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**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, 2014

or

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

For the Transition Period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 1-5581

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**watsco**

**WATSCO, INC.**

(Exact name of registrant as specified in its charter)

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

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

**2665 South Bayshore Drive, Suite 901**  
**Miami, FL 33133**  
(Address of principal executive offices, including zip code)

**(305) 714-4100**  
(Registrant's telephone number, including area code)

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

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
Common stock, \$0.50 par value	New York Stock Exchange and the Professional Segment of NYSE Euronext in Paris
Class B common stock, \$0.50 par value	New York Stock Exchange

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

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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 whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES  NO

Indicate by check mark 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	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>

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 common equity held by non-affiliates of the registrant as of June 30, 2014, the last business day of the registrant's most recently completed second fiscal quarter, was approximately \$2,668 million, based on the closing sale price of the registrant's common stock on that date. For purposes of determining this number, all named executive officers and directors of the registrant as of June 30, 2014 were considered affiliates of the registrant. This number is provided only for the purposes of this Annual Report on Form 10-K and does not represent an admission by either the registrant or any such person as to the affiliate status of such person.

The registrant's common stock outstanding as of February 18, 2015 comprised (i) 30,126,311 shares of Common stock, excluding 6,322,650 treasury shares, and (ii) 4,909,491 shares of Class B common stock, excluding 48,263 treasury shares.

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

Certain information required by Parts I and II is incorporated by reference from the registrant's 2014 Annual Report, attached hereto as Exhibit 13. The information required by Part III (Items 10, 11, 12, 13 and 14) is incorporated herein by reference from the registrant's definitive proxy statement for the 2015 annual meeting of shareholders (to be filed pursuant to Regulation 14A).

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WATSCO, INC. AND SUBSIDIARIES

Form 10-K  
For the Fiscal Year Ended December 31, 2014

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## PART I

### Forward-Looking Statements

*This Annual Report on 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. Statements which are not historical in nature, including the words “anticipate,” “estimate,” “could,” “should,” “may,” “plan,” “seek,” “expect,” “believe,” “intend,” “target,” “will,” “project” and variations of these words and negatives thereof and similar expressions are intended to identify forward-looking statements, including statements regarding, among others, (i) economic conditions, (ii) business and acquisition strategies, (iii) potential acquisitions and/or joint ventures, (iv) financing plans and (v) industry, demographic and other trends affecting our financial condition or results of operations. These forward-looking statements are based on management’s current expectations, are not guarantees of future performance and are subject to a number of risks, uncertainties and changes in circumstances, certain of which are beyond our control. Actual results could differ materially from these forward-looking statements as a result of several factors, including, but not limited to:*

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

*We believe these forward-looking statements are reasonable; however, you should not place undue reliance on any forward-looking statements, which are based on current expectations. For additional information regarding other important factors that may affect our operations and could cause actual results to vary materially from those anticipated in the forward-looking statements see the discussion included in Item 1A “Risk Factors” of this Annual Report on Form 10-K, as well as the other documents and reports that we file with the SEC. 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, except as required by applicable law. We qualify any and all of our forward-looking statements by these cautionary factors.*

### ITEM 1. BUSINESS

#### General

Watsco, Inc. and its subsidiaries (collectively, “Watsco,” or *we, us or our*) was incorporated in Florida in 1956 and is the largest distributor of air conditioning, heating and refrigeration equipment and related parts and supplies (“HVAC/R”) in the HVAC/R distribution industry in North America. At December 31, 2014 we operated from 572 locations in 38 U.S. states, Canada, Mexico and Puerto Rico with additional market coverage on an export basis to Latin America and the Caribbean, through which we serve more than 50,000 contractors and dealers that service the replacement and new construction markets. Our revenues in HVAC/R distribution have increased from \$64.1 million in 1989 to \$3.9 billion in 2014, resulting from our strategic acquisition of companies with established market positions and subsequent building of revenues and profit through a combination of additional locations, introduction of new products and other initiatives.

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Our principal executive office is located at 2665 South Bayshore Drive, Suite 901, Miami, 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). Our website address is included in this report only as an inactive textual reference. Information contained on, or available through, our website is not incorporated by reference in, or made a part of, this report.

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

The HVAC/R distribution industry is highly fragmented with approximately 2,300 distribution companies. The industry in the United States and Canada is well-established, having had its primary period of growth during the post-World War II era with the advent of affordable central air conditioning and heating systems for both residential and commercial applications. The advent of HVAC/R products in Latin America and the Caribbean is also well-established, but has emerged in more recent years as those economies have grown and products have become more affordable and have matured from luxury to necessity.

Based on data published in the IBISWorld Industry Report for Heating and Air Conditioning Wholesaling in the U.S. and other available data, we estimate that the annual market for residential central air conditioning, heating and refrigeration equipment and related parts and supplies in the Americas is approximately \$35.0 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 Daikin Industries, Ltd.; Rheem Manufacturing Company (“Rheem”); Trane Inc., a subsidiary of Ingersoll-Rand Company Limited; York International Corporation, a subsidiary of Johnson Controls, Inc.; Lennox International, Inc.; 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 consumers, businesses and other end-users.

Air conditioning and heating equipment is sold to the residential replacement market, the commercial market and residential new construction market. The residential replacement market has increased in importance 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 consumers’ overall unwillingness to live without air conditioning or heating products. The mechanical life of central air conditioning and furnaces varies by geographical region due to usage and ranges from approximately 8 to 20 years. According to data published by the Energy Information Administration in 2013, there are approximately 89 million central air conditioning and heating systems installed in the United States that have been in service for more than 10 years. Many installed units are currently reaching the end of their useful lives, which we believe will provide a growing and stable replacement market.

We also sell products to the refrigeration market. These 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., Owens Corning Insulating Systems, LLC and The Manitowoc Company, Inc. (“Manitowoc”).

### **Business Strategy**

We have built our network of locations over the last 25 years using a “buy and build” philosophy, which has produced substantial long-term growth in revenues and profits. The “buy” component of the strategy has focused on acquiring market leaders to either expand into new geographic areas or gain additional market share in existing markets. We have employed a disciplined and conservative approach that seeks opportunities that fit well-defined financial and strategic criteria. The “build” component of the strategy has focused on implementing a growth culture at acquired companies, by adding products and locations to better serve 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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### 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, in which customers generally demand immediate, convenient and reliable service. We respond to this need by (i) offering 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) maintaining a strong density of warehouse locations for increased customer convenience, (iii) maintaining well-stocked inventories to ensure that customer orders are filled in a timely manner, (iv) providing a high degree of technical expertise at the point of sale and (v) developing and implementing technology to further enhance customer service capabilities. We believe these concepts provide a competitive advantage over smaller, less-capitalized competitors that 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, which typically do not maintain inventories of parts and supplies that are as diversified as ours and which have fewer warehouse locations than we do, making it more difficult for these competitors to meet the time-sensitive demands of the replacement market.

In addition to the replacement market, we sell to the new construction market, including new homes and commercial construction. 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

We focus on acquiring businesses that either complement our current presence in existing markets or establish a presence in new geographic markets. Since 1989, we have acquired 59 HVAC/R distribution businesses, six of which currently operate as primary operating subsidiaries. The other smaller acquired distributors have been integrated into or are under the management of our primary operating subsidiaries. Through a combination of sales and market share growth, opening of new locations, tuck-in acquisitions, expansion of product lines, improved pricing and programs that have resulted in higher gross profit, performance incentives and a culture of equity value for key leadership, we have produced substantial sales and earnings growth post-acquisition. We continue to pursue additional strategic acquisitions and/or joint ventures to allow further penetration in existing markets and expansion into new geographic markets.

### Product Line Expansion

We actively seek new or expanded territories of distribution from our key equipment suppliers. We currently maintain significant relationships with Carrier, Rheem, Goodman and Nordyne. We continually evaluate new parts and supply products to support equipment sales and further enhance service to our customers. This 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 our private-label branded products complement our existing product offerings at selected locations, based on customer needs and the particular market position and price of these products.

### Operating Philosophy

We encourage our acquired subsidiaries to operate in a manner that builds upon the long-term relationships they have established between their suppliers and customers. Typically, we maintain the identity and culture of acquired businesses by retaining their historical trade names, management teams and sales organizations and continuing their product brand-name offerings. We believe this strategy allows us to build on the value of the acquired operations by creating additional sales opportunities while providing an attractive exit strategy for the former owners of these companies.

We maintain a specialized staff at our corporate headquarters that provides functional support for our subsidiaries' growth strategies in their respective markets. Such functional support staff includes specialists in finance, accounting, product procurement, information technology, 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) the development of mobile applications for iOS and Android devices focused on helping our customers operate more efficiently and interact with our locations more easily; (ii) implementing 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; (iii) enabling connectivity with our suppliers; (iv) enabling e-commerce between our customers and our subsidiaries; (v) the development and implementation of business analytics systems and related data sets, which provides enhanced management tools; and (vi) maintaining our website, ACDoctor.com, which educates consumers about energy efficient HVAC solutions and financial incentives related to the installation of energy efficient systems and connects 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 British Thermal Units ("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, gas, electric and oil furnaces ranging from 50,000 to 150,000 BTUs, commercial air conditioning and heating equipment and systems ranging from 1-1/2 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 64% of our revenues for both the years ended December 31, 2014 and 2013. Sales of other HVAC products (currently sourced from more than 1,200 vendors) comprised 31% of our revenues for both the years ended December 31, 2014 and 2013. Sales of commercial refrigeration products accounted for 5% of our revenues for both the years ended December 31, 2014 and 2013.

### Distribution and Sales

At December 31, 2014, we operated from 572 locations, a vast majority of which are located in regions that we believe have demographic trends favorable to our business. We maintain large inventories at each of our warehouse locations, and either deliver products to customers using one of our 614 trucks or a third party logistics provider, or we make products available for pick-up at the location nearest to the customer. We have approximately 1,030 commissioned salespeople, averaging more than 11 years of experience in the HVAC/R distribution industry.

The markets we serve are as follows:

	<b>% of Revenues for the Year Ended December 31, 2014</b>	<b>Number of Locations as of December 31, 2014</b>
United States	86%	515
Canada	8%	37
Puerto Rico, Latin America and the Caribbean	3%	8
Mexico	3%	12
<b>Total</b>	<b>100%</b>	<b>572</b>

The largest market we serve is the United States, in which the most significant markets for HVAC/R products are in the Sun Belt states. Accordingly, the majority of our distribution locations are in the Sun Belt, with the highest concentration in Florida and Texas. These markets have been a strategic focus of ours given their size, the reliance by homeowners and businesses on HVAC/R products to maintain a comfortable indoor environment and the population growth in these areas over the last 40 years, which has led to a substantial installed base requiring replacement, a shorter useful life for equipment given the hours of operation and the focus by electrical utilities on consumer incentives designed to promote replacement of HVAC/R equipment in an effort to improve energy efficiency.

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### Markets

The table below identifies the number of our stores in the United States by location as of December 31, 2014:

Florida	110
Texas	85
California	37
North Carolina	37
Georgia	35
South Carolina	28
Tennessee	22
Virginia	22
Louisiana	19
Massachusetts	10
New York	10
Alabama	9
Mississippi	9
Maryland	8
Missouri	8
Arizona	7
Arkansas	6
Connecticut	6
Kansas	6
Oklahoma	6
Utah	5
New Jersey	4
Maine	3
Iowa	2
Kentucky	2
Nebraska	2
Nevada	2
Pennsylvania	2
Rhode Island	2
South Dakota	2
West Virginia	2
Colorado	1
Illinois	1
Indiana	1
New Hampshire	1
New Mexico	1
North Dakota	1
Vermont	1
<b>Total</b>	<b><u>515</u></b>

### Joint Ventures with Carrier Corporation

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

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

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

Combined, the joint ventures with Carrier represented 61% of our revenues for the year ended December 31, 2014. See *Supplier Concentration* in “Business Risk Factors” in Item 1A.

The business and affairs of the joint ventures are controlled, directed and managed exclusively by Carrier Enterprise I’s, Carrier Enterprise II’s and Carrier Enterprise III’s respective boards of directors (the “Boards”) pursuant to related operating agreements. The Boards have full, complete and exclusive authority, power and discretion to manage and control the business, property and affairs of their respective joint ventures and to make all decisions regarding those matters and to perform activities customary or incident to the management of such joint ventures, including approval of distributions to us, Carrier and UTC Canada. Each Board is composed of five directors, of whom three directors represent our controlling interest and two directors represent Carrier’s noncontrolling interest. Matters presented to the Boards for vote are considered approved or consented to upon the receipt of the affirmative vote of at least a majority of all directors entitled to vote with the exception of certain governance matters, which require joint approval.

### Customers and Customer Service

Air conditioning and heating contractors and dealers that install HVAC/R products in homes and businesses must be licensed given the highly-regulated nature of the products, refrigerant, natural gas and building and zoning requirements. We currently serve more than 50,000 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 2014, 2013 or 2012 represented more than 1% of our 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 mobile applications and e-commerce, which allows customers to access information online 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, maintenance of well-stocked inventories, density of warehouse locations, high quality reputation, broad product lines and the ability to foresee customer demand for new products.

### Key Suppliers

We have significant relationships with Carrier, Rheem, Goodman, Nordyne, Emerson, Manitowoc and DuPont, each of which is a leading manufacturer of HVAC/R products in the United States. Each manufacturer has a well-established reputation for 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 advertising programs and promotional incentives that are targeted to both dealers and end-users. We estimate that the replacement market for air conditioning products currently accounts for approximately 85% of industry sales in the United States, and we expect this percentage to increase as units installed in the past 20 years wear out or it otherwise becomes practical to replace older units with newer, more energy-efficient models.

Approximately 76%, 73% and 72% of our purchases in 2014, 2013 and 2012, respectively, were from the four key HVAC/R equipment suppliers. Our largest supplier, Carrier and its affiliates, accounted for 61%, 59% and 57% of all purchases made in 2014, 2013 and 2012, respectively. A significant interruption by Carrier, or any of our other three key suppliers, in the delivery of products could impair our ability 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’ respective 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 of this Annual Report on Form 10-K.

### Distribution Agreements

We have entered into distribution agreements 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 geographic markets served. Other than in the geographic markets where such restrictions and limitations apply, we may distribute other manufacturers’ lines of air conditioning or heating equipment.

We maintain separate and distinct trade name and distribution agreements with Carrier. These agreements provide us the use of various Carrier brand names and distribution rights for certain Carrier HVAC brands and products on an exclusive basis in specified territories. The trade name and distribution agreements are not subject to a stated term or expiration date. See *Supplier Concentration* in “Business Risk Factors” in Item 1A of this Annual Report on Form 10-K.

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### 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 typically highest in the second and third quarters, and demand for heating equipment is usually highest in the fourth quarter. Demand related to the new construction sectors throughout most of the markets is fairly even during the year except for dependence on housing completions and related weather and economic conditions.

### 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 our results of operations, cash flows and liquidity.

### **Employees**

We had approximately 5,000 employees as of December 31, 2014, substantially all of whom are non-union employees. Most of these employees are employed on a full-time basis, and our relations with our employees are good.

### **Order Backlog**

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

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

Our business is subject to federal, state and local laws and regulations relating to the storage, handling, transportation and release of hazardous materials into the environment. These laws and regulations include 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. We believe that the business is operated in 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. In addition, we could be affected by future laws or regulations imposed in response to concerns over climate change.

Our industry and business is also subject to a United States Department of Energy (“DOE”) mandate, effective January 1, 2015, that effects changes to the minimum required efficiency of HVAC systems. The DOE has divided the United States into three regions, the North, the Southeast and the Southwest, according to the number of hours that an air conditioner spends cooling a home during the hotter months. Prior to 2015, there was a national minimum standard for energy efficiency of 13 SEER (seasonal energy efficiency rating, the metric used to measure energy efficiency) for all equipment produced in the United States. Beginning in 2015, the new standard increased the minimum allowed efficiency to 14 SEER for the Southeast and Southwest regions.

### **Financial Information About Geographic Areas**

Our operations are primarily within the United States, including Puerto Rico, Canada and Mexico. Products are also sold from the United States on an export-only basis to portions of Latin America and the Caribbean Basin. The following tables set forth revenues and long-lived assets by geographic area (in millions):

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<u>Years Ended December 31,</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>
<b>Revenues:</b>			
United States	\$3,525	\$3,325	\$3,088
Canada	301	318	240
Mexico	119	100	104
Total Revenues	<u>\$3,945</u>	<u>\$3,743</u>	<u>\$3,432</u>
<u>December 31,</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>
<b>Long-Lived Assets:</b>			
United States	\$ 435	\$ 429	\$ 429
Canada	187	208	225
Mexico	5	5	5
Total Long-Lived Assets	<u>\$ 627</u>	<u>\$ 642</u>	<u>\$ 659</u>

Revenues are attributed to countries based on the location of the store from which the sale occurred. Long-lived assets consist of property and equipment, goodwill and intangible assets.

### **Available Information**

Our website is at [www.watsco.com](http://www.watsco.com). Our investor relations website is located at [www.investors.watsco.com](http://www.investors.watsco.com). We promptly make available, free of charge, on our investor relations website under the heading "SEC Filings" our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports filed with or furnished to the Securities and Exchange Commission pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended. Our website address is included in this report only as an inactive textual reference. Information contained on, or available through, our website is not incorporated by reference in, or made a part of, this report.

### **ITEM 1A. RISK FACTORS**

#### **Business Risk Factors**

##### Supplier Concentration

Our purchases from Carrier and its affiliates comprised 61% of all purchases made during 2014. Significant relationships currently exist with four of the seven major HVAC equipment manufacturers; and purchases from these equipment suppliers, including Carrier, comprised 76% of all purchases made in 2014. Given the significant concentration of our supply chain, particularly with Carrier, any significant interruption by any of the manufacturers or a termination of a distribution agreement could temporarily disrupt the operations of certain of our subsidiaries. Additionally, our operations are materially dependent upon the continued market acceptance and quality of these manufacturers' products and their ability to continue to manufacture products that are competitive and that comply with laws relating to environmental and efficiency standards. Our inability to obtain products from one or more of these manufacturers or a decline in market acceptance of these manufacturers' products could have a material adverse effect on our results of operations, cash flows and liquidity.

We maintain separate and distinct trade name distribution agreements with Carrier. These agreements provide us the use of various Carrier brand names and distribution rights for certain Carrier HVAC brands and products on an exclusive basis in specified territories. The trade name and distribution agreements are not subject to a stated term or expiration date.

We also maintain distribution agreements with our other 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 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.

##### Risks Inherent in Acquisitions

As part of our strategy, we intend to pursue additional acquisitions of complementary businesses. If we complete future acquisitions and/or joint ventures, 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 shareholders' ownership interest in us and may affect our results of operations. Growth through acquisitions involves a number of risks, including, but not limited to, the following:

- the ability to identify and consummate transactions with complementary acquisition candidates;
- the successful operation and/or integration of acquired companies;
- diversion of management's attention from other daily functions;

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- issuance by us of equity securities that would dilute ownership of our existing shareholders;
- incurrence and/or assumption of significant debt and contingent liabilities; and
- possible loss of key employees and/or customer relationships of the acquired companies.

In addition, acquired companies may have liabilities that we failed, or were unable, to discover in the course of performing due diligence investigations. We cannot assure you that the indemnification granted to us by sellers of acquired companies will be sufficient in amount, scope or duration to offset the possible liabilities associated with businesses or properties that we assume upon consummation of an acquisition. Any such liabilities, individually or in the aggregate, could have a material adverse effect on our business.

Failure to successfully manage the operational challenges and risks associated with, or resulting from, acquisitions could adversely affect our results of operations, cash flows and liquidity.

### 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 our results of operations, cash flows and liquidity.

### Foreign Currency Exchange Rate Fluctuations

The functional currency of our operations in Canada is the Canadian dollar, and the functional currency of our operations in Mexico is the U.S. dollar because the majority of our Mexican transactions are denominated in U.S. dollars. Foreign currency exchange rates and fluctuations may have an impact on transactions denominated in Canadian dollars and Mexican Pesos, and, therefore, could adversely affect our financial performance. Currently, we do not hold any derivative contracts that hedge our foreign currency translational exposure.

### Seasonality

Sales of residential central air conditioners, heating equipment and parts and supplies have historically been seasonal, resulting in fluctuations in our revenue from quarter to quarter. 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 typically highest in the second and third quarters, and demand for heating equipment is usually highest in the fourth quarter. Demand related to the new construction 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

Much of our success has depended on the skills, experience and services of senior management personnel. The loss of any of our executive officers or other key senior management personnel could harm our business. We must continue to recruit, retain and motivate management and other employees sufficiently in order to both maintain our current business and to execute our strategic initiatives. Our success has also substantially depended on the contributions and abilities of our store employees whom we rely on to give customers a superior in-store experience. Accordingly, our performance depends on our ability to recruit and retain high quality employees to work in and manage our stores. If we are unable to recruit, retain and motivate employees sufficiently in order to maintain our current business and support our projected growth and expansion, our business and financial performance may be adversely affected.

### Decline in Economic Conditions

We rely predominantly on the credit markets and, to a lesser extent, on the capital markets to meet our financial commitments and short-term liquidity needs if internal funds are not available from our operations. Our access to funds under our line of credit is dependent on the ability of the syndicate banks to meet their respective funding commitments. Disruptions in the credit and capital markets could adversely affect our ability to draw on our line of credit and may also affect the determination of certain interest rates, particularly rates based on LIBOR, which is one of the base rates under our line of credit. Any disruptions in these markets could result in increased borrowing costs and/or reduced borrowing capacity under our line of credit. Any long-term disruption could require that we 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.

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A decline in economic conditions and lack of availability of business and consumer credit could have an adverse effect on our business and results of operations. Any capital and credit market disruption could cause broader economic downturns, which may lead to reduced 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 be negatively impacted by deteriorating economic conditions, causing disruption or delay of product availability. These events would adversely impact our results of operations, cash flows and financial position. Additionally, if the conditions of the capital and credit markets adversely affect the financial institutions that have committed to extended credit to us, they may be unable to fund borrowings under such commitments, which could have an adverse impact on our financial condition, liquidity and our ability to borrow funds, if needed, for working capital, acquisitions, capital expenditures and other corporate purposes.

### International Political Risk

Our international sales and operations are subject to various risks associated with changes in local laws, regulations and policies, including those related to tariffs, trade restrictions and trade agreements, investments, taxation, capital controls, employment regulations, different liability standards and limitations on the repatriation of funds due to foreign currency controls. Our international sales and operations are also sensitive to changes in foreign national priorities, including government budgets, as well as political and economic instability. Unfavorable changes in any of the foregoing could adversely affect our results of operations. Additionally, failure to comply with the United States Foreign Corrupt Practices Act could subject us to, among other things, penalties and legal expenses that could harm our reputation and have a material adverse effect on our business, financial condition and results of operations.

### **General Risk Factors**

#### Goodwill and Intangibles

At December 31, 2014, goodwill and intangibles represented approximately 32% of our total assets. The recoverability of goodwill and indefinite lived intangibles is evaluated at least annually and when events or changes in circumstances indicate that the carrying amounts 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. The estimates of fair value of our reporting unit and indefinite lived intangibles are 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, a declining economic environment or market conditions. We cannot assure you that we will not suffer material impairments to goodwill in the future.

#### Risks Related to Insurance Coverage

We carry general liability, comprehensive property damage, workers' compensation, health benefits 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 stop-loss control programs.

#### Control by Existing Shareholder

As of December 31, 2014, Albert H. Nahmad, our Chairman and Chief Executive Officer, a limited partnership and various trusts controlled by him, collectively had beneficial ownership of approximately 53% of the combined voting power of our outstanding Common and Class B common stock. Based on Mr. Nahmad's stock ownership and the stock ownership of the limited partnership and various trusts controlled by him, Mr. Nahmad has the voting power to elect all but three members of our nine-person Board of Directors and to control most corporate actions requiring shareholder approval.

### **ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

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**ITEM 2. PROPERTIES**

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

Warehousing and Distribution Facilities

At December 31, 2014, we operated 572 warehousing and distribution facilities across 38 U.S. states, Canada, Mexico and Puerto Rico, having an aggregate of approximately 12.7 million square feet of space, of which approximately 12.4 million square feet is leased. The majority of these leases are for terms of three to five years. We believe that our facilities are sufficient to meet our present operating needs.

Trucks

At December 31, 2014, we operated 614 ground transport vehicles, including delivery and pick-up trucks, vans and tractors. Of this number, 290 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 support staff are located at our corporate headquarters in Miami, Florida in approximately 31,000 square feet of owned space.

**ITEM 3. LEGAL PROCEEDINGS**

Information with respect to this item may be found in Note 15 to our audited consolidated financial statements contained in this Annual Report on Form 10-K under the caption "Litigation, Claims and Assessments," which information is incorporated by reference in this Item 3 of Part I of this Annual Report on Form 10-K.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

**PART II**

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

**Stock Exchange Information, Common Share Price Performance and Dividends**

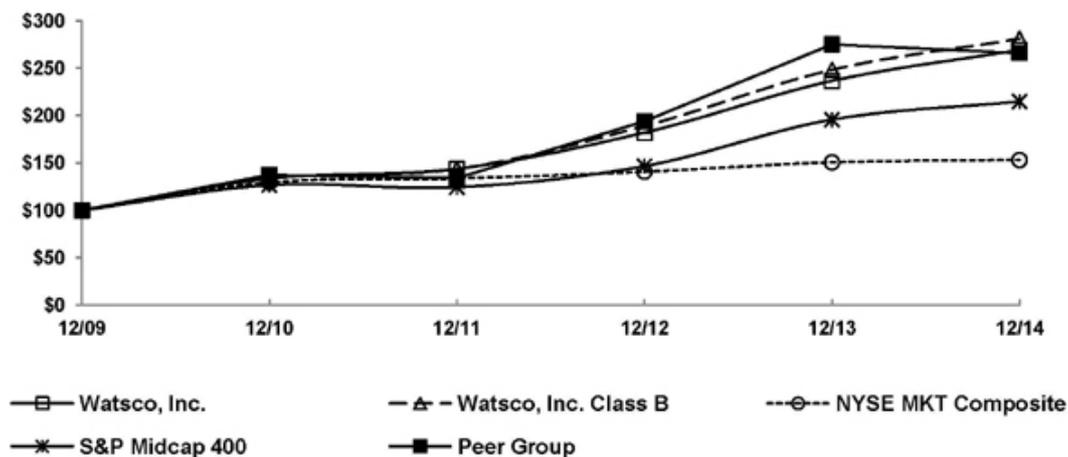
Our Common stock is listed on the New York Stock Exchange and the Professional Segment of NYSE Euronext in Paris under the ticker symbol WSO, and our Class B common stock is listed on the New York Stock Exchange under the ticker symbol WSOB.

Our 2014 Annual Report contains "Information on Common Stock," which identifies the exchanges on which our two classes of common stock are traded and contains the high and low sales prices and dividend information for the years ended December 31, 2014 and 2013, and is incorporated herein by reference.

**Shareholder Return Performance**

The following graph compares the cumulative five-year total return attained by holders of our Common stock and Class B common stock relative to the cumulative total returns of the NYSE MKT Composite index, the S&P Midcap 400 index and a customized peer group of companies, which are: Beacon Roofing Supply, 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 December 31, 2009 and its relative performance is tracked through December 31, 2014.

**COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN\***  
Among Watsco, Inc., the NYSE MKT Composite Index, the S&P Midcap 400 Index, and a Peer Group



\*\$100 invested on 12/31/09 in stock or index, including reinvestment of dividends.  
Fiscal year ending December 31.

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	12/09	12/10	12/11	12/12	12/13	12/14
Watsco, Inc.	100.00	133.52	143.88	182.11	236.69	269.34
Watsco, Inc. Class B	100.00	133.77	143.78	189.10	248.49	281.37
NYSE MKT Composite	100.00	129.56	133.75	140.87	150.79	153.24
S&P Midcap 400	100.00	126.64	124.45	146.69	195.84	214.97
Peer Group	100.00	137.48	134.11	193.95	275.25	266.18

[Table of Contents](#)**Purchases of Equity Securities by the Issuer and Affiliated Purchasers**

The following table provides information with respect to purchases we made of our common stock during the quarter ended December 31, 2014:

Period	Issuer Purchases of Equity Securities			Maximum Number of Shares that May Yet be Purchased under the Program (1)
	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	
October 1 – October 31	—	—	—	1,129,087
November 1 – November 30	—	—	—	1,129,087
December 1 – December 31	—	—	—	1,129,087
Total	—	—	—	1,129,087

- (1) In September 1999, our Board of Directors authorized the repurchase, at management's discretion, of up to 7,500,000 shares of common stock in the open market or via private transactions. No shares were repurchased under this plan in 2014, 2013 or 2012.

**Dividends**

Cash dividends per share of \$2.00, \$1.15 and \$7.48 for both Common and Class B common stock were paid in 2014, 2013 and 2012, respectively. Future dividends will be declared and paid at the sole discretion of the Board of Directors and will depend upon such factors as cash flow generated by operations, profitability, financial condition, cash requirements, future prospects and other factors deemed relevant by our Board of Directors.

**ITEM 6. SELECTED FINANCIAL DATA**

Our 2014 Annual Report contains "Selected Consolidated Financial Data", which section is incorporated herein by reference.

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

Our 2014 Annual Report contains "Management's Discussion and Analysis of Financial Condition and Results of Operations", which section is incorporated herein by reference.

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

Our 2014 Annual Report contains "Quantitative and Qualitative Disclosures about Market Risk", which section is incorporated herein by reference.

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

Our 2014 and 2013 Consolidated Balance Sheets and other consolidated financial statements for the years ended December 31, 2014, 2013 and 2012, together with the report thereon of KPMG LLP dated February 24, 2015 in our 2014 Annual Report are incorporated herein by reference.

The 2014 and 2013 unaudited Selected Quarterly Financial Data appearing in our 2014 Annual Report is incorporated herein by reference.

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

None.

**ITEM 9A. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures**

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

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

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

Our 2014 Annual Report contains “Management’s Report on Internal Control over Financial Reporting” and the report thereon of KPMG LLP dated February 24, 2015, and each 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 were no changes in internal controls over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended December 31, 2014, 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 most recently ended fiscal year, 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**

- (a)(1) Financial Statements. Our consolidated financial statements are incorporated by reference from our 2014 Annual Report.
- (2) Financial Statement Schedules. The schedules are omitted because they are not applicable or the required information is shown in the consolidated financial statements or notes thereto.
- (3) Exhibits. The following exhibits are submitted with this Annual Report on Form 10-K or, where indicated, incorporated by reference to other filings.
  - 3.1 Composite Articles of Incorporation of Watsco, Inc. (filed as Exhibit 3.1 to the Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 and incorporated herein by reference).
  - 3.2 Watsco Inc. Amended and Restated Bylaws effective August 22, 2012 (filed as Exhibit 3.1 to the Current Report on Form 8-K on August 28, 2012 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).

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- 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(a) 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 quarter ended March 31, 1996 and incorporated herein by reference). \*
- 10.1(b) 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). \*
- 10.1(c) 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). \*
- 10.1(d) 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). \*
- 10.1(e) 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 quarter ended March 31, 2004 and incorporated herein by reference). \*
- 10.1(f) 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 quarter ended March 31, 2005 and incorporated herein by reference). \*
- 10.1(g) 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). \*
- 10.1(h) 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). \*
- 10.1(i) 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 quarter ended March 31, 2008 and incorporated herein by reference). \*
- 10.1(j) 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 (filed as Exhibit 10.19 to the Annual Report on Form 10-K for the year ended December 31, 2008 and incorporated herein by reference). \*
- 10.1(k) Tenth Amendment dated January 1, 2009 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 quarter ended March 31, 2009 and incorporated herein by reference). \*
- 10.1(l) Eleventh Amendment dated January 1, 2010 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 quarter ended March 31, 2010 and incorporated herein by reference). \*
- 10.1(m) Twelfth Amendment dated January 1, 2011 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 quarter ended March 31, 2011 and incorporated herein by reference). \*
- 10.1(n) Thirteenth Amendment dated January 1, 2012 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 quarter ended March 31, 2012 and incorporated herein by reference). \*
- 10.1(o) Fourteenth Amendment dated January 1, 2013 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 quarter ended March 31, 2013 and incorporated herein by reference). \*

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- 10.1(p) Fifteenth Amendment dated January 1, 2014 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 quarter ended March 31, 2014 and incorporated herein by reference). \*
- 10.2 Watsco, Inc. Amended and Restated 2001 Incentive Compensation Plan (filed as Appendix A to the Definitive Proxy Statement on Schedule 14A in respect of our 2009 Annual Meeting of Shareholders and incorporated herein by reference). \*
- 10.3 Watsco, Inc. 2014 Incentive Compensation Plan (filed as Appendix A to the Definitive Proxy Statement on Schedule 14A in respect of our 2014 Annual Meeting of Shareholders and incorporated herein by reference). \*
- 10.4 Fourth Amended and Restated 1996 Qualified Employee Stock Purchase Plan dated April 18, 2011 (filed as Appendix A to the Definitive Proxy Statement on Schedule 14A in respect of our 2011 Annual Meeting of Shareholders and incorporated herein by reference). \*
- 10.5(a) Credit Agreement dated as of April 27, 2012, by and among Watsco, Inc., as Borrower, Watsco Canada, Inc., as Canadian Borrower, the Lenders from time to time party thereto, JPMorgan Chase Bank, N.A., as Administrative Agent and Collateral Agent, Bank of America, N.A. and Wells Fargo Bank, National Association as Co-Syndication Agents and U.S. Bank National Association as Documentation Agent (filed as Exhibit 10.1 to the Quarterly Report on Form 10-Q on August 2, 2013 and incorporated herein by reference).
- 10.5(b) Amendment No. 1 dated as of August 8, 2012, to the Credit Agreement dated as of April 27, 2012 (filed as Exhibit 10.4(b) to the Annual Report on Form 10-K for the year ended December 31, 2012, filed on February 28, 2013 and incorporated herein by reference).
- 10.5(c) Amendment No. 2, dated as of July 1, 2013, to Credit Agreement dated as of April 27, 2012, by and among Watsco, Inc., as Borrower, Watsco Canada, Inc., as Canadian Borrower, the Lenders from time to time party thereto, JPMorgan Chase Bank, N.A., as Administrative Agent and Collateral Agent, Bank of America, N.A. and Wells Fargo Bank, National Association as Co-Syndication Agents and U.S. Bank National Association as Documentation Agent (filed as Exhibit 10.1 to the Current Report on Form 8-K on July 2, 2013 and incorporated herein by reference).
- 10.5(d) Amendment No. 3, dated as of June 25, 2014, to Credit Agreement dated as of April 27, 2012, by and among Watsco, Inc., as Borrower, Watsco Canada, Inc., as Canadian Borrower, the Lenders from time to time party thereto, JPMorgan Chase Bank, N.A., as Administrative Agent and Collateral Agent, Bank of America, N.A. and Wells Fargo Bank, National Association as Co-Syndication Agents and U.S. Bank National Association as Documentation Agent (filed as Exhibit 10.1 to the Current Report on Form 8-K on June 27, 2014 and incorporated herein by reference).
- 10.6(a) Purchase and Contribution Agreement dated May 3, 2009 by and between Carrier Corporation and Watsco, Inc. (filed as Exhibit 2.1 to the Current Report on Form 8-K on May 7, 2009 and incorporated herein by reference).
- 10.6(b) Amendment to Purchase and Contribution Agreement dated as of June 29, 2009 by and between Carrier Corporation and Watsco, Inc. (filed as Exhibit 2.2 to the Current Report on Form 8-K on July 8, 2009 and incorporated herein by reference).
- 10.7 Operating Agreement of Carrier Enterprise, LLC (Amended and Restated), dated as of July 1, 2009 (filed as Exhibit 10.2 to the Current Report on Form 8-K on July 8, 2009 and incorporated herein by reference).
- 10.8(a) Shareholder Agreement by and between Watsco, Inc. and Carrier Corporation, dated as of July 1, 2009 (filed as Exhibit 10.3 to the Current Report on Form 8-K on July 8, 2009 and incorporated herein by reference).
- 10.8(b) Amended and Restated Shareholder Agreement by and between Watsco, Inc. and Carrier Corporation, dated as of January 24, 2012 (filed as Exhibit 10.28 to the Annual Report on Form 10-K for the year ended December 31, 2011 and incorporated herein by reference).
- 10.8(c) Second Amended and Restated Shareholder Agreement by and among Watsco, Inc., Carrier Corporation and UTC Canada Corporation, dated as of April 27, 2012 (filed as Exhibit 10.4 to the Current Report on Form 8-K on May 3, 2012 and incorporated herein by reference).

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10.9	Purchase and Contribution Agreement dated March 18, 2011 by and between Carrier Corporation and Watsco, Inc. (filed as Exhibit 2.1 to the Current Report on Form 8-K on March 24, 2011 and incorporated herein by reference).
10.10	Operating Agreement of Carrier Enterprise Northeast, LLC, dated as of April 30, 2011 (filed as Exhibit 10.29 to the Annual Report on Form 10-K for the year ended December 31, 2011 and incorporated herein by reference).
10.11	Asset Purchase Agreement dated March 13, 2012 by and between UTC Canada Corporation, Watsco, Inc., Watsco Canada, Inc. and Carrier Enterprise Canada, L.P. (filed as Exhibit 2.1 to the Current Report on Form 8-K on March 14, 2012 and incorporated herein by reference).
10.12	Carrier Enterprise Canada (G.P.), Inc. Shareholders' Agreement dated as of April 27, 2012 (filed as Exhibit 10.2 to the Current Report on Form 8-K on May 3, 2012 and incorporated herein by reference).
10.13	Subscription Agreement dated March 13, 2012 by and between Watsco, Inc., UTC Canada Corporation and Carrier Corporation (filed as Exhibit 10.1 to the Current Report on Form 8-K on March 14, 2012 and incorporated herein by reference).
13	2014 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 2014 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). #
21.1	Subsidiaries of the Registrant. #
23.1	Consent of Independent Registered Public Accounting Firm – KPMG 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. +
101.INS	XBRL Instance Document. #
101.SCH	XBRL Taxonomy Extension Schema Document. #
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document. #
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document. #
101.LAB	XBRL Taxonomy Extension Label Linkbase Document. #
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document. #

# filed herewith.

+ furnished herewith.

\* Management contract or compensation plan or arrangement.

**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 24, 2015

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

February 24, 2015

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 24, 2015
<u>/S/ BARRY S. LOGAN</u> <b>Barry S. Logan</b>	Director and Senior Vice President	February 24, 2015
<u>/S/ ANA M. MENENDEZ</u> <b>Ana M. Menendez</b>	Chief Financial Officer (principal accounting officer and principal financial officer)	February 24, 2015
<u>/S/ CESAR L. ALVAREZ</u> <b>Cesar L. Alvarez</b>	Director	February 24, 2015
<u>/S/ DAVID C. DARNELL</u> <b>David C. Darnell</b>	Director	February 24, 2015
<u>/S/ DENISE DICKINS</u> <b>Denise Dickins</b>	Director	February 24, 2015
<u>/S/ STEVEN R. FEDRIZZI</u> <b>Steven R. Fedrizzi</b>	Director	February 24, 2015
<u>/S/ PAUL F. MANLEY</u> <b>Paul F. Manley</b>	Director	February 24, 2015
<u>/S/ BOB L. MOSS</u> <b>Bob L. Moss</b>	Director	February 24, 2015
<u>/S/ AARON J. NAHMAD</u> <b>Aaron J. Nahmad</b>	Director and Vice President of Strategy and Innovation	February 24, 2015

**Exhibit Index**

<u>Exhibit Number</u>	<u>Description</u>
13	2014 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 2014 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).
21.1	Subsidiaries of the Registrant.
23.1	Consent of Independent Registered Public Accounting Firm – KPMG 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.
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema Document.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.

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

The following selected consolidated financial data should be read in conjunction with the consolidated financial statements, including the notes thereto, included under Item 8 of Part II, "Financial Statements and Supplementary Data," and the information contained in Item 7 of Part II, "Management's Discussion and Analysis of Financial Condition and Results of Operations" of this Annual Report on Form 10-K for the year ended December 31, 2014.

<i>(In thousands, except per share data)</i>	<u>2014</u>	<u>2013</u>	<u>2012 (1)</u>	<u>2011</u>	<u>2010</u>
<b>FOR THE YEAR</b>					
Revenues	\$3,944,540	\$3,743,330	\$3,431,712	\$2,977,759	\$2,844,595
Gross profit	956,402	899,253	814,395	728,294	673,241
Operating income	305,747	271,209	224,908	199,050	165,572
Net income	208,702	187,719	157,601	137,742	111,722
Less: net income attributable to noncontrolling interest	57,315	59,996	54,267	47,292	30,962
Net income attributable to Watsco, Inc.	<u>\$ 151,387</u>	<u>\$ 127,723</u>	<u>\$ 103,334</u>	<u>\$ 90,450</u>	<u>\$ 80,760</u>
Diluted earnings per share for Common and Class B common stock	\$ 4.32	\$ 3.68	\$ 2.70	\$ 2.74	\$ 2.49
Cash dividends per share:					
Common stock	\$ 2.00	\$ 1.15	\$ 7.48	\$ 2.23	\$ 2.04
Class B common stock	\$ 2.00	\$ 1.15	\$ 7.48	\$ 2.23	\$ 2.04
Weighted-average Common and Class B common shares outstanding—Diluted	32,359	32,258	31,744	30,753	30,579
<b>AT YEAR END</b>					
Total assets	\$1,791,067	\$1,669,531	\$1,682,055	\$1,268,148	\$1,237,227
Total long-term obligations	\$ 303,885	\$ 230,557	\$ 316,196	\$ —	\$ 10,016
Total shareholders' equity	\$1,132,039	\$1,127,392	\$1,022,040	\$1,001,710	\$ 928,896
Number of employees	5,000	4,800	4,600	4,300	4,000

- (1) On October 31, 2012, we paid a special dividend of \$5.00 per share of Common and Class B common stock that resulted in a \$0.33 per share reduction in diluted earnings per share.

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

**Forward-Looking Statements**

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

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

We believe these forward-looking statements are reasonable; however, you should not place undue reliance on any forward-looking statements, which are based on current expectations. For additional information regarding other important factors that may affect our operations and could cause actual results to vary materially from those anticipated in the forward-looking statements see the discussion included in Item 1A "Risk Factors" of this Annual Report on Form 10-K, as well as the other documents and reports that we file with the SEC. 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, except as required by applicable law. We qualify any and all of our forward-looking statements by these cautionary factors.

The following information should be read in conjunction with the information contained in Item 1A, "Risk Factors" and the consolidated financial statements, including the notes thereto, included under Item 8, "Financial Statements and Supplementary Data" of this Annual Report on Form 10-K for the year ended December 31, 2014.

**Company Overview**

Watsco, Inc. was incorporated in Florida in 1956, and, together with its subsidiaries (collectively, "Watsco," or "*we*", "*us*" or "*our*") is the largest distributor of air conditioning, heating and refrigeration equipment and related parts and supplies ("HVAC/R") in the HVAC/R distribution industry in North America. At December 31, 2014, we operated from 572 locations in 38 U.S. States, Canada, Mexico and Puerto Rico with additional market coverage on an export basis to Latin America and the Caribbean.

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

Sales of residential central air conditioners, heating equipment and parts and supplies are seasonal. Furthermore, results of operations can be impacted favorably or unfavorably based on weather patterns, primarily during the summer and winter selling seasons. Demand related to the residential central air conditioning replacement market is typically highest in the second and third quarters, and demand for heating equipment is usually highest in the fourth quarter. Demand related to the new construction market is fairly consistent during the year, subject to weather and economic conditions, including their effect on the number of housing completions.

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

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

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

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

### **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 consolidated 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 our audited consolidated financial statements included with this Annual Report on Form 10-K. 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. We typically do not require our customers to provide collateral. 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 \$5.5 million and \$5.7 million at December 31, 2014 and 2013, respectively, a decrease of \$0.2 million. Accounts receivable balances greater than 90 days past due as a percent of accounts receivable at December 31, 2014 decreased to 1.6% compared to 1.8% at December 31, 2013. These decreases were primarily attributable to an improvement in the underlying quality of our accounts receivable portfolio at December 31, 2014.

Although we believe the allowance for doubtful accounts is sufficient, a decline in economic conditions could lead to the 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. We believe our exposure to concentrations of credit risk is limited due to the large number of customers comprising our customer base and their dispersion across many different geographical regions. Additionally, we mitigate credit risk through credit insurance programs.

#### Inventory Valuation Reserves

Inventory valuation reserves are established in order to report inventories at the lower of weighted-average cost or market and the first-in, first-out method. As part of the valuation process, inventories are adjusted to reflect 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 make estimates and use judgment to determine the future salability of inventories. Inventory policies are reviewed periodically, 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.

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

The recoverability of goodwill is evaluated at least annually and when events or changes in circumstances indicate that the carrying amount may not be recoverable. We have one reporting unit that is subject to goodwill impairment testing. In performing the goodwill impairment test, we use a two-step approach. The first step compares the reporting unit's fair value to its carrying value. If the carrying value exceeds the fair value, a second step is performed to measure the amount of impairment loss, if any. 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. On January 1, 2015, we performed our annual goodwill impairment test and determined that the estimated fair value of our reporting unit significantly exceeded its carrying value.

The recoverability of indefinite lived intangibles is also evaluated on an annual basis or more often if deemed necessary. Indefinite lived 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. Our annual impairment tests did not result in any impairment of our indefinite lived intangibles.

The estimates of fair value of our reporting unit and indefinite lived intangibles are 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, a declining economic environment or market conditions. There have been no events or circumstances from the date of our assessments that would have an impact on this conclusion. The carrying amount of goodwill and intangibles was \$573.8 million and \$596.5 million at December 31, 2014 and 2013, respectively. 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 relative to company-wide casualty insurance and health benefit programs. The level of exposure from catastrophic events is limited by the purchase of stop-loss and aggregate liability reinsurance coverage. When estimating the self-insurance liabilities and related reserves, management considers a number of factors, which include historical claims experience, demographic factors, severity factors and valuations provided by independent third-party actuaries. Management reviews its assumptions with its independent third-party actuaries to evaluate whether the self-

insurance reserves are adequate. If actual claims or adverse development of loss reserves occur and exceed these estimates, additional reserves may be required. 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 amounts of \$4.6 million and \$5.6 million at December 31, 2014 and 2013, respectively, were established related to such insurance programs.

### 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. No valuation allowance was recorded at December 31, 2014. A valuation allowance of \$0.1 million was recorded at December 31, 2013 due to uncertainties related to the ability to utilize a portion of the deferred tax assets primarily arising from foreign net operating loss carryforwards. 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.

### **Recent Accounting Pronouncements**

Refer to Note 1 to our audited consolidated financial statements included in this Annual Report on Form 10-K for a discussion of new accounting pronouncements.

### **Results of Operations**

The following table summarizes information derived from the audited consolidated statements of income, expressed as a percentage of revenues, for the years ended December 31, 2014, 2013 and 2012. Due to rounding, percentages may not add up to operating income.

	<u>2014</u>	<u>2013</u>	<u>2012</u>
Revenues	<b>100.0%</b>	100.0%	100.0%
Cost of sales	<b>75.8</b>	76.0	76.3
Gross profit	<b>24.2</b>	24.0	23.7
Selling, general and administrative expenses	<b>16.5</b>	16.8	17.2
Operating income	<b>7.8</b>	7.2	6.5
Interest expense, net	<b>0.1</b>	0.1	0.1
Income before income taxes	<b>7.6</b>	7.1	6.4
Income taxes	<b>2.3</b>	2.1	1.8
Net income	<b>5.3</b>	5.0	4.6
Less: net income attributable to noncontrolling interest	<b>1.5</b>	1.6	1.6
Net income attributable to Watsco, Inc.	<b>3.8%</b>	3.4%	3.0%

We did not acquire any businesses during 2014 or 2013. The following narratives include the results of operations for businesses acquired during 2012. The results of operations for these acquisitions have been included in our consolidated statements of income beginning on their respective dates of acquisition. See Note 9 to our audited consolidated financial statements included in this Annual Report on Form 10-K for the pro forma financial information combining our results of operations with the operations of Carrier Enterprise III.

The following narratives also reflect our purchase of an additional 20% ownership interest in Carrier Enterprise I, 10% which became effective on July 1, 2014 and 10% which became effective on July 2, 2012.

In the following narratives, computations and disclosure information referring to “same-store basis” exclude the effects of locations acquired or locations opened or closed during the immediately preceding 12 months unless they are within close geographical proximity to existing locations. At December 31, 2014 and 2013, 31 and 16 locations, respectively, were excluded from “same-store basis” information. The table below summarizes the changes in our locations for 2014 and 2013:

	<u>Number of Locations</u>
December 31, 2012	573
Opened	6
Closed	<u>(10)</u>
December 31, 2013	569
Opened	17
Closed	<u>(14)</u>
December 31, 2014	<u><u>572</u></u>

## 2014 Compared to 2013

### Revenues

Revenues for 2014 increased \$201.2 million, or 5%, to \$3,944.5 million, including \$1.9 million from locations opened during the preceding 12 months, partially offset by \$5.7 million from closed locations. On a same-store basis, revenues increased \$205.0 million, or 5%, as compared to 2013, reflecting a 7% increase in sales of HVAC equipment (64% of sales), which included an 8% increase in residential HVAC equipment and a 3% increase in commercial HVAC equipment, a 2% increase in sales of other HVAC products (31% of sales) and a 7% increase in sales of commercial refrigeration products (5% of sales). The increase in same-store revenues is primarily due to higher demand for the replacement of residential HVAC equipment and higher demand related to the new construction market. Sales of residential HVAC equipment also benefited from an improved sales mix of higher-efficiency air conditioning and heating systems, which sell at higher unit prices.

### Gross Profit

Gross profit for 2014 increased \$57.1 million, or 6%, to \$956.4 million, primarily as a result of increased revenues. Gross profit margin improved 20 basis-points to 24.2% in 2014 from 24.0% in 2013, primarily due to higher realized gross margins for residential HVAC equipment.

### Selling, General and Administrative Expenses

Selling, general and administrative expenses for 2014 increased \$22.6 million, or 4%, to \$650.7 million, primarily as a result of increased revenues and additional headcount. Selling, general and administrative expenses as a percentage of revenues decreased to 16.5% for 2014 from 16.8% for 2013. The decrease in selling, general, and administrative expenses as a percentage of revenues was primarily due to improved leveraging of fixed operating costs as compared to 2013.

### Operating Income

Operating income for 2014 increased \$34.5 million, or 13%, to \$305.7 million. Operating margin improved 60 basis-points to 7.8% in 2014 from 7.2% in 2013.

### Interest Expense, Net

Net interest expense for 2014 decreased \$0.6 million, or 11%, to \$5.2 million, primarily as a result of a lower effective interest rate, partially offset by increased average outstanding borrowings in 2014 as compared to 2013.

### Income Taxes

Income taxes increased to \$91.8 million for 2014, as compared to \$77.7 million for 2013 and are a composite of the income taxes attributable to our wholly owned operations and investments and income taxes attributable to the Carrier joint ventures, which are taxed as partnerships for income tax purposes. The effective income tax rate attributable to us was 37.0% in 2014 and 2013.

### Net Income Attributable to Watsco, Inc.

Net income attributable to Watsco in 2014 increased \$23.7 million, or 19%, to \$151.4 million. The increase was primarily driven by higher revenues, expanded profit margins and reduced selling, general and administrative expenses as a percent of revenues, as discussed above, and by a reduction in the net income attributable to the noncontrolling interest related to Carrier Enterprise I following our purchase of an additional 10% ownership interest in Carrier Enterprise I in July 2014.

## 2013 Compared to 2012

### Revenues

Revenues for 2013 increased \$311.6 million, or 9%, to \$3,743.3 million, including \$87.4 million attributable to the 35 new Carrier Enterprise III locations and \$2.5 million from other locations opened during the preceding 12 months, offset by \$7.9 million from locations closed. On a same-store basis, revenues increased \$229.6 million, or 7%, as compared to 2012, reflecting a 9% increase in sales of HVAC equipment (12% increase in residential HVAC equipment offset by a 2% decrease in commercial HVAC equipment), a 3% increase in sales of other HVAC products and a 3% increase in sales of commercial refrigeration products. The increase in same-store revenues is primarily due to strong demand for residential HVAC equipment.

### Gross Profit

Gross profit for 2013 increased \$84.9 million, or 10%, to \$899.3 million, primarily as a result of increased revenues. Gross profit margin improved 30 basis-points to 24.0% in 2013 from 23.7% in 2012. On a same-store basis, gross profit margin also improved 30 basis-points to 24.0% in 2013 from 23.7% in 2012, primarily due to higher realized gross margins for residential HVAC equipment and non-equipment products.

### Selling, General and Administrative Expenses

Selling, general and administrative expenses for 2013 increased \$38.6 million, or 7%, to \$628.0 million, primarily as a result of increased revenues. Selling, general and administrative expenses as a percentage of revenues decreased to 16.8% for 2013 from 17.2% for 2012. The decrease in selling, general, and administrative expenses as a percentage of revenues was primarily due to leveraging of fixed operating costs as compared to 2012. Selling, general and administrative expenses in 2012 included \$1.2 million of acquisition-related costs. On a same-store basis, selling, general and administrative expenses increased 3% as compared to 2012.

### Operating Income

Operating income for 2013 increased \$46.3 million, or 21%, to \$271.2 million. Operating margin improved 70 basis-points to 7.2% in 2013 from 6.5% in 2012. On a same-store basis, operating income increased 19% compared to 2012.

### Interest Expense, Net

Net interest expense for 2013 increased \$1.2 million, or 25%, to \$5.8 million, primarily as a result of increased average outstanding borrowings, partially offset by a lower effective interest rate in 2013 as compared to 2012.

### Income Taxes

Income taxes increased to \$77.7 million for 2013, as compared to \$62.6 million for 2012 and are a composite of the income taxes attributable to our wholly owned operations and investments, and income taxes attributable to the Carrier joint ventures, which are taxed as partnerships for income tax purposes. The effective income tax rate attributable to us was 37.0% and 36.75% in 2013 and 2012, respectively. The increase was primarily due to higher effective tax rates for income generated by our United States subsidiaries.

### Net Income Attributable to Watsco, Inc.

Net income attributable to Watsco in 2013 increased \$24.4 million, or 24%, to \$127.7 million. The increase was primarily driven by higher revenues, expanded profit margins and reduced selling, general and administrative expenses as a percent of revenues as discussed above, and by a reduction in the net income attributable to the noncontrolling interest related to Carrier Enterprise I following our purchase of an additional 10% ownership interest in Carrier Enterprise I in July 2012.

## **Liquidity and Capital Resources**

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

- cash necessary to fund our business (primarily working capital requirements);
- the adequacy of our available bank line of credit;
- the ability to attract long-term capital with satisfactory terms;
- acquisitions, including joint ventures;

- dividend payments;
- capital expenditures; and
- the timing and extent of common stock repurchases.

### Sources and Uses of Cash

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

As of December 31, 2014, we had \$24.4 million of cash and cash equivalents, of which, \$21.6 million was held by foreign subsidiaries. We believe that our operating cash flows, cash on hand and funds available for borrowing under our line of credit will be sufficient to meet our liquidity needs in the foreseeable future. However, there can be no assurance that our current sources of available funds will be sufficient to meet our cash requirements.

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

### Working Capital

Working capital increased to \$870.3 million at December 31, 2014 from \$777.6 million at December 31, 2013, reflecting an increase of inventory, including some additional inventory received in anticipation of the transition to new regional efficiency standards in 2015, and higher levels of accounts receivable commensurate with our increase in overall business volume.

### Cash Flows

The following table summarizes our cash flow activity for 2014 and 2013 (in millions):

	<u>2014</u>	<u>2013</u>	<u>Change</u>
Cash flows provided by operating activities	<b>\$ 145.0</b>	\$ 150.3	\$ (5.3)
Cash flows used in investing activities	<b>\$ (19.1)</b>	\$ (14.3)	\$ (4.8)
Cash flows used in financing activities	<b>\$(120.2)</b>	\$(189.0)	\$ 68.8

The individual items contributing to cash flow changes for the years presented are detailed in the consolidated statements of cash flows contained in this Annual Report on Form 10-K.

#### *Operating Activities*

The decrease in net cash provided by operating activities was primarily due to higher levels of inventory in 2014 as compared to 2013 and higher accounts receivable driven by increased sales, partially offset by higher net income in 2014 as compared to 2013 and the timing of payments for accounts payable and other liabilities.

#### *Investing Activities*

The increase in net cash used in investing activities in 2014 as compared to 2013 is primarily due to higher capital expenditures of \$6.9 million in 2014.

#### *Financing Activities*

The decrease in net cash used in financing activities was primarily attributable to higher net borrowings under our revolving credit agreement used to exercise our second option to acquire an additional 10% ownership interest in Carrier Enterprise I for \$87.7 million and a decrease in distributions to the noncontrolling interest in 2014 as compared to 2013, partially offset by an increase in dividends paid in 2014.

### Revolving Credit Agreement

As amended on June 25, 2014, our unsecured, syndicated revolving credit agreement provides for borrowings of up to \$600.0 million, which we use to fund seasonal working capital needs and other general corporate purposes, including acquisitions, dividends, stock repurchases and issuances of letters of credit. Included in the facility are a \$90.0 million swingline subfacility, a \$50.0 million letter of credit subfacility and a \$75.0 million multicurrency borrowing sublimit. The revolving credit agreement matures on July 1, 2019.

Borrowings under the credit facility bear interest at either LIBOR-based rates plus a spread, which ranges from 87.5 to 250.0 basis-points (LIBOR plus 125.0 basis-points at December 31, 2014), depending on our ratio of total debt to EBITDA, or on rates based on the higher of the Prime rate or the Federal Funds Rate, in each case plus a spread which ranges from 0 to 150.0 basis-points (25.0 basis-points at December 31, 2014), depending on our ratio of total debt to EBITDA. We pay a variable commitment fee on the unused portion of the commitment under the revolving credit agreement, ranging from 12.5 to 35.0 basis-points (17.5 basis-points at December 31, 2014).

At December 31, 2014 and 2013, \$303.2 million and \$230.0 million, respectively, was outstanding under the revolving credit agreement. The revolving credit agreement contains customary affirmative and negative covenants, including financial covenants with respect to consolidated leverage and interest coverage ratios, and other customary restrictions. We believe we were in compliance with all such covenants at December 31, 2014.

### Contractual Obligations

As of December 31, 2014, our significant contractual obligations were as follows (in millions):

<u>Contractual Obligations</u>	<u>Payments due by Period</u>						<u>Total</u>
	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>Thereafter</u>	
Operating leases (1)	\$67.3	\$56.3	\$41.2	\$26.2	\$12.8	\$ 13.5	\$217.3
Purchase obligations (2)	31.8	—	—	—	—	—	31.8
<b>Total</b>	<b>\$99.1</b>	<b>\$56.3</b>	<b>\$41.2</b>	<b>\$26.2</b>	<b>\$12.8</b>	<b>\$ 13.5</b>	<b>\$249.1</b>

- (1) *Represents future minimum payments associated with real property, equipment, vehicles and a corporate aircraft under non-cancelable operating leases. We are committed to pay a portion of the actual operating expenses under certain of these lease agreements and these operating expenses are excluded from the table above.*
- (2) *Purchase obligations include amounts committed under purchase orders for goods with defined terms as to price, quantity and delivery. Purchase orders made in the ordinary course of business that are cancelable are excluded from the above table. Any amounts for which we are liable under purchase orders for goods received are reflected in Accounts Payable in our Consolidated Balance Sheets and are excluded from the above table.*

Commercial obligations outstanding at December 31, 2014 under our revolving credit agreement consisted of borrowings totaling \$303.2 million with revolving maturities of 14 to 31 days.

### Off-Balance Sheet Arrangements

Refer to Note 12 to our audited consolidated financial statements, under the caption "Off-Balance Sheet Financial Instruments," for a discussion of standby letters of credit and performance bonds that we were contingently liable under at December 31, 2014.

### Purchase of Ownership Interest in Joint Venture

On July 1, 2014, we exercised our second option to acquire an additional 10% ownership interest in Carrier Enterprise I for cash consideration of \$87.7 million, following which we have an 80% controlling interest in Carrier Enterprise I. Neither we nor Carrier has any remaining options to purchase additional ownership interests in Carrier Enterprise I or any of our other joint ventures with Carrier.

### Acquisitions

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

### Common Stock Dividends

We paid cash dividends of \$2.00, \$1.15 and \$7.48 per share of Common stock and Class B common stock in 2014, 2013 and 2012, respectively. On January 6, 2015, our Board of Directors approved an increase to the quarterly cash dividend rate to \$0.70 per share from \$0.60 per share of Common and Class B common stock beginning with the dividend that was paid on January 30, 2015 to shareholders of record as of January 21, 2015. 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 cash flow generated by operations, profitability, financial condition, cash requirements, future prospects and other factors deemed relevant by our Board of Directors.

### Company Share Repurchase Program

In September 1999, our Board of Directors authorized the repurchase, at management's discretion, of up to 7,500,000 shares of common stock in the open market or via private transactions. Shares repurchased under the program are accounted for using the cost method and result in a reduction of shareholders' equity. No shares were repurchased in 2014, 2013 or 2012. In aggregate, 6,370,913 shares of Common and Class B common stock have been repurchased at a cost of \$114.4 million since the inception of the program. At December 31, 2014, there were 1,129,087 shares remaining authorized for repurchase under the program.

### **Quantitative and Qualitative Disclosures about Market Risk**

We are exposed to market risks, including fluctuations in foreign currency exchange rates and interest rates. To manage certain of these exposures, we use derivative instruments, including forward contracts and swaps. We use derivative instruments as risk management tools and not for trading purposes.

#### Foreign Currency Exposure

We are exposed to cash flow and earnings fluctuations resulting from currency exchange rate variations. These exposures are transactional and translational in nature. The foreign currency exchange rates to which we are exposed are the Canadian dollar and Mexican peso. Revenues in these markets accounted for 8% and 3%, respectively, of our total revenues for 2014.

Our transactional exposure primarily relates to purchases by our Canadian operations in currencies other than their local currency. To mitigate the impact of currency exchange rate movements on these purchases, we use foreign currency forward contracts. By entering into these foreign currency forward contracts, we lock in exchange rates that would otherwise cause losses should the U.S. dollar strengthen and gains should the U.S. dollar weaken, in each case against the Canadian dollar. The total notional value of our foreign currency forward contracts as of December 31, 2014 was \$37.8 million, and such contracts have varying terms expiring through October 2015.

We have exposure related to the translation of financial statements of our Canadian operations into U.S. dollars, our functional currency. Currently, we do not hold any derivative contracts that hedge our foreign currency translational exposure.

Historically, fluctuations in these exchange rates have not materially impacted our results of operations. Our exposure to currency rate fluctuations could be material in the future if these fluctuations become significant or if our Canadian and Mexican markets grow and represent a larger percentage of our total revenues.

See Note 13 to our audited consolidated financial statements included in this Annual Report on Form 10-K for further information on our derivatives.

#### Interest Rate Exposure

Our revolving credit facility exposes us to interest rate risk because borrowings thereunder accrue interest at one or more variable rates. Our interest rate risk management objectives are to limit the impact of interest rate changes on earnings and cash flows and to lower overall borrowing costs. To achieve these objectives, we have historically entered into interest rate swap agreements with financial institutions that have investment grade credit ratings, thereby minimizing credit risk associated with these instruments. We do not currently hold any such swap agreements or any other derivative contracts that hedge our interest rate exposure, but we may enter into such instruments in the future.

We have evaluated our exposure to interest rates based on the amount of variable debt outstanding under our revolving credit agreement at December 31, 2014, and determined that a 100 basis-point change in interest rates would result in an impact to income before taxes of approximately \$3.0 million. See Note 6 to our audited consolidated financial statements included in this Annual Report on Form 10-K for further information about our debt.

## 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, 2014. The assessment was based on criteria established in the framework *Internal Control — Integrated Framework (2013)*, 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, 2014. The effectiveness of our internal control over financial reporting as of December 31, 2014 has been audited by KPMG LLP, an independent registered public accounting firm, as stated in their report that is included herein.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Shareholders  
Watsco, Inc.:

We have audited Watsco, Inc.'s internal control over financial reporting as of December 31, 2014, based on criteria established in *Internal Control – Integrated Framework (2013)* 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 the Company's 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, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included 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. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2014, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (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, 2014 and 2013, and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2014, and our report dated February 24, 2015 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Miami, Florida  
February 24, 2015  
Certified Public Accountants

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Shareholders  
Watsco, Inc.:

We have audited the accompanying consolidated balance sheets of Watsco, Inc. and subsidiaries as of December 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2014. These consolidated 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, 2014 and 2013, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2014, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Watsco, Inc.'s internal control over financial reporting as of December 31, 2014, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 24, 2015 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP

Miami, Florida  
February 24, 2015  
Certified Public Accountants

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

<i>(In thousands, except per share data)</i>	Years Ended December 31,		
	2014	2013	2012
Revenues	\$3,944,540	\$3,743,330	\$3,431,712
Cost of sales	2,988,138	2,844,077	2,617,317
Gross profit	956,402	899,253	814,395
Selling, general and administrative expenses	650,655	628,044	589,487
Operating income	305,747	271,209	224,908
Interest expense, net	5,206	5,830	4,665
Income before income taxes	300,541	265,379	220,243
Income taxes	91,839	77,660	62,642
Net income	208,702	187,719	157,601
Less: net income attributable to noncontrolling interest	57,315	59,996	54,267
Net income attributable to Watsco, Inc.	<u>\$ 151,387</u>	<u>\$ 127,723</u>	<u>\$ 103,334</u>
Earnings per share for Common and Class B common stock:			
Basic	<u>\$ 4.33</u>	<u>\$ 3.69</u>	<u>\$ 2.70</u>
Diluted	<u>\$ 4.32</u>	<u>\$ 3.68</u>	<u>\$ 2.70</u>

*See accompanying notes to consolidated financial statements.*

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

<i>(In thousands)</i>	Years Ended December 31,		
	2014	2013	2012
Net income	\$208,702	\$187,719	\$157,601
Other comprehensive loss, net of tax			
Foreign currency translation adjustment	(21,117)	(16,365)	(3,191)
Unrealized gain on cash flow hedging instruments arising during the period	280	—	—
Unrealized gain on available-for-sale securities arising during the period	1	24	35
Other comprehensive loss	(20,836)	(16,341)	(3,156)
Comprehensive income	187,866	171,378	154,445
Less: comprehensive income attributable to noncontrolling interest	48,752	53,027	52,861
Comprehensive income attributable to Watsco, Inc.	\$139,114	\$118,351	\$101,584

*See accompanying notes to consolidated financial statements.*

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

<i>(In thousands, except share and per share data)</i>	December 31,	
	2014	2013
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 24,447	\$ 19,478
Accounts receivable, net	434,234	399,565
Inventories	677,990	583,154
Other current assets	20,664	18,905
<b>Total current assets</b>	<b>1,157,335</b>	<b>1,021,102</b>
Property and equipment, net	53,480	45,418
Goodwill	387,311	392,610
Intangible assets, net	186,476	203,843
Other assets	6,465	6,558
	<b>\$1,791,067</b>	<b>\$1,669,531</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Current portion of other long-term obligations	\$ 169	\$ 107
Accounts payable	173,360	141,104
Accrued expenses and other current liabilities	113,493	102,295
<b>Total current liabilities</b>	<b>287,022</b>	<b>243,506</b>
Long-term obligations:		
Borrowings under revolving credit agreement	303,199	230,044
Other long-term obligations, net of current portion	686	513
<b>Total long-term obligations</b>	<b>303,885</b>	<b>230,557</b>
Deferred income taxes and other liabilities	68,121	68,076
Commitments and contingencies		
Watsco, Inc. shareholders' equity:		
Common stock, \$0.50 par value, 60,000,000 shares authorized; 36,444,289 and 36,364,297 shares outstanding at December 31, 2014 and 2013, respectively	18,222	18,182
Class B common stock, \$0.50 par value, 10,000,000 shares authorized; 4,933,245 and 4,733,737 shares outstanding at December 31, 2014 and 2013, respectively	2,467	2,367
Preferred stock, \$0.50 par value, 10,000,000 shares authorized; no shares issued	—	—
Paid-in capital	580,564	606,384
Accumulated other comprehensive loss, net of tax	(23,747)	(11,474)
Retained earnings	420,879	339,362
Treasury stock, at cost, 6,322,650 shares of Common stock and 48,263 shares of Class B common stock at both December 31, 2014 and 2013	(114,425)	(114,425)
<b>Total Watsco, Inc. shareholders' equity</b>	<b>883,960</b>	<b>840,396</b>
Noncontrolling interest	248,079	286,996
<b>Total shareholders' equity</b>	<b>1,132,039</b>	<b>1,127,392</b>
	<b>\$1,791,067</b>	<b>\$1,669,531</b>

*See accompanying notes to consolidated financial statements.*

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

<i>(In thousands, except share and per share data)</i>	Common Stock, Class B Common Stock and Preferred Stock Shares	Common Stock, Class B Common Stock and Preferred Stock Amount	Paid-In Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Treasury Stock	Noncontrolling Interest	Total
<b>Balance at December 31, 2011</b>	<b>33,005,341</b>	<b>\$ 19,688</b>	<b>\$493,519</b>	<b>\$ (352)</b>	<b>\$ 404,360</b>	<b>\$(114,425)</b>	<b>\$ 198,920</b>	<b>\$1,001,710</b>
Net income					103,334		54,267	157,601
Other comprehensive loss				(1,750)			(1,406)	(3,156)
Issuances of non-vested (restricted) shares of common stock	111,301	56	(56)					—
Common stock contribution to 401(k) plan	26,991	13	1,759					1,772
Stock issuances from exercise of stock options and employee stock purchase plan	157,664	79	7,084					7,163
Retirement of common stock	(29,987)	(15)	(2,214)					(2,229)
Share-based compensation			7,716					7,716
Excess tax benefit from share-based compensation			1,079					1,079
Cash dividends declared and paid on Common and Class B common stock, \$7.48 per share					(256,219)			(256,219)
Common stock issued for Carrier Enterprise III	1,250,000	625	92,625					93,250
Fair value of noncontrolling interest in Carrier Enterprise III							104,244	104,244
Decrease in noncontrolling interest in Carrier Enterprise I			(8,692)				(43,189)	(51,881)
Distributions to noncontrolling interest							(39,010)	(39,010)
<b>Balance at December 31, 2012</b>	<b><u>34,521,310</u></b>	<b><u>20,446</u></b>	<b><u>592,820</u></b>	<b><u>(2,102)</u></b>	<b><u>251,475</u></b>	<b><u>(114,425)</u></b>	<b><u>273,826</u></b>	<b><u>1,022,040</u></b>

*Continued on next page.*

	Common Stock, Class B Common Stock and Preferred Stock Shares	Common Stock, Class B Common Stock and Preferred Stock Amount	Paid-In Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Treasury Stock	Noncontrolling Interest	Total
<i>(In thousands, except share and per share data)</i>								
<b>Balance at December 31, 2012</b>	<b>34,521,310</b>	<b>20,446</b>	<b>592,820</b>	<b>(2,102)</b>	<b>251,475</b>	<b>(114,425)</b>	<b>273,826</b>	<b>1,022,040</b>
Net income					127,723		59,996	187,719
Other comprehensive loss				(9,372)			(6,969)	(16,341)
Issuances of non-vested (restricted) shares of common stock	124,043	62	(62)					—
Forfeitures of non-vested (restricted) shares of common stock	(10,000)	(5)	5					—
Common stock contribution to 401(k) plan	22,551	11	1,678					1,689
Stock issuances from exercise of stock options and employee stock purchase plan	87,193	44	3,340					3,384
Retirement of common stock	(17,976)	(9)	(1,668)					(1,677)
Share-based compensation			8,760					8,760
Excess tax benefit from share-based compensation			1,511					1,511
Cash dividends declared and paid on Common and Class B common stock, \$1.15 per share					(39,836)			(39,836)
Distributions to noncontrolling interest							(39,857)	(39,857)
<b>Balance at December 31, 2013</b>	<b>34,727,121</b>	<b>20,549</b>	<b>606,384</b>	<b>(11,474)</b>	<b>339,362</b>	<b>(114,425)</b>	<b>286,996</b>	<b>1,127,392</b>

Continued on next page.

	Common Stock, Class B Common Stock and Preferred Stock Shares	Common Stock, Class B Common Stock and Preferred Stock Amount	Paid-In Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Treasury Stock	Noncontrolling Interest	Total
<i>(In thousands, except share and per share data)</i>								
<b>Balance at December 31, 2013</b>	<b>34,727,121</b>	<b>20,549</b>	<b>606,384</b>	<b>(11,474)</b>	<b>339,362</b>	<b>(114,425)</b>	<b>286,996</b>	<b>1,127,392</b>
Net income					151,387		57,315	208,702
Other comprehensive loss				(12,273)			(8,563)	(20,836)
Issuances of non-vested (restricted) shares of common stock	218,725	109	(109)					—
Forfeitures of non-vested (restricted) shares of common stock	(5,000)	(2)	2					—
Common stock contribution to 401(k) plan	18,309	9	1,750					1,759
Stock issuances from exercise of stock options and employee stock purchase plan	73,948	37	4,629					4,666
Retirement of common stock	(26,482)	(13)	(2,602)					(2,615)
Share-based compensation			12,006					12,006
Excess tax benefit from share-based compensation			1,828					1,828
Cash dividends declared and paid on Common and Class B common stock, \$2.00 per share					(69,870)			(69,870)
Decrease in noncontrolling interest in Carrier Enterprise I			(43,324)				(44,411)	(87,735)
Distributions to noncontrolling interest							(43,258)	(43,258)
<b>Balance at December 31, 2014</b>	<b><u>35,006,621</u></b>	<b><u>\$ 20,689</u></b>	<b><u>\$580,564</u></b>	<b><u>\$ (23,747)</u></b>	<b><u>\$ 420,879</u></b>	<b><u>\$(114,425)</u></b>	<b><u>\$ 248,079</u></b>	<b><u>\$1,132,039</u></b>

See accompanying notes to consolidated financial statements.

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

<i>(In thousands)</i>	Years Ended December 31,		
	2014	2013	2012
<b>Cash flows from operating activities:</b>			
Net income	\$ 208,702	\$ 187,719	\$ 157,601
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>			
Depreciation and amortization	17,927	17,706	15,911
Share-based compensation	11,473	9,967	7,939
Deferred income tax provision	289	8,589	6,724
Provision for doubtful accounts	2,609	961	1,826
Non-cash contribution to 401(k) plan	1,759	1,689	1,772
(Gain) loss on sale of property and equipment	(1,292)	(156)	103
Excess tax benefits from share-based compensation	(1,828)	(1,511)	(1,079)
<b>Changes in operating assets and liabilities, net of effects of acquisitions:</b>			
Accounts receivable	(41,068)	(25,846)	(5,752)
Inventories	(98,741)	(40,575)	(26,652)
Accounts payable and other liabilities	45,242	(7,256)	11,873
Other, net	(92)	(1,018)	3,077
<b>Net cash provided by operating activities</b>	<b>144,980</b>	<b>150,269</b>	<b>173,343</b>
<b>Cash flows from investing activities:</b>			
Capital expenditures	(21,512)	(14,580)	(12,317)
Proceeds from sale of property and equipment	2,388	323	504
Business acquisitions, net of cash acquired	—	—	(80,479)
<b>Net cash used in investing activities</b>	<b>(19,124)</b>	<b>(14,257)</b>	<b>(92,292)</b>
<b>Cash flows from financing activities:</b>			
Purchase of additional ownership from noncontrolling interest	(87,735)	—	(51,881)
Dividends on Common and Class B common stock	(69,870)	(39,836)	(256,219)
Distributions to noncontrolling interest	(43,258)	(69,494)	(16,003)
Payment of fees related to revolving credit agreement	(381)	(458)	(2,116)
Net repayments under prior revolving credit agreements	—	—	(20,000)
Net proceeds from (repayments of) other long-term obligations	235	602	(1)
Excess tax benefits from share-based compensation	1,828	1,511	1,079
Net proceeds from issuances of common stock	4,245	2,185	5,312
Net proceeds (repayments) under current revolving credit agreement	74,729	(83,559)	316,748
<b>Net cash used in financing activities</b>	<b>(120,207)</b>	<b>(189,049)</b>	<b>(23,081)</b>
Effect of foreign exchange rate changes on cash and cash equivalents	(680)	(1,255)	127
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>4,969</b>	<b>(54,292)</b>	<b>58,097</b>
Cash and cash equivalents at beginning of year	19,478	73,770	15,673
<b>Cash and cash equivalents at end of year</b>	<b>\$ 24,447</b>	<b>\$ 19,478</b>	<b>\$ 73,770</b>
Supplemental cash flow information (Note 18)			

*See accompanying notes to consolidated financial statements.*

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

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Organization, Consolidation and Presentation**

Watsco, Inc. and its subsidiaries (collectively, "Watsco," or *we, us or our*) was incorporated in Florida in 1956 and is the largest distributor of air conditioning, heating and refrigeration equipment and related parts and supplies ("HVAC/R") in the HVAC/R distribution industry in North America. At December 31, 2014, we operated from 572 locations in 38 U.S. states, Canada, Mexico and Puerto Rico with additional market coverage on an export basis to Latin America and the Caribbean.

The consolidated financial statements include the accounts of Watsco, all of its wholly owned subsidiaries and the accounts of three joint ventures with Carrier Corporation ("Carrier"), in each of which Watsco maintains a controlling interest. All significant intercompany balances and transactions have been eliminated in consolidation.

**Foreign Currency Translation and Transactions**

The functional currency of our operations in Canada is the Canadian dollar. Foreign currency denominated assets and liabilities are translated into U.S. dollars at the exchange rates in effect at the balance sheet date, and income and expense items are translated at the average exchange rates in effect during the applicable period. The aggregate effect of foreign currency translation is recorded in accumulated other comprehensive loss in our consolidated balance sheets. Our net investment in our Canadian operations is recorded at the historical rate and the resulting foreign currency translation adjustments are included in accumulated other comprehensive loss in our consolidated balance sheets. Gains or losses resulting from transactions denominated in U.S. dollars are recognized in earnings within selling, general and administrative expenses in our consolidated statements of income.

Our operations in Mexico consider their functional currency to be the U.S. dollar because the majority of their transactions are denominated in U.S. dollars. Gains or losses resulting from transactions denominated in Mexican pesos are recognized in earnings within selling, general and administrative expenses in our consolidated statements of income.

**Use of Estimates**

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses for the reporting period. Significant estimates include valuation reserves for accounts receivable, inventories and income taxes, reserves related to self-insurance programs and the valuation of goodwill and indefinite lived intangible assets. While we believe that these estimates are reasonable, actual results could differ from such estimates.

**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 consist of trade receivables due from customers and are stated 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. Upon determination that an account is uncollectible, the receivable balance is written off. At December 31, 2014 and 2013, the allowance for doubtful accounts totaled \$5,461 and \$5,737, respectively.

**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 using a weighted-average cost basis and the first-in, first-out methods. As part of the valuation process, inventories are adjusted to reflect excess, slow-moving and damaged inventories at their estimated net realizable value. Inventory 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.

## **Vendor Rebates**

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 our estimates of earned vendor rebates based on actual purchase levels. At December 31, 2014 and 2013, we had \$10,088 and \$9,333, 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 are classified as available-for-sale and are included in other assets in our consolidated balance sheets. These equity securities are recorded at fair value using the specific identification method with unrealized holding losses, net of deferred taxes, included in accumulated other comprehensive loss within shareholders' equity. Dividend and interest income are recognized in the statements of income when earned.

## **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 3-10 years.

## **Goodwill and Other Intangible Assets**

Goodwill is recorded when the purchase price paid for an acquisition exceeds the fair value of the net identified tangible and intangible assets acquired. We evaluate goodwill for impairment annually or more frequently when an event occurs or circumstances change that indicate that the carrying value may not be recoverable. We test goodwill for impairment by first comparing the fair value of our reporting unit to its carrying value. If the fair value is determined to be less than the carrying value, a second step is performed to measure the amount of impairment loss.

Other intangible assets primarily consist of the value of trade names and trademarks, distributor agreements, customer relationships and non-compete agreements. Indefinite lived 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. Finite lived intangible assets are amortized using the straight-line method over their respective estimated useful lives.

We perform our annual impairment tests each year and have determined there to be no impairment for any of the periods presented. There were no events or circumstances identified from the date of our assessment that would require an update to our annual impairment tests.

## **Long-Lived Assets**

Long-lived assets, other than goodwill, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. Recoverability is evaluated by determining whether the amortization of the balance over its remaining life can be recovered through undiscounted future operating cash flows. We measure the impairment loss 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, 2014, there were no such events or circumstances.

## **Fair Value Measurements**

We carry various assets and liabilities at fair value in the consolidated balance sheets. Fair value is defined as the price that would be received for 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. Fair value measurements are classified based on the following fair value hierarchy:

Level 1	Quoted prices in active markets for identical assets or liabilities. An active market for an asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis.
Level 2	Observable inputs other than Level 1 prices such as quoted prices in active markets for similar assets or liabilities; quoted prices in markets that are not active; or model-driven valuations or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
Level 3	Unobservable inputs for the asset or liability. These inputs reflect our own assumptions about the assumptions a market participant would use in pricing the asset or liability.

### **Revenue Recognition**

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. 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 for the years ended December 31, 2014, 2013 and 2012, was \$19,754, \$22,418 and \$23,730, 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 for the years ended December 31, 2014, 2013 and 2012, was \$43,324, \$39,395 and \$37,676, respectively.

### **Share-Based Compensation**

The fair value of stock option and non-vested (restricted) stock awards are expensed on a straight-line basis over the vesting period of the awards. Share-based compensation expense is included in selling, general and administrative expenses in our consolidated statements of income. Cash flows from the tax benefits resulting from tax deductions in excess of the compensation expense recognized for those options (windfall tax benefits) are classified as financing cash flows. Tax benefits resulting from tax deductions in excess of share-based compensation expense recognized are credited to paid-in capital in the consolidated balance sheets.

### **Income Taxes**

We record United States federal, state and foreign 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 basis 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. We and our 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 we and our 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.

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 compute earnings per share using the two-class method. The two-class method of computing earnings per share is an earnings allocation formula that determines earnings per share for common stock and any participating securities according to dividends declared (whether paid or unpaid) and participation rights in undistributed earnings. Shares of our non-vested

(restricted) stock are considered participating securities because these awards contain a non-forfeitable right to dividends irrespective of whether the awards ultimately vest. Under the two-class method, earnings per common share for our Common and Class B common stock is computed by dividing the sum of distributed earnings to common shareholders and undistributed earnings allocated to common shareholders by the weighted-average number of shares of Common and Class B common stock outstanding for the period. In applying the two-class method, undistributed earnings are allocated to Common stock, Class B common stock and participating securities based on the weighted-average shares outstanding during the period.

Diluted earnings per share reflects the dilutive effect of potential common shares from stock options. The dilutive effect of outstanding stock options is computed using the treasury stock method, which assumes any proceeds that could be obtained upon the exercise of stock options, would be used to purchase common stock at the average market price for the period. The assumed proceeds include the purchase price the optionee pays, the windfall tax benefit that we receive upon assumed exercise and the unrecognized compensation expense at the end of each period.

### **Derivative Instruments and Hedging Activity**

We have used derivative instruments, including forward contracts and swaps, to manage our exposure to fluctuations in foreign currency exchange rates and interest rates. The use of these derivative instruments modifies the exposure of these risks with the intent to reduce the risk or cost to us. We use derivative instruments as risk management tools and not for trading purposes. All derivatives, whether designated as hedging relationships or not, are recorded on the balance sheet at fair value. Cash flows from derivative instruments are classified in the consolidated statements of cash flows in the same category as the cash flows from the items subject to the designated hedge or undesignated (economic) hedge relationships. The hedging designation may be classified as one of the following:

*No Hedging Designation.* The gain or loss on a derivative instrument not designated as an accounting hedging instrument is recognized in earnings.

*Cash Flow Hedge.* A hedge of a forecasted transaction or of the variability of cash flows to be received or paid related to a recognized asset or liability is considered a cash flow hedge. The effective portion of the change in the fair value of a derivative that is designated as a cash flow hedge is recorded in other comprehensive income and reclassified to earnings as a component of cost of sales in the period during which the hedged transaction affects earnings. Ineffective portions of changes in the fair value of cash flow hedges are recognized in earnings.

*Fair Value Hedge.* A hedge of a recognized asset or liability or an unrecognized firm commitment is considered a fair value hedge. Fair value hedges, both the effective and ineffective portions of the changes in the fair value of the derivative, along with the gain or loss on the hedged item that is attributable to the hedged risk, are recorded in earnings.

See Note 13 for additional information pertaining to derivative instruments.

### **New Accounting Pronouncements**

#### *Presentation of Unrecognized Tax Benefits*

On January 1, 2014 we adopted guidance issued by the Financial Accounting Standards Board (“FASB”) that requires the presentation of an unrecognized tax benefit as a reduction to a deferred tax asset for a net operating loss carryforward rather than as a liability when the uncertain tax position would reduce the net operating loss under the tax law of the applicable jurisdiction and the entity intends to use the deferred tax asset for that purpose. The adoption of this guidance did not have an impact on our consolidated financial statements.

#### *Revenue Recognition*

In May 2014, the FASB issued a standard on revenue recognition that provides a single, comprehensive revenue recognition model for all contracts with customers. The standard is principle-based and provides a five-step model to determine the measurement of revenue and timing of when it is recognized. The core principle is that a company will recognize revenue to reflect the transfer of goods or services to customers at an amount that the company expects to be entitled to in exchange for those goods or services. This standard is effective for our interim and annual reporting periods beginning after December 15, 2016 and allows for either full retrospective adoption or modified retrospective adoption. We will adopt this guidance on January 1, 2017, and are currently evaluating the impact on our consolidated financial statements.

## 2. EARNINGS PER SHARE

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

<i>Years Ended December 31,</i>	<u>2014</u>	<u>2013</u>	<u>2012</u>
<b>Basic Earnings per Share:</b>			
Net income attributable to Watsco, Inc. shareholders	\$ 151,387	\$ 127,723	\$ 103,334
Less: distributed and undistributed earnings allocated to non-vested (restricted) common stock	11,444	9,064	17,656
Earnings allocated to Watsco, Inc. shareholders	<u>\$ 139,943</u>	<u>\$ 118,659</u>	<u>\$ 85,678</u>
Weighted-average common shares outstanding - Basic	<u>32,308,073</u>	<u>32,195,598</u>	<u>31,680,187</u>
Basic earnings per share for Common and Class B common stock	<u>\$ 4.33</u>	<u>\$ 3.69</u>	<u>\$ 2.70</u>
Allocation of earnings for Basic:			
Common stock	\$ 128,214	\$ 108,690	\$ 78,359
Class B common stock	11,729	9,969	7,319
	<u>\$ 139,943</u>	<u>\$ 118,659</u>	<u>\$ 85,678</u>
<b>Diluted Earnings per Share:</b>			
Net income attributable to Watsco, Inc. shareholders	\$ 151,387	\$ 127,723	\$ 103,334
Less: distributed and undistributed earnings allocated to non-vested (restricted) common stock	11,435	9,053	17,656
Earnings allocated to Watsco, Inc. shareholders	<u>\$ 139,952</u>	<u>\$ 118,670</u>	<u>\$ 85,678</u>
Weighted-average common shares outstanding - Basic	<u>32,308,073</u>	<u>32,195,598</u>	<u>31,680,187</u>
Effect of dilutive stock options	50,781	62,470	64,212
Weighted-average common shares outstanding - Diluted	<u>32,358,854</u>	<u>32,258,068</u>	<u>31,744,399</u>
Diluted earnings per share for Common and Class B common stock	<u>\$ 4.32</u>	<u>\$ 3.68</u>	<u>\$ 2.70</u>

Diluted earnings per share for our Common stock assumes the conversion of all of our Class B common stock into Common stock as of the beginning of the fiscal year, therefore, no allocation of earnings to Class B common stock is required. At December 31, 2014, 2013 and 2012, our outstanding Class B common stock was convertible into 2,707,725, 2,704,832 and 2,706,338 shares of our Common stock, respectively.

Diluted earnings per share excluded 9,984, 1,066 and 17,492 shares for the years ended December 31, 2014, 2013 and 2012, 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.

### 3. OTHER COMPREHENSIVE LOSS

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

<u>Years Ended December 31,</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>
Foreign currency translation adjustment	<u>\$ (21,117)</u>	<u>\$ (16,365)</u>	<u>\$ (3,191)</u>
Unrealized gain on cash flow hedging instruments	<u>384</u>	<u>—</u>	<u>—</u>
Income tax expense	<u>(104)</u>	<u>—</u>	<u>—</u>
Unrealized gain on cash flow hedging instruments, net of tax	<u>280</u>	<u>—</u>	<u>—</u>
Unrealized gain on available-for-sale securities	<u>1</u>	<u>39</u>	<u>63</u>
Income tax expense	<u>—</u>	<u>(15)</u>	<u>(28)</u>
Unrealized gain on available-for-sale securities, net of tax	<u>1</u>	<u>24</u>	<u>35</u>
Other comprehensive loss	<u>\$ (20,836)</u>	<u>\$ (16,341)</u>	<u>\$ (3,156)</u>

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

<u>Years Ended December 31,</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>
Foreign currency translation adjustment:			
Beginning balance	<u>\$ (11,181)</u>	<u>\$ (1,785)</u>	<u>\$ —</u>
Current period other comprehensive loss	<u>(12,442)</u>	<u>(9,396)</u>	<u>(1,785)</u>
Ending balance	<u>(23,623)</u>	<u>(11,181)</u>	<u>(1,785)</u>
Cash flow hedging instruments:			
Beginning balance	<u>—</u>	<u>—</u>	<u>—</u>
Current period other comprehensive income	<u>168</u>	<u>—</u>	<u>—</u>
Less reclassification adjustments	<u>—</u>	<u>—</u>	<u>—</u>
Ending balance	<u>168</u>	<u>—</u>	<u>—</u>
Available-for-sale securities:			
Beginning balance	<u>(293)</u>	<u>(317)</u>	<u>(352)</u>
Current period other comprehensive income	<u>1</u>	<u>24</u>	<u>35</u>
Ending balance	<u>(292)</u>	<u>(293)</u>	<u>(317)</u>
Accumulated other comprehensive loss, net of tax	<u>\$ (23,747)</u>	<u>\$ (11,474)</u>	<u>\$ (2,102)</u>

### 4. SUPPLIER CONCENTRATION

We have four key suppliers of HVAC/R equipment products. Purchases from these four suppliers comprised 76%, 73% and 72% of all purchases made in 2014, 2013 and 2012, respectively. Our largest supplier, Carrier and its affiliates, accounted for 61%, 59% and 57% of all purchases made in 2014, 2013 and 2012, respectively. See Note 16. A significant interruption by Carrier, or any of our other three key suppliers, in the delivery of products could impair our ability to maintain current inventory levels or a termination of a distribution agreement could disrupt the operations of certain subsidiaries and could materially impact our consolidated results of operations and consolidated financial position.

### 5. PROPERTY AND EQUIPMENT

Property and equipment, net, consists of:

<i>December 31,</i>	<u>2014</u>	<u>2013</u>
Land	\$ 853	\$ 1,131
Buildings and improvements	58,915	49,942
Machinery, vehicles and equipment	68,953	64,012
Furniture and fixtures	21,486	20,523
	<u>150,207</u>	<u>135,608</u>
Accumulated depreciation and amortization	(96,727)	(90,190)
	<u>\$ 53,480</u>	<u>\$ 45,418</u>

Depreciation and amortization expense related to property and equipment included in selling, general and administrative expenses for the years ended December 31, 2014, 2013 and 2012, was \$12,158, \$11,677 and \$10,986, respectively.

## 6. DEBT

We maintain an unsecured, syndicated revolving credit agreement, which we use to fund seasonal working capital needs and other general corporate purposes, including acquisitions, dividends (if and as declared by our Board of Directors), stock repurchases and issuances of letters of credit. On June 25, 2014, we entered into an amendment to this credit agreement, which increased the borrowing capacity from \$500,000 to \$600,000, extended the maturity date from July 1, 2018 to July 1, 2019, increased the swingline subfacility from \$65,000 to \$90,000 and modified certain definitions. In addition to the swingline subfacility, included in the credit facility are a \$50,000 letter of credit subfacility and a \$75,000 multicurrency borrowing sublimit.

Borrowings under the credit facility bear interest at either LIBOR-based rates plus a spread, which ranges from 87.5 to 250.0 basis-points (LIBOR plus 125.0 basis-points at December 31, 2014), depending on our ratio of total debt to EBITDA, or on rates based on the higher of the Prime rate or the Federal Funds Rate, in each case plus a spread which ranges from 0 to 150.0 basis-points (25.0 basis-points at December 31, 2014), depending on our ratio of total debt to EBITDA. We pay a variable commitment fee on the unused portion of the commitment under the revolving credit agreement, ranging from 12.5 to 35.0 basis-points (17.5 basis-points at December 31, 2014).

At December 31, 2014 and 2013, \$303,199 and \$230,044, respectively, was outstanding under the revolving credit agreement. The revolving credit agreement contains customary affirmative and negative covenants, including financial covenants with respect to consolidated leverage and interest coverage ratios, and other customary restrictions. We believe we were in compliance with all such covenants at December 31, 2014.

## 7. INCOME TAXES

The components of income tax expense from our wholly-owned operations and investments and our controlling interest in joint ventures with Carrier are as follows:

<i>Years Ended December 31,</i>	<u>2014</u>	<u>2013</u>	<u>2012</u>
U.S. Federal	\$74,561	\$62,616	\$50,919
State	10,325	9,234	6,245
Foreign	6,953	5,810	5,478
	<u>\$91,839</u>	<u>\$77,660</u>	<u>\$62,642</u>
Current	\$91,550	\$69,071	\$55,918
Deferred	289	8,589	6,724
	<u>\$91,839</u>	<u>\$77,660</u>	<u>\$62,642</u>

We calculate our income tax expense and our effective tax rate for 100% of income attributable to our wholly-owned operations and investments and for our controlling interest of income attributable to our joint ventures with Carrier, which are taxed as partnerships for income tax purposes.

Following is a reconciliation of the effective income tax rate:

<u>Years Ended December 31,</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>
U.S. federal statutory rate	<b>35.0%</b>	35.0%	35.0%
State income taxes, net of federal benefit and other	<b>3.0</b>	3.3	2.5
Tax effects on foreign income	<b>(1.0)</b>	(1.3)	(0.8)
Effective income tax rate attributable to Watsco, Inc.	<b>37.0</b>	37.0	36.7
Taxes attributable to noncontrolling interest	<b>(6.4)</b>	(7.7)	(8.3)
Effective income tax rate	<b><u>30.6%</u></b>	<u>29.3%</u>	<u>28.4%</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>2014</u>	<u>2013</u>
<b>Current deferred tax assets:</b>		
Capitalized inventory costs and inventory reserves	<b>\$ 3,262</b>	\$ 2,883
Self-insurance reserves	<b>759</b>	1,093
Allowance for doubtful accounts	<b>992</b>	882
Other current deferred tax assets	<b>1,588</b>	1,539
Total current deferred tax assets (1)	<b><u>6,601</u></b>	<u>6,397</u>
<b>Long-term deferred tax assets:</b>		
Share-based compensation	<b>20,108</b>	17,455
Other long-term deferred tax assets	<b>746</b>	909
Net operating loss carryforwards	<b>221</b>	283
	<b><u>21,075</u></b>	<u>18,647</u>
Valuation allowance	<b>—</b>	(75)
Total long-term deferred tax assets (2)	<b><u>21,075</u></b>	<u>18,572</u>
<b>Current deferred tax liabilities:</b>		
Other current deferred tax liabilities	<b>(536)</b>	(1,304)
Total current deferred tax liabilities (1)	<b><u>(536)</u></b>	<u>(1,304)</u>
<b>Long-term deferred tax liabilities:</b>		
Deductible goodwill	<b>(80,404)</b>	(76,519)
Depreciation	<b>(2,992)</b>	(2,873)
Other long-term deferred tax liabilities	<b>(1,320)</b>	(2,556)
Total long-term deferred tax liabilities (2)	<b><u>(84,716)</u></b>	<u>(81,948)</u>
Net deferred tax liabilities	<b><u>\$(57,576)</u></b>	<u>\$(58,283)</u>

(1) *Current deferred tax assets and liabilities have been included in the consolidated balance sheets in other current assets.*

(2) *Long-term deferred tax assets and liabilities have been included in the consolidated balance sheets in deferred income taxes and other liabilities.*

Amounts earned by foreign subsidiaries are generally subject to United States income taxation upon repatriation. United States income taxes have not been provided on undistributed earnings of our foreign subsidiaries. The cumulative undistributed earnings related to foreign operations were approximately \$80,000 at December 31, 2014. It is not practicable to estimate the amount of tax that might be payable. Our intention is to indefinitely reinvest these earnings outside of the United States or to repatriate the earnings only when it is tax effective to do so.

Management has determined that no valuation allowance was necessary at December 31, 2014. A valuation allowance of \$75 was recorded at December 31, 2013 to reduce the deferred tax assets to the amount that was more likely than not to be realized. At December 31, 2014, there were state and other net operating loss carryforwards of \$7,231, which expire in varying amounts from 2015 through 2034. These amounts are available to offset future taxable income. There were no federal net operating loss carryforwards at December 31, 2014.

We are subject to United States federal income tax, income tax of multiple state jurisdictions and foreign income tax. We are subject to tax audits in the various jurisdictions until the respective statutes of limitations expire. We are no longer subject to United States federal tax examinations for tax years prior to 2011. For the majority of states, we are no longer subject to tax examinations for tax years prior to 2010.

As of December 31, 2014 and 2013, the total amount of gross unrecognized tax benefits (excluding the federal benefit received from state positions) was \$3,719 and \$3,135, respectively. Of these totals, \$2,417 and \$2,038, 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, 2014 and 2013, the cumulative amount of estimated accrued interest and penalties resulting from such unrecognized tax benefits was \$729 and \$630, respectively, and is included in deferred income taxes and other liabilities in the accompanying consolidated balance sheets.

The changes in gross unrecognized tax benefits are as follows:

Balance at December 31, 2011	\$2,424
Additions based on tax positions related to the current year	416
Reductions due to lapse of applicable statute of limitations	(366)
Balance at December 31, 2012	2,474
Additions based on tax positions related to the current year	673
Reductions due to lapse of applicable statute of limitations	(12)
Balance at December 31, 2013	3,135
Additions based on tax positions related to the current year	751
Reductions due to lapse of applicable statute of limitations	(167)
Balance at December 31, 2014	<u>\$3,719</u>

## 8. SHARE-BASED COMPENSATION AND BENEFIT PLANS

### Share-Based Compensation Plans

We have two share-based compensation plans for employees. The 2014 Incentive Compensation Plan (the “2014 Plan”) provides for the award of a broad variety of share-based compensation alternatives such as non-vested (restricted) stock, non-qualified stock options, incentive stock options, 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 2014 Plan consist of non-qualified stock options and non-vested (restricted) stock.

Under the 2014 Plan, the number of shares of Common and Class B common stock available for issuance is (i) 2,000,000, plus (ii) any shares of Common stock or Class B common stock that remained available for grant in connection with awards under the Watsco, Inc. Amended and Restated 2001 Incentive Compensation Plan (the “2001 Plan”) on the date on which our shareholders approved the 2014 Plan plus (iii) shares underlying currently outstanding awards issued under the 2001 Plan, which shares become reissuable under the 2014 Plan to the extent that such underlying shares are not issued due to their forfeiture, expiration, termination or otherwise. As of December 31, 2014, 2,045,421 shares remained available for issuance under the 2014 Plan. A total of 27,450 shares of Common stock, net of cancellations, and 10,000 shares of Class B common stock, had been awarded under the 2014 Plan as of December 31, 2014. As of December 31, 2014, 2,007,971 shares of common stock were reserved for future grants under the 2014 Plan. Options under the 2014 Plan vest over two to four years of service and have contractual terms of five 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.

The 2001 Plan expired during 2014; therefore, no additional options may be granted. There were 207,450 options to exercise common stock outstanding under the 2001 Plan at December 31, 2014. Options under the 2001 Plan vest over two to four years of service and have contractual terms of five years.

The following is a summary of stock option activity under the 2014 Plan and the 2001 Plan as of and for the year ended December 31, 2014:

	Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Options outstanding at December 31, 2013	267,700	\$ 65.30		
Granted	50,000	97.34		
Exercised	(64,000)	58.53		
Forfeited	(11,250)	68.49		
Expired	(1,000)	60.40		
Options outstanding at December 31, 2014	<u>241,450</u>	<u>\$ 73.62</u>	<u>2.47</u>	<u>\$ 8,060</u>
Options exercisable at December 31, 2014	<u>82,533</u>	<u>\$ 62.69</u>	<u>1.46</u>	<u>\$ 3,657</u>

The following is a summary of non-vested (restricted) stock activity as of and for the year ended December 31, 2014:

	Shares	Weighted-Average Grant Date Fair Value
Non-vested (restricted) stock outstanding at December 31, 2013	2,487,292	\$ 40.70
Granted	218,725	96.84
Vested	(57,300)	45.71
Forfeited	(5,000)	56.69
Non-vested (restricted) stock outstanding at December 31, 2014	<u>2,643,717</u>	<u>\$ 45.21</u>

The weighted-average grant date fair value of non-vested (restricted) stock granted during 2014, 2013 and 2012 was \$96.84, \$80.21 and \$69.66, respectively. The fair value of non-vested (restricted) stock that vested during 2014 was \$5,789. The tax benefits realized from non-vested (restricted) stock that vested during 2014 totaled \$2,142. No non-vested (restricted) stock vested during 2013 or 2012.

During 2014, 21,028 shares of Common stock with an aggregate fair market value of \$2,125 were withheld as payment in lieu of cash to satisfy tax withholding obligations in connection with the vesting of non-vested (restricted) stock. These shares were retired upon delivery.

#### 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. 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, which we believe provides a reasonable estimate of expected life based on our historical data. 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 United States 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 following table presents the weighted-average assumptions used for stock options granted:

<u>Years Ended December 31,</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>
Expected term in years	4.25	4.25	4.25
Risk-free interest rate	1.35%	0.82%	0.57%
Expected volatility	22.07%	24.56%	31.40%
Expected dividend yield	1.69%	2.20%	3.49%
Grant date fair value	\$15.75	\$13.33	\$12.90

## Exercise of Stock Options

The total intrinsic value of stock options exercised during 2014, 2013 and 2012 was \$3,746, \$2,753 and \$5,641, respectively. Cash received from Common stock issued as a result of stock options exercised during 2014, 2013 and 2012 was \$3,324, \$1,554 and \$3,790, respectively. During 2014, 2013 and 2012, 5,454 shares of Class B common stock with an aggregate fair market value of \$490, 4,749 shares of Common stock with an aggregate fair market value of \$450 and 29,987 shares of Common stock with an aggregate fair market value of \$2,229, respectively, were withheld as payment in lieu of cash for stock option exercises and related tax withholdings. During 2013, 13,227 shares of common stock with an aggregate fair market value of \$1,227 were delivered as payment in lieu of cash for stock option exercises and related tax withholdings. These shares were retired upon delivery. In connection with stock option exercises, the tax benefits realized from share-based compensation plans totaled \$936, \$1,557 and \$1,245, for the years ended December 31, 2014, 2013 and 2012, respectively.

## Share-Based Compensation Expense

The following table provides information on share-based compensation expense:

<u>Years Ended December 31,</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>
Stock options	\$ 801	\$ 884	\$ 846
Non-vested (restricted) stock	10,672	9,083	7,093
Share-based compensation expense	<u>\$11,473</u>	<u>\$9,967</u>	<u>\$7,939</u>

At December 31, 2014, there was \$825 of unrecognized pre-tax compensation expense related to stock options granted under the 2014 Plan and 2001 Plan, which is expected to be recognized over a weighted-average period of approximately 1.7 years. The total fair value of stock options that vested during 2014, 2013 and 2012 was \$1,145, \$822 and \$315, respectively.

At December 31, 2014, there was \$76,971 of unrecognized pre-tax compensation expense related to non-vested (restricted) stock, which is expected to be recognized over a weighted-average period of approximately 9.3 years, of which, approximately \$57,000 is related to awards granted to our Chief Executive Officer (“CEO”), which vest in approximately eight years upon his attainment of age 82. 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 with a corresponding tax benefit. At December 31, 2014, we were obligated to issue 102,479 shares of non-vested (restricted) stock in connection with our CEO’s 2014 incentive compensation agreement.

## Employee Stock Purchase Plan

The Watsco, Inc. Fourth Amended and Restated 1996 Qualified Employee Stock Purchase Plan (the “ESPP”) provides for up to 1,500,000 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 shares of Common stock with a discount of 5% of the fair market value at specified times. During 2014, 2013 and 2012, employees purchased 6,995, 5,844 and 6,753 shares of Common stock at an average price of \$90.89, \$79.46 and \$68.76 per share, respectively. Cash dividends received by the ESPP were reinvested in Common stock and resulted in the issuance of 2,953, 1,899 and 15,411 additional shares during 2014, 2013 and 2012, respectively. We received net proceeds of \$921, \$631 and \$1,522, respectively, during 2014, 2013 and 2012, for shares of our Common stock issued under the ESPP. At December 31, 2014, 515,204 shares remained available for purchase under the ESPP.

## 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 has historically been made with the issuance of Common stock to the plan on behalf of our employees. For the years ended December 31, 2014, 2013 and 2012, we issued 18,309, 22,551 and 26,991 shares of Common stock, respectively, to the plan, representing the Common stock discretionary matching contribution of \$1,759, \$1,689 and \$1,772, respectively.

## 9. ACQUISITIONS

### Carrier Enterprise I

Carrier Enterprise, LLC (“Carrier Enterprise I”) is a joint venture formed on July 1, 2009 with Carrier that operates a network of locations primarily throughout the Sun Belt States. From its inception until July 2, 2012, we owned 60% of the joint venture and Carrier owned 40%. We exercised an option to acquire an additional 10% ownership interest in Carrier Enterprise I on July 2, 2012 for cash consideration of \$51,881. On July 1, 2014, we exercised our second option to acquire an additional 10% ownership interest in Carrier Enterprise I for cash consideration of \$87,735, following which we have an 80% controlling interest in Carrier Enterprise I. Neither we nor Carrier has any remaining options to purchase additional ownership interests in Carrier Enterprise I or any of our other joint ventures with Carrier, which are described below.

### Carrier Enterprise II

On April 29, 2011, we formed a second joint venture with Carrier to distribute Carrier, Bryant and Payne branded residential, light-commercial and applied-commercial HVAC products and related parts and supplies in the northeast U.S. We own 60% of the joint venture and Carrier owns 40%.

### Carrier Enterprise III

On April 27, 2012, we completed the formation of a joint venture with UTC Canada Corporation (“UTC Canada”), an affiliate of Carrier, to distribute Carrier-manufactured HVAC products in Canada. This joint venture, Carrier Enterprise Canada, L.P. (“Carrier Enterprise III”), operated 37 locations throughout Canada as of December 31, 2014. We have a 60% controlling interest in Carrier Enterprise III, and Carrier has a 40% noncontrolling interest. Total consideration paid by us for our 60% controlling interest in Carrier Enterprise III comprised cash consideration of \$80,489 and the issuance to UTC Canada of 1,250,000 shares of Common stock, having a fair value of \$93,250.

The purchase price for Carrier Enterprise III resulted in the recognition of \$216,463 in goodwill and intangibles. The fair value of the identified intangible assets was \$151,172 and consisted of \$95,515 in trade names and distribution rights and \$55,657 in customer relationships to be amortized over a 15 year period. For Canadian income tax purposes, 75% of the tax basis of the acquired goodwill is amortized at a rate of 7% annually on a declining balance basis.

The purchase price allocation is based upon a purchase price of \$173,739, which represents the fair value of our 60% controlling interest in Carrier Enterprise III. The table below presents the allocation of the total consideration to tangible and intangible assets acquired, liabilities assumed and the noncontrolling interest from the acquisition of our 60% controlling interest in Carrier Enterprise III based on the respective fair values as of April 27, 2012:

Cash	\$ 10
Accounts receivable	46,718
Inventories	55,024
Other current assets	481
Property and equipment	2,517
Goodwill	65,291
Intangible assets	151,172
Other assets	978
Accounts payable and accrued expenses	(44,208)
Noncontrolling interest	(104,244)
Total purchase price	<u>\$ 173,739</u>

The fair value of the noncontrolling interest was determined by applying a pro-rata value of the total invested capital adjusted for a discount for lack of control that market participants would consider when estimating the fair value of the noncontrolling interest.

The unaudited pro forma financial information, combining our results of operations with the operations of Carrier Enterprise III as if the joint venture had been formed on January 1, 2012, is as follows:

<u>Year ended December 31,</u>	<u>2012</u>
Revenues	\$3,526,621
Net income	156,728
Less: net income attributable to noncontrolling interest	54,153
Net income attributable to Watsco, Inc.	\$ 102,575
Diluted earnings per share for Common and Class B common stock	\$ 2.64

The foregoing unaudited pro forma financial information is presented for informational purposes only. The unaudited pro forma financial information from the beginning of the period presented until the acquisition date includes adjustments to record income taxes related to our portion of Carrier Enterprise III's income, amortization related to identified intangible assets with finite lives and interest expense on borrowings incurred to acquire our 60% controlling interest. This unaudited pro forma financial information does not include adjustments to add or remove certain corporate expenses of Carrier Enterprise III, which may or may not be incurred in future periods, or adjustments for depreciation or synergies that may be realized subsequent to the acquisition date. This unaudited pro forma financial information does not necessarily reflect our future results of operations or what the results of operations would have been had we acquired our 60% controlling interest in and operated Carrier Enterprise III as of the beginning of the period presented.

The results of operations of these acquired locations have been included in the consolidated financial statements from the date of acquisition of our controlling interest in Carrier Enterprise III.

#### Transaction costs

Approximately \$1,200 of transaction costs is included in selling, general and administrative expenses in our consolidated statements of income for the year ended December 31, 2012, primarily associated with the closing and transition of Carrier Enterprise III.

#### 10. GOODWILL AND OTHER INTANGIBLE ASSETS

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

Balance at December 31, 2012	\$ 397,262
Foreign currency translation adjustment	(4,652)
Balance at December 31, 2013	392,610
Foreign currency translation adjustment	(5,299)
Balance at December 31, 2014	<u>\$ 387,311</u>

Other intangible assets are comprised of the following:

<u>December 31,</u>	<u>Estimated Useful Lives</u>	<u>2014</u>	<u>2013</u>
Indefinite lived intangible assets - Trade names, trademarks and distribution rights		\$131,271	\$138,599
Finite lived intangible assets:			
Customer relationships	10-15 years	76,595	80,865
Trade name	10 years	1,150	1,150
Non-compete agreements	7 years	369	369
Accumulated amortization		(22,909)	(17,140)
Finite lived intangible assets, net		<u>55,205</u>	<u>65,244</u>
		<u>\$186,476</u>	<u>\$203,843</u>

Amortization expense related to finite lived intangible assets included in selling, general and administrative expenses for the years ended December 31, 2014, 2013 and 2012, was \$5,769, \$6,029 and \$4,925, respectively. Amortization of finite lived intangible assets for 2015 through 2019 is expected to be approximately \$5,600 per year.

## 11. SHAREHOLDERS' EQUITY

### Common Stock

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 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.

### Preferred Stock

We are authorized to issue preferred stock with such designation, rights and preferences as may be determined from time to time by our Board of Directors. Accordingly, the Board of Directors is empowered, without shareholder approval, to issue preferred stock with dividend, liquidation, conversion, voting or other rights which could adversely affect the voting power or other rights of the holders of our Common stock and Class B common stock and, in certain instances, could adversely affect the market price of this stock. We had no preferred stock outstanding at December 31, 2014 and 2013.

### Stock Repurchase Plan

In September 1999, our Board of Directors authorized the repurchase, at management's discretion, of up to 7,500,000 shares of common stock in the open market or via private transactions. Shares repurchased under the program are accounted for using the cost method and result in a reduction of shareholders' equity. No shares were repurchased during 2014, 2013 or 2012. In aggregate, 6,322,650 shares of Common stock and 48,263 shares of Class B common stock have been repurchased at a cost of \$114,425 since the inception of the program. At December 31, 2014, there were 1,129,087 shares remaining authorized for repurchase under the program.

## 12. 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, 2014 and 2013, 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 our 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.

### Off-Balance Sheet Financial Instruments

At December 31, 2014 and 2013, we were contingently liable under standby letters of credit aggregating \$2,662 and \$2,681, respectively, which are primarily used as collateral to cover any contingency related to additional risk assessments pertaining to our self-insurance programs. Additionally, at December 31, 2014 and 2013, we were contingently liable under various performance bonds aggregating approximately \$2,300 and \$800, respectively, which are used as collateral to cover any contingencies related to our nonperformance under agreements with certain customers. We do not expect that any material losses or obligation will result from the issuance of the standby letters of credit or performance bonds because we expect to meet our obligations under our self-insurance programs and to certain customers in the ordinary course of business. 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 accounts receivable. Concentrations of credit risk 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 credit insurance programs which are used as an additional means to mitigate credit risk.

### 13. DERIVATIVES

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

#### Cash Flow Hedging Instruments

We enter into foreign currency forward contracts that are designated as cash flow hedges. The settlement of these derivatives results in reclassifications from accumulated other comprehensive income to earnings in the period when the hedged transaction occurs. The maximum length of time over which we hedge our exposure to the variability in future cash flows for forecasted transactions is 12 months and, accordingly, at December 31, 2014, all of our open foreign currency forward contracts had maturities of one year or less. The total notional value of our foreign currency exchange contracts designated as cash flow hedges at December 31, 2014 was \$23,000, and such contracts have varying terms expiring through May 2015.

The impact from foreign exchange derivative instruments designated in cash flow hedging relationships were as follows:

<u>Years Ended December 31,</u>	<u>2014</u>	<u>2013</u>
Gain recorded in other comprehensive loss	<b>\$384</b>	—
Gain reclassified from accumulated other comprehensive loss into earnings	—	—

At December 31, 2014, we expect an estimated \$384 pre-tax gain to be reclassified from accumulated other comprehensive loss into earnings to reflect the fixed prices obtained from foreign exchange hedging within the next 12 months.

#### Derivatives Not Designated as Hedging Instruments

We also enter in foreign currency forward contracts that are not designated as hedges and/or did not qualify for hedge accounting. These derivative instruments were effective economic hedges for all of the periods presented. The fair value gains and losses on these contracts are recognized in earnings as a component of selling, general and administrative expenses. The total notional value of our foreign currency exchange contracts not designated as hedging instruments at December 31, 2014 was \$14,750, and such contracts have varying terms expiring through October 2015.

We recognized a gain (loss) of \$142, \$315 and \$(197) in our consolidated statements of income from foreign currency forward contracts not designated as hedging instruments in 2014, 2013 and 2012, respectively.

The following table summarizes the fair value of derivative instruments, which consist solely of foreign currency forward contracts, included in other current assets in our consolidated balance sheets. See Note 14.

<u>December 31,</u>	<u>Asset Derivatives</u>		<u>Liability Derivatives</u>	
	<u>2014</u>	<u>2013</u>	<u>2014</u>	<u>2013</u>
Derivatives designated as hedging instruments	<b>\$ 384</b>	—	—	—
Derivatives not designated as hedging instruments	<b>260</b>	118	—	—
Total derivative instruments	<b>\$ 644</b>	<b>\$ 118</b>	—	—

### 14. FAIR VALUE MEASUREMENTS

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

	Balance Sheet Location	Total	Fair Value Measurements at December 31, 2014 Using		
			Level 1	Level 2	Level 3
<b>Assets:</b>					
Available-for-sale securities	Other assets	\$266	\$ 266	—	—
Derivative financial instruments	Other current assets	\$644	—	\$ 644	—

	Balance Sheet Location	Total	Fair Value Measurements at December 31, 2013 Using		
			Level 1	Level 2	Level 3
<b>Assets:</b>					
Available-for-sale securities	Other assets	\$265	\$ 265	—	—
Derivative financial instruments	Other current assets	\$118	—	\$ 118	—

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

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

*Derivative financial instruments* – the derivatives are foreign currency forward contracts. See Note 13. Fair value is based on observable market inputs, such as forward rates in active markets; therefore, we classify these derivatives within Level 2 of the valuation hierarchy.

There were no transfers in or out of Level 1 and Level 2 during 2014 or 2013.

## 15. COMMITMENTS AND CONTINGENCIES

### Litigation, Claims and Assessments

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

### Self-Insurance

Self-insurance reserves are maintained relative to company-wide casualty insurance and health benefit programs. The level of exposure from catastrophic events is limited by the purchase of stop-loss and aggregate liability reinsurance coverage. When estimating the self-insurance liabilities and related reserves, management considers a number of factors, which include historical claims experience, demographic factors, severity factors and valuations provided by independent third-party actuaries. Management reviews its assumptions with its independent third-party actuaries to evaluate whether the self-insurance reserves are adequate. If actual claims or adverse development of loss reserves occur and exceed these estimates, additional reserves may be required. Reserves in the amounts of \$4,630 and \$5,582 at December 31, 2014 and 2013, respectively, were established related to such programs and are included in accrued expenses and other current liabilities in our consolidated balance sheets.

### Variable Interest Entity

As of December 31, 2014, 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 entity meets the definition of Variable Interest Entity (“VIE”); however, we do not meet the requirements to include this entity in the consolidated financial statements. The maximum exposure to

loss related to our involvement with this entity is limited to approximately \$4,100. See “Self-Insurance” above for further information on commitments associated with the insurance programs and Note 12, under the caption “Off-Balance Sheet Financial Instruments,” for further information on standby letters of credit. At December 31, 2014, there were no other entities that met the definition of a VIE.

### Operating Leases

We are obligated under various non-cancelable operating lease agreements for real property, equipment, vehicles and a corporate aircraft used in our operations with varying terms through 2025. We are committed to pay a portion of the actual operating expenses under certain of these lease agreements. These operating expenses are not included in the table below. Some of these arrangements have free or escalating rent payment provisions. We recognize rent expense under such arrangements on a straight-line basis over the lease term.

At December 31, 2014, future minimum payments under non-cancelable operating leases over each of the next five years and thereafter were as follows:

2015	\$ 67,307
2016	56,263
2017	41,174
2018	26,221
2019	12,849
Thereafter	13,525
<b>Total minimum payments</b>	<b><u>\$217,339</u></b>

Rental expense for the years ended December 31, 2014, 2013 and 2012, was \$81,155, \$79,585 and \$76,547, respectively.

### Purchase Obligations

At December 31, 2014, we were obligated under various non-cancelable purchase orders with Carrier and its affiliates for goods aggregating approximately \$32,000.

## 16. RELATED PARTY TRANSACTIONS

Purchases from Carrier and its affiliates comprised 61%, 59% and 57% of all inventory purchases made during 2014, 2013 and 2012, respectively. At December 31, 2014 and 2013, approximately \$61,000 and \$53,000, respectively, was payable to Carrier and its affiliates, net of receivables. Our joint ventures with Carrier also sell HVAC products to Carrier and its affiliates. Revenues in our consolidated statements of income for 2014, 2013 and 2012 included \$38,195, \$30,819 and \$32,961, respectively, of sales to Carrier and its affiliates. We believe these transactions are conducted at arm’s-length in the ordinary course of business.

Carrier Enterprise III entered into Transaction Service Agreements (“TSAs”) with UTC Canada, pursuant to which UTC Canada performed certain business processes on behalf of Carrier Enterprise III, including processes involving the use of certain information technologies, and UTC Canada entered into TSAs with Carrier Enterprise III, pursuant to which Carrier Enterprise III performed certain business processes on behalf of UTC Canada. The services provided pursuant to the TSAs terminated on December 31, 2012. The fees payable by Carrier Enterprise III to UTC Canada under one TSA were substantially offset by the fees payable to Carrier Enterprise III by UTC Canada under the other TSA.

## 17. INFORMATION ABOUT GEOGRAPHIC AREAS

Our operations are primarily within the United States, including Puerto Rico, Canada and Mexico. Products are also sold from the United States on an export-only basis to portions of Latin America and the Caribbean Basin. The following tables set forth revenues and long-lived assets by geographical area:

<u>Years Ended December 31,</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>
<b>Revenues:</b>			
United States	\$3,525,176	\$3,325,114	\$3,087,256
Canada	300,289	318,165	240,254
Mexico	119,075	100,051	104,202
Total revenues	<u>\$3,944,540</u>	<u>\$3,743,330</u>	<u>\$3,431,712</u>

<u>December 31,</u>	<u>2014</u>	<u>2013</u>
<b>Long-Lived Assets:</b>		
United States	\$434,910	\$429,202
Canada	187,064	207,340
Mexico	5,293	5,329
Total long-lived assets	<u>\$627,267</u>	<u>\$641,871</u>

Revenues are attributed to countries based on the location of the store from which the sale occurred. Long-lived assets consist of property and equipment, goodwill and intangible assets.

## 18. SUPPLEMENTAL CASH FLOW INFORMATION

Supplemental cash flow information was as follows:

<u>Years Ended December 31,</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>
Interest paid	\$ 4,393	\$ 5,334	\$ 2,802
Income taxes net of refunds	\$82,850	\$73,168	\$46,819
Common stock issued for Carrier Enterprise III	—	—	\$93,250

## 19. SUBSEQUENT EVENT

On January 6, 2015, our Board of Directors approved an increase in the quarterly cash dividend payable on each share of Common stock and Class B common stock to \$0.70 per share from \$0.60 per share.

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

*(In thousands, except per share data)*

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Total
<b>Year Ended December 31, 2014</b>					
Revenues (1)	\$762,568	\$1,170,186	\$1,134,999	\$876,787	\$3,944,540
Gross profit	188,069	279,273	274,765	214,295	956,402
Net income attributable to Watsco, Inc.	<u>\$ 16,753</u>	<u>\$ 56,101</u>	<u>\$ 54,461</u>	<u>\$ 24,072</u>	<u>\$ 151,387</u>
Earnings per share for Common and Class B common stock (2):					
Basic	<u>\$ 0.48</u>	<u>\$ 1.60</u>	<u>\$ 1.56</u>	<u>\$ 0.69</u>	<u>\$ 4.33</u>
Diluted	<u>\$ 0.48</u>	<u>\$ 1.60</u>	<u>\$ 1.56</u>	<u>\$ 0.69</u>	<u>\$ 4.32</u>
<b>Year Ended December 31, 2013</b>					
Revenues (1)	\$713,633	\$1,120,452	\$1,081,893	\$827,352	\$3,743,330
Gross profit	175,446	266,680	258,597	198,530	899,253
Net income attributable to Watsco, Inc.	<u>\$ 13,385</u>	<u>\$ 51,318</u>	<u>\$ 45,699</u>	<u>\$ 17,321</u>	<u>\$ 127,723</u>
Earnings per share for Common and Class B common stock (2):					
Basic	<u>\$ 0.39</u>	<u>\$ 1.48</u>	<u>\$ 1.32</u>	<u>\$ 0.50</u>	<u>\$ 3.69</u>
Diluted	<u>\$ 0.39</u>	<u>\$ 1.48</u>	<u>\$ 1.32</u>	<u>\$ 0.50</u>	<u>\$ 3.68</u>

- (1) *Sales of residential central air conditioners, heating equipment and parts and supplies are seasonal. Demand related to the residential central air conditioning replacement market is typically highest in the second and third quarters and demand for heating equipment is usually highest in the fourth quarter. Demand related to the new construction sectors throughout most of the markets is fairly consistent during the year, except for dependence on housing completions and related weather and economic conditions.*
- (2) *Quarterly and year-to-date earnings per share are calculated on an individual basis; therefore, the sum of earnings per share amounts for the quarters may not equal earnings per share amounts for the year.*

**WATSCO, INC. AND SUBSIDIARIES**  
**INFORMATION ON COMMON STOCK**  
**(UNAUDITED)**

Our Common stock is traded on the New York Stock Exchange (“NYSE”) and the Professional Segment of NYSE Euronext in Paris under the ticker symbol WSO. Our Class B common stock is traded on the NYSE under the ticker symbol WSOB. The following table presents the high and low prices of our Common stock and Class B common stock, as reported by the NYSE. Also presented below are dividends paid per share for each quarter during the years ended December 31, 2014 and 2013. At February 18, 2015, there were 230 Common stock registered shareholders and 91 Class B common stock registered shareholders.

	<u>Common</u>		<u>Class B Common</u>		<u>Cash Dividend</u>	
	<u>High</u>	<u>Low</u>	<u>High</u>	<u>Low</u>	<u>Common</u>	<u>Class B</u>
<b>Year Ended December 31, 2014:</b>						
First quarter	\$100.47	\$91.12	\$ 99.94	\$91.42	\$ 0.40	\$ 0.40
Second quarter	104.84	96.93	105.22	96.68	0.40	0.40
Third quarter	104.16	85.53	104.90	87.41	0.60	0.60
Fourth quarter	<u>108.20</u>	<u>86.14</u>	<u>107.12</u>	<u>87.41</u>	<u>0.60</u>	<u>0.60</u>
<b>Year Ended December 31, 2013:</b>						
First quarter	\$ 84.25	\$74.13	\$ 84.38	\$74.50	\$ 0.25	\$ 0.25
Second quarter	89.16	77.72	89.48	78.19	0.25	0.25
Third quarter	95.39	85.58	96.00	85.59	0.25	0.25
Fourth quarter	<u>97.47</u>	<u>91.73</u>	<u>97.15</u>	<u>92.72</u>	<u>0.40</u>	<u>0.40</u>

## SUBSIDIARIES OF THE REGISTRANT

The following table sets forth the significant subsidiaries of Watsco, Inc. as of December 31, 2014, and their respective incorporation jurisdictions. The names of various other wholly owned subsidiaries have been omitted. None of the foregoing omitted subsidiaries, considered either alone or in the aggregate as a single subsidiary, constitutes a significant subsidiary.

<u>Name of Subsidiary</u>	<u>State or Other Jurisdiction of Incorporation</u>	<u>Percent of Ownership</u>
Baker Distributing Company LLC	Delaware	100%
Boreal International Corporation	Florida	100%
Carrier Enterprise Canada, L.P.	Ontario, Canada	60%
Carrier Enterprise Mexico S. de R.L. de C.V.	Mexico	60%
Carrier Enterprise, LLC	Delaware	80%
Carrier Enterprise Northeast, LLC	Delaware	60%
Carrier InterAmerica Corporation	United States Virgin Islands	80%
Carrier (Puerto Rico), Inc.	Delaware	80%
East Coast Metal Distributors LLC	Delaware	100%
Gemaire Distributors LLC	Delaware	100%
Heating & Cooling Supply LLC	California	100%
Tradewinds Distributing Company, LLC	Delaware	100%

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors  
Watsco, Inc.:

We consent to the incorporation by reference in the registration statements listed below of Watsco, Inc. of our reports dated February 24, 2015, with respect to the consolidated balance sheets of Watsco, Inc. and subsidiaries as of December 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2014, and the effectiveness of internal control over financial reporting as of December 31, 2014, which reports appear in the December 31, 2014 annual report on Form 10-K of Watsco, Inc.

- Form S-3 (Registration No. 333-185347)
- Form S-8 (Registration Nos. 333-197795, 333-185345, 333-159776, 333-149467, 333-126824, 333-86006, 333-39380, 333-82011, 333-80341, 333-10363, 33-51934, and 33-72798)

/s/ KPMG LLP

Miami, Florida  
February 24, 2015  
Certified Public Accountants

## 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 24, 2015

/s/ Albert H. Nahmad

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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 24, 2015

/s/ Barry S. Logan

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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 24, 2015

/s/ Ana M. Menendez

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Ana M. Menendez  
Chief Financial Officer

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

In connection with the Annual Report of Watsco, Inc. ("Watsco") on Form 10-K for the year ended December 31, 2014, 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 24, 2015

/s/ Barry S. Logan

Barry S. Logan  
Senior Vice President  
February 24, 2015

/s/ Ana M. Menendez

Ana M. Menendez  
Chief Financial Officer  
February 24, 2015

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.