

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

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934

For the Fiscal Year Ended December 31, 2003

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

WATSCO, INC.

(Exact name of registrant as specified in its charter)

FLORIDA
(State or other jurisdiction of
incorporation or organization)

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

Address of principal executive offices: 2665 South Bayshore Drive, Suite 901, Coconut Grove, FL 33133
Registrant's telephone number, including area code: (305) 714-4100

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, \$.50 par value	New York Stock Exchange
Class B Common Stock, \$.50 par value	American Stock Exchange

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities and Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES NO

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in 12b-2 of the Securities Exchange Act of 1934). YES NO

The aggregate market value of the voting stock (common stock) held by non-affiliates of the registrant as of June 30, 2003, the last business day of the registrant's most recently completed second fiscal quarter, was approximately \$364 million, based on the closing sale price of the common stock on that date. For purposes of determining this number all executive officers and directors of the registrant as of June 30, 2003 are considered to be affiliates of the registrant. This number is provided only for the purposes of this report on Form 10-K and does not represent an admission by either the registrant or any such person as to the status of such person.

The number of shares of common stock outstanding as of February 29, 2004 was 22,723,262 shares of Common Stock, excluding treasury shares of 5,364,850, and 3,623,335 shares of Class B Common Stock, excluding treasury shares of 48,263.

DOCUMENTS INCORPORATED BY REFERENCE

Certain information required by Parts I and II is incorporated by reference from the Annual Report to Shareholders for the year ended December 31, 2003, attached hereto as Exhibit 13. The information required by Part III (Items 10, 11, 12, 13 and 14) will be incorporated by reference from the Registrant's definitive proxy statement (to be filed pursuant to Regulation 14A).

WATSCO, INC.

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PART I

This Form 10-K contains or incorporates by reference statements that are not historical in nature and that are intended to be, and are hereby identified as, “forward-looking statements” as defined in the Private Securities Litigation Reform Act of 1995, including statements regarding, among other items, (i) the Company’s business and acquisition strategies, (ii) potential acquisitions by the Company, (iii) the Company’s financing plans and (iv) industry, demographic and other trends affecting the Company’s financial condition or results of operations. These forward-looking statements are based largely on the Company’s expectations and are subject to a number of risks and uncertainties, certain of which are beyond the Company’s control.

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

- general economic conditions affecting general business spending,
- consumer spending,
- consumer debt levels,
- seasonal nature of sales of the Company’s products,
- weather conditions,
- effects of supplier concentration,
- competitive factors within the Company’s industry,
- insurance coverage risks,
- prevailing interest rates, and
- the ability of the Company to continue to implement its business and acquisition strategies.

In light of these uncertainties, there can be no assurance that the forward-looking information contained herein will be realized or, even if substantially realized, that the information will have the expected consequences to or effects on the Company or its business or operations. A discussion of certain of these risks and uncertainties that could cause actual results to differ materially from those predicted in such forward-looking statements is included in the Company’s Annual Report to Shareholders for the fiscal year ended December 31, 2003 in the section captioned “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” which section has been incorporated in the Form 10-K by reference. Forward-looking statements speak only as of the date the statement was made. The Company assumes no obligation to update forward-looking information or the discussion of such risks and uncertainties to reflect actual results, changes in assumptions or changes in other factors affecting forward-looking information.

ITEM 1. BUSINESS

General

Watsco, Inc. (the “Registrant” or “Company”) was incorporated in 1956 and is the largest independent distributor of air conditioning, heating, and refrigeration equipment and related parts and supplies (“HVAC”) in the United States. The Company has two business segments – the HVAC distribution (“Distribution”) segment, which accounted for 98% of 2003 revenue and presently operates from 318 locations in 31 states and a temporary staffing and permanent placement services (“Staffing”) segment, which accounted for 2% of 2003 revenue. The Company’s revenue has increased from \$80 million in 1989 to over \$1.23 billion in 2003 via a strategy of acquisitions and internal growth. See Note 13 to the Company’s consolidated financial statements for more information regarding revenue, operating income, assets and other financial information on the Company’s Distribution and Staffing segments as well as “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

The Company’s principal executive offices are located at 2665 South Bayshore Drive, Suite 901, Coconut Grove, Florida 33133, and its telephone number is (305) 714-4100. The Company’s Internet website address is www.watsco.com and e-mail may be sent to the Company at mweber@watsco.com.

Residential Central Air Conditioning, Heating and Refrigeration Industry

According to data published by the Air Conditioning and Refrigeration Institute (“ARI”) and Gas Appliance Manufacturers Association, the market for residential central air conditioning, heating and refrigeration equipment and related parts and supplies in the United States is approximately \$20 billion with unitary equipment shipments having grown at a compounded annual rate of 5% since 1993. 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 Corporation, Rheem Manufacturing Company (“Rheem”), American Standard Companies Inc. (“American Standard”), York International Corporation (“York”), Lennox International, Inc. (“Lennox”) and Nordyne Corporation (“Nordyne”), a subsidiary of Nortek Corporation. These manufacturers distribute their products through a combination of factory-owned and independent distributors who, in turn, supply the equipment and related parts and supplies to contractors and dealers nationwide that sell to and install the products for the consumer.

Residential central air conditioning and heating equipment is sold to both the replacement and the homebuilding markets. The replacement market has increased substantially in size and importance over the past several years as a result of the aging of the installed base of residential central air conditioners, the introduction of new energy efficient models, the upgrading of existing homes to central air conditioning and the consumers’ overall unwillingness to live without air conditioning or heating products. According to industry data, over 120 million central air conditioning units and warm air gas furnaces have been installed in the United States in the past 20 years. Many units installed during this period have reached the end of their useful lives, thus providing a growing and substantial replacement market. The mechanical life of central air conditioning and warm-air gas furnaces varies by geographical region due to usage and is estimated to range from 8 to 20 years.

The Company also sells products to the refrigeration market. Such products include condensing units, compressors, evaporators, valves, refrigerant, walk-in coolers and ice machines for industrial and commercial applications. The Company distributes products manufactured by Copeland Compressor Corporation, a subsidiary of Emerson Electric Co., E. I. Du Pont De Nemours and Company, Heatcraft Refrigeration Products, LLC, Tecumseh Products Company and The Manitowoc Company, Inc.

Business Strategy

The Company’s business strategy includes five primary concepts: (i) implement programs to build market share in existing markets, (ii) complete strategic acquisitions to expand in existing markets or to extend the Company’s geographic reach into new markets, (iii) leverage fixed-costs in the Company’s existing infrastructure by adding products and expanding territories, (iv) implement initiatives to streamline operations, reduce cost structures and improve operating margins of both acquired and existing businesses and (v) develop and implement technology strategies that compete favorably in the marketplace.

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

In addition to the replacement market, the Company sells to the homebuilding market, including both traditional site-built homes and manufactured housing. The Company believes that its reputation for reliable, high-quality service and its relationships with contractors, who may serve both the replacement and new construction markets, allow it to compete effectively in these markets.

Acquisition Strategy The Company's acquisition strategy is focused on acquiring businesses that complement the Company's presence in existing markets or establishing a presence in new markets. Since 1989, the Company has made 45 acquisitions relating to distributors of air conditioning, heating and refrigeration products, 10 of which operate as primary operating subsidiaries of the Company. The other smaller distributors acquired have been integrated into the Company's primary operating subsidiaries. The Company continues to pursue additional strategic acquisitions to allow further penetration in existing markets and expand into new geographic markets. For additional discussion of recent acquisitions see Note 7 to the Company's consolidated financial statements as well as "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Product Line Expansion The Company actively seeks new or expanded territories of distribution from the major equipment manufacturers. The Company maintains significant relationships with Rheem, Carrier, Nordyne, American Standard, York and Lennox. See "Distribution Agreements" below. The Company continually evaluates new parts and supply products to support its equipment sales and further enhance its position with customers. The initiative includes increasing the product offering with existing vendors and identifying new product opportunities through traditional and non-traditional supply channels.

The Company has also introduced private-label products as a means to obtain market share and grow revenue. Historically, the Company's ability to expand product offerings of HVAC equipment has been dependent on the granting of distribution rights by the industry's major manufacturers. In 1999, the Company introduced its first private-label brand of equipment, "Grandaire," positioned as a value-oriented brand. The Grandaire equipment, manufactured by Nordyne, is currently being distributed from 140 locations in the United States. The Company has also entered into a ten year exclusive licensing arrangement with Whirlpool Corporation (the "Whirlpool Licensing Agreement"), the nation's leading manufacturer of appliances. During the Summer and Fall of 2003, the Company introduced its line of Whirlpool® branded HVAC equipment targeted at both the residential replacement and new homebuilding markets. The line of Whirlpool® branded HVAC equipment, manufactured by Lennox, is presently offered at 131 locations of the Company. The Company believes that the private-label brand products complement the existing offerings at the selected locations based on their particular market position and customer needs. See Note 12 to the consolidated financial statements for further information on terms of the Whirlpool licensing agreement.

Operating Philosophy The Company's operating subsidiaries operate in a manner that recognizes the long-term relationships established between the distributors and their customers. Generally, the Company preserves the identity of acquired businesses by retaining its existing operating name at the time of acquisition, their management and sales organizations, maintaining the product brand name offerings previously distributed by them and selectively expanding complementary product offerings. The Company believes this strategy builds on the value of the acquired operations by creating additional sales opportunities.

The Company maintains a specialized functional support staff at its corporate headquarters to support the individual operating subsidiaries' strategies for growth in their respective markets. Such functional support includes specialists in finance, accounting, human resources, product procurement, treasury and working capital management, tax planning, risk management and safety. The Company targets certain general and administrative expenses for cost savings initiatives that leverage the Company's overall volume and improve operating efficiencies.

Technology The Company's technology initiatives include: (i) implementation of effective point-of-sale systems that allow timely and effective customer service, including up-to-date pricing and inventory availability, (ii) enabling connectivity by customers to the

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subsidiaries' operating software and (iii) a web site, ACDoctor.com, which provides homeowners and businesses useful information and a variety of services.

In addition to point-of-sale systems at each operating location, the Company's subsidiaries have operating software that allows customers to access the Company's systems on-line 24 hours a day, 7 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.

ACDoctor.com, a website service created and maintained by the Company, provides consumers useful information in areas that broaden knowledge about HVAC products. The site highlights new products and allows homeowners and businesses to locate, select and hire a licensed contractor. The primary functionality of the site provides consumers a choice of contractors in their area that can service their air conditioning and heating systems.

DESCRIPTION OF BUSINESS

Distribution Segment

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

Sales of air conditioning and heating equipment accounted for approximately 50%, 52% and 53% of revenue for the years ended December 31, 2003, 2002 and 2001, respectively. Sales of parts and supplies (currently sourced through a network of over 1,500 different vendors) comprised 50%, 48% and 47% of revenue for such periods, respectively.

Distribution and Sales The Company currently operates from 318 locations, most of which are located in regions that the Company believes have favorable demographic trends. The Company maintains large inventories at each warehouse location, which is accomplished by transporting inventory between locations daily and either directly delivering products to customers with the Company's fleet of 699 trucks or making the products available for pick-up at the location nearest to the customer. The Company has over 280 commissioned salespeople, averaging 9 years or more of experience in the air conditioning, heating and refrigeration distribution industry.

Markets The Company's network serves 31 states from these 318 locations. The Company's primary markets include (in order of the number of locations in the state): Florida, Texas, California, Georgia, South Carolina, North Carolina, Tennessee, Louisiana, Alabama, Arkansas, Mississippi and Virginia. The Company also serves Arizona, Massachusetts, Missouri, Kansas, Oklahoma, Iowa, Kentucky, Maine, Nebraska, New Hampshire, New York, South Dakota, Connecticut, Maryland, Nevada, New Jersey, North Dakota, Rhode Island and Vermont. The Company also exports products to portions of Latin America and the Caribbean Basin. Export sales are less than 1% of the Company's total revenue.

Customers and Customer Service The Company sells to contractors and dealers who service the replacement and new construction markets for residential and light commercial central air conditioning, heating and refrigeration systems. The Company currently serves over 38,000 customers, with no single customer in 2003, 2002 or 2001 representing more than 1% of consolidated revenue.

The Company focuses 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 the locations. The Company also provides increased customer convenience through e-commerce, which allows customers to access the Company's systems on-line 24 hours a day, 7 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. Management believes that the Company successfully competes with other distributors primarily on the basis of its experienced sales organization, strong service support, high quality reputation and broad product lines.

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Key Equipment Suppliers The Company maintains significant relationships with Rheem, Carrier, Nordyne, American Standard, York and Lennox, each a leading manufacturer of residential central air conditioning and heating equipment in the United States. Each manufacturer has a well-established reputation of producing high-quality, competitively priced products. The Company believes the manufacturers' current product offerings, quality, serviceability and brand-name recognition allow the Company to operate favorably against its competitors. To maintain brand-name recognition, the manufacturers provide national advertising and participate with the Company in cooperative advertising programs and promotional incentives that are targeted to both contractors and end-users. The Company estimates the replacement market currently accounts for approximately two-thirds of industry sales in the United States and expects this percentage to increase as units installed in the past 20 years wear out and get replaced or updated to more energy-efficient models.

The Company made approximately 44%, 46% and 45% of its total 2003, 2002 and 2001 purchases, respectively, from six key equipment suppliers. The Company's largest supplier accounted for 15%, 17% and 16% of all purchases made by the Company in 2003, 2002 and 2001, respectively. A significant interruption in the delivery of these products could impair the Company's ability to continue to maintain its current inventory levels and could adversely affect the Company's business. The Company's future results of operations are also materially dependent upon the continued market acceptance of these manufacturers' products and their ability to continue to manufacture products that comply with laws relating to environmental and efficiency standards. The Company believes that its sales of other complementary equipment products and continued emphasis to expand sales of parts and supplies are mitigating factors against such risks.

Distribution Agreements The Company has distribution agreements with each of its 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, the Company may distribute other manufacturers' lines of air conditioning or heating equipment.

Seasonality Sales of residential central air conditioners, heating equipment and parts and supplies distributed by the Company have historically been seasonal. See "Business Risk Factors."

Competition All of the Company's businesses operate in highly competitive environments. See "Business Risk Factors."

Staffing Segment

The Company also owns Dunhill Staffing Systems, Inc. ("Dunhill"), which was founded in 1952 and is one of the nation's best-known staffing service networks. Through franchised, licensed and company-owned offices in 30 states and Canada, Dunhill provides temporary staffing and permanent placement services to businesses (including the Company's operating subsidiaries), professional and service organizations, government agencies, health care providers and other employers. Dunhill's operations primarily consist of 13 company-owned and 10 licensed temporary staffing offices, as well as 67 franchised permanent placement offices and one franchised temporary staffing office. Dunhill's franchisees operate their businesses autonomously within the framework of Dunhill's policies and standards and recruit, employ and pay their own employees, including temporary employees. Dunhill's permanent placement division recruits primarily middle management, sales, technical, administrative and support personnel for permanent employment in a wide variety of industries and positions. See Note 13 to the consolidated financial statements and "Management's Discussion and Analysis of Financial Condition and Results of Operations" for additional information.

Employees

The Company employed approximately 2,600 persons as of December 31, 2003, substantially all of which are non-union employees. The Company believes that its relations with its employees are good.

Order Backlog

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

Government Regulations, Environmental and Health and Safety Matters

The Company's operations are subject to federal, state and local laws and regulations relating to the generation, storage, handling, emission, transportation and discharge of materials into the environment. These include laws and regulations implementing the Clean

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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 CFC-based refrigerants. The Company is also subject to regulations concerning the transport of hazardous materials, including regulations adopted pursuant to the Motor Carrier Safety Act of 1990. The Company's operations are also subject to health and safety requirements including the Occupational, Safety and Health Act (OSHA). Management believes that the Company is in substantial compliance with all applicable federal, state and local provisions relating to the protection of the environment, transport of hazardous materials and health and safety requirements.

Non-U.S. Operations

All of the Company's operations are within the United States. The Company does not have any international operations.

BUSINESS RISK FACTORS

Supplier Concentration The Company has agreements with six 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, the Company may distribute other manufacturers' lines of air conditioning or heating equipment. Purchases from these six suppliers comprised 44% of all purchases made in 2003. The Company's largest supplier accounted for 15% of all purchases made in 2003. Any significant interruption by the manufacturers or a termination of a distribution agreement could temporarily disrupt the operations of certain subsidiaries. The Company's future results of operations are also materially dependent upon the continued market acceptance of these manufacturers' products and their ability to continue to manufacture products that comply with laws relating to environmental and efficiency standards.

Competition All of the Company's businesses operate in highly competitive environments. The Company's Distribution segment competes 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 the Company's products or services to lose market acceptance or result in significant price erosion, all of which would have a material adverse effect on the Company's profitability.

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

Temporary Staffing Services The Company's Staffing segment (representing 2% of revenue in 2003) derives 98% of its revenue from temporary staffing services, which are sensitive to changes in the level of economic activity. Significant declines in demand for temporary staffing services would reduce the Staffing segment's operating profits and underlying asset carrying values. See "Management's Discussion and Analysis of Financial Condition and Results of Operations" for further information.

GENERAL RISK FACTORS

Risks Related to Insurance Coverage The Company carries general liability, comprehensive property damage, workers' compensation and other insurance coverages 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 the Company. A successful claim against the Company in excess of insurance coverages could have a material adverse effect on the Company's financial position or results of operations. The Company retains certain self-insurance risks for health benefits and casualty insurance programs. Self-insurance reserves are established based on claims filed and estimates of claims incurred but not yet reported. The Company cannot provide assurance that the Company's actual claims will not exceed the Company's estimates. The Company has limited its exposure by maintaining excess and aggregate liability coverages and implementing loss control programs.

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Goodwill At December 31, 2003, goodwill represented approximately 24% of the Company's total assets. Goodwill is no longer amortized and is subject to impairment testing at least annually using a fair value based approach. The identification and measurement of goodwill impairment involves the estimation of the fair value of reporting units. The Company's accounting for impairment contains uncertainty because management must use judgment in determining appropriate assumptions to be used in the measurement of fair value. The estimates of fair value of reporting units are based on the best information available as of the date of the assessment and incorporate management assumptions about expected future cash flows and contemplate other valuation techniques. Future cash flows can be affected by changes in industry or market conditions.

The Company evaluates the recoverability of goodwill for impairment when events or changes in circumstances indicate that the carrying amount of goodwill may not be recoverable. As previously discussed, operating results of the Staffing segment have been negatively impacted by economic softness experienced in the past three years. In the event that the operating results of the Staffing segment do not improve, a goodwill impairment charge may be necessary to the extent that the implied fair value of goodwill is less than the carrying value. Although no goodwill impairment has been recorded to date, there can be no assurances that future goodwill impairments will not occur.

Control by Existing Shareholder As of December 31, 2003, Albert H. Nahmad, the Company's Chairman of the Board of Directors and President, and a limited partnership controlled by him, collectively had beneficial ownership of approximately 60% of the combined voting power of the outstanding Common Stock and Class B Common Stock. Based on Mr. Nahmad's stock ownership and the stock ownership of the limited partnership controlled by him, Mr. Nahmad has the voting power to elect all but three members of the Company's nine-person Board of Directors and to control most corporate actions requiring shareholder approval.

ADDITIONAL INFORMATION

The Company files reports with the Securities and Exchange Commission ("SEC"), including annual reports on Form 10-K, quarterly reports on Form 10-Q and other reports from time to time. The public may read and copy any materials the Company files with the SEC at the SEC's Public Reference Room at 450 Fifth Street, NW, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The Company is an electronic filer and the SEC maintains an Internet site at www.sec.gov that contains the reports, proxy and information statements, and other information filed electronically.

The Company's Internet website address is www.watsco.com. The Company makes available free of charge on or through its website its Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K and amendments to these reports, as soon as reasonably practicable after the Company electronically files such material with, or furnishes such material to, the SEC. The Company also makes available on its web site other reports filed with the SEC under the Securities Exchange Act of 1934, as amended, including its proxy statements and reports filed by officers and directors under Section 16(a) of that Act. These reports may be found on the web site by selecting the option entitled "SEC FILINGS" under the "INVESTORS INFO" area of the web site. The Company does not intend for information contained in its website to be part of this Form 10-K.

The Company maintains an "Employee Code of Business Ethics and Conduct" that is applicable to all employees and additionally a "Code of Conduct for Senior Executives" that is applicable to members of the Company's Board of Directors, executive officers and senior operating and financial personnel. These codes require continued observance of high ethical standards such as honesty, integrity and compliance with the law in the conduct of the Company's business. These codes are publicly available on the Company's website at <http://www.watsco.com/careers/codeofconduct.cfm>. These materials may also be requested in print by writing to the Company's Investor Relations department at Watsco, Inc., Investor Relations, 2665 South Bayshore Drive, Suite 901, Coconut Grove, FL 33133.

ITEM 2. PROPERTIES

The Company's principally owned and leased properties include the Company's trucks, warehousing and distribution facilities, administration office space and Staffing segment facilities.

Trucks At December 31, 2003, the Company's Distribution segment operated 699 ground transport vehicles, including delivery and pick-up trucks, vans and tractors. The Company believes that the present size of its truck fleet is adequate to support its operations.

Warehousing and Distribution Facilities At December 31, 2003, the Company's Distribution segment operated 318 warehousing and distribution facilities across 31 states in the United States having approximately 5.8 million square feet of space in the aggregate of which approximately 5.4 million square feet is leased. The majority of these leases are for terms of 3 to 5 years.

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Administrative and Other Properties and Facilities The Company maintains a specialized functional support staff at its corporate headquarters in Coconut Grove, Florida on approximately 6,000 square feet of leased space. The Company also leases approximately 101,000 square feet of space for additional storage and offices.

Staffing Segment Facilities The Company's Staffing segment operates from 14 locations, with an aggregate of approximately 28,000 square feet, all of which are leased. The majority of these leases are for terms of 3 to 5 years.

Management believes that suitable alternative facilities are available on satisfactory terms, if necessary. The Company believes that its facilities are well-maintained and adequate to meet its needs and believes that its insurance coverage with respect to its real property interests and its truck fleet are adequate.

ITEM 3. LEGAL PROCEEDINGS

The Company and its subsidiaries are involved in litigation incidental to the operation of the Company's business. The Company vigorously defends all matters in which the Company or its subsidiaries are named defendants and, for insurable losses, maintains significant levels of insurance to protect against adverse judgments, claims or assessments that may affect the Company. In the opinion of the Company, although the adequacy of existing insurance coverage or the outcome of any legal proceedings cannot be predicted with certainty, the ultimate liability associated with any claims or litigation in which the Company or its subsidiaries are involved will not materially affect the Company's financial condition or results of operations.

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

No matters were submitted to a vote of the Company's security holders during the fourth quarter of the year ended December 31, 2003.

PART II

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

Page 46 of the Company's 2003 Annual Report contains "Information on Common Stock," which identifies the market on which the Registrant's common stocks are being traded and contains the high and low sales prices and dividend information for the years ended December 31, 2003, 2002 and 2001 and is incorporated herein by reference.

Securities Authorized for Issuance Under Equity Compensation Plans

The following table provides information as of December 31, 2003 with respect to compensation plans (including individual compensation arrangements) under which the Company's equity securities are authorized for issuance.

Plan Category	Equity Compensation Plan Information(4)		
	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders	3,342,426(1)	\$ 12.99	1,675,281(3)
Equity compensation plans not approved by security holders	(2)	—	—
Total	3,342,426	\$ 12.99	1,675,281

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- (1) Comprised of 1,792,426 shares of Common Stock and 1,550,000 shares of Class B Common Stock.
- (2) Does not include 183,750 shares of restricted Common Stock and 505,000 shares of restricted Class B Common Stock granted to certain employees of the Company prior to the adoption of the 2001 Incentive Compensation Plan.
- (3) Does not include 107,965 shares reserved for issuance under the Company's Employee Stock Purchase Plan ("ESPP"). An aggregate of 81,768 shares of Common Stock was purchased under the ESPP in 2003.
- (4) See Note 6 to the consolidated financial statements for additional information regarding stock-based compensation and benefit plans.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

No purchases of the Company's equity securities were made by the Company or affiliated purchasers during the fourth quarter of the year ended December 31, 2003.

Recent Sales of Unregistered Securities

None.

Dividends

The Company paid cash dividends of 20 cents, 11.5 cents and 10 cents per share of Common Stock and Class B Common Stock in 2003, 2002 and 2001, respectively. In February 2004, the Company's Board of Directors approved an increase in the quarterly cash dividend to 10 cents per share from 8 cents per share of Common Stock and Class B Common Stock. Future dividends will be at the sole discretion of the Board of Directors and will depend upon such factors as the Company's profitability, financial condition, cash requirements, restrictions existing on the Company's credit agreements, future prospects and other factors deemed relevant by the Company's Board of Directors.

ITEM 6. SELECTED FINANCIAL DATA

Page 47 of the Company's 2003 Annual Report contains "Selected Financial Data" and is incorporated herein by reference.

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

Pages 8 through 19 of the Company's 2003 Annual Report contain "Management's Discussion and Analysis of Financial Condition and Results of Operations" and is incorporated herein by reference.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Page 14 of the Company's 2003 Annual Report contains "Quantitative and Qualitative Disclosures About Market Risk" and is incorporated herein by reference.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Pages 20 through 44 of the Company's 2003 Annual Report contain the 2003 and 2002 Consolidated Balance Sheets and other consolidated financial statements for the years ended December 31, 2003, 2002 and 2001, together with the reports thereon of Ernst & Young LLP dated February 12, 2004 and Arthur Andersen LLP dated February 11, 2002, and are incorporated herein by reference.

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

There were no disagreements with accountants on accounting or financial disclosures during the last three fiscal years. On May 22, 2002, the Board of Directors of the Company and its Audit Committee dismissed Arthur Andersen LLP as the Company's independent public accountants and engaged Ernst & Young LLP to serve as the Company's new independent public accountants. For more information with respect to this matter, see our Report on Form 8-K filed on May 22, 2002.

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ITEM 9A. CONTROLS AND PROCEDURES

Based on their evaluation as of the end of the period covered by this Annual Report on Form 10-K, the Company's Chief Executive Officer and Chief Financial Officer have each concluded that the Company's disclosure controls and procedures, (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act")) are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. There have been no significant changes in internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal year to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART III

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

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

	<u>Page No. in Annual Report</u>
(a) Consolidated Financial Statements, Consolidated Financial Statement Schedule and Exhibits	
(1) Consolidated Financial Statements (incorporated by reference from the 2003 Annual Report of Watsco, Inc.):	
Consolidated Statements of Income for the years ended December 31, 2003, 2002 and 2001	20
Consolidated Balance Sheets as of December 31, 2003 and 2002	21
Consolidated Statements of Shareholders' Equity for the years ended December 31, 2003, 2002 and 2001	22
Consolidated Statements of Cash Flows for the years ended December 31, 2003, 2002 and 2001	23
Notes to Consolidated Financial Statements	24-42
Report of Independent Certified Public Accountants Ernst & Young LLP and Arthur Andersen LLP	43-44
Selected Quarterly Financial Data (Unaudited)	45
	<u>Page No. in Form 10-K</u>
(2) Consolidated Financial Statement Schedule for the three years ended December 31, 2003, 2002 and 2001	
Report of Independent Certified Public Accountants Ernst & Young LLP on Schedule	S-1
Report of Independent Certified Public Accountants Arthur Andersen LLP on Schedule	S-2
Schedule II. Valuation and Qualifying Accounts	S-3
All other schedules have been omitted since the required information is not present, or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the consolidated financial statements or notes thereto.	
(3) Exhibits: The following list of exhibits includes exhibits submitted with this Form 10-K as filed with the SEC and those incorporated by reference to other filings.	

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- 3.1 Company's Amended and Restated Articles of Incorporation (filed as Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2001 and incorporated herein by reference).
- 3.2 Company's Amended Bylaws (filed as Exhibit 3.2 to the Company's Annual Report on Form 10-K for the fiscal year ended January 31, 1985 and incorporated herein by reference).
- 4.1 Specimen form of Class B Common Stock Certificate (filed as Exhibit 4.6 to the Company's Registration Statement on Form S-1 (No. 33-56646) and incorporated herein by reference).
- 4.2 Specimen form of Common Stock Certificate (filed as Exhibit 4.4 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1994 and incorporated herein by reference).
- 10.1 Revolving Credit Agreement dated as of April 19, 2002 among Watsco, Inc., as borrower, the Lenders from Time to Time Party and SunTrust Bank as administrative agent (filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the period ended March 31, 2002 and incorporated herein by reference).
- 10.2 Key Executive Deferred Compensation Agreement dated January 31, 1983, between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.8 to the Company's Registration Statement on Form S-1 (No. 33-56646) and incorporated herein by reference). +*
- 10.3 Watsco, Inc. Amended and Restated 1991 Stock Option Plan (filed as Exhibit 4.23 to the Company's Registration Statement on Form S-8 (333-82011) and incorporated herein by reference). +
- 10.4 Watsco, Inc. Amended and Restated Profit Sharing Retirement Plan and Trust Agreement dated October 21, 1994 (filed as Exhibit 10.25 to the Company's Annual Report on Form 10-K for the year ended December 31, 1994 and incorporated herein by reference). +
- 10.5 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 Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1996 and incorporated herein by reference). +*
- 10.6 Watsco, Inc. 1996 Qualified Employee Stock Purchase Plan (filed as Exhibit 4.3 to the Company's Registration Statement on Form S-8 (333-80341) and incorporated herein by reference). +
- 10.7 Watsco, Inc. 2001 Incentive Compensation Plan (filed as Appendix B to the Company's Definitive Proxy Statement for the year ended December 31, 2000 and incorporated herein by reference). +
- 10.8 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 Company's Annual Report on Form 10-K for the year ended December 31, 2000 and incorporated herein by reference). +*
- 10.9 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 Company's Annual Report on Form 10-K for the year ended December 31, 2001 and incorporated herein by reference). +*
- 10.10 Third Amendment dated February 10, 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 Company's Annual Report on Form 10-K for the year ended December 31, 2002 and incorporated herein by reference). +*
- 10.11 Amended and Restated Watsco, Inc. \$125,000,000 Private Shelf Agreement as of October 30, 2002 by and among Watsco Inc., and the Prudential Insurance Company of America (filed as Exhibit 10.12 to the Company's Annual Report on Form 10-K for the year ended December 31, 2002 and incorporated herein by reference).

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- 13. 2003 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 2003 Annual Report to Shareholders is provided solely for the information of the Securities and Exchange Commission and is not deemed “filed” as part of this Form 10-K). #
- 21. Subsidiaries of the Registrant. #
- 23.1 Consent of Independent Certified Public Accountants. #
- 23.2 Statement Regarding Consent of Arthur Andersen LLP. #
- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. #
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. #
- 32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. #
- 32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. #

Note to exhibits:

- # Submitted electronically herewith.
- + Compensation Plan or Arrangement
- * Management Contract

(b) Reports on Form 8-K:

A report on Form 8-K dated October 22, 2003, disclosed in Item 9, Regulation FD Disclosure and Item 12, Results of Operations and Financial Condition, that the Company issued a press release announcing its financial results for the quarter ended September 30, 2003. A copy of the Company’s press release was attached as Exhibit 99.1 to the Form 8-K.

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.

March 15, 2004

By: /s/ Albert H. Nahmad

Albert H. Nahmad, President

March 15, 2004

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>
/s/ Albert H. Nahmad _____ Albert H. Nahmad	Chairman of the Board and President (principal executive officer)	March 15, 2004
/s/ Ana M. Menendez _____ Ana M. Menendez	Chief Financial Officer (principal accounting officer)	March 15, 2004
/s/ Cesar L. Alvarez _____ Cesar L. Alvarez	Director	March 15, 2004
/s/ William Graham _____ William Graham	Director	March 15, 2004
/s/ Frederick H. Joseph _____ Frederick H. Joseph	Director	March 15, 2004
/s/ Victor Lopez _____ Victor Lopez	Director	March 15, 2004
/s/ Paul F. Manley _____ Paul F. Manley	Director	March 15, 2004
/s/ Bob L. Moss _____ Bob L. Moss	Director	March 15, 2004
/s/ George P. Sape _____ George P. Sape	Director	March 15, 2004
/s/ Sherwood M. Weiser _____ Sherwood M. Weiser	Director	March 15, 2004

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS ON SCHEDULE

Board of Directors and Shareholders
Watsco, Inc.

We have audited the consolidated financial statements of Watsco, Inc. and subsidiaries as of December 31, 2003 and 2002, and for the years then ended, and have issued our report thereon dated February 12, 2004 (included elsewhere in this Form 10-K). Our audit also included Schedule II-Valuation and Qualifying Accounts as of December 31, 2003 and 2002, and for the years then ended, included in this Annual Report on Form 10-K. This schedule is the responsibility of the Company's management. Our responsibility is to express an opinion on this schedule based on our audits. The financial statement schedule of Watsco, Inc. and subsidiaries as of December 31, 2001, and for the year then ended was subjected to the auditing procedures applied by other auditors in their audit of the consolidated financial statements for that year and whose report dated February 11, 2002, indicated that such financial statement schedule fairly stated in all material respects the financial data required to be set forth therein in relation to the basic financial statements taken as a whole.

In our opinion, the financial statement schedule as of December 31, 2003 and 2002, and for the years then ended, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/ ERNST & YOUNG LLP

Miami, Florida
February 12, 2004

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The following is a copy of the previously issued report of Arthur Andersen LLP on Schedule II dated February 11, 2002, issued in connection with their audit of the consolidated financial statements of Watsco, Inc. and subsidiaries (the "Company") for the year ended December 31, 2001 and has not been reissued by Arthur Andersen LLP. Arthur Andersen LLP has ceased operations and is no longer practicing before the Commission and, accordingly, is unable to reissue this report or provide its consent to the inclusion of the report in this annual report on Form 10-K. For further discussion, see Exhibit 23.2 which is filed herewith and hereby incorporated by reference into the Form 10-K for the fiscal year ended December 31, 2003 of which this report forms a part.

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS ON SCHEDULE

To Watsco, Inc.:

We have audited in accordance with auditing standards generally accepted in the United States, the consolidated financial statements included in Watsco, Inc.'s annual report to shareholders incorporated by reference in this Form 10-K, and have issued our report thereon dated February 11, 2002 (except with respect to the matter discussed in Note 14, as to which the date is March 22, 2002). Our audits were made for the purpose of forming an opinion on those statements taken as a whole. The accompanying Schedule II is the responsibility of the Company's management and is presented for purposes of complying with the Securities and Exchange Commission's rules and is not part of the basic financial statements. This schedule has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, fairly states in all material respects the financial data required to be set forth therein in relation to the basic financial statements taken as a whole.

ARTHUR ANDERSEN LLP

Miami, Florida,
February 11, 2002.

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WATSCO, INC.
SCHEDULE II-VALUATION AND QUALIFYING ACCOUNTS
For the Years Ended December 31, 2003, 2002 and 2001
(In thousands)

Allowance for Doubtful Accounts:	
BALANCE, December 31, 2000	\$ 6,970
Additions charged to costs and expenses	6,319
Write-offs, net	(6,968)
BALANCE, December 31, 2001	6,321
Additions charged to costs and expenses	5,317
Write-offs, net	(7,880)
BALANCE, December 31, 2002	3,758
Additions charged to costs and expenses	3,628
Write-offs, net	(4,358)
BALANCE, December 31, 2003	\$ 3,028
Valuation Allowance for Deferred Tax Assets:	
BALANCE, December 31, 2000	\$ 1,758
Deductions credited to income tax expense	—
BALANCE, December 31, 2001	1,758
Deductions credited to income tax expense	(1,253)
BALANCE, December 31, 2002	505
Deductions credited to income tax expense	(181)
BALANCE, December 31, 2003	\$ 324
Restructuring Liability and Valuation Reserves:	
BALANCE, December 31, 2000	\$ 5,155
Additions charged to costs and expenses	3,424
Write-down of assets to net realizable value	(4,891)
Cash payments	(1,748)
Change in estimate	(227)
BALANCE, December 31, 2001	1,713
Write-down of assets to net realizable value	(574)
Cash payments	(846)
Change in estimate	(293)
BALANCE, December 31, 2002 ⁽¹⁾	\$ —

(1) All restructuring activities were completed as of December 31, 2002.

Exhibit Index

<u>Exhibit Number</u>	<u>Description</u>
13.	2003 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 2003 Annual Report to Shareholders is provided solely for the information of the Securities and Exchange Commission and is not deemed "filed" as part of this Form 10-K).
21.	Subsidiaries of the Registrant.
23.1	Consent of Independent Certified Public Accountants.
23.2	Statement Regarding Consent of Arthur Andersen LLP.
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

WATSCO, INC. AND SUBSIDIARIES
SELECTED FINANCIAL DATA

*Years Ended December 31,
(In thousands, except per share data)*

	2003	2002(1)	2001(2)	2000(3)	1999
OPERATIONS					
Revenue	\$ 1,232,908	\$ 1,181,136	\$ 1,238,646	\$ 1,310,166	\$ 1,249,550
Gross profit	305,083	287,276	299,040	306,780	295,116
Operating income	61,189	50,924	48,324	45,815	59,439
Net income	34,895	28,536	24,441	19,114	29,481
Net income adjusted for SFAS No. 142(1)	34,895	28,536	26,726	21,382	31,533
SHARE DATA					
Diluted earnings per share	\$ 1.34	\$ 1.07	\$ 0.90	\$ 0.69	\$ 0.99
Diluted earnings per share adjusted for SFAS No. 142(1)	1.34	1.07	0.98	0.77	1.06
Cash dividends declared per share:					
Common Stock	\$ 0.20	\$ 0.115	\$ 0.10	\$ 0.10	\$ 0.10
Class B Common Stock	0.20	0.115	0.10	0.10	0.10
Weighted average shares outstanding for diluted earnings per share	26,037	26,674	27,251	27,793	29,741
Common stock outstanding	26,324	26,032	26,745	26,497	27,907
BALANCE SHEET INFORMATION					
Total assets	\$ 535,095	\$ 503,719	\$ 520,820	\$ 563,470	\$ 588,180
Long-term obligations	60,153	80,233	101,900	140,878	159,415
Shareholders' equity	360,869	329,201	322,420	304,164	301,716

- (1) Effective January 1, 2002, goodwill is no longer being amortized in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets" as more fully described in Notes 1 and 9 to the consolidated financial statements. Adjusted net income and adjusted diluted earnings per share exclude goodwill amortization on an after-tax basis.
- (2) During 2001, the Company recorded restructuring charges of \$3,424 (\$2,181 or \$0.08 per share on an after-tax basis), as more fully described in Note 8 to the consolidated financial statements.
- (3) During 2000, the Company recorded restructuring charges of \$8,481 (\$5,326 or \$0.19 per share on an after-tax basis).

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

Results of Operations

Watsco, Inc. and its subsidiaries (collectively, the "Company" or "Watsco") is the largest independent distributor of air conditioning, heating and refrigeration equipment and related parts and supplies ("HVAC") in the United States. The Company has two business segments – the HVAC distribution ("Distribution") segment, which accounted for 98% of 2003 revenue and presently operates from 318 locations in 31 states and a national temporary staffing and permanent placement services ("Staffing") segment, which accounted for 2% of 2003 revenue.

Revenue for the Company primarily consists of sales of air conditioning, heating and refrigeration equipment and related parts and supplies and service fee revenue from the Company's Staffing segment. The Company's selling, general and administrative expenses primarily consist of selling expenses, the largest components of which are salaries, commissions and marketing expenses which tend to be variable in nature and relate to sales growth. Other significant selling expenses relate to warehousing and distribution facilities and trucks, which are under non-cancelable operating leases. Refer to Note 12 to the consolidated financial statements for minimum annual rentals.

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

In addition, the Company continues to pursue its acquisition strategy which is focused on acquiring businesses that complement the Company's presence in existing markets or establishing a presence in new markets.

Matters Affecting Comparability

The following matters affect the comparability of results between 2003, 2002 and 2001.

During 2001, the Company implemented several initiatives to improve operating efficiency and enhance profitability. As a result of these initiatives, the Company closed certain under performing locations and reduced market overlap, disposed of inventory related to discontinued product lines, eliminated other unproductive SKUs, integrated operations of certain subsidiaries and exited certain business relationships. The Company's initiatives related to the 2001 Restructuring Plan were complete as of December 31, 2002. Refer to Note 8 to the consolidated financial statements and in this section under "Restructuring Activities" for further information.

Effective January 1, 2002, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets." SFAS No. 142 requires that goodwill and certain other intangible assets deemed to have indefinite useful lives are no longer amortized but are reviewed annually for impairment. SFAS No. 142 does not require retroactive restatement for all periods presented; however, it does require the disclosure of prior year effects adjusted for the elimination of amortization of goodwill and indefinite-lived intangible assets. The initial impairment review as of the transition date of January 1, 2002 was completed in the second quarter of 2002 and resulted in no goodwill impairment charge. Also, on January 1, 2004 and 2003, the Company performed the required annual impairment tests and determined there was no impairment. Refer to Note 9 to the consolidated financial statements for further information.

The following table summarizes information derived from the Company's consolidated statements of income expressed as a percentage of revenue for the years ended December 31, 2003, 2002 and 2001:

	2003	2002	2001
Revenue	100.0%	100.0%	100.0%
Cost of sales	75.3	75.7	75.9
Gross profit	24.7	24.3	24.1
Selling, general and administrative expenses	19.7	20.0	19.7
Goodwill amortization	—	—	.3
Restructuring costs	—	—	.2
Operating income	5.0	4.3	3.9
Interest expense	(.5)	(.6)	(.8)
Income taxes	(1.7)	(1.3)	(1.1)
Net income	2.8%	2.4%	2.0%

The following table sets forth revenue (in thousands) by business segment for the years ended December 31, 2003, 2002 and 2001:

	2003		2002		2001	
Distribution	\$ 1,206,526	98%	\$ 1,147,561	97%	\$ 1,194,587	96%
Staffing	26,382	2%	33,575	3%	44,059	4%
Total revenue	\$ 1,232,908	100%	\$ 1,181,136	100%	\$ 1,238,646	100%

The following narratives include the results of operations acquired during 2003 and 2002. Acquisitions have been accounted for under the purchase method of accounting and, accordingly, their results of operations have been included in the consolidated results of the Company beginning on their respective dates of acquisition. Data presented in the following narratives referring to "same-store basis" exclude the effects of operations acquired or locations opened and closed during the prior twelve months.

Consolidated Comparison of Year Ended December 31, 2003 with Year Ended December 31, 2002

Revenue in 2003 increased \$51.8 million, or 4%, as compared to 2002.

Distribution segment revenue in 2003 increased \$59.0 million, or 5%, over 2002 including a \$41.0 million contribution from locations acquired and opened during 2003 offset by \$13 million from closed locations. On a same-store basis, revenue in the Distribution segment increased \$30.6 million, or 3%, over 2002, including a \$45.0 million or 4.2% same-store sales increase in residential and light commercial HVAC products and a 24% same-store sales decline to the manufactured housing market. Sales to the manufactured housing market, which represented 4% of the Distribution segment's revenue in 2003, continue to be affected by a tightened financing market for dealers and consumers.

Staffing segment revenue in 2003 decreased \$7.2 million, or 21%, over 2002. This decrease is primarily attributable to lower sales demand due to economic conditions affecting labor markets in the United States.

Gross profit in 2003 increased \$17.8 million, or 6%, over 2002, primarily as a result of the aforementioned revenue increase and improved selling margins in the Distribution segment. Gross profit margin increased to 24.7% in 2003 from 24.3% in 2002, primarily due to higher markups on certain product offerings and higher sales of parts and supplies versus equipment sales as compared to 2002.

Selling, general and administrative expenses in 2003 increased \$7.5 million, or 3%, over 2002, primarily due to the aforementioned revenue increase and on a same store-sales basis, remained flat. The Company's Distribution segment selling, general and administrative expenses increased \$3.2 million or 2% on a same-store basis and as a percent of revenue selling, general and administrative expenses decreased to 18.0% in 2003 from 18.6% in 2002.

Interest expense, net decreased \$1.7 million, or 23%, in 2003 from 2002 primarily due to 25% lower average daily borrowings during the year.

The effective tax rate increased to 37.3% in 2003 from 34.8% in 2002. This reflects a reduced benefit of changes in valuation reserves related to state operating loss carryforwards.

Consolidated Comparison of Year Ended December 31, 2002 with Year Ended December 31, 2001

Revenue in 2002 decreased \$57.5 million, or 5%, as compared to 2001.

Distribution segment revenue in 2002 decreased \$47.0 million, or 4%, over 2001. On a same-store basis, revenue in the Distribution segment decreased \$44.5 million, or 4%, over 2001, including a \$27.6 million or 2.5% same-store sales decline in residential and light commercial HVAC products, as sales increases in the Company's southeastern markets were offset by declines in other markets. Sales results also include lower sales of commercial products and an 18% decline in sales to the manufactured housing market. Sales to the manufactured housing market, which represented 6% of the Distribution segment's revenue, were affected by a tightened financing market for home dealers and consumers.

Staffing segment revenue in 2002 decreased \$10.5 million, or 24%, over 2001. This decrease is primarily attributable to lower sales demand due to economic softness in 2002 and the effect of seven location closures during 2001. On a same-store basis, Staffing segment revenue in 2001 decreased \$7.4 million, or 18%, over 2001.

Gross profit in 2002 decreased \$11.8 million, or 4%, over 2001, primarily as a result of the aforementioned revenue decrease offset by gross profit margin improvement in the Distribution segment. Gross profit margin increased to 24.3% in 2002 from 24.1% in 2001, primarily as a result of improved pricing disciplines in the Distribution segment.

Selling, general and administrative expenses in 2002 decreased \$11.0 million, or 4%, over 2001, primarily due to the aforementioned revenue decrease and other cost savings initiatives. Selling, general and administrative expenses, excluding restructuring charges of \$2.9 million and goodwill amortization of \$3.6 million in 2001, as a percent of revenue, increased from 19.7% to 20.0%. Such increase was primarily due to operating inefficiencies resulting from lower than expected sales volume to the Distribution segment's manufactured housing market and in the Staffing segment. On a same-store basis and excluding restructuring charges and goodwill amortization incurred in 2001, the Company's Distribution segment selling, general and administrative expenses decreased \$7.6 million or 3%, and as a percent of revenue selling, general and administrative expenses increased to 18.6% in 2002 from 18.5% in 2001.

Interest expense, net in 2002 decreased \$2.8 million, or 28%, from 2001 primarily due to 35% lower average daily borrowings during the year and lower interest rates.

The effective tax rate declined to 34.8% in 2002 from 36.3% in 2001. This reflects the benefit of a \$1.3 million reduction in valuation reserves related to state operating loss carryforwards and an internal reorganization of the Company's subsidiary ownership structure that was more tax efficient than the previous structure.

Restructuring Activities

During 2001, the Company implemented several initiatives to improve operating efficiency and enhance profitability. As a result of these initiatives, the Company closed certain under performing locations and reduced market overlap, disposed of inventory related to discontinued product lines, integrated operations of certain subsidiaries and exited certain business relationships (the "2001 Restructuring Plan"). In connection with the 2001 Restructuring Plan, the Company recorded restructuring charges of \$3.4 million (\$2.2 million after-tax) during the third quarter of 2001. The portion of the restructuring charge that relates to the valuation of inventory to be disposed of \$.3 million (on a pre-tax basis) has been classified in cost of sales in the Company's consolidated statement of income for the year ended December 31, 2001. The Company's activities related to the 2001 Restructuring Plan were complete as of December 31, 2002.

Liquidity and Capital Resources

Management assesses the Company's liquidity in terms of its ability to generate cash to execute its business strategy, fund its operating and investing activities and takes into consideration the seasonal demand of the Company's products, which peaks in the months of May through August. Significant factors affecting liquidity include the adequacy of available bank lines of credit and the ability to attract long-term capital with satisfactory terms, cash flows generated from operating activities, capital expenditures, acquisitions, the timing and extent of common stock repurchases and dividend policy.

The Company maintains a bank-syndicated, unsecured revolving credit agreement that provides for borrowings of up to \$225.0 million, expiring in April 2005. At December 31, 2003, \$30.0 million was outstanding under the revolving credit agreement. Borrowings under the agreement are used to fund seasonal working capital needs and for other general corporate purposes, including acquisitions. Borrowings under the revolving credit agreement bear interest at primarily LIBOR-based rates plus a spread that is dependent upon the Company's financial performance (LIBOR plus 1.0% at December 31, 2003 and 2002, respectively). The Company pays a variable commitment fee on the unused portion of the commitment.

The Company also has a \$125.0 million unsecured private placement shelf facility. The uncommitted shelf facility provides the Company with a source of long-term, fixed-rate financing as a complement to the variable rate borrowings available under its existing revolving credit agreement through January 2006. The Company has \$30.0 million Senior Series A Notes ("Notes") outstanding under its private placement shelf facility, bearing interest at 7.07%. The Notes have an average life of 5 years with repayment in equal installments of \$10.0 million beginning on April 9, 2005 until the final maturity on April 9, 2007. Interest is paid on a quarterly basis. The Notes allow for redemption prior to maturity subject to a redemption premium and other restrictions.

Both the revolving credit agreement and the private placement shelf facility contain customary affirmative and negative covenants including certain financial covenants with respect to the Company's consolidated net worth, interest and debt coverage ratios and limits capital expenditures, dividends and share repurchases in addition to other restrictions. The Company is in compliance with all covenants and financial ratios at December 31, 2003.

At December 31, 2003, the Company's debt-to-total capitalization ratio (total capital is defined as debt plus equity) improved to 14% as compared to 20% at December 31, 2002, primarily as a result of current year net repayments under the Company's revolving credit agreement.

At December 31, 2003, the Company had one interest rate swap agreement with a notional value of \$30.0 million to manage its net exposure to interest rate changes related to all of the borrowings under the revolving credit agreement. The interest rate swap agreement effectively converts the Company's LIBOR-based variable rate borrowings into fixed rate borrowings. The Company continuously monitors developments in the capital markets and only enters into swap transactions with established counterparties having investment grade ratings. See Note 11 to the consolidated financial statements and "Quantitative and Qualitative Disclosures About Market Risk," for further information.

At December 31, 2003, the Company is contingently liable under standby letters of credit aggregating approximately \$7.2 million that are primarily used as collateral to cover possible future assessments pertaining to a self-insurance program maintained by the Company. The Company does not expect any material losses to result from the issuance of the standby letters of credit because claims are not expected to exceed premiums paid. Accordingly, the estimated fair value of these instruments is zero at December 31, 2003.

Working capital increased to \$269.5 million at December 31, 2003 from \$259.1 million at December 31, 2002, primarily due to an increase in cash as a result of improved days sales outstanding to 39 in 2003 from 42 in 2002 and improved inventory turns to 5.0 in 2003 from 4.9 in 2002, an increase in inventories as a result of the introduction of new product lines in 2003 and from an increase in accounts receivable driven by increased sales volume, offset by an increase in accounts payable and accrued liabilities.

Net cash provided by operating activities was \$60.3 million in 2003 compared to \$66.9 million in 2002, a decrease of \$6.6 million, primarily due to the aforementioned improvements in working capital and an increase in net income. Net cash provided by operating activities was \$66.9 million in 2002 compared to \$52.6 million in 2001, an increase of \$14.3 million, due to reductions in working capital.

During 2003, wholly-owned subsidiaries of the Company completed three transactions resulting in the purchase of certain assets (consisting primarily of accounts receivable, inventories and property and equipment) and the assumption of certain lease obligations of 52 locations in Arkansas, Kentucky, Louisiana, Mississippi, Tennessee, Texas and Virginia. The acquired locations sell heating, air conditioning, refrigeration equipment and related parts and supplies. These acquisitions were funded by cash on hand in an amount equal to \$18.4 million.

In accordance with SFAS No. 141, "Business Combinations," the Company applied the purchase method of accounting to record these transactions. The purchase price allocation for the acquisitions is as follows (in millions):

Accounts receivable	\$ 5.4
Inventories	8.3
Property and equipment	.3
Goodwill	4.9
Accrued liabilities	(.5)
	<hr/>
Cash used in acquisition, net of cash acquired	\$18.4
	<hr/>

During 2002, the Company acquired two wholesale distributors of air conditioning and heating products in Arizona and Mississippi for aggregate cash consideration of \$1.9 million (net of cash acquired) and 27,688 shares of Common Stock having a fair value of \$.3 million. These acquisitions were accounted for under the purchase method and resulted in the recording of goodwill of \$.8 million.

The results of operations of these locations have been included in the Company's consolidated financial statements from their respective dates of acquisition. The proforma effect of these acquisitions was not deemed material to the Company's consolidated financial statements for the years ended December 31, 2003, 2002 and 2001.

Net cash used in investing activities increased to \$22.5 million in 2003 from \$4.1 million in 2002, primarily as a result of acquisitions during 2003. Net cash used in investing activities increased to \$4.1 million in 2002 from \$3.3 million in 2001 primarily as a result of capital expenditures and acquisitions during 2002, offset by the proceeds received from the sale of property and equipment.

Net cash used in financing activities of \$27.3 million in 2003 resulted primarily from net repayments under the revolving credit agreement, purchases of the Company's common stock and payments of common stock dividends, offset by proceeds from the issuance of common stock. Net cash used in financing activities of \$46.0 million in 2002 resulted primarily from purchases of the Company's common stock, net repayments under the revolving credit agreement and payments of common stock dividends, offset by proceeds from the issuance of common stock. Net cash used in financing activities of \$44.9 million in 2001 resulted primarily from net repayments under the revolving credit agreement and purchases of the Company's common stock, offset by proceeds from the issuance of Notes under the private placement facility.

The Company's Board of Directors has authorized the repurchase, at management's discretion, of 7.5 million shares to be repurchased 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. The Company purchased .4 million shares at a cost of \$6.7 million in 2003, 1.6 million shares at a cost of \$24.5 million in 2002 and .3 million shares at a cost of \$3.2 million in 2001. In aggregate, the Company has repurchased 5.4 million shares of Common Stock and Class B Common Stock at a cost of \$66.3 million. The remaining 2.1 million shares authorized for repurchase are subject to certain restrictions included in the Company's credit agreements. The Company has not made any purchases subsequent to December 31, 2003 through the date of this filing.

Cash dividends of 20 cents, 11.5 cents and 10 cents per share of Common Stock and Class B Common Stock were paid in 2003, 2002 and 2001, respectively. In February 2004, the Company's Board of Directors approved an increase in the quarterly cash dividend to 10 cents per share from 8 cents per share of Common Stock and Class B Common Stock. Future dividends will be at the sole discretion of the Board of Directors and will depend upon such factors as the Company's profitability, financial condition, cash requirements, restrictions existing on the Company's credit agreements, future prospects and other factors deemed relevant by the Company's Board of Directors.

As of December 31, 2003, the Company had \$36.3 million of cash and cash equivalents and \$195.0 million of unused borrowing capacity under its existing revolving credit agreement and \$95.0 million available under the Company's private placement shelf facility (subject to certain borrowing limitations) to fund present operations and anticipated growth, including expansion in its current and targeted market areas. The Company continually evaluates potential acquisitions and has ongoing discussions with a number of acquisition candidates. Should suitable acquisition opportunities or working capital needs arise that would require additional financing, the Company believes that its financial position and earnings history provide a solid base for obtaining additional financing resources at competitive rates and terms.

The Company believes it has adequate availability of capital from operations and current credit facilities to fund its working capital requirements and support the development of its short-term and long-term operating strategies. Additionally, the Company has the ability to raise funds through the issuance of common or preferred stock if required.

The following summarizes the Company's contractual obligations at December 31, 2003:

	Payments due by Period (in millions)			
	Within 1 Year	2-3 Years	4-5 Years	After 5 Years
Non-cancelable operating lease obligations	\$ 26.5	\$ 32.6	\$ 13.8	\$ 3.6
Long-term debt	—	20.0	10.0	—
Minimum royalty payments	1.0	2.0	2.0	3.0
Other debt	0.2	0.1	—	—
Total	\$ 27.7	\$ 54.7	\$ 25.8	\$ 6.6

At December 31, 2003, the Company also had commercial obligations outstanding under its existing revolving credit agreement for borrowings of \$30.0 million and standby letters of credit of \$7.2 million. Borrowings under the revolving credit agreement at December 31, 2003 had revolving maturities of three months and letters of credit have varying terms expiring through January 2005.

Quantitative and Qualitative Disclosures About Market Risk

The Company's primary market risk exposure consists of interest rate risk. The Company's objective in managing the exposure to interest rate changes is to limit the impact of interest rate changes on earnings and cash flows and to lower its overall borrowing costs. To achieve its objectives, the Company uses interest rate swaps to manage net exposure to interest rate changes to its borrowings. These swaps are entered into with financial institutions with investment grade credit ratings, thereby minimizing the risk of credit loss. All items described are non-trading. See Notes 1 and 11 to the consolidated financial statements for further information.

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

At December 31, 2003, the Company's interest rate swap had a notional value of \$30.0 million maturing in 2007. The swap agreement exchanges the variable rate of LIBOR plus the spread on its revolving credit agreement to fixed interest rate payments of 6.25% in 2003. An interest rate swap with a notional value of \$20.0 million matured in 2003. All interest rate swaps are effective as cash flow hedges and therefore there is no effect on current earnings from hedge ineffectiveness.

Effective January 1, 2001, the Company adopted SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," which established accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. All derivatives, whether designated in hedging relationships or not, are required to be recorded on the balance sheet at fair value. If the derivative is designated as a fair value hedge, the changes in the fair value of the derivative and of the hedged item attributable to the hedged risk are recognized in earnings. If the derivative is designated as a cash flow hedge, the effective portions of changes in the fair value of the derivative are recorded in other comprehensive income ("OCI") and are recognized in the income statement when the hedged items affect earnings. Ineffective portions of changes in the fair value of cash flow hedges are recognized in earnings. All interest rate swaps are effective as cash flow hedges and therefore there is no effect on current earnings from hedge ineffectiveness.

The Company recorded a gain (loss) in OCI relating to the change in value of the cash flow hedges of \$1.3 million, net of income tax expense of \$(.8) million, \$(1.3) million, net of income tax benefit of \$.7 million, and \$(1.5) million, net of income tax benefit of \$.9 million for the years ended December 31, 2003, 2002 and 2001, respectively. The fair market values of the derivative financial instruments are long-term liabilities of \$3.8 million and \$5.4 million at December 31, 2003 and 2002, respectively, and are included in deferred income taxes and other liabilities in the Company's consolidated balance sheets.

During the years ended December 31, 2003, 2002 and 2001, the Company reclassified \$1.3 million, net of income tax benefit of \$.8 million, \$1.6 million, net of income tax benefit of \$.9 million and \$.8 million, net of income tax benefit of \$.4 million, respectively, from accumulated OCI to current period earnings (recorded as interest expense, net in the consolidated statements of income). The net deferred loss recorded in accumulated OCI will be reclassified to earnings on

a quarterly basis as interest payments occur. As of December 31, 2003, approximately \$1.5 million in deferred losses on derivative instruments accumulated in OCI is expected to be reclassified to earnings during the next twelve months using a current three month LIBOR-based average receive rate (1.33% at December 31, 2003).

The earnings and cash flows to be paid under the Company's revolving credit agreement are sensitive to changes in LIBOR. The Company performed a sensitivity analysis to determine the potential variability on earnings and cash flows based on the Company's swap portfolio and variable rate debt through the respective maturity dates of the swap portfolio. The average interest rates on the variable rate debt and the average receive rate on the interest rate swap were derived from implied forward three-month LIBOR curves. The variability on earnings and cash flows aggregated approximately \$3.6 million over the remaining life of the swap. This information constitutes a "forward looking statement" and actual results may differ significantly based on actual borrowings and interest rates.

Critical Accounting Policies

Management's discussion and analysis of the Company's financial condition and results of operations is based upon the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amount of revenue and expenses during the reporting period. Actual results may differ from these estimates under different assumptions or conditions. Management frequently 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.

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

Allowance for Doubtful Accounts

The Company maintains an allowance for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. The Company's accounting for doubtful accounts contains uncertainty because management must use judgment to assess the collectibility 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. The Company's business is seasonal, and the Company's customers' businesses are also seasonal. Sales are lowest during the first and fourth quarters and the Company's past due accounts receivable balance as a percentage of total trade receivables generally increases during these quarters. The Company reviews its accounts receivable reserve policy periodically, reflecting current risks, trends and changes in industry conditions. The allowance for doubtful accounts was \$3.0 million and \$3.8 million at December 31, 2003 and December 31, 2002, respectively. Although the Company believes its allowance is sufficient, if the financial condition of the Company's customers were to unexpectedly deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required that could materially impact the Company's consolidated financial statements. Concentrations of credit risk with respect to accounts receivable are limited due to the large number of customers comprising the Company's customer base and their dispersion across many different geographical regions.

Inventory Valuation

Inventories consist of air conditioning, heating and refrigeration equipment and related parts and supplies and are valued at the lower of cost or market on a first-in, first-out basis. As part of this valuation process, excess, slow-moving and damaged inventories are reduced to their estimated net realizable value. The Company's accounting for excess, slow-moving and damaged inventory contains uncertainty because management must use judgment to estimate when the inventory will be sold and the quantities and prices at which the inventory will be sold in the normal course of business. The Company reviews its inventory reserve policy periodically, current risks, trends and changes in industry conditions. The Company also maintains a provision for estimated inventory shrinkage and conducts cycle counts and physical inventories to calculate actual shrinkage and inventory on hand. When preparing these estimates, management considers historical results, inventory levels and current operating trends. The Company has established valuation reserves associated with excess, slow-moving and damaged inventory and estimated shrinkage reserves of \$3.1 million and \$3.0 million at December 31, 2003 and December 31, 2002, respectively. These estimates can be affected by a number of factors, including general economic conditions and other factors affecting demand for the Company's inventory. In the event the

Company's estimates differ from actual results, the allowance for excess, slow-moving and damaged inventories may be adjusted and could materially impact the Company's consolidated financial statements.

Goodwill

Goodwill is no longer amortized and is subject to impairment testing at least annually using a fair value-based approach. The identification and measurement of goodwill impairment involves the estimation of the fair value of reporting units. The Company's accounting for impairment contains uncertainty because management must use judgment in determining appropriate assumptions to be used in the measurement of fair value. The estimates of fair value of reporting units are based on the best information available as of the date of the assessment and incorporate management assumptions about expected future cash flows and contemplate other valuation techniques. Future cash flows can be affected by changes in industry or market conditions.

The Company evaluates the recoverability of goodwill for impairment at least annually, as required, and when events or changes in circumstances indicate that the carrying amount of goodwill may not be recoverable. Operating results of the Staffing segment have been negatively impacted by economic softness experienced in the past three years. In the event that the operating results of the Staffing segment do not improve, a goodwill impairment charge may be necessary to the extent that the implied fair value of goodwill is less than the carrying value. During 2003, the Company completed a number of measures to reduce the costs of operations of its Staffing segment in response to the decline in demand for services. The carrying amount of goodwill at December 31, 2003 for the Staffing segment was \$4.0 million. In the event that factors occur prior to the next annual impairment test that indicate that the carrying value of its goodwill may not be recoverable, a goodwill impairment charge may be necessary to the extent that the implied fair value of goodwill is less than the carrying value. Although no goodwill impairment has been recorded to date, there can be no assurances that future goodwill impairments will not occur. An adjustment to the carrying value of goodwill could materially impact the Company's consolidated financial statements.

Self-Insurance Reserves

The Company maintains self-insured retentions for its health benefits and casualty insurance programs and limits its exposure by maintaining stop-loss and aggregate liability coverages. The estimate of the Company's self-insurance liability 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. When estimating the Company's self-insurance liability, management considers a number of factors, which include historical claim 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 liability is adequate. If actual claims exceed these estimates, additional reserves may be required.

Income Taxes

Income taxes are accounted for under the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial reporting basis and the tax basis of assets and liabilities at enacted tax rates expected to be in effect when such amounts are recovered or settled. The use of estimates by management is required to determine income tax expense, deferred tax assets and any related valuation allowance and deferred tax liabilities. The Company has recorded a valuation allowance of \$.3 million as of December 31, 2003, due to uncertainties related to the ability to utilize a portion of the deferred tax assets, consisting of state net operating loss carryforwards totaling \$78.5 million, which will expire in varying amounts through 2023. The valuation allowance is based on the Company's 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 the Company's future taxable income. Although management believes that the estimates discussed above are reasonable and the related calculations conform to accounting principles generally accepted in the United States, if management's estimates of future taxable income differ from actual taxable income, the deferred tax asset and any related valuation allowance will need to be adjusted. An adjustment to the deferred tax asset and any related valuation allowance could materially impact the Company's consolidated financial statements.

New Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and (or) the normal operation of a long-lived asset, except for certain obligations of lessees. SFAS No. 143 requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made and subsequently allocated to expense using a systematic and rational

method. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset and subsequently allocated to expense over the asset's useful life. SFAS No. 143 is effective for financial statements issued for fiscal years beginning after June 15, 2002. The adoption of SFAS No. 143 on January 1, 2003 did not have a material impact on the Company's consolidated financial statements.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. SFAS No. 146 requires that the initial measurement of a liability be at fair value. The adoption of SFAS No. 146 on January 1, 2003 did not have a material impact on the Company's consolidated financial statements.

In January 2003, the Company adopted Emerging Issues Task Force ("EITF") Issue No. 02-16, "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor." EITF Issue No. 02-16 permits recognition of a rebate or refund of a specified amount of cash consideration that is payable if the customer completes a specified cumulative level of purchases as a reduction of cost of sales, if the customer can reasonably estimate the amount of the rebate or refund on a systematic and rational allocation. The Company enters into agreements with certain vendors providing for inventory purchase rebates upon achievement of specified volume purchasing levels. The Company accrues the receipt of vendor rebates as part of its cost of sales for products sold based on progress towards earning the vendor rebates taking into consideration cumulative purchases of inventory to date and projected purchases through the end of the year. An estimate of unearned vendor rebates is included in the carrying value of inventories for vendor rebates received or receivable on products not yet sold. Substantially all vendor rebate receivables are collected within three months immediately following calendar year-end. The adoption of EITF Issue No. 02-16 did not have a material impact on the Company's consolidated financial statements.

In January 2003, the FASB issued Interpretation ("FIN") No. 46, "Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51." This Interpretation provides clarification on the consolidation of certain entities in which equity investors do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. Such entities are defined as variable interest entities ("VIEs"). FIN No. 46 requires that VIEs be consolidated by the entity considered to be the primary beneficiary of the VIE. In December 2003, the FASB issued FIN No. 46 (revised December 2003), which effectively modified and clarified certain provisions of FIN No. 46, as originally issued, and modified the effective date for certain entities. Public companies will apply the provisions of FIN No. 46, as revised, no later than the first reporting period that ends after March 15, 2004. The Company does not expect the adoption of FIN No. 46 to have a material impact on the Company's consolidated financial statements.

Information About Forward-Looking Statements

This Annual Report contains statements that are not historical in nature and that are intended to be, and are hereby identified as, "forward-looking statements" as defined in the Private Securities Litigation Reform Act of 1995, including statements regarding, among other items, (i) the Company's business and acquisition strategies, (ii) potential acquisitions by the Company, (iii) the Company's financing plans and (iv) industry, demographic and other trends affecting the Company's financial condition or results of operations. These forward-looking statements are based largely on the Company's expectations and are subject to a number of risks and uncertainties, certain of which are beyond the Company's control.

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

- general economic conditions affecting general business spending,
- consumer spending,
- consumer debt levels,
- seasonal nature of sales of the Company's products,
- weather conditions,
- effects of supplier concentration,
- competitive factors within the Company's industry,
- insurance coverage risks,
- prevailing interest rates, and
- the ability of the Company to continue to implement its business and acquisition strategies.

In light of these uncertainties, there can be no assurance that the forward-looking information contained herein will be realized or, even if substantially realized, that the information will have the expected consequences to or effects on the Company or its business or operations.

For additional information identifying some other important factors which may affect the Company's operations and could cause actual results to vary materially from those anticipated in the forward-looking statements, see the Company's Commission filings, including but not limited to, the discussion included in the Business section of the Company's Form 10-K under the headings "General Risk Factors" and "Business Risk Factors." Forward-looking statements speak only as of the date the statement was made. The Company assumes no obligation to update forward-looking information or the discussion of such risks and uncertainties to reflect actual results, changes in assumptions or changes in other factors affecting forward-looking information.

WATSCO, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

Years Ended December 31,

(In thousands, except per share data)

	2003	2002	2001
Revenue	\$ 1,232,908	\$ 1,181,136	\$ 1,238,646
Cost of sales	927,825	893,614	939,278
Cost of sales—restructuring	—	246	328
Gross profit	305,083	287,276	299,040
Selling, general and administrative expenses	243,894	236,891	247,847
Restructuring activities	—	(539)	2,869
Operating income	61,189	50,924	48,324
Interest expense, net	5,509	7,190	9,955
Income before income taxes	55,680	43,734	38,369
Income taxes	20,785	15,198	13,928
Net income	<u>\$ 34,895</u>	<u>\$ 28,536</u>	<u>\$ 24,441</u>
Earnings per share:			
Basic	\$ 1.39	\$ 1.12	\$ 0.94
Diluted	\$ 1.34	\$ 1.07	\$ 0.90
Weighted average shares and equivalent shares used to calculate earnings per share:			
Basic	25,086	25,558	25,946
Diluted	<u>26,037</u>	<u>26,674</u>	<u>27,251</u>

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

WATSCO, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

December 31,

(In thousands, except share data)

	2003	2002
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 36,339	\$ 25,880
Accounts receivable, net	137,678	129,396
Inventories	194,267	176,407
Other	9,244	13,878
Total current assets	377,528	345,561
Property and equipment, net	22,066	25,850
Goodwill	130,412	125,536
Other	5,089	6,772
	\$ 535,095	\$ 503,719
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term obligations	\$ 172	\$ 272
Accounts payable	76,526	59,965
Accrued liabilities	31,305	26,215
Total current liabilities	108,003	86,452
Long-term obligations:		
Borrowings under revolving credit agreement	30,000	50,000
Long-term notes	30,000	30,000
Other debt, net of current portion	153	233
Total long-term obligations	60,153	80,233
Deferred income taxes and other liabilities	6,070	7,833
Commitments and contingencies (Notes 11 and 12)		
Shareholders' equity:		
Common Stock, \$0.50 par value, 60,000,000 shares authorized in 2003 and 2002 and 28,061,811 and 27,468,289 shares issued in 2003 and 2002, respectively	14,031	13,734
Class B Common Stock, \$0.50 par value, 10,000,000 shares authorized in 2003 and 2002 and 3,674,999 and 3,533,676 shares issued in 2003 and 2002, respectively	1,838	1,767
Paid-in capital	226,363	216,124
Unearned compensation related to outstanding restricted stock	(12,294)	(9,067)
Accumulated other comprehensive loss, net of tax	(2,075)	(3,399)
Retained earnings	199,340	169,649
Treasury stock, at cost, 5,413,113 and 4,970,213 shares of common stock in 2003 and 2002, respectively	(66,334)	(59,607)
Total shareholders' equity	360,869	329,201
	\$ 535,095	\$ 503,719

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

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

<i>(In thousands, except share data)</i>	Common Stock and Class B Common Stock		Paid-In Capital	Unearned Compensation	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Treasury Stock	Total
	Shares	Amount						
Balance at December 31, 2000	26,497,089	\$ 14,796	\$ 204,871	\$ (6,031)	\$ 105	\$ 122,348	\$ (31,925)	\$ 304,164
Net income						24,441		24,441
Cumulative effect of accounting change in derivatives, net of income taxes					(629)			(629)
Changes in value of investments and derivatives, net of income taxes					(1,538)			(1,538)
Comprehensive income								22,274
Contribution to 401(k) plan	63,368	32	868					900
Issuances from exercise of stock options and employee stock purchase plan	102,749	51	789					840
Tax benefit from exercise of stock options			167					167
Issuances of restricted shares of common stock	375,173	188	4,642	(4,830)				—
Forfeitures of restricted shares of common stock	(30,000)	(15)	(478)	493				—
Amortization of unearned compensation				596				596
Common stock dividends, \$0.10 per share						(3,302)		(3,302)
Purchase of treasury stock	(263,800)						(3,219)	(3,219)
Balance at December 31, 2001	26,744,579	15,052	210,859	(9,772)	(2,062)	143,487	(35,144)	322,420
Net income						28,536		28,536
Changes in value of investments and derivatives, net of income taxes					(1,337)			(1,337)
Comprehensive income								27,199
Retirement of common stock	(482,680)	(241)	(7,897)					(8,138)
Contribution to 401(k) plan	51,140	25	814					839
Issuances from exercise of stock options and employee stock purchase plan	1,297,806	649	6,770					7,419
Tax benefit from exercise of stock options			5,153					5,153
Issuances of restricted shares of common stock	14,560	7	235	(242)				—
Forfeitures of restricted shares of common stock	(10,441)	(5)	(126)	131				—
Amortization of unearned compensation				816				816
Issuance for acquisition	27,688	14	316					330
Common stock dividends, \$0.115 per share						(2,374)		(2,374)
Purchase of treasury stock	(1,610,900)						(24,463)	(24,463)
Balance at December 31, 2002	26,031,752	15,501	216,124	(9,067)	(3,399)	169,649	(59,607)	329,201
Net income						34,895		34,895
Changes in value of investments and derivatives, net of income taxes					1,324			1,324
Comprehensive income								36,219
Retirement of common stock	(100,314)	(50)	(1,806)					(1,856)
Contribution to 401(k) plan	36,900	18	820					838
Issuances from exercise of stock options and employee stock purchase plan	593,607	297	5,298					5,595
Tax benefit from exercise of stock options			1,884					1,884
Issuances of restricted shares of common stock	237,152	119	4,454	(4,573)				—
Forfeitures of restricted shares of common stock	(32,500)	(16)	(411)	427				—
Amortization of unearned compensation				919				919
Common stock dividends, \$0.20 per share						(5,204)		(5,204)
Purchase of treasury stock	(442,900)						(6,727)	(6,727)
Balance at December 31, 2003	26,323,697	\$ 15,869	\$ 226,363	\$ (12,294)	\$ (2,075)	\$ 199,340	\$ (66,334)	\$ 360,869

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

WATSCO, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

<i>(In thousands)</i>	<i>Years Ended December 31,</i>		
	2003	2002	2001
Cash flows from operating activities:			
Net income	\$ 34,895	\$ 28,536	\$ 24,441
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	6,499	7,295	7,900
Amortization of goodwill	—	—	3,587
Amortization of unearned compensation	919	816	596
Provision for doubtful accounts	3,628	5,317	6,319
Restructuring activities	—	(293)	2,938
Deferred income tax provision (benefit)	1,817	1,351	(1,838)
Non-cash stock contribution to 401(k) plan	838	839	900
Tax benefit from exercise of stock options	1,884	5,153	167
Changes in operating assets and liabilities, net of effects of acquisitions:			
Accounts receivable	(6,472)	9,999	14,150
Inventories	(9,554)	10,211	19,534
Accounts payable and accrued liabilities	19,172	(5,634)	(25,830)
Other, net	6,626	3,271	(291)
Net cash provided by operating activities	60,252	66,861	52,573
Cash flows from investing activities:			
Business acquisitions, net of cash acquired	(18,424)	(1,864)	—
Capital expenditures	(3,069)	(4,539)	(4,624)
Purchase of minority interest in consolidated subsidiary	(1,294)	—	—
Proceeds from sale of property and equipment	278	2,338	1,285
Other, net	—	—	35
Net cash used in investing activities	(22,509)	(4,065)	(3,304)
Cash flows from financing activities:			
Net repayments under revolving credit agreement	(20,000)	(20,000)	(68,000)
Purchase of treasury stock	(6,727)	(24,463)	(3,219)
Common stock dividends	(5,204)	(3,017)	(2,638)
Net repayments of other debt	(180)	(1,824)	(1,901)
Net proceeds from issuances of common stock	4,827	4,031	840
Payment of debt acquisition costs	—	(775)	—
Proceeds from issuance of long-term notes	—	—	30,000
Net cash used in financing activities	(27,284)	(46,048)	(44,918)
Net increase in cash and cash equivalents	10,459	16,748	4,351
Cash and cash equivalents at beginning of year	25,880	9,132	4,781
Cash and cash equivalents at end of year	\$ 36,339	\$ 25,880	\$ 9,132

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

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

1. Significant Accounting Policies

Nature of Operations

Watsco, Inc. and its subsidiaries (collectively, the "Company" or "Watsco") is the largest independent distributor of air conditioning, heating and refrigeration equipment and related parts and supplies ("HVAC") in the United States. The Company has two business segments – the HVAC distribution ("Distribution") segment, which accounted for 98% of 2003 consolidated revenue and presently operates from 318 locations in 31 states and a temporary staffing and permanent employment services ("Staffing") segment, which accounted for 2% of 2003 consolidated revenue. Included in the Distribution segment are operations that sell products for residential and commercial applications and products specifically designed for the manufactured housing market.

Basis of Consolidation

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

Use of Estimates

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

Cash and Cash Equivalents

The Company considers all highly liquid instruments purchased with an original maturity of three months or less to be cash equivalents. In addition to cash, the Company's cash equivalents include municipal securities with put options of 7 days or less. The Company considers such investments to be cash equivalents for purposes of the consolidated financial statements. At December 31, 2003, the Company held approximately \$17 million in such municipal securities. No individual municipal security equaled or exceeded 1% of total assets and such securities are investment grade and collateralized by a letter of credit issued by the remarketing agent.

Investment Securities

Investments in marketable equity securities of \$215 and \$170 at December 31, 2003 and 2002, respectively, are included in "other" current assets and are classified as available-for-sale. The Company records the securities at fair value with unrealized holding gains and losses, net of applicable income taxes, included as a separate component of shareholders' equity. Dividend and interest income are recognized when earned. The difference between cost and market was an unrealized holding gain of \$100 and \$76 in 2003 and 2002, respectively, net of income tax expense of \$60 and \$41 in 2003 and 2002, respectively.

Accounts Receivable

The Company maintains an allowance for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. 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. The Company reviews its accounts receivable reserve policy periodically, reflecting current risks, trends and changes in industry conditions.

Inventories

Inventories consist of air conditioning, heating and refrigeration equipment and related parts and supplies and are valued at the lower of cost or market on a first-in, first-out basis. As part of this valuation process, excess and slow-moving inventories are reduced to their estimated net realizable value. The Company reviews its inventory reserve policy periodically, reflecting current risks, trends and changes in industry conditions. The Company also maintains a provision for estimating inventory shrinkage and conducts cycle counts and physical inventories to calculate actual shrinkage and inventory on hand.

Property and Equipment

Property and equipment are stated at cost. Depreciation and amortization of property and equipment is computed using the straight-line method. Buildings and improvements are being depreciated or amortized over estimated useful lives ranging from 1-40 years. Leasehold improvements are amortized over the shorter of the respective lease terms or useful lives. Estimated useful lives for other depreciable assets range from 3-12 years. Included in property and equipment is a corporate aircraft with an estimated useful life of 10 years. Depreciation and amortization expense related to property and equipment amounted to \$6,499, \$7,295 and \$7,900 for the years ended December 31, 2003, 2002 and 2001, respectively.

Recoverability of Long-Lived Assets

The Company evaluates the recoverability of long-lived assets when events or changes in circumstances indicate that the carrying amount of long-lived assets may not be recoverable. When events or changes in circumstances indicate that the carrying amount of long-lived assets may not be recoverable, the Company determines whether the amortization of the balance over its remaining life can be recovered through undiscounted future operating cash flows. The amount of impairment, if any, is measured based on projected discounted cash flows using a discount rate reflecting the Company's average cost of funds and compared to the asset's carrying value. The assessment for the recoverability of long-lived assets will be impacted if estimated future operating cash flows are not achieved.

Goodwill

In accordance with Statement of Financial Accounting Standards ("SFAS") No. 142, goodwill is no longer amortized but instead the Company is required to perform an annual impairment test for goodwill for each reporting unit or on an interim basis if the Company encounters events or changes in circumstance that would indicate that the book value of goodwill might be impaired. If the fair value of the reporting unit is less than its carrying value, an impairment loss is recorded to the extent that the implied fair value of goodwill (as defined under SFAS No. 142) within the reporting unit is less than its carrying value (see Note 9). Prior to January 1, 2002, amortization of goodwill was computed using the straight-line method over 40 years.

Revenue Recognition

The Company recognizes revenue in accordance with Securities and Exchange Commission Staff Accounting Bulletin ("SAB") No. 104, "Revenue Recognition," (which superceded SAB No. 101, "Revenue Recognition in Financial Statements," as amended by SAB 101A and 101B). Revenue for the Company primarily consists of sales of air conditioning, heating and refrigeration equipment and related parts and supplies and service fee revenue from the Company's Staffing segment. SAB 104 requires that four basic criteria must be met before revenue can be recognized: (1) persuasive evidence of an arrangement exists, (2) delivery has occurred or services have been rendered, (3) the amounts recognized are fixed and determinable, and (4) collectibility is reasonably assured. The Company records revenue after it receives a purchase commitment with a fixed determinable price from the customer and shipment of products or delivery of services has occurred. The Company assesses collection based on a number of factors, including past transactions and credit-worthiness of customers, historical trends and other information. Substantially all customer returns relate to products that are returned under warranty obligations underwritten by the Company's manufacturers. Accordingly, the Company believes that its risk of loss for customer returns is mitigated.

Advertising Costs

Advertising costs are expensed as incurred. Advertising expense amounted to \$4,847, \$4,674 and \$4,305 for the years ended December 31, 2003, 2002 and 2001, respectively.

Shipping and Handling

The Company includes shipping and handling costs in selling, general and administrative expenses. Shipping and handling costs amounted to \$5,348, \$5,214 and \$5,697 for the years ended December 31, 2003, 2002 and 2001, respectively.

Stock-Based Compensation

The Company applies the intrinsic value-based method of accounting prescribed by Accounting Principles Board ("APB") No. 25, "Accounting for Stock Issued to Employees," and related interpretations, in accounting for its stock options under fixed plans. As such, compensation expense would be recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price. Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure – an amendment of FASB Statement No. 123," established preferred accounting and mandatory disclosure requirements using a fair value-based method of accounting for stock-based employee compensation plans. As allowed by SFAS No. 123, the Company has elected to continue to apply the intrinsic value-based method of accounting described above and has adopted the disclosure requirements of SFAS No. 123 and SFAS No. 148. Had compensation cost for the Company's stock-based compensation plans been determined based on the fair value method at the grant dates for awards under the stock option plans and purchases under the employee stock purchase plan consistent with the method of SFAS No. 123, the Company's pro forma net income and earnings per share would be as follows:

<i>Years Ended December 31,</i>	<u>2003</u>	<u>2002</u>	<u>2001</u>
Net income, as reported	\$ 34,895	\$ 28,536	\$ 24,441
Stock-based compensation expense included in net income, net of tax	576	532	380
Stock-based compensation expense determined under the fair value-based method, net of tax	(2,690)	(3,298)	(4,567)
Net income, pro forma	<u>\$ 32,781</u>	<u>\$ 25,770</u>	<u>\$ 20,254</u>
Basic earnings per share:			
As reported	\$ 1.39	\$ 1.12	\$ 0.94
Pro forma	\$ 1.31	\$ 1.01	\$ 0.78
Diluted earnings per share:			
As reported	\$ 1.34	\$ 1.07	\$ 0.90
Pro forma	\$ 1.26	\$ 0.97	\$ 0.74

The Company's pro forma information above is not representative of the pro forma effect of the fair value provisions of SFAS No. 123 on the Company's net income in future years because pro forma compensation expense related to grants made prior to 1995 may not be taken into consideration.

The weighted-average fair value at date of grant for stock options granted during 2003, 2002 and 2001 was \$8.78, \$9.37 and \$8.16, respectively, and was estimated using the Black-Scholes option valuation model with the following weighted-average assumptions:

<u>Years Ended December 31,</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
Expected life in years	6.3	6.5	7.2
Risk-free interest rate	4.3%	3.8%	5.1%
Expected volatility	58.2%	59.4%	67.5%
Dividend yield	1.14%	0.7%	0.7%

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including expected stock price volatility. The Company's stock-based compensation arrangements have characteristics significantly different from those of traded options, and changes in the subjective input assumptions used in valuation models can materially affect the fair value estimate. As a result, the existing models may not necessarily provide a reliable single measure of the fair value of its stock-based compensation.

Income Taxes

The Company provides for federal and state income taxes currently payable, as well as for those deferred because of temporary differences between reporting income and expenses for financial statement purposes versus tax purposes. Deferred tax assets and liabilities reflect the temporary differences between the financial statement and income tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect of a change in tax rates is recognized as income or expense in the period that includes the enactment date. The Company and its eligible subsidiaries file a consolidated United States federal income tax return. As the Company generally does not file its income tax returns 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 the Company and its subsidiaries are required to file, the potential utilization of operating loss carry-forwards for both federal and state income tax purposes and valuation allowances required, if any, for tax assets that may not be realizable in the future.

Earnings Per Share

Basic earnings per share is computed by dividing net income by the weighted average number of shares outstanding. Diluted earnings per share additionally assumes, if dilutive, any added dilution from common stock equivalents. Shares used to calculate earnings per share are as follows:

<u>Years Ended December 31,</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
Weighted average shares outstanding	25,086,321	25,557,653	25,946,110
Dilutive stock options and restricted shares of common stock	951,004	1,116,112	1,304,941
Shares for diluted earnings per share	<u>26,037,325</u>	<u>26,673,765</u>	<u>27,251,051</u>
Stock options and restricted shares of common stock outstanding which are not included in the calculation of diluted earnings per share because their impact is antidilutive	<u>739,262</u>	<u>1,504,607</u>	<u>1,994,350</u>

Derivative Instruments

The Company applies the provisions of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," which establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. All derivatives, whether designated in hedging relationships or not, are required to be recorded on the balance sheet at fair value. If the derivative is designated as a fair value hedge, the changes in the fair value of the derivative and of the hedged item attributable to the hedged risk are recognized in earnings. If the derivative is designated as a cash flow hedge, the effective portions of changes in the fair value of the derivative are recorded in other comprehensive income ("OCI") and are recognized in the income

statement when the hedged items affect earnings. Ineffective portions of changes in the fair value of cash flow hedges are recognized in earnings. See Note 11 for further information regarding the Company's hedging activities.

Comprehensive Income

Comprehensive income consists of net income and changes in the value of available-for-sale securities and derivative instruments for the years ended December 31, 2003, 2002 and 2001. The changes in components of OCI for available-for-sale securities and derivative instruments for the years ended December 31, 2003, 2002 and 2001, respectively, are as follows:

<u>Years Ended December 31,</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
Unrealized holding gain (loss) on derivative instruments, net of income tax (expense) benefit of \$(772), \$700 and \$894, respectively	\$ 1,296	\$(1,315)	\$(1,528)
Cumulative effect of accounting change of derivative instruments, net of income tax benefit of \$372	—	—	(629)
Unrealized holding gain (loss) on available-for-sales securities arising during the period, net of income tax (expense) benefit of \$(17), \$12 and \$4, respectively	28	(22)	(11)
Reclassification adjustment for losses realized from the write-down of available-for-sale securities, net of income tax of \$1	—	—	1
Changes in value of available-for-sale securities and derivative instruments, net of income taxes	\$ 1,324	\$(1,337)	\$(2,167)

New Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and (or) the normal operation of a long-lived asset, except for certain obligations of lessees. SFAS No. 143 requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made and subsequently allocated to expense using a systematic and rational method. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset and subsequently allocated to expense over the asset's useful life. SFAS No. 143 is effective for financial statements issued for fiscal years beginning after June 15, 2002. The adoption of SFAS No. 143 on January 1, 2003 did not have a material impact on the Company's consolidated financial statements.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146, requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. SFAS No. 146 requires that the initial measurement of a liability be at fair value. The adoption of SFAS No. 146 on January 1, 2003 did not have a material impact on the Company's consolidated financial statements.

In January 2003, the Company adopted Emerging Issues Task Force ("EITF") Issue No. 02-16, "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor." EITF Issue No. 02-16 permits recognition of a rebate or refund of a specified amount of cash consideration that is payable if the customer completes a specified cumulative level of purchases as a reduction of cost of sales, if the customer can reasonably estimate the amount of the rebate or refund on a systematic and rational allocation. The Company enters into agreements with certain vendors providing for inventory purchase rebates upon achievement of specified volume purchasing levels. The Company accrues the receipt of vendor rebates as part of its cost of sales for products sold based on progress towards earning the vendor rebates taking into consideration cumulative purchases of inventory to date and projected purchases through the end of the year. An estimate of unearned vendor rebates is included in the carrying value of inventories for vendor rebates received or receivable on products not yet sold. Substantially all vendor rebate receivables are collected within three months immediately following calendar year-end. The adoption of EITF Issue No. 02-16 did not have a material impact on the Company's consolidated financial statements.

In January 2003, the FASB issued Interpretation ("FIN") No. 46, "Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51." This Interpretation provides clarification on the consolidation of certain entities in which equity investors do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. Such entities are defined as variable interest entities ("VIEs"). FIN No. 46 requires that VIEs be consolidated by the entity considered to be the primary beneficiary of the VIE. In December 2003, the FASB issued FIN No. 46 (revised December 2003), which effectively modified and clarified certain provisions of FIN No. 46, as originally issued, and modified the effective date for certain entities. Public companies will apply the provisions of FIN No. 46, as revised, no later than the first reporting period that ends after March 15, 2004. The Company does not expect the adoption of FIN No. 46 to have a material impact on the Company's consolidated financial statements.

2. Supplier Concentration

The Company has six primary agreements related to the distribution of HVAC equipment products. Purchases from these six suppliers comprised 44%, 46% and 45% of all purchases made in 2003, 2002 and 2001, respectively. The Company's largest supplier accounted for 15%, 17% and 16% of all purchases made in 2003, 2002 and 2001, respectively. Any significant interruption by the manufacturers or a termination of a distribution agreement could disrupt the operations of certain subsidiaries.

3. Property and Equipment, net

Property and equipment, net, consists of:

<u>December 31,</u>	<u>2003</u>	<u>2002</u>
Land, buildings and improvements	\$ 15,066	\$ 15,567
Machinery, vehicles and equipment	29,523	31,396
Furniture and fixtures	19,420	19,805
Corporate aircraft	7,303	7,542
	<u>71,312</u>	<u>74,310</u>
	(49,246)	(48,460)
Less: accumulated depreciation and amortization		
	<u>\$ 22,066</u>	<u>\$ 25,850</u>

4. Long-Term Obligations

Revolving Credit Agreement and Long-Term Notes

The Company maintains a bank-syndicated, unsecured revolving credit agreement that provides for borrowings of up to \$225,000, expiring in April 2005. At December 31, 2003 and 2002, \$30,000 and \$50,000, respectively, was outstanding under the revolving credit agreement. Borrowings under the agreement are used to fund seasonal working capital needs and for other general corporate purposes, including acquisitions. Borrowings under the revolving credit agreement bear interest at primarily LIBOR-based rates plus a spread that is dependent upon the Company's financial performance (LIBOR plus 1.0% at December 31, 2003 and 2002). The Company pays a variable commitment fee on the unused portion of the commitment. See Note 11 for details related to interest rate swap agreements designated as hedges.

The Company has a \$125,000 unsecured private placement shelf facility. The uncommitted loan facility provides the Company a source of long-term, fixed-rate financing as a complement to the variable rate borrowings available under its existing revolving credit agreement through January 2006. The Company has \$30,000 Senior Series A Notes ("Notes") outstanding under its private placement shelf facility, bearing interest at 7.07%. The Notes have an average life of 5 years with repayment in equal installments of \$10,000 beginning on April 9, 2005, until the final maturity on April 9, 2007. Interest is paid on a quarterly basis. The Notes allow for redemption prior to maturity subject to a redemption premium and other restrictions.

Both the revolving credit agreement and the private placement shelf facility contain customary affirmative and negative covenants including certain financial covenants with respect to the Company's consolidated net worth, interest and debt coverage ratios and limits capital expenditures, dividends and share repurchases in addition to other restrictions. The Company is in compliance with all covenants and financial ratios at December 31, 2003.

Other Debt

Other debt (net of current portion) of \$153 and \$233 at December 31, 2003 and 2002, respectively, relates to capital leases on equipment and promissory notes issued for business acquisitions. Interest rates on other debt range from 3.9% to 9.5% and mature at varying dates through 2008. Annual maturities of other debt for the years subsequent to December 31, 2003 are \$172 in 2004, \$86 in 2005, \$26 in 2006, \$26 in 2007 and \$15 in 2008.

Total cash payments for interest were \$6,090, \$7,165 and \$9,888 for the years ended December 31, 2003, 2002 and 2001, respectively.

5. Income Taxes

The components of income tax expense (benefit) are as follows:

<u>Years Ended December 31,</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
Federal	\$ 20,464	\$ 15,420	\$ 14,587
State	321	(222)	(659)
	<u>\$ 20,785</u>	<u>\$ 15,198</u>	<u>\$ 13,928</u>
Current	\$ 18,968	\$ 13,847	\$ 15,766
Deferred	1,817	1,351	(1,838)
	<u>\$ 20,785</u>	<u>\$ 15,198</u>	<u>\$ 13,928</u>

Following is a reconciliation of the effective income tax rate:

<u>Years Ended December 31,</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
Federal statutory rate	35.0%	35.0%	35.0%
State income taxes, net of federal benefit and other	2.6	2.6	1.3
Change in valuation allowance	(.3)	(2.8)	—
	<u>37.3%</u>	<u>34.8%</u>	<u>36.3%</u>

The following is a summary of the significant components of the Company's deferred tax assets and liabilities:

<u>December 31,</u>	<u>2003</u>	<u>2002</u>
Deferred tax assets:		
Accounts receivable reserves	\$ 1,042	\$ 1,546
Capitalized inventory costs and inventory reserves	1,288	1,520
Depreciation	119	327
Unrealized loss on derivative instruments	1,417	2,006
Net operating loss carryforwards	3,083	4,330
Other	3,328	1,268
	<u>10,277</u>	<u>10,997</u>
Less valuation allowance	(324)	(505)
Total deferred tax assets	<u>9,953</u>	<u>10,492</u>
Deferred tax liabilities:		
Deductible goodwill	(9,075)	(6,937)
Other	(45)	(905)
Total deferred tax liabilities	<u>(9,120)</u>	<u>(7,842)</u>
Net deferred tax assets (1)	<u>\$ 833</u>	<u>\$ 2,650</u>

(1) Net deferred current tax assets of \$3,166 and \$3,185 have been included in the consolidated balance sheets in "other" current assets at December 31, 2003 and 2002, respectively.

SFAS No. 109 requires a valuation allowance to reduce the deferred tax assets reported if, based on the weight of the evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Management has determined that \$324 of valuation allowance at December 31, 2003 is necessary to reduce the deferred tax assets to the amount that will more likely than not be realized. The change in valuation allowance for the current year of \$(181) is reflected as a reduction in the provision for income taxes during 2003. At December 31, 2003, the Company had federal net operating loss carryforwards of \$464, which expire in the year 2005, and state net operating loss carryforwards of \$78,500, which expire in varying amounts from 2004 through 2023. These amounts are available to offset future taxable income.

The number of years that are open for tax audit vary depending on the tax jurisdiction. A number of years may elapse before a particular matter is audited and finally resolved. While it is often difficult to predict the final outcome or the timing of resolution of any particular tax matter, the Company believes that the consolidated financial statements reflect the probable outcome of known tax contingencies.

Total cash payments for income taxes were \$14,169, \$6,973 and \$13,280 for the years ended December 31, 2003, 2002 and 2001, respectively.

6. Stock Based Compensation and Benefit Plans

2001 Incentive Compensation Plan

In June 2001, the Company's shareholders approved the 2001 Incentive Compensation Plan ("2001 Plan"). The 2001 Plan is administered by the Compensation Committee and the Stock Option Committee (the "Committees") of the Board of Directors. Decisions with regard to stock-based compensation of the Company's executives are made by the Compensation Committee and are submitted for approval to the Stock Option Committee. Decisions with regard to stock-based compensation for other employees of the Company are made by the Stock Option Committee. The 2001 Plan provides for the award of a broad variety of stock-based compensation alternatives such as non-qualified stock options, incentive stock options, restricted stock, performance awards, dividend equivalents, deferred stock and stock appreciation rights at no less than 100% of the market price on the date the option is granted. Options under the 2001 Plan are for a term of ten years and are exercisable as determined by the Committees.

The Company's 2001 Plan provides for acceleration of exercisability of the options upon the occurrence of certain events relating to a change of control, merger, sale of assets or liquidation of the Company. Additionally, the Committees or Board of Directors may impose on any award or the exercise thereof, at the date of grant or thereafter, such additional terms and conditions not inconsistent

with the provisions of the 2001 Plan, as the Committees or the Board of Directors shall determine, including terms requiring forfeiture of awards in the event of termination of employment by the participant and terms permitting a participant to make elections relating to his or her award. The Committees or the Board of Directors shall retain full power and discretion to accelerate, waive or modify, at any time, any term or condition of an award that is not mandatory under the 2001 Plan.

Under the 2001 Plan, awards for an aggregate of 3,000,000 shares of Common Stock and Class B Common Stock may be granted. There were 1,675,281 shares of common stock reserved for future grants as of December 31, 2003 under the 2001 Plan.

During 2003, 2002 and 2001, the Company granted 237,152, 14,560 and 122,673 shares of restricted common stock, respectively, under the 2001 Plan, which are subject to certain restrictions. Prior to the adoption of the 2001 Plan, certain employees were also granted an aggregate of 252,500 and 127,000 shares of restricted common stock in 2001 and 2000, respectively. The restrictions lapse upon attainment of retirement age or under other circumstances. During 2003, 2002 and 2001, 32,500, 10,441 and 30,000 shares, respectively, were forfeited. The unearned compensation resulting from the grant of restricted shares is reported as a reduction of shareholders' equity in the consolidated balance sheets and is being amortized to earnings over the period from date of issuance to the respective estimated retirement age of each employee. Total amortization expense related to the restricted shares amounted to \$919, \$816 and \$596 for the years ended December 31, 2003, 2002 and 2001, respectively.

Options as to 765,775 shares of Common Stock, net of cancellations and 200,000 shares of Class B Common Stock have been granted through December 31, 2003. There are 906,975 options of common stock outstanding under the 2001 Plan at December 31, 2003.

1991 Stock Option Plan

The Company also maintains the 1991 Stock Option Plan (the "1991 Plan"), which expired during 2001; therefore, no additional options may be granted. Options as to 2,435,451 of common stock are outstanding under the 1991 Plan at December 31, 2003. Options under the 1991 Plan are for a term of ten years and are exercisable as determined by the Committees. During 2003 and 2002, 100,314 shares of Common Stock with an aggregate market value of \$1,856 and 4,446 shares of Common Stock and 195,912 shares of Class B Common Stock with an aggregate market value of \$3,367, respectively, were delivered to the Company as payment for stock option exercises. Under the 1991 Plan, the Committees may waive the vesting period and permit options to be exercised immediately.

A summary of option activity is shown below:

	2003		2002		2001	
	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
Outstanding on January 1,	3,714,113	\$ 12.13	5,003,809	\$ 10.48	4,923,096	\$ 10.78
Granted	384,500	16.21	206,625	14.30	655,325	11.46
Exercised	(509,475)	8.71	(1,243,533)	5.43	(69,301)	6.95
Forfeited	(246,712)	13.88	(252,788)	14.12	(505,311)	15.11
Outstanding on December 31,	3,342,426	\$ 12.99	3,714,113	\$ 12.13	5,003,809	\$ 10.48
Options exercisable at end of year	2,451,527	\$ 12.99	2,682,088	\$ 12.42	3,428,980	\$ 10.07

The following sets forth certain information with respect to those stock options outstanding on December 31, 2003:

	Options Outstanding			Options Exercisable	
	Number Outstanding at December 31, 2003	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life	Number Exercisable at December 31, 2003	Weighted-Average Exercise Price
\$ 4.74-\$ 5.00	19,913	\$ 4.74	0.8	19,913	\$ 4.74
\$ 5.01-\$10.00	806,750	8.32	5.1	603,750	8.25
\$10.01-\$15.00	1,179,025	12.61	6.5	798,525	12.74
\$15.01-\$20.00	1,285,988	16.05	5.1	1,017,422	16.05
\$20.01-\$23.17	50,750	22.14	9.2	11,917	21.88
	3,342,426	\$ 12.99	5.6	2,451,527	\$ 12.99

Employee Stock Purchase Plan

Effective July 1, 1996, the Company adopted the Watsco, Inc. Qualified Employee Stock Purchase Plan under which full-time employees with at least 90 days of service may purchase up to an aggregate of 800,000 shares of the Company's Common Stock. The plan allows participating employees to purchase, through payroll deductions or lump-sum contribution, shares of the Company's

Common Stock at 85% of the fair market value at specified times subject to certain restrictions. During 2003, 2002 and 2001 employees purchased 81,768, 52,795 and 31,681 shares of Common Stock at an average price of \$13.55, \$12.39 and \$10.38 per share, respectively. Cash dividends received by the Employee Stock Purchase Plan were reinvested in the Company's Common Stock and resulted in additional shares issued in the amount of 2,364, 1,478 and 1,767 for the years ended December 31, 2003, 2002 and 2001, respectively. At December 31, 2003, 107,965 shares remained available for purchase under the plan.

401(k) Plan

The Company has a profit sharing retirement plan for its employees that is qualified under Section 401(k) of the Internal Revenue Code. The Company makes an annual matching contribution based on a percentage of eligible employee compensation deferrals. The contribution is made in cash or by the issuance of the Company's Common Stock to the plan on behalf of its employees. For the years ended December 31, 2003, 2002 and 2001, the Company's aggregate contribution to the plan was \$852, \$848 and \$909, respectively.

7. Acquisitions

During 2003, wholly-owned subsidiaries of the Company completed three acquisition transactions resulting in the purchase of certain assets (consisting primarily of accounts receivable, inventories and property and equipment) and the assumption of certain lease obligations of 52 locations in Arkansas, Kentucky, Louisiana, Mississippi, Tennessee, Texas and Virginia. The acquired locations sell heating, air conditioning, refrigeration equipment and related parts and supplies. These acquisitions were funded by cash on hand in an amount equal to \$18,424.

In accordance with SFAS No. 141, "Business Combinations," the Company applied the purchase method of accounting to record these transactions. The purchase price allocation for the acquisitions is as follows:

Accounts receivable	\$ 5,438
Inventories	8,306
Property and equipment	251
Goodwill	4,876
Other assets	48
Accrued liabilities	(495)
	<hr/>
Cash used in acquisition, net of cash acquired	<u>\$18,424</u>

During 2002, the Company acquired two wholesale distributors of air conditioning and heating products in Arizona and Mississippi for aggregate cash consideration of \$1,864 (net of cash acquired) and 27,688 shares of Common Stock having a fair value of \$330. These acquisitions were accounted for under the purchase method of accounting and resulted in the recording of goodwill of \$790.

The results of operations of these locations have been included in the Company's consolidated financial statements from their respective dates of acquisition. The proforma effects of these acquisitions were not deemed material to the Company's consolidated financial statements for the years ended December 31, 2003, 2002 and 2001.

8. Restructuring Activities

During 2001, the Company implemented several initiatives to improve operating efficiency and enhance profitability. As a result of these initiatives, the Company closed certain under performing locations and reduced market overlap, disposed of inventory related to discontinued product lines, integrated operations of certain subsidiaries and exited certain business relationships (the "2001 Restructuring Plan"). In connection with the 2001 Restructuring Plan, the Company recorded restructuring charges of \$3,424 (\$2,181 after-tax) during the third quarter of 2001. The portion of the restructuring charge that related to the valuation of disposed inventory of \$328 (on a pre-tax basis) was classified in cost of sales in the Company's consolidated statement of income for the year ended December 31, 2001. The Company's activities related to the 2001 Restructuring Plan were complete as of December 31, 2002.

9. Goodwill

Effective January 1, 2002, goodwill is no longer amortized and is subject to impairment testing at least annually using a fair value-based approach. Based on an analysis of economic characteristics and how the Company operates its business, the Company has designated its business segments as its reporting units: Distribution and Staffing. The Company evaluates the recoverability of goodwill for impairment when events or changes in circumstances indicate that the carrying amount of goodwill may not be recoverable. The Company's accounting for impairment contains uncertainty because management must use judgment in determining appropriate assumptions to be used in the measurement of fair value. The estimates of fair value of reporting units are based on the best information available as of the date of the assessment, and incorporate management assumptions about expected future cash flows and contemplate other valuation techniques. Future cash flows can be affected by changes in industry or market conditions. On January 1, 2004, the Company performed the required annual impairment test and determined there was no impairment. Operating

results of the Staffing segment have been negatively impacted by economic softness experienced in the past three years. The Company has completed a number of measures to reduce the costs of operations of its Staffing segment during 2003 in response to the decline in demand for services. In the event that factors occur prior to the next annual impairment test that indicate that the carrying value of its goodwill may not be recoverable, a goodwill impairment charge may be necessary to the extent that the implied fair value of goodwill is less than the carrying value. Although no goodwill impairment has been recorded to date, there can be no assurances that future goodwill impairments will not occur.

Net income and basic and diluted earnings per share for the year ended December 31, 2001 adjusted to exclude amounts no longer being amortized are as follows:

<u>Year Ended December 31,</u>	<u>2001</u>
Reported net income	\$ 24,441
Adjustments:	
Goodwill amortization expense	3,587
Income tax effect	(1,302)
Adjusted net income	\$ 26,726
Basic earnings per share:	
Reported	\$ 0.94
Adjusted	\$ 1.03
Diluted earnings per share:	
Reported	\$ 0.90
Adjusted	\$ 0.98

The changes in the carrying amount of goodwill for the years ended December 31, 2003 and 2002 are as follows:

	<u>Distribution</u>	<u>Staffing</u>	<u>Total</u>
Balance at December 31, 2001	\$ 120,754	\$ 3,983	\$ 124,737
Goodwill acquired during the period	790	9	799
Balance at December 31, 2002	121,544	3,992	125,536
Goodwill acquired during the period	4,876	—	4,876
Balance at December 31, 2003	\$ 126,420	\$ 3,992	\$ 130,412

See Note 7 for additional information regarding acquisitions made in 2003 and 2002.

10. Shareholders' Equity

Common Stock and Class B Common Stock share equally in the earnings of the Company and are identical in most other respects except (i) Common Stock has limited voting rights, each share of Common Stock being entitled to one vote on most matters and each share of Class B Common Stock being 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.

The Company's Board of Directors has authorized the repurchase, at management's discretion, of 7,500,000 shares to be repurchased 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. The Company purchased 442,900 shares at a cost of \$6,727 in 2003, 1,610,900 shares at a cost of \$24,463 in 2002 and 263,800 shares at a cost of \$3,219 in 2001. In aggregate since the inception of the repurchase plan in 1999, the Company has repurchased 5,413,113 shares of Common Stock and Class B Common Stock at a cost of \$66,334. The remaining 2,086,887 shares authorized for repurchase are subject to certain restrictions included in the Company's credit agreements.

11. Financial Instruments

Recorded Financial Instruments

The Company's recorded financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable, the current portion of long-term obligations, borrowings under revolving credit agreement and debt instruments included in other long-term obligations. At December 31, 2003 and 2002, 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 borrowings under the revolving credit agreement and debt instruments included in long-term obligations also approximate their carrying value based upon interest rates available to the Company for similar instruments with consistent terms and remaining maturities.

Off-Balance Sheet Financial Instruments

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

At December 31, 2003 and 2002, the Company's interest rate swap portfolio consisted of swaps aggregating a notional value of \$30,000 and \$50,000, respectively and maturity dates ranging from 2003 to 2007. The swap agreements exchange the variable rate of LIBOR plus the spread on its revolving credit agreement to fixed interest rate payments ranging from 6.25% to 6.49% in 2003 and 2002. An interest rate swap with a notional value of \$20,000 matured in 2003. All interest rate swaps are effective as cash flow hedges and therefore there is no effect on current earnings from hedge ineffectiveness.

The Company recorded a gain (loss) in OCI relating to the change in value of the cash flow hedges of \$1,296, net of income tax expense of \$(772), \$(1,315), net of income tax benefit of \$700, and \$(1,528), net of income tax benefit of \$894 for the years ended December 31, 2003, 2002 and 2001, respectively. The fair market values of the derivative financial instruments are long-term liabilities of \$3,815 and \$5,438 at December 31, 2003 and 2002, respectively, and are included in deferred income taxes and other liabilities in the Company's consolidated balance sheets.

During the years ended December 31, 2003, 2002 and 2001, the Company reclassified \$1,296, net of income tax benefit of \$772, \$1,613, net of income tax benefit of \$859 and \$786, net of income tax benefit of \$448, respectively from accumulated OCI to current period earnings (recorded in interest expense, net in the consolidated statements of income). The net deferred loss recorded in accumulated OCI will be reclassified to earnings on a quarterly basis as interest payments occur. As of December 31, 2003, approximately \$1,500 in deferred losses on derivative instruments accumulated in OCI are expected to be reclassified to earnings during the next twelve months using a current three month LIBOR-based average receive rate (1.33% at December 31, 2003).

At December 31, 2003 and 2002, the Company is contingently liable under standby letters of credit aggregating \$7,172 and \$5,819, respectively that are primarily used as collateral to cover any contingency related to additional risk assessments pertaining to the self-insurance programs maintained by the Company. The Company does not expect any material losses to result from the issuance of the standby letters of credit because claims are not expected to exceed premiums paid. Accordingly, the estimated fair value of these instruments is zero.

Concentrations of Credit Risk

Financial instruments which potentially subject the Company to concentrations of credit risk consist principally of cash investments and accounts receivable. The Company places its temporary cash investments with high credit quality financial institutions and limits the amount of credit exposure to any one financial institution or investment. Concentrations of credit risk with respect to accounts receivable are limited due to the large number of customers comprising the Company's customer base and their dispersion across many different geographical regions. The Company establishes and monitors an allowance for doubtful accounts based on the aging of customer accounts, past transactions with customers, the credit worthiness of specific customers, historical trends and other information. At December 31, 2003 and 2002, the allowance for doubtful accounts was \$3,028 and \$3,758, respectively. Although the Company believes its allowance is sufficient, if the financial condition of the Company's customers were to unexpectedly deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

12. Commitments and Contingencies

Operating Leases

At December 31, 2003, the Company is obligated under non-cancelable operating leases of real property and equipment used in its operations for minimum annual rentals of \$26,457 in 2004, \$19,603 in 2005, \$12,949 in 2006, \$8,790 in 2007, \$4,963 in 2008 and \$3,630 thereafter. Rental expense for the years ended December 31, 2003, 2002 and 2001 was \$28,806, \$27,490 and \$27,962, respectively.

Minimum Royalty Payments

At December 31, 2003, the Company is obligated under its licensing agreement with Whirlpool Corporation to make minimum royalty payments of \$1,000 each year starting in 2004 and ending in 2011.

Litigation, Claims and Assessments

The Company and its subsidiaries are involved in litigation incidental to the operation of the Company's business. The Company

vigorously defends all matters in which the Company or its subsidiaries are named defendants and, for insurable losses, maintains significant levels of insurance to protect against adverse judgments, claims or assessments that may affect the Company. In the opinion of the Company, although the adequacy of existing insurance coverage or the outcome of any legal proceedings cannot be predicted with certainty, the ultimate liability associated with any claims or litigation in which the Company or its subsidiaries are involved will not materially affect the Company's financial condition or results of operations.

Self-Insurance

The Company maintains self-insured retentions for its health benefits and casualty insurance programs and limits its exposure by maintaining stop-loss and aggregate liability coverages. The estimate of the Company's self-insurance liability 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. When estimating the Company's self-insurance liability, management considers a number of factors, which include historical claim 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 liability is adequate. If actual claims exceed these estimates, additional reserves may be required.

13. Segment Information

SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," requires companies to provide certain information about their operating segments. The Company has two reportable segments: HVAC equipment and related parts and supplies—which comprises 98%, 97% and 96% of revenue in 2003, 2002 and 2001, respectively, and a personnel staffing services business. The Distribution segment has similar products, customers, marketing strategies and operations. The operating segments are managed separately because each offers distinct products and services. No single customer accounted for more than 10% of the Company's revenue in 2003, 2002 and 2001.

The reporting segments follow the same accounting policies used for the Company's consolidated financial statements as described in Note 1. The chief operating decision maker evaluates performance of the segments based on operating income. Costs excluded from this profit measure are interest expense and income taxes. Corporate expenses are primarily comprised of corporate overhead expenses. Thus, operating income includes only the costs that are directly attributable to the operations of the individual segment. Assets not identifiable to an individual segment are corporate assets, which are primarily comprised of cash and cash equivalents, deferred taxes and certain property and equipment.

Years ended December 31,	2003	2002	2001
Revenue:			
Distribution	\$ 1,206,526	\$ 1,147,561	\$ 1,194,587
Staffing	26,382	33,575	44,059
	<u>\$ 1,232,908</u>	<u>\$ 1,181,136</u>	<u>\$ 1,238,646</u>
Operating income (loss):			
Distribution	\$ 75,856	\$ 64,626	\$ 60,659
Staffing	(1,268)	(1,739)	(2,265)
Corporate expenses	(13,399)	(11,963)	(10,070)
	<u>\$ 61,189</u>	<u>\$ 50,924</u>	<u>\$ 48,324</u>
Depreciation and amortization:			
Distribution	\$ 5,809	\$ 6,648	\$ 10,713
Staffing	259	301	548
Corporate	431	346	226
	<u>\$ 6,499</u>	<u>\$ 7,295</u>	<u>\$ 11,487</u>
Restructuring and non-cash charges:			
Distribution	\$ —	\$ (277)	\$ 3,272
Staffing	—	(16)	2,523
	<u>\$ —</u>	<u>\$ (293)</u>	<u>\$ 5,795</u>
Assets:			
Distribution	\$ 475,942	\$ 446,411	\$ 476,499
Staffing	10,081	10,379	10,836
Corporate	49,072	46,929	33,485
	<u>\$ 535,095</u>	<u>\$ 503,719</u>	<u>\$ 520,820</u>
Capital expenditures:			
Distribution	\$ 2,709	\$ 3,380	\$ 4,366
Staffing	58	237	228
Corporate	302	922	30
	<u>\$ 3,069</u>	<u>\$ 4,539</u>	<u>\$ 4,624</u>

14. Related Party Transactions

At December 31, 2002, the Company and a then member of the Board of Directors had a 75% and 25% equity interest, respectively, in Atlantic Jet Charter LLC ("Atlantic Jet"), a company which provides aircraft leasing services primarily to the Company, a former member of the Board of Directors and his affiliates. During 2003, 2002 and 2001, Atlantic Jet recovered \$66, \$770 and \$702, respectively, in costs from the member of the Board of Directors pertaining to his and his affiliates' usage of the aircraft. In February 2003, the Company purchased the 25% equity interest for total cash consideration of \$1,294 and, based on an independent appraisal, has allocated this purchase price to the carrying value of the aircraft.

A member of the Company's Board of Directors is the President and Chief Executive Officer of Greenberg Traurig, P.A., which serves as the Company's principal outside counsel and receives customary fees for legal services. During 2003, 2002 and 2001, the Company paid this firm \$123, \$61 and \$42, respectively, for services performed.

On April 15, 2002, prior to the enactment of the Sarbanes-Oxley Act of 2002, the Company granted a loan in the amount of \$160 to an executive officer. The loan bore interest at 5%, payable annually. The loan was approved by the Compensation Committee of the Board of Directors of the Company and was made on substantially the same terms as those prevailing at the time for comparable transactions with unrelated persons. The loan was paid in full in June 2003.

15. Subsequent Event

In February 2004, the Company's Board of Directors approved an increase in the quarterly cash dividend to \$.10 per share from \$.08 per share. On an annualized basis, the dividend rate will be \$.40 per share.

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Directors and Shareholders
Watsco, Inc.

We have audited the accompanying consolidated balance sheets of Watsco, Inc. and subsidiaries as of December 31, 2003 and 2002, and the related consolidated statements of income, shareholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. The consolidated financial statements of Watsco, Inc. for the year ended December 31, 2001, were audited by other auditors who have ceased operations. Those auditors expressed an unqualified opinion on those financial statements in their report dated February 11, 2002 (except with respect to the matters discussed in Note 14, as to which the date is March 22, 2002).

We conducted our audits in accordance with auditing standards generally accepted in the 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 2003 and 2002 financial statements referred to above present fairly, in all material respects, the consolidated financial position of Watsco, Inc. and subsidiaries at December 31, 2003 and 2002, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

As discussed in Note 9 to the consolidated financial statements, effective January 1, 2002, the Company changed its method of accounting for goodwill to conform with FASB Statement of Financial Accounting Standards (Statement) No. 142, "Goodwill and Other Intangible Assets."

As discussed above, the financial statements of Watsco, Inc. for the year ended December 31, 2001, were audited by other auditors who have ceased operations. As described in Note 9, these financial statements have been revised to include the transitional disclosures required by Statement No. 142, which was adopted by the Company as of January 1, 2002. Our audit procedures with respect to the disclosures in Note 9 with respect to 2001 included (a) agreeing the previously reported net income to the previously issued financial statements and the adjustments to reported net income representing amortization expense (including any related tax effects) recognized in that period related to goodwill to the Company's underlying records obtained from management, and (b) testing the mathematical accuracy of the reconciliation of adjusted net income to reported net income, and the related earnings per share amounts. In our opinion, the disclosures for 2001 in Note 9 are appropriate. However, we were not engaged to audit, review, or apply any procedures to the 2001 financial statements of the Company other than with respect to such disclosures and, accordingly, we do not express an opinion or any other form of assurance on the 2001 financial statements taken as a whole.

ERNST & YOUNG LLP

Miami, Florida
February 12, 2004

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

This is a copy of the audit report previously issued by Arthur Andersen LLP (“Arthur Andersen”) in connection with Watsco, Inc.’s Form 10-K filing for the fiscal year ended December 31, 2001. The inclusion of this previously issued Arthur Andersen report is pursuant the “temporary final rule requirements for Arthur Andersen LLP auditing client,” issued by the U.S. Securities and Exchange Commission in March 2002. Note that the previously issued Arthur Andersen report includes references to certain fiscal years that are not required to be presented in the accompanying consolidated financial statements as of and for the years ended December 31, 2001 and 2000. This audit report has not been reissued by Arthur Andersen in connection with this filing on Form 10-K.

As described in Note 9, the Company revised its consolidated financial statements for the year ended December 31, 2001 to include the transitional disclosures required by SFAS No. 142, “Goodwill and Intangible Assets.”

The Arthur Andersen LLP report does not extend to these revisions to the 2001 consolidated financial statements. These revisions to the 2001 consolidated financial statements were reported on by Ernst & Young LLP, as stated in their report appearing on the preceding page.

To Watsco, Inc.:

We have audited the accompanying consolidated balance sheets of Watsco, Inc. (a Florida corporation) and subsidiaries as of December 31, 2001 and 2000, and the related consolidated statements of income, shareholders’ equity and comprehensive income and cash flows for each of the three years in the period ended December 31, 2001. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the 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 financial statements referred to above present fairly, in all material respects, the financial position of Watsco, Inc. and subsidiaries as of December 31, 2001 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2001 in conformity with accounting principles generally accepted in the United States.

As discussed in Note 1 to the consolidated financial statements, effective January 1, 2001, Watsco, Inc. and subsidiaries adopted Statement of Financial Accounting Standards No. 133, “Accounting for Derivative Instruments and Hedging Activities,” which changed their method of accounting for derivative instruments.

ARTHUR ANDERSEN LLP

Miami, Florida,

February 11, 2002 (except with respect to the matters discussed in Note 14, as to which the date is March 22, 2002).

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

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Total
(In thousands, except per share data)					
Year ended December 31, 2003					
Revenue (1)	\$ 257,398	\$ 340,516	\$ 348,597	\$ 286,397	\$ 1,232,908
Gross profit	63,786	84,344	85,832	71,121	305,083
Net income	<u>\$ 3,806</u>	<u>\$ 13,426</u>	<u>\$ 13,218</u>	<u>\$ 4,445</u>	<u>\$ 34,895</u>
Earnings per share(2)					
Basic	\$ 0.15	\$ 0.54	\$ 0.53	\$ 0.18	\$ 1.39
Diluted	<u>\$ 0.15</u>	<u>\$ 0.52</u>	<u>\$ 0.51</u>	<u>\$ 0.17</u>	<u>\$ 1.34</u>
Year ended December 31, 2002					
Revenue (1)	\$ 256,815	\$ 331,170	\$ 326,286	\$ 266,865	\$ 1,181,136
Gross profit	62,975	81,270	80,085	62,946	287,276
Net income	<u>\$ 3,042</u>	<u>\$ 12,466</u>	<u>\$ 11,842</u>	<u>\$ 1,186</u>	<u>\$ 28,536</u>
Earnings per share(2)					
Basic	\$ 0.12	\$ 0.48	\$ 0.47	\$ 0.05	\$ 1.12
Diluted	<u>\$ 0.11</u>	<u>\$ 0.46</u>	<u>\$ 0.45</u>	<u>\$ 0.05</u>	<u>\$ 1.07</u>

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

WATSCO, INC. AND SUBSIDIARIES
INFORMATION ON COMMON STOCK

The Company's Common Stock is traded on the New York Stock Exchange under the symbol WSO and its Class B Common Stock is traded on the American Stock Exchange under the symbol WSOB. The following table indicates the high and low prices of the Company's Common Stock and Class B Common Stock, as reported by the New York Stock Exchange and American Stock Exchange, respectively, and dividends paid per share for each quarter during the years ended December 31, 2003, 2002 and 2001. At February 29, 2004, excluding shareholders with stock in street name, the Company had 433 Common Stock shareholders of record and 198 Class B Common Stock shareholders of record.

	Common		Class B		Cash Dividends	
	High	Low	High	Low	Common	Class B
Year Ended December 31, 2003:						
Fourth quarter	\$ 24.10	\$ 19.50	\$ 24.00	\$ 19.50	\$.080	\$.080
Third quarter	20.39	16.19	20.10	16.70	.040	.040
Second quarter	16.56	14.09	15.80	13.90	.040	.040
First quarter	16.89	12.90	17.21	13.00	.040	.040
Year Ended December 31, 2002:						
Fourth quarter	\$ 16.91	\$ 13.70	\$ 17.00	\$ 14.89	\$.030	\$.030
Third quarter	18.49	12.87	17.95	13.50	.030	.030
Second quarter	19.25	16.30	19.50	17.00	.030	.030
First quarter	18.29	12.90	18.50	14.45	.025	.025
Year Ended December 31, 2001:						
Fourth quarter	\$ 14.59	\$ 11.78	\$ 14.35	\$ 11.75	\$.025	\$.025
Third quarter	14.48	11.30	14.30	11.00	.025	.025
Second quarter	14.50	11.20	14.30	11.40	.025	.025
First quarter	13.93	10.48	13.75	11.00	.025	.025

REGISTRANT'S SUBSIDIARIES

The following table sets forth, at February 29, 2004, the Registrant's significant operating subsidiaries and other associated companies and their respective incorporation jurisdictions. The Registrant owns 100% of the voting securities of each of the subsidiaries listed below. There are no subsidiaries not listed in the table, which would, in the aggregate, be considered significant.

<u>Active Subsidiaries</u>	<u>State of Incorporation</u>
Distribution:	
Atlantic Jet Charter LLC	Florida
ACDoctor.com Inc.	Texas
Air Supply Distributing LLC	California
Air Systems Distributors LLC	Delaware
Atlantic Service and Supply LLC	Delaware
Baker Distributing Company LLC	Delaware
Coastline Distribution LLC	Delaware
Comfort Supply, Inc.	Delaware
Comfort Products Distributors LLC	Delaware
Gemaire Distributors LLC	Delaware
HBA Distributors LLC	Delaware
Heat Incorporated LLC	New Hampshire
Heating & Cooling Supply LLC	California
Homans Associates LLC	Delaware
TCS Distributors LLC	Delaware
Three States Supply Company LLC	Tennessee
Tradewinds Distributing Company LLC	Delaware
Watsco Holdings, Inc.	Delaware
Weathertrol Supply Company	North Carolina
WSO Distributors, Inc.	Nevada
Staffing:	
Dunhill Personnel Systems of New Jersey, Inc.	New Jersey
Dunhill Professional Search, Inc.	Delaware
Dunhill Staffing Systems, Inc.	Delaware
Dunhill Temporary Systems, Inc.	New York

CONSENT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

We consent to the incorporation by reference in the Registration Statements (Forms S-3 No. 33-7758, No. 33-37982, No. 333-00371, No. 333-01441 and No. 333-19803 and Forms S-8 No. 333-86006, No. 333-39380, No. 33-6229, No. 33-72798, No. 333-10363, No. 333-80341 and No. 333-82011) of Watsco, Inc., as amended, and in the related Prospectus of Watsco, Inc. of our reports dated February 12, 2004, with respect to the 2003 consolidated financial statements and schedule of Watsco, Inc. included in this Annual Report (Form 10-K) for the year ended December 31, 2003.

/s/ Ernst & Young LLP

Miami, Florida,
March 12, 2004

STATEMENT REGARDING CONSENT OF ARTHUR ANDERSEN LLP

Section 11(a) of the Securities Act of 1933, as amended (the "Securities Act"), provides that if part of a registration statement at the time it becomes effective contains an untrue statement of a material fact, or omits a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring a security pursuant to such registration statement (unless it is proved that at the time of such acquisition such person knew of such untruth or omission) may assert a claim against, among others, an accountant who has consented to be named as having certified any part of the registration statement or as having prepared any report for use in connection with the registration statement.

On May 22, 2002, the Registrant decided to no longer engage Arthur Andersen LLP ("Arthur Andersen") as its independent public accountants and appointed Ernst & Young LLP to serve as its independent public accountants for the fiscal year 2002. In 2002, Arthur Andersen ceased practicing before the Securities and Exchange Commission (the "Commission"). As a result, the Registrant has been unable to obtain Arthur Andersen's written consent to the incorporation by reference into registration statements filed with the Commission by the Registrant of their audit report with respect to the Registrant's consolidated financial statement for the year ended December 31, 2001, included in the Annual Report on Form 10-K for the year ended December 31, 2003.

The absence of such consent may limit recovery by investors on certain claims. In particular, and without limitation, investors may not be able to assert claims against Arthur Andersen under Section 11(a) of the Securities Act for any untrue statements of a material fact contained in the financial statements audited by Arthur Andersen or any omissions of a material fact required to be stated therein. Accordingly, investors would be unable to assert a claim against Arthur Andersen under Section 11(a) of the Securities Act because it has not consented to the incorporation by reference of its previously issued report into registration statements filed with the Commission by the Registrant.

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 annual 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 officer 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)) 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) 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
 - c) 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 officer 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 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: March 15, 2004

/s/ Albert H. Nahmad

Albert H. Nahmad
Chief Executive Officer

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 officer 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)) 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) 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
 - c) 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 officer 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 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: March 15, 2004

/s/ Ana M. Menendez

Ana M. Menendez
Chief Financial Officer

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

In connection with the Annual Report of Watsco, Inc. (the "Company") on Form 10-K for the year ended December 31, 2003, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Albert H. Nahmad, the Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (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 the Company.

/s/ Albert H. Nahmad

Albert H. Nahmad
Chief Executive Officer

March 15, 2004

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, Inc. and will be retained by Watsco, Inc. 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 the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

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

In connection with the Annual Report of Watsco, Inc. (the "Company") on Form 10-K for the year ended December 31, 2003, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Ana M. Menendez, the Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (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 the Company.

/s/ Ana M. Menendez

Ana M. Menendez
Chief Financial Officer

March 15, 2004

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, Inc. and will be retained by Watsco, Inc. 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 the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.