortizable intangible assets:		
Trade names and trademarks	\$ 5,683	\$ 5,683
Amortizable intangible assets:		
Customer relationships	5,420	5,420
Non-compete agreements	369	369
Less: accumulated amortization	(814)	(355)
Amortizable intangible assets, net	<u>4,975</u>	<u>5,434</u>
	<u>\$10,658</u>	<u>\$11,117</u>

## 9. Shareholders' Equity

Common stock and Class B common stock share equally in earnings and are identical in most other respects except (i) Common stock is entitled to one vote on most matters and each share of Class B common stock is entitled to ten votes; (ii) shareholders of Common stock are entitled to elect 25% of the Board of Directors (rounded up to the nearest whole number) and Class B shareholders are

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entitled to elect the balance of the Board of Directors; (iii) cash dividends may be paid on Common stock without paying a cash dividend on Class B common stock and no cash dividend may be paid on Class B common stock unless at least an equal cash dividend is paid on Common stock and (iv) Class B common stock is convertible at any time into Common stock on a one-for-one basis at the option of the shareholder.

Our Board of Directors has authorized the repurchase, at management's discretion, of 7,500,000 shares 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. During 2008, 2007 and 2006, 105,600, 231,100 and 243,600 Common shares were repurchased at a cost of \$4,820, \$9,386 and \$15,328, respectively. In aggregate since the inception of the repurchase plan in 1999, 6,322,650 shares of Common stock and 48,263 shares of Class B common stock were repurchased at a cost of \$114,425. The remaining 1,129,087 shares authorized for repurchase are subject to certain restrictions included in our debt agreement.

## **10. Financial Instruments**

### Recorded Financial Instruments

Recorded financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable, the current portion of long-term obligations, borrowings under our revolving credit agreement and debt instruments included in other long-term obligations. At December 31, 2008 and 2007, the fair values of cash and cash equivalents, accounts receivable, accounts payable and the current portion of long-term obligations approximated their carrying values due to the short-term nature of these instruments.

The fair values of variable rate borrowings under the revolving credit agreement and debt instruments included in long-term obligations also approximate their carrying value based upon interest rates available for similar instruments with consistent terms and remaining maturities.

### Derivative Financial Instruments

Periodically, we enter into interest rate swap agreements to reduce our exposure to market risks from changing interest rates under our revolving credit agreement. Under the terms of the swap agreements, we agree to exchange, at specified intervals, the difference between fixed and variable interest amounts calculated by reference to the notional principal amount. Any differences paid or received on our interest rate swap agreements are recognized as adjustments to interest expense over the life of each swap, thereby adjusting the effective interest rate on the underlying obligation. Financial instruments are not held or issued for trading purposes. In order to obtain hedge accounting treatment, any derivatives used for hedging purposes must be designated as, and effective as, a hedge of an identified risk exposure at the inception of the contract. Changes in the fair value of the derivative contract must be highly correlated with changes in the fair value of the underlying hedged item at inception of the hedge and over the life of the hedge contract. Accordingly, we record all derivative instruments as either assets or liabilities on the consolidated balance sheets at their respective fair values. We record the change in the fair value of a derivative instrument designated as a cash flow hedge in other comprehensive income to the extent the derivative is effective, and recognize the change in the statement of operations when the hedged item affects earnings. All of our interest rate hedges are designated as cash flow hedges.

At December 31, 2008 and 2007, two interest rate swap agreements were in effect with notional values of \$10,000 each, maturing in October 2009 and October 2011. The swap agreement maturing in October 2009 exchanges the variable rate of 30-day LIBOR to a fixed interest rate of 5.04%. The swap agreement maturing in October 2011 exchanges the variable rate of 30-day LIBOR to a fixed interest rate of 5.07%. During the years ended December 31, 2008 and 2007, both hedging relationships were determined to be highly effective in achieving offsetting changes in cash flows.

We were party to an interest rate swap agreement with a notional amount of \$30,000, which matured on October 9, 2007, that was designated as a cash flow hedge and effectively exchanged the variable rate of 90-day LIBOR to a fixed interest rate of 6.25%. During 2007 and 2006, the hedging relationship was determined to be highly effective in achieving offsetting changes in cash flows.

The negative fair value of the derivative financial instruments was \$1,287 and \$628 at December 31, 2008 and 2007, respectively, and is included, net of accrued interest, in deferred income taxes and other liabilities in the consolidated balance sheets. At December 31, 2008, 2007 and 2006, \$778, net of deferred tax benefits of \$467, \$366, net of deferred tax benefits of \$219 and \$136, net of deferred tax benefits of \$82 was included in accumulated OCL associated with cash flow hedges.



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The net change in OCL during 2008, 2007 and 2006, reflected the reclassification of \$274, net of income tax benefit of \$164, \$128, net of income tax benefit of \$77 and \$221, net of income tax benefit of \$132, respectively, of unrealized losses from accumulated OCL to current period earnings (recorded in interest expense, net in the consolidated statements of income). The net unrealized loss recorded in accumulated OCL will be reclassified to earnings on a monthly basis as interest payments occur. We estimate that approximately \$800 in unrealized losses on the derivative instruments accumulated in OCL are expected to be reclassified to earnings during 2009 using a current one month LIBOR-based average receive rate (1.17% at December 31, 2008).

#### Off-Balance Sheet Financial Instruments

At December 31, 2008 and 2007, we were contingently liable under standby letters of credit aggregating \$4,627 and \$4,992, respectively that are primarily used as collateral to cover any contingency related to additional risk assessments pertaining to the self-insurance programs. We do not expect any material losses to result from the issuance of the standby letters of credit because claims are not expected to exceed premiums paid. Accordingly, the estimated fair value of these instruments is zero.

#### Concentrations of Credit Risk

Financial instruments which potentially subject us to concentrations of credit risk consist principally of cash investments and accounts receivable. Temporary cash investments are placed with high credit quality financial institutions and we limit the amount of credit exposure to any one financial institution or investment. Concentrations of credit risk with respect to accounts receivable are limited due to the large number of customers comprising the customer base and their dispersion across many different geographical regions.

### 11. Fair Value Measurements

Effective January 1, 2008, we adopted SFAS No. 157 for our financial assets and liabilities, which defines fair value as an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, SFAS No. 157 establishes a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. The three levels of inputs used to measure fair value are as follows:

- Level 1 Quoted prices in active markets for identical assets or liabilities.
- Level 2 Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.
- Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. This includes certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs.

The following table summarizes our financial assets and liabilities measured at fair value on a recurring basis as of December 31, 2008, segregated among the appropriate levels within the fair value hierarchy:

Description	Fair Value at December 31, 2008	Fair Value Measurements at December 31, 2008 Using		
		Level 1	Level 2	Level 3
<b>Assets:</b>				
Available-for-sale securities	\$ 279	\$279	—	—
<b>Liabilities:</b>				
Derivative financial instruments	\$ 1,287	—	\$1,287	—

The following is a description of the valuation techniques used for these items, as well as the general classification of such items pursuant to the fair value hierarchy of SFAS No. 157:

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

*Derivative financial instruments* – the derivatives are pay-variable, receive fixed interest rate swaps based on 30-day LIBOR. Fair value is based on model-derived valuations using the respective LIBOR rate, which is observed at quoted intervals for the full term of the swaps. Therefore, the derivatives are classified within Level 2 of the fair value hierarchy. See Note 10 for further discussion on our derivative financial instruments.

## 12. Commitments and Contingencies

### Litigation, Claims and Assessments

In November 2007, one of our subsidiaries was named in a complaint filed in the Circuit Court of the Seventh Judicial Circuit, in and for, Volusia County, Florida, brought by CODISCO, Inc. and CODISCO International, Inc. (“CODISCO”), an existing landlord of facilities leased by our subsidiary. CODISCO alleged that eleven former and existing leased premises were not properly maintained and that our subsidiary failed to perform the necessary repairs breaching the lease agreements. During January 2009, an Order of Joint Stipulation for Voluntary Dismissal with Prejudice regarding this complaint was granted.

We are 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 or 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 impact to our financial condition or results of operations.

### Self-Insurance

Self-insurance reserves are maintained for company-wide casualty insurance programs and for one subsidiary’s health benefit program. 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 occurs and exceed these estimates, additional reserves may be required. The estimation process contains uncertainty since management must use judgment to estimate the ultimate cost that will be incurred to settle reported claims and unreported claims for incidents incurred but not reported as of the balance sheet date. Reserves in the amount of \$3,875 and \$4,593 at December 31, 2008 and 2007, respectively, were established related to such insurance programs and are included in accrued expenses and other current liabilities in our consolidated balance sheets.

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#### Variable Interest Entities

As of December 31, 2008, in conjunction with our casualty insurance programs, limited equity interests are held in a captive insurance entity. The programs permit us to self-insure a portion of losses, to gain access to a wide array of safety-related services, to pool insurance risks and resources in order to obtain more competitive pricing for administration and reinsurance and to limit risk of loss in any particular year. The entities meet the definition of variable interest entities ("VIEs"), however, based on the criteria set forth in FASB Interpretation No. 46R, "Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51," there is not a requirement to include these entities in the consolidated financial statements. The maximum exposure to loss related to our involvement with these entities is limited to approximately \$5,200. See Note 12, "Self-Insurance," for additional discussion of commitments associated with the insurance programs and Note 10, "Off-Balance Sheet Financial Instruments," for further information on standby letters of credit. As of December 31, 2008, there are no other entities that met the definition of a VIE.

#### Minimum Royalty Payments

We are obligated under a licensing agreement with Whirlpool Corporation to make minimum annual royalty payments of \$1,000 through 2011.

#### Operating Leases

We are obligated under non-cancelable operating leases of real property, equipment, vehicles and a corporate aircraft used in our operations with varying terms through 2017. Some of our leases contain renewal options, some of which involve rate increases. For leases with step rent provisions whereby the rental payments increase incrementally over the life of the lease, we recognize the total minimum lease payments on a straight-line basis over the lease term. The corporate aircraft lease is subject to adjustment from changes in LIBOR-based interest rates.

As of December 31, 2008, future minimum lease payments under non-cancelable operating leases are as follows:

2009	\$ 46,255
2010	36,744
2011	26,943
2012	18,724
2013	12,085
Thereafter	14,698
	<u>\$ 155,449</u>

Rental expense for the years ended December 31, 2008, 2007 and 2006 was \$45,606, \$42,739 and \$36,333, respectively.

### 13. Discontinued Operations

During June 2007, our Board of Directors approved and we executed an agreement to sell the stock of our non-core staffing unit, Dunhill Staffing Systems, Inc. ("Dunhill"). The transaction closed on July 19, 2007. Dunhill represented our "other" segment and consequently, the amounts related to this operation are presented as discontinued operations in our consolidated statements of income and our consolidated statements of cash flows for all periods presented. The divestiture of Dunhill did not have a material impact on our financial condition or results of operations.

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Included in discontinued operations as presented in our consolidated statements of income are the following:

<u>Years Ended December 31,</u>	<u>2007</u>	<u>2006</u>
Revenues	\$ 12,431	\$ 29,545
(Loss) income from discontinued operations	(3,060)	210
Income tax benefit (expense)	1,148	(79)
Net (loss) income from discontinued operations	(1,786)	131
Loss on sale of discontinued operations	(126)	—

#### **14. Related Party Transaction**

A member of the Board of Directors is the President and Chief Executive Officer of Greenberg Traurig, LLP, which serves as our principal outside counsel and receives customary fees for legal services. During 2008, 2007 and 2006, this firm was paid \$128, \$78 and \$295, respectively, for services performed.

#### **15. Subsequent Event**

In February 2009, our Board of Directors approved an increase in the quarterly cash dividend to \$0.48 per share from \$0.45 per share.

**WATSCO, INC. AND SUBSIDIARIES**  
**SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)**

<i>(In thousands, except per share data)</i>	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Total
<b>Year Ended December 31, 2008</b>					
Revenues (1)	\$ 380,399	\$ 509,822	\$ 475,225	\$ 334,791	\$ 1,700,237
Gross profit	98,004	131,060	126,673	86,257	441,994
Net income	<u>\$ 7,644</u>	<u>\$ 26,050</u>	<u>\$ 23,332</u>	<u>\$ 3,343</u>	<u>\$ 60,369</u>
Earnings per share for Common and Class B common stock (2):					
Basic	<u>\$ 0.29</u>	<u>\$ 0.98</u>	<u>\$ 0.88</u>	<u>\$ 0.13</u>	<u>\$ 2.28</u>
Diluted	<u>\$ 0.28</u>	<u>\$ 0.94</u>	<u>\$ 0.84</u>	<u>\$ 0.12</u>	<u>\$ 2.18</u>
<b>Year Ended December 31, 2007</b>					
Revenues (1)	\$ 370,681	\$ 471,110	\$ 518,596	\$ 397,635	\$ 1,758,022
Gross profit	95,313	119,592	130,932	101,148	446,985
Net income from continuing operations	10,978	24,448	25,364	6,699	67,489
Loss from discontinued operations, net of income taxes	164	1,598	116	34	1,912
Net income	<u>\$ 10,814</u>	<u>\$ 22,850</u>	<u>\$ 25,248</u>	<u>\$ 6,665</u>	<u>\$ 65,577</u>
Basic earnings per share for Common and Class B common stock (2):					
Net income from continuing operations	\$ 0.42	\$ 0.93	\$ 0.96	\$ 0.26	\$ 2.57
Net loss from discontinued operations	0.01	0.06	—	—	0.07
Net income	<u>\$ 0.41</u>	<u>\$ 0.87</u>	<u>\$ 0.96</u>	<u>\$ 0.25</u>	<u>\$ 2.49</u>
Diluted earnings per share for Common and Class B common stock (2):					
Net income from continuing operations	\$ 0.40	\$ 0.88	\$ 0.91	\$ 0.24	\$ 2.43
Net loss from discontinued operations	0.01	0.06	—	—	0.07
Net income	<u>\$ 0.39</u>	<u>\$ 0.82</u>	<u>\$ 0.90</u>	<u>\$ 0.24</u>	<u>\$ 2.36</u>

- (1) Sales of residential central air conditioners, heating equipment and related parts and supplies are seasonal. Demand related to the residential central air conditioning replacement market is highest in the second and third quarters with demand for heating equipment usually highest in the fourth quarter. Demand related to the new construction sectors throughout most of the markets is fairly even during the year except for dependence on housing completions and related weather and economic conditions.
- (2) Quarterly earnings per Common and Class B common share are calculated on an individual basis and, because of rounding and changes in the weighted-average shares outstanding during the year, the summation of each quarter may not equal the amount calculated for the year as a whole.

**WATSCO, INC. AND SUBSIDIARIES**  
**INFORMATION ON COMMON STOCK**

Our Common stock is traded on the New York Stock Exchange under the symbol WSO and our Class B common stock is traded on the American Stock Exchange under the symbol WSOB. The following table indicates the high and low prices of our Common stock and Class B common stock, as reported by the New York Stock Exchange and American Stock Exchange, respectively, and dividends paid per share for each quarter during the years ended December 31, 2008 and 2007. At February 24, 2009, excluding shareholders with stock in street name, there were 325 Common stock shareholders of record and 131 Class B common stock shareholders of record.

	Common		Class B		Cash Dividend	
	High	Low	High	Low	Common	Class B
<b>Year Ended December 31, 2008:</b>						
First quarter	\$ 43.80	\$ 31.44	\$ 44.50	\$ 31.15	\$ .40	\$ .40
Second quarter	47.47	40.27	47.82	40.30	.45	.45
Third quarter	58.49	40.86	55.55	41.42	.45	.45
Fourth quarter	<u>49.00</u>	<u>30.62</u>	<u>49.07</u>	<u>30.85</u>	<u>.45</u>	<u>.45</u>
<b>Year Ended December 31, 2007:</b>						
First quarter	\$ 54.15	\$ 45.76	\$ 53.50	\$ 46.03	\$ .25	\$ .25
Second quarter	63.50	48.97	63.39	48.71	.33	.33
Third quarter	58.26	45.50	58.33	46.42	.33	.33
Fourth quarter	<u>45.37</u>	<u>35.54</u>	<u>45.40</u>	<u>35.52</u>	<u>.40</u>	<u>.40</u>

## REGISTRANT'S SUBSIDIARIES

The following table sets forth, at February 24, 2009, the Registrant's significant operating subsidiaries and other associated companies and their respective incorporation jurisdictions. The Registrant owns 100% of the voting securities of each of the subsidiaries listed below. There are no subsidiaries not listed in the table, which would, in the aggregate, be considered significant.

<u>Active Subsidiaries</u>	<u>State of Incorporation</u>
ACH Supply LLC	Nevada
ACR Supply, LLC	Texas
Air Systems Distributors LLC	Delaware
Atlantic Service & Supply LLC	Delaware
Baker Distributing Company LLC	Delaware
Comfort Products Distributing, LLC	Delaware
East Coast Metal Distributors LLC	Delaware
Florida Cooling Supply LLC	Nevada
Gemaire Distributors LLC	Delaware
Heating & Cooling Supply LLC	California
Tradewinds Distributing Company LLC	Delaware
Watsco Holdings, Inc.	Delaware

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We have issued our reports dated February 27, 2009, with respect to the consolidated financial statements and internal control over financial reporting of Watsco, Inc. and subsidiaries which are incorporated by reference in the Annual Report of Watsco, Inc. on Form 10-K for the year ended December 31, 2008 and accompanying the schedule which is included in the Annual Report of Watsco, Inc. on Form 10-K for the year ended December 31, 2008. We hereby consent to the incorporation by reference of said reports in the following Registration Statements of Watsco, Inc. on Forms S-3 (No. 33-7758 and No. 33-37982) and on Forms S-8 (No. 333-149467, No. 333-126824, No. 333-86006, No. 333-39380, No. 333-82011, No. 333-80341, No. 333-10363, No. 33-51934 and No. 33-72798).

/s/ GRANT THORNTON LLP

Miami, Florida  
February 27, 2009



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

I, Albert H. Nahmad, certify that:

1. I have reviewed this Annual Report on Form 10-K 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 this 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: February 27, 2009

/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 Annual Report on Form 10-K 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 this 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: February 27, 2009

/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 Annual Report on Form 10-K 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 this 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: February 27, 2009

/s/ Ana M. Menendez

Ana M. Menendez  
Chief Financial Officer

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

In connection with the Annual Report of Watsco, Inc. ("Watsco") on Form 10-K for the year ended December 31, 2008, 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  
February 27, 2009

/s/ Barry S. Logan

Barry S. Logan  
Senior Vice President  
February 27, 2009

/s/ Ana M. Menendez

Ana M. Menendez  
Chief Financial Officer  
February 27, 2009

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version 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.