

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

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

For the Fiscal Year Ended December 31, 2002

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.)

2665 South Bayshore Drive, Suite 901, Coconut Grove, FL 33133  
(Address of principal executive offices)

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

Securities Registered Pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
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 Exchange Act Rule 12b-2). YES  NO

The aggregate market value of the voting stock held by non-affiliates of the Registrant as of June 30, 2002 was approximately \$412 million.

The number of shares of common stock outstanding as of March 20, 2003 was 22,296,748 shares of Common Stock, excluding treasury shares of 5,127,750, and 3,576,913 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, 2002, attached hereto as Exhibit 13. The information required by Part III (Items 10, 11, 12 and 13) 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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YEAR ENDED DECEMBER 31, 2002

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## PART I

This Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, 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, weather conditions, prevailing interest rates, competitive factors 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.

## 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 97% of 2002 revenue and presently operates from 276 locations in 31 states and a national temporary staffing and permanent placement services ("Staffing") segment, which accounted for 3% of 2002 revenue. The Company's revenue has increased from \$80 million in 1989 to over \$1.18 billion in 2002 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. 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 6% 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., 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 the fixed-cost investments of the Company's existing infrastructure by obtaining new or expanded territories from the grant of distribution rights by manufacturers, (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.

Strategy in Existing Markets The Company's strategy for growth in existing

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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.

The Company has also developed private-label brand strategies 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 a private-label brand of equipment, "Grandaire," that is currently being distributed from 83 locations in one of its subsidiaries located in the Southeast United States. Based on the launch of this value-oriented brand, the Company pursued and, on January 1, 2002, executed an exclusive licensing arrangement with Whirlpool Corporation (the "Whirlpool Licensing Agreement"), the nation's leading manufacturer of appliances. Under the Whirlpool Licensing Agreement, the Company plans to introduce during the spring of 2003 a line of Whirlpool(R)-branded HVAC equipment targeted at both the replacement and new homebuilding markets.

Acquisition Strategy The Company's acquisition strategy is focused on acquiring  
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businesses that complement the Company's presence in existing markets or establishing a presence in new markets. Since 1989, the Company has acquired 42 distributors of air conditioning, heating and refrigeration products, 11 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.

Distribution Rights The Company actively seeks new or expanded territories of  
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distribution from the major equipment manufacturers. The Company maintains significant distribution relationships with Rheem, Carrier, Nordyne, American Standard and York.

Operating Philosophy The Company's operating subsidiaries operate in a manner  
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that recognizes the long-term relationships established between the distributors and their customers. Generally, the Company preserves the identity of acquired businesses by retaining 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, information technology, 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  
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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 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 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 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 52%, 53% and 52% of revenue for the years ended December 31, 2002, 2001 and 2000, respectively. Sales of parts and supplies (currently sourced through a network of over 1,500 different vendors) comprised 48%, 47% and 48% of revenue for such periods respectively.

Distribution and Sales The Company currently operates from 276 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 698 trucks or making the products available for pick-up at the location nearest to the customer. The Company has over 260 commissioned salespeople, averaging 11 years or more of experience in the air conditioning, heating and refrigeration distribution industry.

Markets The Company's network serves 31 states from these 276 locations. The -----

Company's primary markets include (in order of the number of locations in the state): Florida, Texas, Georgia, California, South Carolina, North Carolina, Alabama, Tennessee, Arizona, Arkansas, Mississippi and Massachusetts. The Company also serves Missouri, Kansas, Louisiana, Virginia, Oklahoma, Connecticut, Iowa, Maine, Nebraska, New Hampshire, New York, South Dakota, Kentucky, 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 35,000 customers, with no single customer in 2002, 2001 or 2000 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- -----

\* 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.

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.

Key Equipment Suppliers The Company maintains significant relationships with

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 Rheem, Carrier, Nordyne, American Standard and York, 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 46%, 45% and 46% of its total 2002, 2001 and 2000 purchases, respectively, from five key equipment suppliers. The Company's largest supplier accounted for 17%, 16% and 16% of all purchases made by the Company in 2002, 2001 and 2000, 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

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 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

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 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

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 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 36 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 20 company-owned and 11

licensed temporary staffing offices, as well as 89 franchised permanent placement offices and 4 franchised temporary staffing offices. 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 2,400 persons as of December 31, 2002, 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.

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#### GOVERNMENT REGULATIONS AND ENVIRONMENTAL 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 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. Management believes that the Company is in compliance with all applicable federal, state and local provisions relating to the protection of the environment and transport of hazardous materials.

#### BUSINESS RISK FACTORS

Supplier Concentration The Company has distribution agreements with five key

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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 five suppliers comprised 46% of all purchases made in 2002. The Company's largest supplier accounted for 17% of all purchases made in 2002. 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. 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.

Competition All of the Company's businesses operate in highly competitive

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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 3% of -----

revenue in 2002) derives 98% of its revenue from temporary staffing services, which are sensitive to changes in the level of economic activity. As economic activity begins to slow down, companies tend to reduce their use of temporary employees before undertaking layoffs of their regular employees, resulting in decreased demand for temporary personnel. Significant declines in demand for temporary staffing services and thus in the Company's revenue, would have a material adverse effect on the Staffing segment's operating profits. The Staffing segment has experienced a decline in sales and profits due to the economic softness in the past two years. 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. 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. There can be no 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.

Goodwill At December 31, 2002, goodwill represented approximately 25% of the -----

Company's total assets. On January 1, 2002 the Company adopted the provisions of SFAS No. 142. SFAS No. 142 eliminates the requirement to amortize goodwill and indefinite-lived intangible assets, addresses the amortization of intangible assets with a defined life and addresses the impairment testing and recognition for goodwill and intangible assets. In accordance with the transition provisions of SFAS No. 142, the Company was required to perform an initial impairment review of goodwill as of the transition date of January 1, 2002. This test involved the use of estimates to determine the fair value of the Company's reporting units with which goodwill was associated and compared to the carrying value of the reporting unit. 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. On January 1, 2003, the Company performed the required annual goodwill impairment test and determined there was no impairment.

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 market value multiples. As previously discussed, operating results of the Staffing segment have been negatively impacted by economic softness experienced in the past two 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. There can be no assurance that goodwill impairment will not occur in the future.

Control by Existing Shareholder As of December 31, 2002, Albert H. Nahmad, the  
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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](http://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](http://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 Web site 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.

#### ITEM 2. PROPERTIES

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

Trucks At December 31, 2002, the Company's Distribution segment operated 698  
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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 operation.

Warehousing and Distribution Facilities At December 31, 2002, the Company's

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Distribution segment operated 276 warehousing and distribution facilities across 31 states in the United States having approximately 5.4 million square feet of space in the aggregate of which approximately 5 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  
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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 99,000 square feet of space for additional storage and offices.

Staffing Segment Facilities The Company's Staffing segment operates from 20  
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locations, with an aggregate of approximately 46,000 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, 2002.

### PART II

#### ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Page 44 of the Company's 2002 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, 2002, 2001 and 2000 and is incorporated herein by reference.

#### Securities Authorized for Issuance Under Equity Compensation Plans

The following table provides information as of December 31, 2002 with respect to compensation plans (including individual compensation arrangements) under which the Company's equity securities are authorized for issuance.

#### EQUITY COMPENSATION PLAN INFORMATION(3)

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NUMBER OF SECURITIES REMAINING AVAILABLE FOR FUTURE ISSUANCE
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PLAN CATEGORY	NUMBER OF SECURITIES TO BE ISSUED UPON EXERCISE OF OUTSTANDING OPTIONS, WARRANTS AND RIGHTS (IN THOUSANDS) (a)	WEIGHTED-AVERAGE EXERCISE PRICE OF OUTSTANDING OPTIONS, WARRANTS AND RIGHTS (b)	UNDER EQUITY COMPENSATION PLANS (EXCLUDING SECURITIES REFLECTED IN COLUMN (a) (IN THOUSANDS) (c)
Equity compensation plans approved by security holders.....	3,714,113	\$ 12.13	2,227,733 (2)
Equity compensation plans not approved by security holders.....	(1)	-	-
Total.....	3,714,113	\$ 12.13	2,227,733

- (1) Does not include 211,250 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.
- (2) Does not include 189,733 shares reserved for issuance under the Company's Employee Stock Purchase Plan ("ESPP"). An aggregate of 52,795 shares of Common Stock was purchased under the ESPP in 2002.
- (3) See Note 6 to the consolidated financial statements for additional information regarding stock based compensation and benefit plans.

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ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

Page 8 of the Company's 2002 Annual Report contains "Selected Consolidated Financial Data" and is incorporated herein by reference.

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

Pages 9 through 18 of the Company's 2002 Annual Report contain "Management's Discussion and Analysis of Financial Condition and Results of Operations" and is incorporated herein by reference.

ITEM 7A. QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK

Page 16 of the Company's 2002 Annual Report contains "Qualitative and Quantitative Disclosures about Market Risk" and is incorporated herein by reference.

ITEM 8. CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Pages 19 through 41 of the Company's 2002 Annual Report contain the 2002 and 2001 Consolidated Balance Sheets and other consolidated financial statements for the years ended December 31, 2002, 2001 and 2000, together with the reports thereon of Ernst & Young LLP dated February 14, 2003 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

On May 22, 2002, the Board of Directors of the Company and its Audit Committee dismissed Arthur Andersen LLP ("Andersen") as the Company's independent public accountants and engaged Ernst & Young LLP ("E&Y") to serve as the Company's independent public accountants for the fiscal year 2002.

Andersen's reports on the Company's financial statements for the fiscal years ended 2001 and 2000 did not contain an adverse opinion or a disclaimer of opinion, nor were they qualified as to uncertainty, audit scope or accounting principles.

During the years ended December 31, 2001 and 2000, and the interim period between December 2001 and May 22, 2002, there were no disagreements between the Company and Andersen on any matters of accounting principles or practices,

financial statement disclosure, or auditing scope or procedure, which, if not resolved to Andersen's satisfaction, would have caused it to make a reference to the subject matter of the disagreements in connection with their reports on the Company's consolidated financial statements for such years; and there were no reportable events as defined in Item 304 (a) (1) (v) of Regulation S-K.

The Company previously provided Andersen with a copy of the foregoing disclosures, and a letter from Andersen, dated May 29, 2002, stating its agreement with such statements was filed as Exhibit 16.1 to the Company's Current Report on Form 8-K filed with the Commission on May 22, 2002 and is hereby incorporated by reference.

During the years ended December 31, 2001 and 2000 and through May 22, 2002, the Company did not consult E&Y with respect to the application of accounting principles to a specified transaction, either completed or proposed, or the type of audit opinion that might be rendered on the Company's consolidated financial statements, or any other matters or reportable events as set forth in items 304 (a) (2) (i) and (ii) of Regulation S-K.

### PART III

This part of Form 10-K, which includes Items 10 through 13, 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 13 and is incorporated herein by reference.

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### PART IV

#### ITEM 14. CONTROLS AND PROCEDURES

Based on their most recent evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures, which was completed within 90 days of the filing of 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 required to be included in this Annual Report, were effective as of the date of their evaluation in timely alerting them to material information relating to the Company, including its consolidated subsidiaries. There have been no significant changes in internal controls or in factors that could significantly affect internal controls, subsequent to the date the Chief Executive Officer and Chief Financial Officer completed their evaluation.

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

PAGE NO. IN  
ANNUAL REPORT  
-----

(a) Consolidated Financial Statements, Consolidated Financial Statement Schedule and Exhibits

(1) Consolidated Financial Statements (incorporated by reference from the 2002 Annual Report of Watsco, Inc.):

Consolidated Statements of Income for the years ended December 31, 2002, 2001 and 2000	19
Consolidated Balance Sheets as of December 31, 2002 and 2001	20
Consolidated Statements of Shareholders' Equity and Comprehensive Income for the years ended December 31, 2002, 2001 and 2000	21
Consolidated Statements of Cash Flows for the years ended December 31, 2002, 2001 and 2000	22
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Report of Independent Certified Public Accountants Ernst & Young LLP  
and Arthur Andersen LLP  
Selected Quarterly Financial Data (Unaudited)

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(2) Consolidated Financial Statement Schedule  
for the three years ended December 31, 2002, 2001 and 2000

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.

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).

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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 Watsco, Inc. \$125,000,000 Private Shelf Agreement as of January 31, 2000 by and among, Watsco, Inc. and the Prudential Insurance Company of America. (filed as Exhibit 10.13 to the Company's Annual Report on Form 10-K for the year ended December 31, 1999 and incorporated herein by reference).
- 10.9 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). +\*
- 10.10 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). +\*
- 10.11 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. #+\*
- 10.12 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. #
- 13. 2002 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 2002 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. #

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- 99.1 Certification of Chief Executive Officer pursuant to 18 USC Section 1350. #
- 99.2 Certification of Chief Financial Officer pursuant to 18 USC Section 1350. #

Notes to exhibits:

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

(b) Reports on Form 8-K:

None.

## 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 31, 2003                   By: /s/ Albert H. Nahmad  
-----  
                                  Albert H. Nahmad, President

March 31, 2003                   By: /s/ Barry S. Logan  
-----  
                                  Barry S. Logan, Vice President

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.

SIGNATURE -----	TITLE -----	DATE -----
/s/ Albert H. Nahmad ----- Albert H. Nahmad	Chairman of the Board and President (principal executive officer)	March 31, 2003
/s/ Barry S. Logan ----- Barry S. Logan	Vice President - Finance and Secretary (principal accounting officer)	March 31, 2003
/s/ Cesar L. Alvarez ----- Cesar L. Alvarez	Director	March 31, 2003
/s/ George Fugelsang ----- George Fugelsang	Director	March 31, 2003
/s/ William Graham ----- William Graham	Director	March 31, 2003
/s/ Victor Lopez ----- Victor Lopez	Director	March 31, 2003
/s/ Paul F. Manley ----- Paul F. Manley	Director	March 31, 2003
/s/ Bob L. Moss ----- Bob L. Moss	Director	March 31, 2003
/s/ Roberto Motta ----- Roberto Motta	Director	March 31, 2003
/s/ Alan Potamkin ----- Alan Potamkin	Director	March 31, 2003



CERTIFICATIONS

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 annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual 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 annual report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
  - a) designed such disclosure controls and procedures 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 annual report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and
  - c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, 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 in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 31, 2003

/s/ Albert H. Nahmad

-----  
Albert H. Nahmad  
Chief Executive Officer

CERTIFICATIONS

I, Barry S. Logan, certify that:

1. I have reviewed this annual report on Form 10-K of Watsco, Inc.;
2. Based on my knowledge, this 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 annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual 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 annual report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
  - a) designed such disclosure controls and procedures 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 annual report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and
  - c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, 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 in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 31, 2003

/s/ Barry S. Logan  
-----  
Barry S. Logan  
Chief Financial Officer

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Directors and Shareholders  
Watsco, Inc.

We have audited the consolidated financial statements of Watsco, Inc. and subsidiaries as of December 31, 2002, and for the year then ended, and have issued our report thereon dated February 14, 2003 (included elsewhere in this Form 10-K). Our audit also included Schedule II-Valuation and Qualifying Accounts as of December 31, 2002, and for the year 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 audit. The financial statement schedule of Watsco, Inc. and subsidiaries as of December 31, 2001 and 2000, and for the years then ended was subjected to the auditing procedures applied by other auditors in their audit of the consolidated financial statements for those years 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, 2002, and for the year 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.

ERNST & YOUNG LLP

Miami, Florida  
February 14, 2003

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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 December 31, 2001 and each of the two years in the period 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, 2002 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, 2002, 2001 and 2000  
(In thousands)

ALLOWANCE FOR DOUBTFUL ACCOUNTS:

BALANCE, December 31, 1999	\$	5,564
Additions charged to costs and expenses		5,386
Write-offs, net		(3,980)
		-----
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
		=====

RESTRUCTURING LIABILITY AND VALUATION RESERVES:

BALANCE, December 31, 1999	\$	-
Additions charged to costs and expenses		8,481
Write-down of assets to net realizable value		(1,826)
Cash payments		(1,500)
		-----
BALANCE, December 31, 2000(1)		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(2)		1,713
Write-down of assets to net realizable value		(574)
Cash payments		(846)
Change in estimate		(293)
		-----
BALANCE, December 31, 2002	\$	-
		=====

(1) At December 31, 2000, valuation reserves of \$3,484 and \$30, respectively, were netted against related asset balances - inventories and accounts receivable, net and a \$1,641 restructuring liability was included in accrued liabilities in the consolidated balance sheet.

(2) At December 31, 2001, a restructuring liability of \$1,385 is included in accrued liabilities and an inventory valuation reserve of \$328 is netted against inventories in the consolidated balance sheet.

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Exhibit Index

Exhibit  
Number

Description

- 10.11 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.
- 10.12 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.
- 13 2002 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 2002 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.
- 99.1 Certification of Chief Executive Officer pursuant to 18 USC Section 1350.
- 99.2 Certification of Chief Financial Officer pursuant to 18 USC Section 1350.

THIRD AMENDMENT  
TO  
EMPLOYMENT AGREEMENT

This Third Amendment to Employment Agreement is made and entered into effective as of January 1, 2003, by and between WATSCO, INC., a Florida corporation (hereinafter called the "Company"), and ALBERT H. NAHMAD (hereinafter called the "Employee").

RECITALS

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

WHEREAS, the Compensation Committee of the Company's Board of Directors amended the Employment Agreement effective as of January 1, 2001 and January 1, 2002; and

WHEREAS, the Compensation Committee of the Company's Board of Directors has determined to increase the Employee's Base Salary from \$750,000 to \$850,000, effective as of January 1, 2003, and has set the targets for the performance based compensation payable by the Company to the Employee for the year 2003; and

WHEREAS, the Company and the Employee now desire to amend Employment Agreement and Exhibit A-1 to the Employment Agreement to reflect the increase in Base Salary and specify the performance based compensation amount payable by the Company to the Employee for the calendar year 2003.

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

1. All capitalized terms in this Third Amendment shall have the same meaning as in the Employment Agreement, unless otherwise specified.

2. The first sentence of Section 4 of the Employment Agreement is hereby amended to read as follows:

"Effective as of January 1, 2003, the Company agrees to pay to Employee and Employee agrees to accept from the Company a salary at the annual rate of not less than Eight Hundred Fifty Thousand (\$850,000) Dollars, payable in bi-weekly or monthly installments."

3. The Employment Agreement is hereby amended by replacing "Exhibit A-1 -- 2002 Performance Goals and Performance Based Compensation" with the attached "Exhibit A-1 -- 2003 Performance Goals and Performance Based Compensation" thereto.

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

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

COMPANY:

WATSCO, INC.

By: /s/Barry S. Logan

-----  
Barry S. Logan, Vice President

EMPLOYEE:

/s/ Albert H. Nahmad  
-----  
ALBERT H. NAHMAD

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EXHIBIT A-1

2003 Performance Goals and Performance Based Compensation

V. Formula

	Performance Based Compensation Formula -----
A. Earnings Per Share	
For each \$.01 increase.....	\$ 65,250
B. Increase in Common Stock Price	
(i) If the closing price of a share of Common Stock on 12/31/03 does not exceed \$16.38.....	\$ 0
(ii) If the closing price of a share of Common Stock on 12/31/03 exceeds \$16.38 but does not equal or exceed \$19.25, for each \$.01 increase in per share price of a share of Common Stock above \$16.38	\$ 1,200
(iii) If the closing price of a share of Common Stock on 12/31/03 equals or exceeds \$19.25, for each \$.01 increase in per share price of a share of Common Stock above \$16.38.....	\$ 1,800

VI. Method of Payment

- A. Cash. The Performance Based Compensation determined for 2003 under the formula set forth in Section I above shall be paid in cash if and to the extent such Compensation does not exceed \$1,500,000.
- B. Restricted Stock. If the Performance Based Compensation determined for 2003 under the formula set forth in Section I above exceeds \$1,500,000 (such excess amount being referred to as the "Additional Amount"), the Executive shall be granted a number of shares of restricted Class B Common Stock of the Company (the "Shares") equal to the amount determined by dividing (i) two times the Additional Amount, by (ii) the closing price for the Class B Common Stock of the Company on the American Stock Exchange as of the close of trading on December 31, 2003. The value of any fractional shares shall be paid in cash. The restrictions on the Shares shall lapse on the first to occur of (i) October 15, 2015 (ii) termination of the Executive's employment with the Company by reason of Executive's disability or death, (iii) the Executive's termination of employment with the Company for Good Reason; (iv) the Company's termination of Executive's employment without Cause, or (v) the occurrence of a Change in Control of the Company ("Good Reason", "Cause", and "Change in Control" to be defined in a manner consistent with the most recent grant of Restricted Stock by the Company to the Executive).

VII. 2001 Incentive Compensation Plan

The performance based award and method of payment specified above (the "Award") were made by the Compensation Committee in accordance with Section 8 of the Company's 2001 Incentive Compensation Plan (the "Incentive Plan") and are subject to the limitations contained in Section 5 of the Incentive Plan. The Award is intended to qualify as "performance based compensation" under Section 162(m) of the Internal Revenue Code.

Dated: Effective as of January 1, 2003

/s/Paul Manley

-----  
Paul Manley, Chairman  
Compensation Committee

Acknowledged and Accepted:

/s/ Albert H. Nahmad

-----  
Albert H. Nahmad



WATSCO, INC.

\$125,000,000

AMENDED AND RESTATED  
PRIVATE SHELF AGREEMENT

as of October 30, 2002

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WATSCO, INC.  
2665 South Bayshore Drive, Suite 901  
Coconut Grove, Florida 33133

As of October 30, 2002

The Prudential Insurance Company of America ("Prudential")

Hartford Life Insurance Company

Medica Health Plan

Pruco Life Insurance Company of New Jersey

Each Other Prudential Affiliate (as hereinafter defined)  
which becomes bound by certain provisions of this  
Agreement as hereinafter provided (together with  
Prudential, the "Purchasers")

c/o Prudential Capital Group  
1170 Peachtree Street, Suite 500  
Atlanta, Georgia 30309

Ladies and Gentlemen:

The undersigned, Watsco, Inc., a Florida corporation (the "Company"), is a party with you to that certain Private Shelf Agreement, dated as of January 31, 2000 (as amended, modified or supplemented from time to time, the "2000 Agreement"), pursuant to which the Company has issued Notes. The Company has requested and you have agreed (on the terms and subject to the conditions hereinafter set forth) to amend and restate the 2000 Agreement in its entirety as set forth herein.

NOW THEREFORE, in consideration of the covenants and agreements herein contained, the parties hereto hereby agree that the 2000 Agreement shall be and hereby is amended and restated effective as of the date hereof to read in its entirety as follows:

1. PRELIMINARY STATEMENTS.

1A. Authorization and Issue of Series A Notes. The Company has authorized and issued Senior Series A Notes in the aggregate principal amount of \$30,000,000, dated February 7, 2001 to mature April 9, 2007 and bearing interest at 7.07% per annum on the unpaid balance thereof from the date thereof until the principal thereof shall have become due and payable (the "Issued Series A Notes"). The Company will authorize and agree to execute an Allonge, in substantially the form of Exhibit A-1 (each an "Allonge"), for each Issued Series A Note issued and outstanding as of the date hereof. The terms "Issued Series A Note" and "Issued Series A Notes" as used herein shall include each Issued Series A Note previously delivered pursuant to

the 2000 Agreement, as amended by such Allonge, and any such Note delivered in substitution or exchange therefor.

1B. Authorization of Issue of Notes. The Company may authorize the issue of its senior unsecured promissory notes (the "Shelf Notes") in the aggregate principal amount of up to \$125,000,000, to be dated the date of issue thereof, to mature, in the case of each Shelf Note so issued, no more than twelve years after the date of original issuance thereof, to have an average life, in the case of each Shelf Note so issued, of no more than ten years after the date of original issuance thereof, to bear interest on the unpaid balance thereof from the date thereof at the rate per annum, and to have such other particular terms, as shall be set forth, in the case of each Shelf Note so issued, in the Confirmation of Acceptance with respect to such Shelf Note delivered pursuant to paragraph 2G, and to be substantially in the form of Exhibit A-2 attached hereto. The terms "Shelf Note" and "Shelf Notes" as used herein shall include each Issued Series A Note and each Shelf Note delivered pursuant to any provision of this Agreement and each Shelf Note delivered in substitution or exchange for any such Shelf Note pursuant to any such provision. The terms "Note" and "Notes" as used herein shall include each Issued Series A Note and each Shelf Note delivered pursuant to any provision of this Agreement and each Note delivered in substitution or exchange for any such Note pursuant

to any such provision. Notes which have (i) the same final maturity, (ii) the same principal prepayment dates, (iii) the same principal prepayment amounts (as a percentage of the original principal amount of each Note), (iv) the same interest rate, (v) the same interest payment periods and (vi) the same date of issuance (which, in the case of a Note issued in exchange for another Note, shall be deemed for these purposes the date on which such Note's ultimate predecessor Note was issued), are herein called a "Series" of Notes.

## 2. PURCHASE AND SALE OF NOTES.

2A. Purchase and Sale of Issued Notes. On February 7, 2001, the Company sold to you the Issued Series A Notes in the aggregate principal amount of \$30,000,000. The Company hereby agrees to execute and deliver to you and, subject to the terms and conditions herein set forth, you agree to accept from the Company, for each Issued Series A Note, an Allonge, in substantially the form of Exhibit A-1.

## 2B. Purchase and Sale of Shelf Notes.

2B(1) Facility. Prudential is willing to consider, in its sole discretion and within limits which may be authorized for purchase by Prudential and Prudential Affiliates from time to time, the purchase of Shelf Notes pursuant to this Agreement. The willingness of Prudential to consider such purchase of Shelf Notes is herein called the "Facility". At any time, the aggregate principal amount of Shelf Notes stated in paragraph 1B, minus the aggregate principal amount of Shelf Notes purchased and sold pursuant to this Agreement prior to such time, minus the aggregate principal amount of Accepted Notes (as hereinafter defined) which have not yet been purchased and sold hereunder prior to such time, plus the aggregate principal amount of Shelf Notes purchased and sold pursuant to this Agreement and thereafter retired prior to such time is herein called the "Available Facility Amount" at such time. NOTWITHSTANDING THE WILLINGNESS OF PRUDENTIAL TO CONSIDER PURCHASES OF SHELF NOTES, THIS AGREEMENT IS ENTERED INTO ON THE EXPRESS UNDERSTANDING THAT

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NEITHER PRUDENTIAL NOR ANY PRUDENTIAL AFFILIATE SHALL BE OBLIGATED TO MAKE OR ACCEPT OFFERS TO PURCHASE SHELF NOTES, OR TO QUOTE RATES, SPREADS OR OTHER TERMS WITH RESPECT TO SPECIFIC PURCHASES OF SHELF NOTES, AND THE FACILITY SHALL IN NO WAY BE CONSTRUED AS A COMMITMENT BY PRUDENTIAL OR ANY PRUDENTIAL AFFILIATE.

2C. Issuance Period. Shelf Notes may be issued and sold pursuant to this Agreement until the earlier of:

- (i) January 31, 2006;
- (ii) the thirtieth day after Prudential shall have given to the Company, or the Company shall have given to Prudential, a notice stating that it elects to terminate the issuance and sale of Shelf Notes pursuant to this Agreement (or if such thirtieth day is not a Business Day, the Business Day next preceding such thirtieth day),
- (iii) the last Closing Day after which there is no Available Facility Amount,
- (iv) the termination of the Facility under paragraph 7A, and
- (v) the acceleration of any Note under paragraph 7A of this Agreement.

The period during which Shelf Notes may be issued and sold pursuant to this Agreement is herein called the "Issuance Period".

2D. Periodic Spread Information. Not later than 9:30 A.M. (New York City local time) on a Business Day during the Issuance Period if there is an Available Facility Amount on such Business Day, the Company may request by

telecopier or telephone, and Prudential will, to the extent reasonably practicable, provide to the Company on such Business Day (or, if such request is received after 9:30 A.M. (New York City local time) on such Business Day, on the following Business Day), information (by telecopier or telephone) with respect to various spreads at which Prudential or Prudential Affiliates might be interested in purchasing Shelf Notes of different average lives; provided, however, that the Company may not make such requests more frequently than once in every five Business Days or such other period as shall be mutually agreed to by the Company and Prudential. The amount and content of information so provided shall be in the sole discretion of Prudential but it is the intent of Prudential to provide information which will be of use to the Company in determining whether to initiate procedures for use of the Facility. Information so provided shall be representative of potential interest only for the periods commencing on the day such information is provided and ending on the earlier of the fifth Business Day after such day and the first day after such day on which further spread information is provided. Prudential may suspend or terminate providing information pursuant to this paragraph 2D for any reason, including its determination that the credit quality of the Company has declined since the date of this Agreement.

2E. Request for Purchase. The Company may from time to time during the Issuance Period make requests for purchases of Shelf Notes (each such request being herein called a

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"Request for Purchase"). Each Request for Purchase shall be made to Prudential by telecopier or overnight delivery service, and shall:

(i) specify the aggregate principal amount of Shelf Notes covered thereby, which shall not be less than the lesser of (A) \$10,000,000 and (B) the Available Facility Amount if such Available Facility Amount is equal to or greater than \$5,000,000 and not be greater than the Available Facility Amount at the time such Request for Purchase is made,

(ii) specify the principal amounts, final maturities (which shall be no more than twelve years from the date of issuance), average life (which shall be no more than 10 years from the date of issuance) principal prepayment dates, if any, and amounts and interest payment periods (which shall be quarterly or semiannually in arrears) of the Shelf Notes covered thereby,

(iii) specify the use of proceeds of such Shelf Notes,

(iv) specify the proposed day for the closing of the purchase and sale of such Shelf Notes, which shall be a Business Day during the Issuance Period not less than 10 days and not more than 20 days after the making of such Request for Purchase,

(v) specify the number of the account and the name and address of the depository institution to which the purchase prices of such Shelf Notes are to be transferred on the Closing Day for such purchase and sale,

(vi) certify that the representations and warranties contained in paragraph 8 are true on and as of the date of such Request for Purchase and that there exists on the date of such Request for Purchase no Event of Default or Default, and

(vii) be substantially in the form of Exhibit B attached hereto.

Each Request for Purchase shall be in writing and shall be deemed made when received by Prudential.

2F. Rate Quotes. Not later than five Business Days after the Company shall have given Prudential a Request for Purchase pursuant to paragraph 2E, Prudential may, but shall be under no obligation to, provide to the Company by telephone or telecopier, in each case between 9:30 A.M. and 2:00 P.M. New York City local time (or such later time as Prudential may elect), interest rate quotes for the several principal amounts, maturities, principal prepayment schedules, and interest payment periods of Shelf Notes specified in such Request for Purchase. Each quote shall represent the interest rate per annum payable on the outstanding principal balance of such Shelf Notes at which Prudential or a Prudential Affiliate would be willing to purchase such Shelf Notes at 100% of the principal amount thereof.

2G. Acceptance. Within 30 minutes after Prudential shall have provided any interest rate quotes pursuant to paragraph 2F or such shorter period as Prudential may specify to the Company (such period herein called the "Acceptance Window"), the Company may, subject to

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paragraph 2H, elect to accept such interest rate quotes as to not less than the lesser of (A) \$10,000,000 aggregate principal amount of the Shelf Notes specified in the related Request for Purchase or (B) the Available Facility Amount if such Available Facility Amount is equal to or greater than \$5,000,000. Such election shall be made by an Authorized Officer of the Company notifying Prudential by telephone or telecopier within the Acceptance Window (but not earlier than 9:30 A.M. or later than 2:00 P.M., New York City local time) that the Company elects to accept such interest rate quotes, specifying the Shelf Notes (each such Shelf Note being herein called an "Accepted Note") as to which such acceptance (herein called an "Acceptance") relates. The day the Company notifies Prudential of an Acceptance with respect to any Accepted Notes is herein called the "Acceptance Day" for such Accepted Notes. Any interest rate quotes as to which Prudential does not receive an Acceptance within the Acceptance Window shall expire, and no purchase or sale of Shelf Notes hereunder shall be made based on such expired interest rate quotes. Subject to paragraph 2H and the other terms and conditions hereof, the Company agrees to sell to Prudential or a Prudential Affiliate, and Prudential agrees to purchase, or to cause the purchase by a Prudential Affiliate of, the Accepted Notes at 100% of the principal amount of such Notes. As soon as practicable following the Acceptance Day, the Company, Prudential and each Prudential Affiliate which is to purchase any such Accepted Notes will execute a confirmation of such Acceptance substantially in the form of Exhibit C attached hereto (herein called a "Confirmation of Acceptance"). If the Company should fail to execute and return to Prudential within three Business Days following receipt thereof a Confirmation of Acceptance with respect to any Accepted Notes, Prudential may at its election at any time prior to its receipt thereof cancel the closing with respect to such Accepted Notes by so notifying the Company in writing.

2H. Market Disruption. Notwithstanding the provisions of paragraph 2G, if Prudential shall have provided interest rate quotes pursuant to paragraph 2F and thereafter prior to the time an Acceptance with respect to such quotes shall have been notified to Prudential in accordance with paragraph 2G the domestic market for U.S. Treasury securities or other financial instruments shall have closed or there shall have occurred a general suspension, material limitation, or significant disruption of trading in securities generally on the New York Stock Exchange or in the domestic market for U.S. Treasury securities or other financial instruments, then such interest rate quotes shall expire, and no purchase or sale of Shelf Notes hereunder shall be made based on such expired interest rate quotes. If the Company thereafter notifies Prudential of the Acceptance of any such interest rate quotes, such Acceptance shall be ineffective for all purposes of this Agreement, and Prudential shall promptly notify the Company that the provisions of this paragraph 2H are applicable with respect to such Acceptance.

2I. Facility Closings. Not later than 11:30 A.M. (New York City local time) on the Closing Day for any Accepted Notes, the Company will deliver to each Purchaser listed in the Confirmation of Acceptance relating thereto at the

offices of the Prudential Capital Group, 1114 Avenue of the Americas, 30th Floor, New York, New York, the Accepted Notes to be purchased by such Purchaser in the form of one or more Notes in authorized denominations as such Purchaser may request for each Series of Accepted Notes to be purchased on the Closing Day, dated the Closing Day and registered in such Purchaser's name (or in the name of its nominee), against payment of the purchase price thereof by transfer of immediately available funds for credit to the Company's account specified in the Request for Purchase of such Notes. If the

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Company fails to tender to any Purchaser the Accepted Notes to be purchased by such Purchaser on the scheduled Closing Day for such Accepted Notes as provided above in this paragraph 2I, or any of the conditions specified in paragraph 3 shall not have been fulfilled by the time required on such scheduled Closing Day, the Company shall, prior to 1:00 P.M., New York City local time, on such scheduled Closing Day notify Prudential (which notification shall be deemed received by each Purchaser) in writing whether (i) such closing is to be rescheduled (such rescheduled date to be a Business Day during the Issuance Period not less than one Business Day and not more than 10 Business Days after such scheduled Closing Day (the "Rescheduled Closing Day") and certify to Prudential (which certification shall be for the benefit of each Purchaser) that the Company reasonably believes that it will be able to comply with the conditions set forth in paragraph 3 on such Rescheduled Closing Day and that the Company will pay the Delayed Delivery Fee, if applicable, in accordance with paragraph 2J(3) or (ii) such closing is to be canceled. In the event that the Company shall fail to give such notice referred to in the preceding sentence, Prudential (on behalf of each Purchaser) may at its election, at any time after 1:00 P.M., New York City local time, on such scheduled Closing Day, notify the Company in writing that such closing is to be canceled. Notwithstanding anything to the contrary appearing in this Agreement, the Company may elect to reschedule a closing with respect to any given Accepted Notes on not more than one occasion, unless Prudential shall have otherwise consented in writing.

2J. Fees.

2J(1) Facility Fee. In consideration for the time, effort and expense involved in the preparation, negotiation and execution of this Agreement, on the Amendment Closing Day, the Company will pay to Prudential in immediately available funds a nonrefundable fee (herein called the "Facility Fee") in the amount of \$30,000.00.

2J(2) Issuance Fee. The Company will pay to Prudential in immediately available funds a fee (herein called the "Issuance Fee") on each Closing Day (other than on the Amendment Closing Day) in an amount equal to 0.125% of the aggregate principal amount of Notes sold on such Closing Day.

2J(3) Delayed Delivery Fee. If the closing of the purchase and sale of any Accepted Note is delayed for any reason beyond the original Closing Day for such Accepted Note, the Company will pay to Prudential (a) on the Cancellation Date or actual closing date of such purchase and sale and (b) if earlier, the next Business Day following 90 days after the Acceptance Day for such Accepted Note and on each Business Day following 90 days after the prior payment hereunder, a fee (herein called the "Delayed Delivery Fee") calculated as follows:

(BEY - MMY) X DTS/360 X PA

where "BEY" means Bond Equivalent Yield, i.e., the bond equivalent yield per annum of such Accepted Note, "MMY" means Money Market Yield, i.e., the yield per annum on a commercial paper investment of the highest quality selected by Prudential on the date Prudential receives notice of the delay in the closing for such Accepted Note having a maturity date or dates the same as, or closest to, the Rescheduled Closing Day or Rescheduled Closing Days (a new alternative investment being selected by Prudential each time such closing is delayed); "DTS"

means Days to Settlement, i.e., the number of actual days elapsed from and including the original Closing Day with respect to such Accepted Note (in the case of the first such payment with respect to such Accepted Note) or from and including the date of the next preceding payment (in the case of any subsequent delayed delivery fee payment with respect to such Accepted Note) to but excluding the date of such payment; and "PA" means Principal Amount, i.e., the principal amount of the Accepted Note for which such calculation is being made. In no case shall the Delayed Delivery Fee be less than zero. If the foregoing calculation yields a negative number or zero, no Delayed Delivery Fee shall be due. Nothing contained herein shall obligate any Purchaser to purchase any Accepted Note on any day other than the Closing Day for such Accepted Note, as the same may be rescheduled from time to time in compliance with paragraph 2I.

2J(4) Cancellation Fee. If the Company at any time notifies Prudential in writing that the Company is canceling the closing of the purchase and sale of any Accepted Note, or if Prudential notifies the Company in writing under the circumstances set forth in the last sentence of paragraph 2G or the penultimate sentence of paragraph 2I that the closing of the purchase and sale of such Accepted Note is to be canceled, or if the closing of the purchase and sale of such Accepted Note is not consummated on or prior to the last day of the Issuance Period (the date of any such notification, or the last day of the Issuance Period, as the case may be, being herein called the "Cancellation Date"), the Company will pay the Purchasers in immediately available funds an amount (the "Cancellation Fee") calculated as follows:

$$PI \times PA$$

where "PI" means Price Increase, i.e., the quotient (expressed in decimals) obtained by dividing (a) the excess of the ask price (as determined by Prudential) of the Hedge Treasury Note(s) on the Cancellation Date over the bid price (as determined by Prudential) of the Hedge Treasury Notes(s) having a maturity date the same as, or closest to, such Accepted Note, on the Acceptance Day (if the difference is a negative number or zero, no Cancellation Fee shall be due) by (b) such bid price; and "PA" has the meaning ascribed to it in paragraph 2J(3). The foregoing bid and ask prices shall be as reported by Telerate Systems, Inc. (or, if such data for any reason ceases to be available through Telerate Systems, Inc., any publicly available source of similar market data). Each price shall be based on a U.S. Treasury security having a par value of \$100.00 and shall be rounded to the second decimal place. In no case shall the Cancellation Fee be less than zero.

3. CONDITIONS OF CLOSING. The obligation of any Purchaser to purchase and pay for any other Notes is subject to the satisfaction of (i) all of the conditions set forth in this paragraph 3 other than paragraph 3A(2) on or before the closing date, October 30, 2002 (hereinafter "Amendment Closing Day"), which closing shall occur at the offices of King & Spalding, 1185 Avenue of the Americas, New York, New York, and (ii) all of the conditions set forth in this paragraph 3 other than paragraph 3A(1) on or before such other Closing Day for the purchase of any Notes:

3A.Certain Documents. Such Purchaser shall have received the following:

3A(1) Amendment Closing Day. Such Purchaser shall have received, each dated the date of the Amendment Closing Day:

- (i) This Agreement and an Allonge for each holder of Issued Series A Notes duly executed by the parties hereto;
- (ii) Each Guaranty Agreement duly executed by the applicable



Guarantor;

(iii) Certified copies of the resolutions of the Board of Directors of (A) the Company authorizing the execution and delivery of this Agreement and the issuance of the Notes, and of all documents evidencing other necessary corporate action and governmental approvals, if any, with respect to this Agreement and the Notes and (B) each Guarantor authorizing the execution and delivery of its Guaranty Agreement and of all documents evidencing other necessary corporate action and governmental approvals, if any, with respect to its Guaranty Agreement;

(iv) A certificate of the Secretary or an Assistant Secretary and one other officer of (A) the Company certifying the names and true signatures of the officers of the Company authorized to sign this Agreement and the Notes and the other documents to be delivered hereunder and (B) each Guarantor certifying the names and true signatures of the officers of such Guarantor authorized to sign its Guaranty Agreement and the other documents to be delivered thereunder;

(v) Certified copies of the Articles of Incorporation and By-laws of the Company and each Guarantor;

(vi) A good standing certificate for (A) the Company from the Secretary of State of Florida and (B) each Guarantor from the Secretary of State of the State of its formation, each dated as of a recent date and good standing and such other evidence of the status of the Company or such Guarantor as such Purchaser may reasonably request;

(vii) A favorable opinion of Moore Van Allen, PLLC, special counsel to the Company (or such other counsel designated by the Company and acceptable to the Purchaser(s)) satisfactory to such Purchaser and substantially in the form of Exhibit D-1 attached hereto and as to such other matters as such Purchaser may reasonably request. The Company hereby directs each such counsel to deliver such opinion, agrees that the issuance and sale of any Notes will constitute a reconfirmation of such direction, and understands and agrees that each Purchaser receiving such an opinion will and is hereby authorized to rely on such opinion;

(viii) A favorable opinion of Greenberg Traurig Hoffman Lipoff Rosen & Quentel P.A., special Florida counsel to the Company (or such other counsel designated by the Company and acceptable to the Purchaser(s)) satisfactory to such Purchaser and substantially in the form of Exhibit D-2 attached hereto and as to such other matters as such Purchaser may reasonably request. The Company hereby directs each such counsel to deliver such opinion, agrees that the issuance and sale of any Notes will constitute a

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reconfirmation of such direction, and understands and agrees that each Purchaser receiving such an opinion will and is hereby authorized to rely on such opinion; and

(ix) Additional documents or certificates with respect to legal matters or corporate or other proceedings related to the transactions contemplated hereby as may be reasonably requested by such Purchaser.

3A(2) Subsequent Closing Day. Such Purchaser shall have received, each dated the date of the applicable Closing Day:

(i) Certified copies of the resolutions of the Board of Directors of the Company authorizing the execution and delivery and the issuance of the Notes on such Closing Day, and of all documents

evidencing other necessary corporate action and governmental approvals, if any, with respect to such Notes;

(ii) A certificate of the Secretary or an Assistant Secretary and one other officer of the Company certifying the names and true signatures of the officers of the Company authorized to sign such Notes and the other documents to be delivered hereunder;

(iii) Certified copies of the Articles of Incorporation and By-laws of the Company or confirmation that there have been no modifications to such documents delivered on the Amendment Closing Day;

(iv) A good standing certificate for the Company from the Secretary of State of Florida dated of a recent date and good standing and such other evidence of the status of the Company as such Purchaser may reasonably request; and

(v) A favorable opinion of Moore Van Allen, PLLC, special counsel to the Company (or such other counsel designated by the Company and acceptable to the Purchaser(s)) satisfactory to such Purchaser and substantially in the form of Exhibit D-3 attached hereto and as to such other matters as such Purchaser may reasonably request. The Company hereby directs each such counsel to deliver such opinion, agrees that the issuance and sale of any Notes will constitute a reconfirmation of such direction, and understands and agrees that each Purchaser receiving such an opinion will and is hereby authorized to rely on such opinion.

(vi) A favorable opinion of Greenberg Traurig Hoffman Lipoff Rosen & Quentel P.A., special Florida counsel to the Company (or such other counsel designated by the Company and acceptable to the Purchaser(s)) satisfactory to such Purchaser and substantially in the form of Exhibit D-4 attached hereto and as to such other matters as such Purchaser may reasonably request. The Company hereby directs each such counsel to deliver such opinion, agrees that the issuance and sale of any Notes will constitute a reconfirmation of such direction, and understands and agrees that each Purchaser receiving such an opinion will and is hereby authorized to rely on such opinion.

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(vii) A Private Placement number issued by Standard & Poor's CUSIP Service Bureau (in cooperation with the Securities Valuation Office of the National Association of Insurance Commissioners) shall have been obtained for the Notes to be purchased.

(viii) Additional documents or certificates with respect to legal matters or corporate or other proceedings related to the transactions contemplated hereby as may be reasonably requested by such Purchaser.

3B.Opinion of Purchaser's Special Counsel. Such Purchaser shall have received from King & Spalding or such other counsel who is acting as special counsel for it in connection with this transaction, a favorable opinion satisfactory to such Purchaser as to such matters incident to the matters herein contemplated as it may reasonably request.

3C.Representations and Warranties; No Default. The representations and warranties contained in paragraph 8 shall be true on and as of such Closing Day, except to the extent of changes caused by the transactions herein contemplated and for any Closing Day after the Amendment Closing Day changes since the date of this Agreement which are disclosed in writing to Prudential and to which Prudential shall have consented in writing; there shall exist on such Closing Day no Event of Default or Default; and the Company shall have delivered to such Purchaser an Officer's Certificate, dated such Closing Day, to both such effects.

3D.Purchase Permitted by Applicable Laws. The purchase of and payment for the Notes to be purchased by such Purchaser on the terms and conditions herein provided (including the use of the proceeds of such Notes by the Company) shall not violate any applicable law or governmental regulation (including, without limitation, Section 5 of the Securities Act or Regulation T, U or X of the Board of Governors of the Federal Reserve System) and shall not subject such Purchaser to any tax (other than any income taxes arising from such Purchaser's ownership of the Notes), penalty, liability or other onerous condition under or pursuant to any applicable law or governmental regulation, and such Purchaser shall have received such certificates or other evidence as it may request to establish compliance with this condition.

3E.Payment of Fees. The Company shall have paid to Prudential any fees due it pursuant to or in connection with this Agreement, including any Facility Fee due pursuant to paragraph 2J(1), any Issuance Fee due pursuant to paragraph 2J(2) and any Delayed Delivery Fee due pursuant to paragraph 2J(3) and any fees and expenses of its legal counsel.

3F.No Material Adverse Effect. Prudential shall have received a certificate from the chief financial officer of the Company, dated the applicable Closing Day, stating that since December 31, 2001, there shall have been no change which has had or could reasonably be expected to have a Material Adverse Effect.

3G.Guaranty Agreements. Each Guaranty Agreement, on and after the date of its execution and delivery, shall remain in full force and effect, and the Company shall have delivered an Officer's Certificate, dated such Closing Day, to such effect.

4. PREPAYMENTS. Any Notes shall be subject to required prepayment as and to the extent provided in paragraph 4A. Any Notes shall also be subject to prepayment under the

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circumstances set forth in paragraphs 4B, 4D and 4F. Any prepayment made by the Company pursuant to any other provision of this paragraph 4 shall not reduce or otherwise affect its obligation to make any required prepayment as specified in paragraph 4A.

4A.Required Prepayments of Notes. Until the Issued Series A Notes shall be paid in full, the Company shall apply to the prepayment of the Issued Series A Notes, without Yield-Maintenance Amount, the sum of \$10,000,000 on each of April 9, 2005 and April 9, 2006, and such principal amounts of the Issued Series A Notes, together with interest thereon to the payment dates, shall become due on such payment dates. The remaining unpaid principal amount of the Issued Series A Notes, together with interest accrued thereon, shall become due on the maturity date of the Issued Series A Notes. Each other Series of Shelf Notes shall be subject to required prepayments, if any, set forth in the Notes of such Series.

4B.Optional Prepayment With Yield-Maintenance Amount. The Notes of each Series shall be subject to prepayment, in whole at any time or from time to time in part (in integral multiples of \$1,000,000 and in a minimum amount of \$5,000,000), at the option of the Company, at 100% of the principal amount so prepaid plus interest thereon to the prepayment date and the Yield-Maintenance Amount, if any, with respect to each such Note. Any partial prepayment of a Series of the Notes pursuant to this paragraph 4B shall be applied in satisfaction of required payments of principal in inverse order of their scheduled due dates.

4C.Notice of Optional Prepayment. The Company shall give the holder of each Note of a Series to be prepaid pursuant to paragraph 4B irrevocable written notice of such prepayment not less than 10 Business Days prior to the prepayment date, specifying such prepayment date, the aggregate principal amount of the

Notes of such Series to be prepaid on such date, the principal amount of the Notes of such Series held by such holder to be prepaid on that date and that such prepayment is to be made pursuant to paragraph 4B. Notice of prepayment having been given as aforesaid, the principal amount of the Notes specified in such notice, together with interest thereon to the prepayment date and together with the Yield-Maintenance Amount, if any, herein provided, shall become due and payable on such prepayment date. The Company shall, on or before the day on which it gives written notice of any prepayment pursuant to paragraph 4B, give telephonic notice of the principal amount of the Notes to be prepaid and the prepayment date to each Significant Holder which shall have designated a recipient for such notices in the Purchaser Schedule attached hereto or the applicable Confirmation of Acceptance or by notice in writing to the Company.

4D.Mandatory Offer to Prepay.

(a) Upon receipt by the Company or any Subsidiary of Net Cash Proceeds from any Securitization Transaction, the Company shall certify to the Purchasers the amount of such Net Cash Proceeds so received and offer to prepay the Notes (as provided in clause (b) below) in an aggregate principal amount equal to 50% of the Net Cash Proceeds.

(b) The offer to prepay Notes contemplated by the foregoing subparagraph (a) shall be made in writing to each holder of a Note at least 10 Business Days before the proposed date of prepayment specifying such proposed date and the amount available for prepayment. A holder of a Note may accept such offer to prepay by causing a notice of

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such acceptance to be delivered to the Company within seven Business Days after receipt of the notice required pursuant to this subparagraph (b). A failure by a holder of Notes to respond to an offer to prepay made pursuant to this subparagraph (b) within such seven Business Day period shall be deemed to constitute a rejection of such offer by such holder. The amount of all prepayments pursuant to subparagraph (a) shall be made ratably to each holder of a Note accepting an offer to prepay made under this paragraph 4D. For purposes of subparagraph (a) and this subparagraph (b), each Note's pro rata share shall be a fraction, the numerator of which is the unpaid principal balance of such Note on the date of such prepayment (the "Note Prepayment Amount"), and the denominator of which is the sum of the Note Prepayment Amount for such Note plus the Note Prepayment Amount for each other Note to be prepaid on the date of prepayment, provided, however, that in no event will the aggregate amount the Company or any Subsidiary may be obligated to pay under this paragraph 4D exceed 50% of Net Cash Proceeds received by such entity. No Yield-Maintenance Amount shall be payable in connection with any prepayment under this paragraph 4D.

4E.Allocation of Partial Prepayments. In the case of each prepayment of less than the entire unpaid principal amount of all outstanding Notes of any Series pursuant to paragraphs 4A, 4B or 4D, the amount to be prepaid shall be applied pro rata to all outstanding Notes of such Series (including, for the purpose of this paragraph 4E only, all Notes prepaid or otherwise retired or purchased or otherwise acquired by the Company or any of its Subsidiaries or Affiliates other than by prepayment pursuant to paragraph 4A, 4B or 4D) according to the respective unpaid principal amounts thereof.

4F.Offer to Prepay Notes in the Event of a Change in Control.

4F(1) Notice of Impending Change in Control. The Company shall give to each holder of Notes prompt written notice of any impending Change in Control for which it has received a written offer or notice.

4F(2) Notice of Occurrence of Change in Control. The Company will,

within five Business Days after any Responsible Officer has knowledge of the occurrence of any Change in Control, give written notice of such Change in Control to each holder of Notes. If a Change in Control has occurred and in connection therewith (i) the Availability Period (as defined in the Bank Agreement), the Commitment Termination Date (as defined in the Bank Agreement), or any other similar or corresponding terms used in the Bank Agreement, is reduced or accelerated (whether by waiver, amendment, or otherwise), (ii) any Debt under the Bank Agreement becomes due and payable or is required to be prepaid or redeemed (other than by a regularly scheduled required prepayment or redemption), purchased or defeased or (iii) any Commitments (as defined in the Bank Agreement) under the Bank Agreement are terminated, then such notice shall contain and constitute an offer to prepay the Notes as described in paragraphs 4F(3) and 4F(5) and shall be accompanied by the certificate described in paragraph 4F(6) hereof.

4F(3) Offer to Prepay Notes. The offer to prepay Notes contemplated by the foregoing paragraph 4F(2) shall be an offer to prepay, in accordance with and subject to this paragraph 4F, all, but not less than all, the Notes held by each holder (in this case only, "holder" in respect of any Note registered in the name of a nominee for a disclosed beneficial owner shall mean such

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beneficial owner) on a date specified in such offer (the "Proposed Prepayment Date"). Such Proposed Prepayment Date shall be not less than 30 days and not more than 90 days after the date of such offer (if the Proposed Prepayment Date shall not be specified in such offer, the Proposed Prepayment Date shall be the 60th day after the date of such offer).

4F(4) Rejection, Acceptance. A holder of Notes may accept the offer to prepay made pursuant to this paragraph 4F by causing a notice of such acceptance to be delivered to the Company no later than seven Business Days prior to the Proposed Prepayment Date. A failure by a holder of Notes to respond to an offer to prepay made pursuant to this paragraph 4F within such seven Business Day period shall be deemed to constitute a rejection of such offer by such holder.

4F(5) Prepayment. Prepayment of the Notes to be prepaid pursuant to this paragraph 4F shall be at 100% of the principal amount of such Notes, together with interest on such Notes accrued but unpaid to the date of prepayment. The prepayment shall be made on the Proposed Prepayment Date. No Yield-Maintenance Amount shall be payable in connection with any prepayment under this paragraph 4F.

4F(6) Officer's Certificate. Each offer to prepay the Notes pursuant to this paragraph 4F shall be accompanied by a certificate, executed by a Responsible Officer of the Company and dated the date of such offer, specifying: (a) the Proposed Prepayment Date; (b) that such offer is made pursuant to this paragraph 4F; (c) the principal amount of each Note offered to be prepaid; (d) the interest that would be due on each Note offered to be prepaid, accrued to the Proposed Prepayment Date; (e) that the conditions of paragraphs 4F(2), 4F(3), 4F(5) and 4F(6) have been fulfilled; and (f) in reasonable detail, the nature and date of the Change in Control.

4F(7) Termination of Effectiveness. Immediately upon the effectiveness of an amendment of the Bank Agreement such that a Change of Control shall cease to constitute an "Event of Default" thereunder and not otherwise cause a prepayment or commitment reduction thereunder, the provisions of this paragraph 4F shall no longer be applicable to the Notes.

4G.Maturity; Surrender, Etc. In the case of the prepayment of Notes pursuant to this paragraph 4, the principal amount of each Note to be prepaid shall mature and become due and payable on the date fixed for such prepayment, together with interest on such principal amount accrued but unpaid prior to such date and the applicable Yield-Maintenance Amount, if any. From and after such date, unless prior thereto the Company shall fail to pay such principal amount when so due and payable, together with the interest and the applicable

Yield-Maintenance Amount, if any, as aforesaid, interest on such principal amount shall cease to accrue. Any Note paid or prepaid in full shall be surrendered to the Company and canceled and the Company shall be immediately discharged from any obligation under such Notes.

4H. Retirement of Notes. The Company shall not, and shall not permit any of its Subsidiaries or Affiliates to, prepay or otherwise retire in whole or in part prior to their stated final maturity (other than by prepayment pursuant to paragraphs 4A, 4B, 4D or 4F or upon acceleration of such final maturity pursuant to paragraph 7A), or purchase or otherwise

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acquire, directly or indirectly, Notes of any Series held by any holder unless the Company or such Subsidiary or Affiliate shall have offered to prepay or otherwise retire or purchase or otherwise acquire, as the case may be, the same proportion of the aggregate principal amount of Notes of such Series held by each other holder of Notes of such Series at the time outstanding upon the same terms and conditions. Any Notes so prepaid or otherwise retired or purchased or otherwise acquired by the Company or any of its Subsidiaries or Affiliates shall not be deemed to be outstanding for any purpose under this Agreement, except as provided in paragraph 4E.

#### 5. AFFIRMATIVE COVENANTS.

##### 5A. Reporting Requirements.

5A(1) General Information. The Company covenants that it will deliver to each Significant Holder:

(i) as soon as practicable and in any event within 45 days after the end of each quarterly period (other than the fourth quarterly period) in each fiscal year,

(1) Consolidated statements of income, stockholders' equity and cash flows for the period from the beginning of the current fiscal year to the end of such quarterly period, and

(2) a Consolidated balance sheet as at the end of such quarterly period,

setting forth in each case in comparative form figures for the corresponding period in the preceding fiscal year, all in reasonable detail and reasonably satisfactory in form to the Required Holder(s) and certified by an authorized financial officer of the Company as fairly presenting, in all material respects, the financial condition of the Company and its Consolidated Subsidiaries as of the end of such period and the results of their operations for the period then ended in accordance with generally accepted accounting principles, subject to changes resulting from normal year-end adjustments and the inclusion of abbreviated footnotes; provided, however, that delivery pursuant to clause (iii) below of copies of the Quarterly Report on Form 10-Q of the Company for such quarterly period filed with the Securities and Exchange Commission shall be deemed to satisfy the requirements of this clause (i);

(ii) as soon as practicable and in any event within 90 days after the end of each fiscal year,

(1) Consolidated statements of income, stockholders' equity and cash flows for such year, and

(2) a Consolidated balance sheet as at the end of such year,

setting forth in each case in comparative form corresponding

Consolidated figures from the preceding annual audit, all in reasonable detail and reasonably satisfactory in scope to the Required Holder(s) and reported on by independent public accountants of recognized standing selected by the Company whose report shall be without limitation as to the scope of the audit and reasonably satisfactory in substance to the Required Holder(s); provided, however, that delivery pursuant to clause (iii) below of copies of the Annual

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Report on Form 10-K of the Company for such year filed with the Securities and Exchange Commission shall be deemed to satisfy the requirements of this clause (ii);

(iii) if the Company shall be publicly held, promptly upon transmission thereof, copies of all such financial statements, proxy statements, notices, certificates and reports as it shall send to its public stockholders and copies of all registration statements (without exhibits) and all reports (other than any registration statement filed on Form S-8) and certificates which it files with the Securities and Exchange Commission (or any governmental body or agency succeeding to the functions of the Securities and Exchange Commission), including without limitation the certifications of the chief executive officer and the chief financial officer described in Sections 302 and 906 of the Sarbanes-Oxley Act of 2002 (as amended from time to time);

(iv) promptly upon receipt thereof, a copy of each other report (including, without limitation, management letters) submitted to the Company or any Subsidiary by independent accountants in connection with any annual, interim or special audit made by them of the books of the Company or any Subsidiary;

(v) promptly upon receipt thereof, a copy of each report, survey, study, evaluation, assessment or other document prepared by any consultant, engineer, Environmental Authority or other Person relating to compliance by the Company or any Subsidiary with any Environmental Requirements, if the cost of remediation, repair or compliance may be reasonably expected to exceed \$250,000 in any one case or in the aggregate;

(vi) with reasonable promptness, upon the request of the holder of any Note, provide such holder, and any qualified institutional buyer designated by such holder, such financial and other information as such holder may reasonably determine to be necessary in order to permit compliance with the information requirements of Rule 144A under the Securities Act in connection with the resale of Notes, except at such times as the Company is subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act. For the purpose of this clause (vi), the term "qualified institutional buyer" shall have the meaning specified in Rule 144A under the Securities Act; and

(vii) with reasonable promptness, such other data relating to the business, operations, properties or financial condition of the Company or any of its Subsidiaries as a Significant Holder may reasonably request;

5A(2) Officer's Certificates. Together with each delivery of financial statements required by clauses 5A(i) and (ii) above, the Company will deliver to each Significant Holder an Officer's Certificate demonstrating (with computations in reasonable detail) compliance with the provisions of paragraphs 6A, 6B(1), 6B(2), 6B(3) and 6C and stating that there exists no Event of Default or Default, or, if any Event of Default or Default exists, specifying the nature and period of existence thereof and what action the Company has taken, is taking or proposes to take with respect thereto.

5A(3) Special Information. The Company also covenants that immediately after any Responsible Officer obtains actual knowledge of:

- (a) an Event of Default or Default;
- (b) a material adverse change in the financial condition, business or operations of the Company and its Subsidiaries, taken as a whole;
- (c) legal proceedings filed or commenced against, or to the knowledge of the Company, affecting the Company and/or any Subsidiary, which reasonably could be expected to have a Material Adverse Effect or which in any manner draws into question the validity of this Agreement or the Notes;
- (d) a default under any agreement or note evidencing Debt for which the Company or any Subsidiary is liable;
- (e) the occurrence of any other event that reasonably could be expected to impair the ability of the Company to meet its obligations hereunder;
- (f) any (i) Environmental Liabilities, (ii) pending, threatened or anticipated Environmental Proceedings, (iii) Environmental Notices, (iv) Environmental Judgments and Orders, or (v) Environmental Releases at, on, in, under or in any way affecting the Properties which reasonably could be expected to have a Material Adverse Effect;
- (g) the occurrence of any other event that results in, or could reasonably be expected to result in, a Material Adverse Effect;
- (h) the occurrence of any ERISA Event that alone, or together with any other ERISA Events that have occurred, could reasonably be expected to result in liability of the Company and its Subsidiaries in an aggregate amount exceeding \$1,000,000;
- (i) any change in the fiscal year of the Company or any Subsidiary, except to change the fiscal year of a Subsidiary to conform its fiscal year to that of the Company; or
- (j) the occurrence of each of the following:

- (i) any request for a material amendment, modification or waiver of any of the terms contained in any Major Distribution Agreement which, if granted, would result in, or could reasonably be expected to result in, a Material Adverse Effect, which notice shall be accompanied by a copy (if available) or summary of the terms of the proposed amendment, modification or waiver;

- (ii) written notice from the manufacturer or supplier under any Major Distribution Agreement of any default or event of default, or the assertion by any party thereto of the occurrence of a default or event of default, under any such Major Distribution Agreement that results in, or could reasonably be expected to result in, a Material Adverse Effect, which notice shall be accompanied by a copy

of any summary of the circumstances relating thereto, and an explanation of what action, if any, the Company intends to take



with respect thereto; and

(iii) the assertion by any Person, whether in a proceeding before a Governmental Authority or otherwise, that any Major Distribution Agreement is void, invalid, unenforceable or subject to rejection, avoidance, rescission or reformation in any material respect which, if successful, would result in, could reasonably be expected to result in, a Material Adverse Effect, which notice shall be accompanied by a summary of the circumstances relating to such assertion together, if applicable, with copies of any pleadings or other submissions made to any Governmental Authority relating to such assertion;

the Company will deliver to each Significant Holder an Officer's Certificate specifying the nature and period of existence thereof and what action the Company or the Subsidiary has taken, is taking or proposes to take with respect thereto.

5B. Inspection of Property. The Company covenants that, at such reasonable times and upon reasonable notice and as often as a Significant Holder may reasonably request, it will permit any Person designated by a Significant Holder in writing, at such Significant Holder's expense unless a Default has occurred and is continuing in which case at the Company's expense, to:

(i) visit and inspect any of the properties of the Company and any Subsidiary;

(ii) examine the corporate books and financial records of the Company and its Subsidiaries and make copies thereof or extracts therefrom; and

(iii) discuss the affairs, finances and accounts of any of such corporations with the principal officers of the Company or any Subsidiary and their independent public accountants.

5C. Covenant to Secure Notes Equally. The Company covenants that if it or any Subsidiary shall create or assume any Lien upon any of its property or assets, whether now owned or hereafter acquired, other than Liens permitted by paragraph 6B(1) (unless prior written consent shall have been obtained under paragraph 11C), it will make or cause to be made effective provision whereby the Notes will be secured by such Lien equally and ratably with any and all other Debt thereby secured so long as any such other Debt shall be so secured.

5D. Guaranteed Obligations. The Company covenants that if any Person (other than the Company) Guarantees or provides collateral in any manner for any Debt of the Company or any Subsidiary other than as permitted by paragraph 6B(1), it will simultaneously cause such Person to Guarantee or provide collateral for the Notes equally and ratably with all Debt Guaranteed or secured by such Person for so long as such Debt is Guaranteed and pursuant to documentation in form and substance reasonably satisfactory to such holder. Subject to the foregoing, the Company shall cause each of its Subsidiaries not existing as of the date hereof to execute and deliver a guaranty agreement, in substantially the form of the Guaranty Agreements, as soon as practicable and in any event within thirty days of the creation or acquisition of any such

Subsidiary. The delivery of such guaranty agreement shall be accompanied by such other documents as the Required Holders may reasonably request including charter, bylaws, appropriate resolutions of the Board of Directors of any such Subsidiary providing such a guaranty agreement and legal opinions. Upon the delivery thereof, such guaranty agreement and such other documents shall constitute Related Documents hereunder.

5E. Maintenance of Insurance. The Company covenants that it and each Subsidiary will maintain, with responsible insurers, insurance with respect to

its properties and business against such casualties and contingencies (including, but not limited to, public liability, larceny, embezzlement or other criminal misappropriation) and in such amounts as is customary in the case of similarly situated corporations engaged in the same or similar businesses.

5F.Maintenance of Corporate Existence/Compliance with Law/Preservation of Property. The Company covenants that, except as permitted under paragraphs 6B(3) and 6C, it and each Subsidiary will do or cause to be done all things necessary to, at all times:

(i) preserve, renew and maintain in full force and effect its legal existence of the Company and its Subsidiaries and continue to engage in the same business as presently conducted or such other businesses that are reasonably related thereto; provided, however, the Company shall not be required to preserve the legal existence of any Subsidiary if the Company reasonably determines that the preservation thereof is no longer necessary or desirable in the conduct of the business of the Company and its Subsidiaries taken as a whole.

(ii) comply with all laws and regulations (including, without limitation, laws and regulations relating to equal employment opportunity and employee safety) applicable to it and any Subsidiary, except where the failure to comply, either individually or in the aggregate, could not reasonably be expected to result in a Material Adverse Effect;

(iii) maintain, preserve and protect all material licenses, certificates, permits, franchises and intellectual property of the Company and its Subsidiaries; and

(iv) preserve all the remainder of its property used or useful in the conduct of its business and keep the same in good repair, working order and condition excluding normal wear and tear, except where the failure to preserve such property, either individually or in the aggregate, could not reasonably be expected to have a Material Adverse Effect.

5G.Compliance with Environmental Laws. The Company covenants that it and each Subsidiary will, comply in a timely fashion with, or operate pursuant to valid waivers of the provisions of, all applicable Environmental Requirements, including, without limitation, the emission of wastewater effluent, solid and hazardous waste and air emissions together with any other applicable Environmental Requirements for conducting, on a timely basis, periodic tests and monitoring for contamination of ground water, surface water, air and land and for biological toxicity of the aforesaid, and all applicable regulations of the Environmental Protection Agency or other relevant Governmental Authority, except where the failure to comply could not

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reasonably be expected to have a Material Adverse Effect. The Company agrees to indemnify and hold you, your officers, agents and employees (each an "Indemnified Person") harmless from any loss, liability, claim or expense that you may incur or suffer as a result of a breach by the Company or any Subsidiary, as the case may be, of this covenant other than as a result of the gross negligence or willful misconduct of such Indemnified Person. The Company shall not be deemed to have breached or violated this paragraph 5G if the Company or any Subsidiary is challenging in good faith by appropriate proceedings diligently pursued the application or enforcement of such Environmental Requirements for which adequate reserves have been established in accordance with generally accepted accounting principles.

5H.No Integration. The Company covenants that it has taken and will take all necessary action so that the issuance of the Notes does not and will not require registration under the Securities Act. The Company covenants that no future offer and sale of debt securities of the Company of any class will be

made if there is a reasonable possibility that such offer and sale would, under the doctrine of "integration", subject the issuance of the Notes to you to the registration requirements of the Securities Act.

5I. Financial Records. The Company covenants that it and each Subsidiary will keep proper books of record and account in which full and correct entries (in all material respects and subject to normal year end adjustments and, as to interim statements, the absence of footnotes) will be made of the business and affairs of the Company or such Subsidiary under generally accepted accounting principles consistently applied (except for changes disclosed in the financial statements furnished to you pursuant to paragraph 5A and concurred in by the independent public accountants referred to in paragraph 5A).

5J. Other Covenants. If (in the reasonable opinion of the Required Holders) at any time and from time to time, after the date hereof, any of the material covenants, material representations and warranties or material events of default, or any other material term or provision (other than any term or provision relating to payment terms, interest rates or penalties) (collectively, "Material Provisions"), contained in any document evidencing any Debt in excess of \$5,000,000, or in any document, agreement or instrument from time to time entered into by the Company in respect thereof (collectively, the "Other Debt Documents"), is more favorable to the lender or beneficiary under such Other Debt Documents than are the terms of this Agreement to the holders of the Notes, this Agreement shall be deemed amended to contain each more favorable Material Provision on the same basis and to the extent that such Material Provisions are reflected in such Other Debt Documents. The Company hereby agrees to so amend this Agreement and to execute and deliver all such documents required by the Required Holder(s) to reflect such Amendment. Prior to the execution and delivery of such documents by the Company, this Agreement shall be deemed to contain each more favorable Material Provision for purposes of determining the rights and obligations hereunder.

5K. Payment of Obligations. The Company will, and will cause each Subsidiary to, pay and discharge at or before maturity, all of its obligations and liabilities, including without limitation:

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(i) all taxes, assessments and governmental charges or levies imposed upon it or any of its property other than any taxes, assessments and government charges or levies; and

(ii) all claims or demands of materialmen, mechanics, carriers, warehousemen, vendors, landlords and other like Persons that, if unpaid, could reasonably be expected to result in the creation of a Lien upon any of its property:

provided, that items of the foregoing clauses (i) and (ii) need not be paid

(1) while being actively contested in good faith by appropriate proceedings diligently conducted and with respect to which adequate reserves or other appropriate provisions have been established and are being maintained in accordance with generally accepted accounting principles;

(2) if applicable, so long as the title to, and right to use, such property, is not materially adversely affected thereby; and

(3) the failure to make payment pending such contest could not reasonably be expected to result in a Material Adverse Effect.

5L. Additional Subsidiaries. If any additional Subsidiary is acquired or formed after the date hereof, the Company will, within fifteen (15) Business

Days after such Subsidiary is acquired or formed, notify each of the Significant Holders and will cause such Subsidiary to deliver simultaneously therewith similar documents applicable to such Subsidiary required under paragraph 3A as reasonably requested by the Required Holders.

5M. Compliance with Major Distribution Agreements. The Company and each applicable Subsidiary (a) will strictly comply with all of the terms and provisions of all Major Distribution Agreements, (b) will not make or permit to be made any material modification or amendment to any such Major Distribution Agreement without the prior written consent of the Required Holders, and (c) will maintain each such Major Distribution Agreement in full force and effect and free of default thereunder at all times during of the term of this Agreement, provided, in the case of each of clauses (a), (b) and (c) hereof, such failure to do so would result in, or could reasonably be expected to result in, a Material Adverse Effect.

6. NEGATIVE COVENANTS. Unless the Required Holders otherwise agree in writing, the Company shall not, and shall not permit any Subsidiary, to take any of the following actions or permit the occurrence or existence of any of the following events or conditions:

6A. Financial Limitation. The Company covenants that it will not permit at any time:

(i) Consolidated Debt to exceed 300% of Consolidated EBITDA calculated at the end of each fiscal quarter of the Company on a rolling four quarter basis; or

(ii) Consolidated Debt to exceed 50% of Consolidated Total Capitalization calculated at the end of each fiscal quarter of the Company; or

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(iii) Priority Debt to exceed 15% of Consolidated Net Worth, calculated at the end of each fiscal quarter of the Company; or

(iv) the Interest Coverage Ratio of the Company and its Subsidiaries, as of the end of each fiscal quarter of the Company, commencing with the fiscal quarter ended June 30, 2002, to be less than 3.00:1.00, calculated on a rolling four-quarter basis; or

(v) the Company and its Subsidiaries, as of the end of each fiscal quarter of the Company, commencing with the fiscal quarter ended June 30, 2002, to have a Consolidated Net Worth in an amount less than (a) \$290,178,000 and (b) as at the last day of each succeeding fiscal quarter of the Company and until (but excluding) the last day of the next following fiscal quarter of the Company, the sum of (i) the amount of Consolidated Net Worth required to be maintained pursuant to this covenant as at the end of the immediately preceding fiscal quarter, plus (ii) fifty percent (50%) of Consolidated Net Income (with no reduction for net losses during any period) for the fiscal quarter of the Company ending on such day (adjusting the computation of Consolidated Net Income for certain items, as provided for in the definition of "Consolidated Net Income"), plus (iii) one hundred percent (100%) of the aggregate Net Cash Proceeds of any Equity Issuance and net proceeds of other capital investments, in each case calculated quarterly on the last day of each fiscal quarter; or

(vi) the Company and its Subsidiaries to have, as of the end of each fiscal quarter of the Company, commencing with the fiscal quarter ended June 30, 2002, a ratio of Consolidated Current Assets to Consolidated Debt less than 1.50:1.00, calculated at the end of each fiscal quarter of the Company;

provided, however, that if (A) the Bank Agreement is amended to increase the

Consolidated Debt to Consolidated EBITDA ratio for the most recently ended four fiscal quarter period, the Purchasers agree to amend clause (i) above so that the Consolidated Debt to Consolidated EBITDA ratio is also increased accordingly, provided, however, that the Consolidated Debt to Consolidated EBITDA ratio shall not, at any time, exceed 375%, (B) the Bank Agreement is amended to increase the Consolidated Debt to Consolidated Total Capitalization ratio for the most recently ended four fiscal quarter period, the Purchasers agree to amend clause (ii) above so that the Consolidated Debt to Consolidated Total Capitalization ratio is also increased accordingly, provided, however, that the Consolidated Debt to Consolidated Total Capitalization ratio shall not, at any time, exceed 62.5%, and (C) if the Bank Agreement is amended to delete Section 6.2, Section 6.3 or Section 6.5 thereof, the Purchasers agree to delete the corresponding clause (iv), (v) or (vi) above, as the case may be.

6B.Liens, Debt and Other Restrictions. The Company covenants that it will not and will not permit any Subsidiary to:

6B(1) Liens. Create, assume or suffer to exist any Lien upon any of its property or assets, whether now owned or hereafter acquired (whether or not provision is made for the equal and ratable securing of the Notes pursuant to paragraph 5C), except:

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(i) Liens existing on the Amendment Closing Day and specified on Schedule 6B(1);

(ii) Liens imposed by law for taxes, assessments or charges of any Governmental Authority for claims not yet due or which are being contested in good faith by appropriate proceedings diligently conducted and with respect to which adequate reserves or other appropriate provisions are being maintained in accordance with generally accepted accounting principles and which Liens do not constitute a prior or senior lien;

(iii) statutory Liens of landlords and Liens of carriers, warehousemen, mechanics, materialmen and other Liens imposed by law or created in the ordinary course of business and in existence less than 120 days from the date of creation thereof for amounts not yet due or which are being contested in good faith by appropriate proceedings diligently conducted and with respect to which adequate reserves or other appropriate provisions are being maintained in accordance with generally accepted accounting principles and which Liens do not constitute a prior or senior lien;

(iv) Liens incurred or deposits made in the ordinary course of business (including, without limitation, surety bonds and appeal bonds) in connection with workers' compensation, taxes (and with respect to Liens, to the extent permitted under paragraph 5K), unemployment insurance and other types of social security benefits or to secure the performance of tenders, bids, leases, contracts (other than for the repayment of Debt), statutory obligations and other similar obligations or arising as a result of progress payments under government contracts;

(v) easements (including reciprocal easement agreements and utility agreements), rights-of-way, covenants, consents, reservations, encroachments, variations and zoning and other restrictions, charges or encumbrances (whether or not recorded), which do not interfere materially with the ordinary conduct of the business of the Company and its Subsidiaries taken as a whole and which do not materially detract from the value of the property to which they attach or materially impair the use thereof to the Company and its Subsidiaries taken as a whole;

(vi) any right of set off or banker's lien (whether by

common law, statute, contract or otherwise) in connection with ordinary course of business deposit arrangements maintained by the Company or its Subsidiaries with a bank a party to the Bank Agreement or with its other banks or financial institutions so long as any such bank or other financial institution (A) shall not at any time make loans or otherwise extend credit to the Company or any Subsidiary, (B) does not maintain accounts (for the deposit of cash or otherwise) for the benefit of the Company or any Subsidiary, (C) shall have waived in writing for the benefit of each holder of a Note such right of setoff or banker's lien, or (D) shall be subject to a pro rata sharing agreement in form and substance satisfactory to each Significant Holder;

(vii) any Lien renewing, extending, or refunding any outstanding obligations secured by a Lien described in clause (i), provided (A) the principal amount secured is

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not increased or the weighted average life to maturity thereof reduced; (B) such Lien is not extended to any other property of the Company or its Subsidiaries; (C) the Debt secured thereby is permitted under paragraph 6A and (D) no Default or Event of Default has occurred and is continuing;

(viii) Liens on insurance policies owned by the Company on the lives of its officers securing policy loans obtained from the insurers under such policies, provided that (A) the aggregate amount borrowed on each policy shall not exceed the loan value thereof and (B) the Company shall not incur any liability to repay any such loan;

(ix) additional Liens securing Priority Debt permitted by paragraph 6A(iii); and

(x) any Lien arising out of any Securitization Transaction permitted by Paragraph 6C(vi).

6B(2) Debt. Create, incur, assume or suffer to exist any Debt, except:

(i) Debt represented by this Agreement or any of the Related Documents;

(ii) Debt existing on the Amendment Closing Day as set forth on Schedule 6B(2) and refinancings or replacements thereof in an amount not to exceed (A) in the case of the Bank Agreement, \$315 million and (B) in all cases, the principal amount specified on such Schedule;

(iii) Debt of any Subsidiary owing to the Company or any other Subsidiary of the Company;

(iv) Debt represented by endorsement of negotiable instruments for collection in the ordinary course of business;

(v) additional Debt of the Company or any Subsidiary (whether Secured or Unsecured) incurred in the ordinary course of business as conducted on the date hereof;

(vi) Debt of any Person which becomes a Subsidiary after the date of this Agreement; provided, that (i) such Debt exists at the time that such Person becomes a Subsidiary and is not created in contemplation of or in connection with such Person becoming a Subsidiary and (ii) the aggregate principal amount of such Debt permitted hereunder shall not exceed \$5,000,000 outstanding at any time;

(vii) Debt in respect of any Securitization Transaction permitted by Paragraph 6C(vi);

(viii) Debt in respect of obligations under Hedging Agreements under the Bank Agreement;

(ix) other unsecured (other than by a Letter of Credit (as defined in the Bank Agreement) or Guarantee of the Company or any of its Subsidiaries) Debt in an aggregate

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principal amount not to exceed \$20,000,000 at any time outstanding that represents a portion of the costs of an Acquisition permitted by Paragraph 6B(4)(vi) payable to Persons selling an equity interest or assets to the Company or any of its Subsidiaries; provided, that such Debt is fully subordinate (other than in those cases where supported by a Letter of Credit) to the payment and performance of the Obligations on terms and in form and substance satisfactory to the Required Holders; provided, further, that in computing such \$20,000,000 aggregate Debt amount, in the event that any such Debt is secured or enhanced by a Letter of Credit or by a Guarantee of the Company or any of its Subsidiaries, the principal amount of the Debt and not the amount of any such Letter of Credit or Guarantee, shall count towards such \$20,000,000 limitation.

Notwithstanding the foregoing exceptions to the prohibition against incurring or maintaining Debt, the Company shall not permit at any time, prior to or after the incurrence thereof, the aggregate outstanding amount of Debt to exceed the limitations of paragraph 6A hereof or incur any Debt if a Default or Event of Default has occurred and is continuing.

6B(3) Merger or Consolidation. Merge, consolidate or exchange shares with any other Person, except that:

(i) any Subsidiary may merge or consolidate with the Company or any other Subsidiary;

(ii) the Company may merge or consolidate with any other corporation (including a Subsidiary) provided (A) the Company is the surviving corporation, and (B) immediately after giving effect to such transaction, no Default or Event of Default shall occur or exist;

(iii) any Subsidiary may merge or consolidate with any other corporation provided (A) such Subsidiary is the surviving corporation, and (B) immediately after giving effect to such transaction, no Default or Event of Default shall occur or exist; and

(iv) Dunhill may merge or consolidated with any other Person in connection with a transaction permitted by paragraph 6C(iii).

6B(4) Investments. Make or permit to remain outstanding any Investments except any of the following:

(i) securities of any Person acquired in an Acquisition provided that such Person shall become a Guarantor at the time of, or promptly after, such Acquisition;

(ii) Eligible Securities;

(iii) Investments existing on the Amendment Closing Day and specified in Schedule 6B(4);

(iv) accounts receivable arising and trade credit granted in the ordinary course of business and any securities or other assets received in satisfaction or partial

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satisfaction thereof in connection with accounts of financially troubled Persons to the extent reasonably necessary in order to prevent or limit loss;

(v) Investments in the Company and in Subsidiaries which are Guarantors;

(vi) additional investments in other Persons, provided that (A) the aggregate costs incurred in making such investments (reduced by cash dividends or other cash payments received on or in consideration of such investments) shall not exceed \$20,000,000 in the aggregate at any time and (B) prior to and immediately after giving effect to such investment, no Default or Event of Default shall exist and be continuing;

(vii) loans and advances between or among the Company and the Guarantors permitted by paragraph 6B(2)(iii);

(viii) travel and entertainment advances made to employees of the Company or any of its Subsidiaries in the ordinary course of business;

(ix) Investments consisting of ownership interests in another Person resulting from the dispositions or mergers permitted under paragraphs 6C(iii) or 6B(3); and

(x) notes of purchasers of Dunhill (A) not exceeding an aggregate principal amount of \$25,000,000 and (B) having a repayment term less than or equal to seven years.

6B(5) Transactions with Related Party. Except as permitted in paragraph 6B(3) and 6B(4), effect any transaction with any Affiliate or Subsidiary by which any asset or services of the Company or a Subsidiary of the Company is transferred to such Affiliate or Subsidiary, or from such Affiliate or Subsidiary or enter into any other transaction with an Affiliate or Subsidiary, on terms more favorable than would be reasonably expected to be given in a similar transaction with an unrelated entity.

6C.Sale of Assets. The Company will not, and will not permit any Subsidiary to, Dispose of any property or assets (including the Capital Stock of a Subsidiary), except:

(i) inventory in the ordinary course of business;

(ii) any Subsidiary may Dispose of its assets to the Company or a wholly-owned Subsidiary;

(iii) the sale or other disposition of all or substantially all of the Capital Stock or assets of Dunhill for no less than Fair Market Value, as reasonably determined by the Board of Directors of the Company (upon which event, all of the Required Holders, at the request and expense of the Company, will execute such documents as shall be acceptable to the Required Holders and its counsel releasing the Guaranty Agreement of Dunhill, Inc.), consideration for which may include notes or other evidence of indebtedness of purchasers in an aggregate amount not exceeding \$25,000,000 and a repayment term not exceeding three years;

(iv) the Disposition of Eligible Securities in the ordinary course of management of the investment portfolio of the Company and its Subsidiaries;



(v) Dispositions of property that is substantially worn, damaged, obsolete or in the judgment of the Company, no longer best used or useful in its business or that of any Subsidiary;

(vi) the sale or other disposition of such assets in connection with any Securitization Transaction in an aggregate amount not to exceed \$75,000,000 at any time during the term of this Agreement, provided, that 50% of the Net Cash Proceeds resulting from such Securitization Transaction are used by the Company to prepay the outstanding Obligations hereunder as described in Section 4D;

(vii) the Company or any Subsidiary may Dispose of its assets (whether or not leased back) so long as, immediately after giving effect to such proposed Disposition:

(A) the consideration for such assets represents the Fair Market Value of such assets at the time of such Disposition; and

(B) (1) the net book value of all assets so Disposed of by the Company and its Subsidiaries (other than pursuant to clause (iv)) does not constitute a Substantial Part of the Consolidated assets or (2) the proceeds of such Disposition are reinvested in a similar business or assets within 12 months of such Disposition; and

(C) no Default or Event of Default shall exist;

(viii) the sale, without recourse, other than for misrepresentation, by any Subsidiary of accounts receivable having a value, net of all allowances and discounts, not to exceed during any fiscal year of the Company an aggregate dollar value of \$5,000,000, which receivables shall be payable by Persons who are not United States citizens or organized and existing under the laws of the United States or a state or territory thereof; and

(ix) the sale or other disposition of such assets in an aggregate amount not to exceed \$25,000,000 in any fiscal year of the Company;

provided, however, that if the Bank Agreement is amended to delete Section 7.6(e) or Section 7.6(f) thereof, respectively, the Purchasers agree to delete the corresponding clause (viii) or (ix) above, as the case may be.

For purposes of this paragraph 6C:

(i) "Dispose" means the sale, lease, transfer or other disposition of property of the Company or any of its Subsidiaries, and "Disposition" and "Disposed of" has a corresponding meaning to Dispose;

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(ii) Calculation of net book value. The net book value of any assets shall be determined as of the respective date of Disposition of those assets; and

(iii) Sales of less than all the stock of a Subsidiary. In the case of the sale or issuance of the stock of a Subsidiary, the amount of Consolidated Assets contributed by the stock Disposed of shall be assumed to be the percentage of outstanding stock sold or to be sold.

6D. Subsidiary Stock and Debt. The Company will not:

(i) directly or indirectly sell, assign, pledge or otherwise dispose of any Debt of or any shares of stock of (or warrants, rights

or options to acquire stock of) any Subsidiary except to a wholly-owned Subsidiary and except as permitted pursuant to paragraph 6C;

(ii) permit any Subsidiary directly or indirectly to sell, assign, pledge or otherwise dispose of any Debt of the Company or any other Subsidiary, or any shares of stock of (or warrants, rights or options to acquire stock of) any other Subsidiary, except to the Company or a wholly-owned Subsidiary and except as permitted pursuant to paragraph 6C;

(iii) permit any Subsidiary directly or indirectly to issue or sell any shares of its stock (or warrants, rights or options to acquire its stock) except to the Company or a wholly-owned Subsidiary and except as permitted pursuant to paragraph 6B(3) and 6C;

(iv) permit any Subsidiary to enter into or otherwise be bound by or subject to any contract or agreement (including, without limitation, any provision of its certificate or articles of incorporation or bylaws) that restricts its ability to pay dividends or other distributions on account of its stock except for such restrictions set forth in the Bank Agreement, so long as such restrictions do not prohibit or restrict any Subsidiary's ability to pay dividends or other distributions on account of its stock to the Company or another Subsidiary;

(v) permit any Subsidiary to create, incur, assume or maintain any Debt except as permitted by paragraph 6B(2); or

(vi) permit any Guarantor to make any payments under any Subsidiary Guarantee Agreement (as defined in the Bank Agreement) unless the holders of Notes receive a pro rata payment pursuant to the Guaranty Agreement.

6E. Sale of Receivables. The Company covenants that it will not, and will not permit any Subsidiary to, sell (with or without recourse), or discount or otherwise sell for less than the face value thereof, any of its Receivables other than in connection with a sale in accordance with paragraph 6C(vi).

6F. ERISA. The Company covenants that it will not, nor permit any Subsidiary to:

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(i) terminate or withdraw from any Plan (other than a Multiemployer Plan) resulting in the incurrence of any material liability to the Pension Benefit Guaranty Corporation;

(ii) engage in or permit any Person to engage in any prohibited transaction (as defined in Section 4975 of the Code) involving any Plan (other than a Multiemployer Plan) which would subject the Company or any Subsidiary to any material tax, penalty or other liability;

(iii) incur or suffer to exist any material accumulated funding deficiency (as defined in Section 302 of ERISA and Section 412 of the Code), whether or not waived, involving any Plan (other than a Multiemployer Plan); or

(iv) allow or suffer to exist any risk or condition which presents a risk of incurring a material liability to the Pension Benefit Guaranty Corporation.

6G. Environmental Matters. The Company covenants that it will not, and will not permit any Third Party to, use, produce, manufacture, process, generate, store, dispose of, manage at, or ship or transport to or from the Properties any Hazardous Materials except for Hazardous Materials used,

produced, released or managed in the ordinary course of business in compliance with all applicable Environmental Requirements except where the failure to do so could not reasonably be expected to have a Material Adverse Effect and except for Hazardous Materials released in amounts which do not require remediation pursuant to applicable Environmental Requirements or if remediation is required, such remediation could not reasonably be expected to have a Material Adverse Effect.

6H.Specified Laws. Neither the Company nor any agent acting on its behalf will take any action which could reasonably be expected to cause this Agreement or the Notes to violate Regulation T or any other regulation of the Board of Governors of the Federal Reserve System or to violate the Exchange Act, in any case as in effect now or as the same may hereafter be in effect.

6I.Business Activities. Neither the Company nor any of its Subsidiaries will engage directly or indirectly (whether through subsidiaries or otherwise) in any type of business other than the businesses conducted by the Company or such Subsidiary on the date hereof and in related businesses.

#### 7. EVENTS OF DEFAULT.

7A.Acceleration. If any of the following events shall occur and be continuing for any reason whatsoever (and whether such occurrence shall be voluntary or involuntary or come about or be effected by operation of law or otherwise):

(i) the Company defaults in the payment of any principal of, or Yield- Maintenance Amount payable with respect to, any Note when the same shall become due, either by the terms thereof or otherwise as herein provided; or

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(ii) the Company defaults in the payment of any interest on any Note for more than 5 days after the date due; or

(iii) the Company or any Subsidiary defaults (whether as primary obligor or as guarantor or other surety) in any payment of principal of or interest on any other obligation for money borrowed (or any Capitalized Lease Obligation, any obligation under a conditional sale or other title retention agreement, any obligation issued or assumed as full or partial payment for property whether or not secured by a purchase money mortgage or any obligation under notes payable or drafts accepted representing extensions of credit) beyond any period of grace provided with respect thereto, or the Company or any Subsidiary fails to perform or observe any other agreement, term or condition contained in any agreement under which any such obligation is created (or if any other event thereunder or under any such agreement shall occur and be continuing) and the effect of such failure or other event is to cause, or to permit the holder or holders of such obligation (or a trustee on behalf of such holder or holders) to cause, such obligation to become due (or to be repurchased by the Company or any Subsidiary) prior to any stated maturity, provided that the aggregate amount of all obligations as to which any default shall occur and be continuing or any such a failure or other event permitting acceleration (or resale to such Company or any such Subsidiary) shall occur and be continuing exceeds \$500,000; or

(iv) any representation or warranty made by the Company herein or by the Company or any of its officers in any writing furnished in connection with or pursuant to this Agreement shall be false in any material respect on the date as of which made; or

(v) the Company fails to perform or observe any agreement contained in paragraphs 5D or 5J or 6; or

(vi) the Company fails to perform or observe any other agreement, term or condition contained herein and such failure shall not be remedied within 30 days after the occurrence thereof; or

(vii) the Company or any Subsidiary makes an assignment for the benefit of creditors or is generally not paying its debts as such debts become due; or

(viii) any decree or order for relief in respect of the Company or any Subsidiary is entered under any bankruptcy, reorganization, compromise, arrangement, insolvency, readjustment of debt, dissolution or liquidation or similar law, whether now or hereafter in effect (herein called the "Bankruptcy Law"), of any jurisdiction; or

(ix) the Company or any Subsidiary petitions or applies to any tribunal for, or consents to, the appointment of, or taking possession by, a trustee, receiver, custodian, liquidator or similar official of the Company or any Subsidiary, or of any substantial part of the assets of the Company or any Subsidiary, or commences a voluntary case under the Bankruptcy Law of the United States or any proceedings (other than proceedings for the voluntary liquidation and dissolution of a Subsidiary) relating to the Company or any Subsidiary under the Bankruptcy Law of any other jurisdiction; or

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(x) any such petition or application is filed, or any such proceedings are commenced, against the Company or any Subsidiary and the Company or such Subsidiary by any act indicates its approval thereof, consent thereto or acquiescence therein, or an order, judgment or decree is entered appointing any such trustee, receiver, custodian, liquidator or similar official, or approving the petition in any such proceedings, and such order, judgment or decree remains unstayed and in effect for more than 60 days; or

(xi) any judgment or order for the payment of money where the amount not covered by insurance exceeds \$1,000,000 individually or in the aggregate shall be rendered against the Company or any Subsidiary, and either (i) enforcement proceedings shall have been commenced by any creditor upon such judgment or order or (ii) there shall be a period of thirty (30) consecutive days during which a stay of enforcement of such judgment or order, by reason of a pending appeal or otherwise, shall not be in effect; or

(xii) any order, judgment or decree is entered in any proceedings against the Company or any Subsidiary decreeing a split-up of the Company or such Subsidiary which requires the divestiture of assets representing a substantial part, or the divestiture of the stock of a Subsidiary whose assets represent a substantial part, of the consolidated assets of the Company and its Subsidiaries (determined in accordance with generally accepted accounting principles) or which requires the divestiture of assets, or stock of a Subsidiary, which shall have contributed a substantial part of the consolidated net income of the Company and its Subsidiaries (determined in accordance with generally accepted accounting principles) for any of the three fiscal years then most recently ended, and such order, judgment or decree remains unstayed and in effect for more than 60 days; or

(xiii) the Company or any ERISA Affiliate, in its capacity as an employer under a Multiemployer Plan, makes a complete or partial withdrawal from such Multiemployer Plan resulting in the incurrence by such withdrawing employer of a withdrawal liability in an amount exceeding \$1,000,000; or

(xiv) the Company or any Guarantor or any other Person shall disavow or attempt to terminate any or all of the Guaranty Agreements

or any or all of the Guaranty Agreements shall cease to be in full force and effect in whole or in part for any reason whatsoever; or

(xv) the Company or any of its Subsidiaries shall default in the performance or observance of any term, condition or provision of any Major Distribution Agreement that results in, or could reasonably be expected to result in, a Material Adverse Effect; or

(xvi) any non-monetary judgment or order shall be rendered against the Company or any Subsidiary that could reasonably be expected to have a Material Adverse Effect, and there shall be a period of thirty (30) consecutive days during which a stay of enforcement of such judgment or order, by reason of a pending appeal or otherwise, shall not be in effect;

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then:

(a) if such event is an Event of Default specified in clause (i) or (ii) of this paragraph 7A, any holder (other than the Company or any of its Subsidiaries) of any Note may at its option during the continuance of such Event of Default, by notice in writing to the Company, terminate the Facility and/or declare all of the Notes held by such holder to be, and all of the Notes held by such holder shall thereupon be and become, immediately due and payable at par together with interest accrued thereon, without presentment, demand, protest or notice of any kind, all of which are hereby waived by the Company,

(b) if such event is an Event of Default specified in clause (viii), (ix) or (x) of this paragraph 7A with respect to the Company, the Facility shall automatically terminate and all of the Notes at the time outstanding shall automatically become immediately due and payable together with interest accrued thereon and together with the Yield-Maintenance Amount, if any, with respect to each Note, without presentment, demand, protest or notice of any kind, all of which are hereby waived by the Company, and

(c) with respect to any event constituting an Event of Default, the Required Holder(s) of the Notes of any Series may at its or their option during the continuance of such Event of Default, by notice in writing to the Company, terminate the Facility and/or declare all of the Notes of such Series to be, and all of the Notes of such Series shall thereupon be and become, immediately due and payable together with interest accrued thereon and together with the Yield-Maintenance Amount, if any, with respect to each Note of such Series, without presentment, demand, protest or notice of any kind, all of which are hereby waived by the Company.

7B. Rescission of Acceleration. At any time after any or all of the Notes of any Series shall have been declared immediately due and payable pursuant to paragraph 7A, the Required Holder(s) of the Notes of such Series may, by notice in writing to the Company, rescind and annul such declaration and its consequences if:

(i) the Company shall have paid all overdue interest on the Notes of such Series, the principal of and Yield-Maintenance Amount, if any, payable with respect to any Notes of such Series which have become due otherwise than by reason of such declaration, and interest on such overdue interest and overdue principal and Yield-Maintenance Amount at the rate specified in the Notes of such Series,

(ii) the Company shall not have paid any amounts which have become due solely by reason of such declaration,

(iii) all Events of Default and Defaults, other than

non-payment of amounts which have become due solely by reason of such declaration, shall have been cured or waived pursuant to paragraph 11C, and

(iv) no judgment or decree shall have been entered for the payment of any amounts due pursuant to the Notes of such Series or this Agreement.

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No such rescission or annulment shall extend to or affect any subsequent Event of Default or Default or impair any right arising therefrom.

7C. Notice of Acceleration or Rescission. Whenever any Note shall be declared immediately due and payable pursuant to paragraph 7A or any such declaration shall be rescinded and annulled pursuant to paragraph 7B, the Company shall forthwith give written notice thereof to the holder of each Note of each Series at the time outstanding.

7D. Other Remedies. If any Event of Default or Default shall occur and be continuing, the holder of any Note may proceed to protect and enforce its rights under this Agreement and such Note by exercising such remedies as are available to such holder in respect thereof under applicable law, either by suit in equity or by action at law, or both, whether for specific performance of any covenant or other agreement contained in this Agreement or in aid of the exercise of any power granted in this Agreement. No remedy conferred in this Agreement upon the holder of any Note is intended to be exclusive of any other remedy, and each and every such remedy shall be cumulative and shall be in addition to every other remedy conferred herein or now or hereafter existing at law or in equity or by statute or otherwise.

8. REPRESENTATIONS, COVENANTS AND WARRANTIES. The Company represents, covenants and warrants as follows (all references to "Subsidiary" and "Subsidiaries" in this paragraph 8 shall be deemed omitted if the Company has no Subsidiaries at the time the representations herein are made or repeated):

8A. Organization.

(i) The Company is a corporation duly organized and existing in good standing under the laws of the State of Florida, and each Subsidiary is duly organized and existing in good standing under the laws of the jurisdiction in which it is incorporated. Schedule 8A hereto is an accurate and complete list of all Subsidiaries as of the Amendment Closing Day, including the jurisdiction of incorporation and ownership of all such Subsidiaries. The Company and each Subsidiary has the corporate power to own its respective properties and to carry on its respective businesses as now being conducted and is duly qualified and authorized to do business in each other jurisdiction in which the character of its respective properties or the nature of its respective businesses require such qualification or authorization except where the failure to be so qualified or authorized could not reasonably be expected to have a Material Adverse Effect.

(ii) No Subsidiary is a party to, or otherwise subject to, any legal restriction or any agreement restricting the ability of such Subsidiary to pay dividends out of profits or make other similar distributions of profits to the Company or any of its Subsidiaries that owns outstanding shares of Capital Stock or similar equity interests of such Subsidiary.

8B. Financial Statements. The Company has furnished you with the following financial statements, identified by a principal financial officer of the Company:

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(i) a Consolidated balance sheet as at the last day of the fiscal year in each of the years 2000 to 2001, inclusive, a Consolidated statement of income, stockholders' equity and cash flows for each such year, all reported on by Arthur Andersen LLC; and

(ii) a Consolidated balance sheet as at June 30, 2002 and Consolidated statements of income, stockholders' equity and cash flows for the six-month period ended on each such date, prepared by the Company.

Those financial statements (including any related schedules and/or notes) fairly present in all material respects (subject, as to interim statements, to the absence of footnotes or to changes resulting from normal year-end adjustments) the financial condition of the Company and have been prepared in accordance with generally accepted accounting principles consistently applied throughout the periods involved and show all liabilities, direct and contingent, of the Company and its Subsidiaries required to be shown in accordance with such principles. The balance sheets fairly present, in all material respects, the Consolidated financial condition of the Company and its Subsidiaries as at the dates thereof, and the statements of income, stockholders' equity and cash flows fairly present, in all material respects, the Consolidated results of the operations of the Company and its Subsidiaries, the changes in the Company's stockholders' equity and their Consolidated cash flows for the periods indicated. Since December 31, 2001, there have been no changes with respect to the Company and its Subsidiaries which have had or could reasonably be expected to have, singly or in the aggregate, a Material Adverse Effect.

8C.Actions Pending. Except as set forth on Schedule 8C hereto, there is no action, suit, investigation or proceeding pending or, to the knowledge of the Company, threatened against or affecting the Company or any of its Subsidiaries, or any properties or rights of the Company or any of its Subsidiaries, by or before any court, arbitrator or administrative or governmental body (i) as to which there is a reasonable possibility of an adverse determination that could reasonably be expected to have, either individually or in the aggregate, a Material Adverse Effect or (ii) which in any manner draws into question the validity or enforceability of this Agreement or any of the Notes.

8D.Outstanding Debt. Neither the Company nor any of its Subsidiaries has outstanding any Debt except as permitted by paragraphs 6A and 6B(2). There exists no default under the provisions of any instrument evidencing such Debt or of any agreement relating thereto. Schedule 8D hereto (as such Schedule 8D may have been modified from time to time by written supplements thereto delivered by the Company to Prudential) is an accurate and complete list of Debt of the Company and its Subsidiaries on the applicable Closing Day.

8E.Title to Properties. The Company has and each of its Subsidiaries has good and indefeasible title to its respective real properties (other than properties which it leases) and good title to all of its other respective properties and assets, including the properties and assets reflected in the most recent audited balance sheet referred to in paragraph 8B (other than properties and assets disposed of in the ordinary course of business), subject to no Lien of any kind except Liens permitted by paragraph 6B(1). All leases necessary in any material respect for the conduct of the respective businesses of the Company and its Subsidiaries are valid and subsisting and are in full force and effect.

8F.Taxes. The Company has filed and each of its Subsidiaries has filed all federal, state and other income tax returns which, to the best knowledge of the chief financial officer of the Company and its Subsidiaries, are required to be filed, and each has paid all taxes as shown on such returns and on all assessments received by it to the extent that such taxes have become due, except such taxes as are being contested in good faith by appropriate proceedings for which adequate reserves have been established in accordance with generally

accepted accounting principles.

8G. Conflicting Agreements and Other Matters. Neither the Company nor any of its Subsidiaries is a party to any contract or agreement or subject to any charter or other corporate restriction which materially and adversely affects its business, property or assets, condition (financial or otherwise) or operations. Neither the execution nor delivery of this Agreement or the Notes, nor the offering, issuance and sale of the Notes, nor fulfillment of nor compliance with the terms and provisions hereof and of the Notes will conflict with, or result in a breach of the terms, conditions or provisions of, or constitute a default under, or result in any violation of, or result in the creation of any Lien upon any of the properties or assets of the Company or any of its Subsidiaries pursuant to, the charter or by-laws of the Company or any of its Subsidiaries, any award of any arbitrator or any agreement (including any agreement with stockholders), instrument, order, judgment, decree, statute, law, rule or regulation to which the Company or any of its Subsidiaries is subject. Neither the Company nor any of its Subsidiaries is a party to, or otherwise subject to any provision contained in, any instrument evidencing Debt of the Company or such Subsidiary, any agreement relating thereto or any other contract or agreement (including its charter) which limits the amount of, or otherwise imposes restrictions on the incurring of, Debt of the Company or such Subsidiary of the type and in the amount to be evidenced by the Notes except as set forth in the agreements listed in Schedule 8G hereto.

8H. Offering of Notes. Neither the Company nor any agent acting on its behalf has, directly or indirectly, offered the Notes or any similar security of the Company for sale to, or solicited any offers to buy the Notes or any similar security of the Company from, or otherwise approached or negotiated with respect thereto with, any Person other than institutional investors, and neither the Company nor any agent acting on its behalf has taken or will take any action which would subject the issuance or sale of the Notes to the provisions of Section 5 of the Securities Act or to the provisions of any securities or Blue Sky law of any applicable jurisdiction. The Company hereby represents and warrants to you that, within the preceding twelve months, neither the Company nor any other Person acting on behalf of the Company has offered or sold to any Person (other than accredited investors) any Notes, or any securities of the same or a similar class as the Notes, or any other substantially similar securities of the Company.

8I. Use of Proceeds. None of the proceeds of the sale of any Notes will be used, directly or indirectly, for the purpose, whether immediate, incidental or ultimate, of purchasing or carrying any "margin stock" as defined in Regulation U or X (12 C.F.R. Parts 221 and 224) of the Board of Governors of the Federal Reserve System (herein called "margin stock") or for the purpose of maintaining, reducing or retiring any Debt which was originally incurred to purchase or carry any stock that is then currently a margin stock or for any other purpose which might constitute the purchase of such Notes a "purpose credit" within the meaning of such Regulation U, unless the Company shall have delivered to the Purchaser which is purchasing such Notes, on

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the Closing Day for such Notes, an opinion of counsel satisfactory to such Purchaser stating that the purchase of such Notes does not constitute a violation of such Regulation U. Neither the Company nor any agent acting on its behalf has taken or will take any action which might cause this Agreement or the Notes to violate Regulation U, Regulation T or any other regulation of the Board of Governors of the Federal Reserve System or to violate the Exchange Act, in each case as in effect now or as the same may hereafter be in effect. None of the proceeds of the sale of the Notes has been or will be used to finance a Hostile Tender Offer.

8J. ERISA. No accumulated funding deficiency (as defined in Section 302 of ERISA and Section 412 of the Code), whether or not waived, exists with respect to any Plan (other than a Multiemployer Plan). No liability to the Pension Benefit Guaranty Corporation has been or is expected by the Company or



any ERISA Affiliate to be incurred with respect to any Plan (other than a Multiemployer Plan) by the Company, any Subsidiary or any ERISA Affiliate which could reasonably be expected to result in a Material Adverse Effect. Neither the Company, any Subsidiary nor any ERISA Affiliate has incurred or presently expects to incur any withdrawal liability under Title IV of ERISA with respect to any Multiemployer Plan which could reasonably be expected to result in a Material Adverse Effect. The execution and delivery of this Agreement and the issuance and sale of the Notes will be exempt from or will not involve any transaction which is subject to the prohibitions of Section 406 of ERISA and will not involve any transaction in connection with which a penalty could be imposed under Section 502(i) of ERISA or a tax could be imposed pursuant to Section 4975 of the Code. The representation by the Company in the next preceding sentence is made in reliance upon and subject to the accuracy of the representation of each Purchaser in paragraph 9B as to the source of funds to be used by it to purchase any Notes.

8K. Governmental Consent. Neither the nature of the Company or of any Subsidiary, nor any of their respective businesses or properties, nor any relationship between the Company or any Subsidiary and any other Person, nor any circumstance in connection with the offering, issuance, sale or delivery of the Notes is such as to require any authorization, consent, approval, exemption or any action by or notice to or filing with any court or administrative or governmental body (other than routine filings after the Closing Day for any Notes with the Securities and Exchange Commission and/or state Blue Sky authorities) in connection with the execution and delivery of this Agreement, the offering, issuance, sale or delivery of the Notes or fulfillment of or compliance with the terms and provisions hereof or of the Notes.

8L. Environmental Compliance.

(i) The Company and its Subsidiaries and all of their respective Properties have complied at all times (during such period of time the Company or its Subsidiaries have owned or operated each such Property) and in all respects with all Environmental Requirements where failure to comply could reasonably be expected to have a Material Adverse Effect.

(ii) Except as set forth in Schedule 8L, neither the Company nor any of its Subsidiaries (i) has failed to comply with any Environmental Requirement or to obtain, maintain or comply with any permit, license or other approval required under any Environmental Requirement that could reasonably be expected to have, either

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individually or in the aggregate, a Material Adverse Effect, (ii) is subject to any Environmental Liability or Environmental Requirement that could reasonably be expected to have, either individually or in the aggregate, a Material Adverse Effect, (iii) has received notice of any claim with respect to any Environmental Liability that could reasonably be expected to have, either individually or in the aggregate, a Material Adverse Effect or (iv) knows of any basis for any Environmental Liability that could reasonably be expected to have, either individually or in the aggregate, a Material Adverse Effect.

(iii) Except as set forth in Schedule 8L, neither the Company nor any Subsidiary has been designated as a potentially responsible party under CERCLA or under any state statute similar to CERCLA. None of the Properties has been identified on any current or proposed National Priorities List under 40 C.F.R. Section 300 or any list arising from a state statute similar to CERCLA. None of the Properties has been identified on any CERCLIS list.

(iv) No Hazardous Materials have been or are being used, produced, manufactured, processed, generated, stored, disposed of, released, managed at or shipped or transported to or from the

Properties (during such period of time the Company or its Subsidiaries have owned or operated each such Property) or, to the actual knowledge of the Company, are otherwise present at, on, in or under the Properties or, to the actual knowledge of the Company, at or from any adjacent site or facility, except for Hazardous Materials used, produced, manufactured, processed, generated, stored, disposed of, released and managed in the ordinary course of the Company's and any Subsidiary's business in compliance with all applicable Environmental Requirements and except for Hazardous Materials present in amounts which have not required and do not require remediation, pursuant to applicable law or regulation, or if remediation is required, such remediation could not reasonably be expected to have, either individually or in the aggregate, a Material Adverse Effect.

(v) The Company and each Subsidiary have procured all permits necessary under Environmental Requirements for the conduct of their respective businesses or is otherwise in compliance with all applicable Environmental Requirements, except to the extent the failure to do so would not reasonably be expected to have, either individually or in the aggregate, a Material Adverse Effect.

8M. Disclosure. Neither this Agreement nor any other document, certificate or statement furnished to any Purchaser by or on behalf of the Company in connection herewith contains any untrue statement of a material fact or omits to state a material fact necessary in order to make the statements contained herein and therein not misleading. There is no fact peculiar to the Company or any of its Subsidiaries which materially adversely affects or in the future may (so far as the Company can now reasonably foresee) materially adversely affect the business, property or assets, condition (financial or otherwise) or operations of the Company or any of its Subsidiaries and which has not been set forth in this Agreement. The Company has disclosed to the Purchasers all agreements, instruments, and corporate or other restrictions to which the Company or any of its Subsidiaries is subject, and all other matters known to any of

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them, that, individually or in the aggregate, could reasonably be expected to result in a Material Adverse Effect.

8N. Compliance with Laws and Agreements. The Company and each Subsidiary is in compliance with (a) all applicable laws, rules, regulations and orders of any Governmental Authority, and (b) all indentures, agreements or other instruments binding upon it or its properties, except where non-compliance, either singly or in the aggregate, could not reasonably be expected to result in a Material Adverse Effect.

8O. Labor Relations. There are no strikes, lockouts or other material labor disputes or grievances against the Company or any of its Subsidiaries, or, to the Company's knowledge, threatened against or affecting the Company or any of its Subsidiaries, and no significant unfair labor practice, charges or grievances are pending against the Company or any of its Subsidiaries, or to the Company's knowledge, threatened against any of them before any Governmental Authority. All payments due from the Company or any of its Subsidiaries pursuant to the provisions of any collective bargaining agreement have been paid or accrued as a liability on the books of the Company or any such Subsidiary, except where the failure to do so could not reasonably be expected to have a Material Adverse Effect.

8P. Major Distribution Agreements. Schedule 8P sets forth a complete and accurate list of all Major Distribution Agreements of the Company and its Subsidiaries in effect as of the Amendment Closing Day. Other than as set forth in Schedule 8P, each such Major Distribution Agreement is, and after giving effect to the transactions contemplated by the Related Documents will be, in full force and effect in accordance with the terms thereof, and no default has occurred that could reasonably be expected to have a Material Adverse Effect,

and after giving effect to the transactions contemplated by the Related Documents will occur, thereunder. If requested by any Significant Holder, the Company and its Subsidiaries have delivered to such Significant Holder a true and complete copy of each Major Distribution Agreement so requested.

8Q.Solvency. Each of the Company and its Subsidiaries is Solvent and, in executing the Related Documents and consummating the transactions contemplated thereby, neither the Company or any of its Subsidiaries intends to hinder, delay or defraud either present or future creditors or other Persons to which one or more of them is or will become indebted.

8R.Senior Debt. The Obligations constitute senior debt for purposes of all subordinated debt facilities, if any.

#### 9. REPRESENTATIONS OF THE PURCHASERS.

Each Purchaser represents as follows:

9A.Nature of Purchase. Such Purchaser has acquired the Issued Series A Notes and will acquire any Shelf Notes purchased from the Company pursuant to this Agreement for investment for its own account, not as a nominee or agent, and not with a view to, or for resale in connection with, any distribution thereof within the meaning of the Securities Act, provided that the disposition of such Purchaser's property shall at all times be and remain within its control.

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9B. Source of Funds. You represent that at least one of the following statements is an accurate representation as to each source of funds (a "Source") to be used by you to pay the purchase price of the Notes to be purchased by you hereunder:

(a) the Source constitutes assets allocated to your "insurance company general account" (as such term is defined under Section V of the United States Department of Labor's Prohibited Transaction Exemption ("PTE") 95-60), and as of the date of the purchase of the Notes, you satisfy all of the applicable requirements for relief under Sections I and IV of PTE 95-60; or

(b) if you are an insurance company, the Source does not include assets allocated to any separate account maintained by you in which any employee benefit plan (or its related trust) has any interest, other than a separate account that is maintained solely in connection with your fixed contractual obligations under which the amounts payable, or credited, to such plan and to any participant or beneficiary of such plan (including any annuitant) are not affected in any manner by the investment performance of the separate account; or

(c) the Source is either (i) an insurance company pooled separate account, within the meaning PTE 90-1 (issued January 29, 1990), or (ii) a bank collective investment fund, within the meaning of the PTE 91-38 (issued July 12, 1991) and, except as you have disclosed to the Company in writing pursuant to this clause (c), no employee benefit plan or group of plans maintained by the same employer or employee organization beneficially owns more than 10% of all assets allocated to such pooled separate account or collective investment fund; or

(d) the Source constitutes asset of an "investment fund" (within the meaning of Part V of the QPAM Exemption) managed by a "qualified professional asset manager" or "QPAM" (within the meaning of Part V of the QPAM Exemption), no employee benefit plan's assets that are included in such investment fund, when combined with the assets of all other employee benefit plans established or maintained by the same employer or by an affiliate (within the meaning of Section V(c)(1) of the QPAM Exemption) of such employer or by the same employee

organization and managed by such QPAM, exceed 20% of the total client assets managed by such QPAM, the conditions of Part I(c) and (g) of the QPAM Exemption are satisfied, neither the QPAM nor a person controlling or controlled by the QPAM (applying the definition of "control" in Section V(e) of the QPAM Exemption) owns a 5% or more interest in the company and (i) the identity of such QPAM and (ii) the names of all employee benefit plans whose assets are included in such investment fund have been disclosed to the Company in writing pursuant to clause (c); or

(e) the Source is a governmental plan; or

(f) the Source is one or more employee benefit plans, or a separate account or trust fund comprised of one or more employee benefit plans, each of which has been identified to the Company in writing pursuant to this clause (f); or

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(g) the Source does not include assets of any employee benefit plan, other than a plan exempt from the coverage of ERISA.

As used in this paragraph 9B, the terms "employee benefit plan", "governmental plan", "party in interest" and "separate account" shall have the respective meanings assigned to such terms in Section 3 of ERISA.

10. DEFINITIONS; ACCOUNTING MATTERS. For the purpose of this Agreement, the terms defined in paragraphs 10A and 10B (or within the text of any other paragraph) shall have the respective meanings specified therein and all accounting matters shall be subject to determination as provided in paragraph 10C.

10A. Yield-Maintenance Terms.

"Called Principal" shall mean, with respect to any Note, the principal of such Note that is to be prepaid pursuant to paragraphs 4B, 4D or 4F or is declared to be immediately due and payable pursuant to paragraph 7A, as the context requires.

"Designated Spread" shall mean 50 of 1%, except with respect to paragraph 4D it shall mean 1.50 of 1%.

"Discounted Value" shall mean, with respect to the Called Principal of any Note, the amount obtained by discounting all Remaining Scheduled Payments with respect to such Called Principal from their respective scheduled due dates to the Settlement Date with respect to such Called Principal, in accordance with accepted financial practice and at a discount factor (as converted to reflect the periodic basis on which interest on such Note is payable, if payable other than on a semi-annual basis) equal to the Reinvestment Yield with respect to such Called Principal.

"Reinvestment Yield" shall mean, with respect to the Called Principal of any Note, the Designated Spread over the yield to maturity implied by (i) the yields reported as of 10:00 a.m. (New York City local time) on the Business Day next preceding the Settlement Date with respect to such Called Principal for actively traded U.S. Treasury securities having a maturity equal to the Remaining Average Life of such Called Principal as of such Settlement Date on the Treasury Yield Monitor page of Standard & Poor's MMS - Treasury Market Insight (or, if Standard & Poor's shall cease to report such yields in MMS - Treasury Market Insight or shall cease to be Prudential Capital Group's customary source of information for calculating yield-maintenance amounts on privately placed notes, then such source as is then Prudential Capital Group's customary source of such information), or if such yields shall not be reported as of such time or the yields reported as of such time shall not be ascertainable, (ii) the Treasury Constant Maturity Series yields reported, for the latest day for which such yields shall have been so reported as of the Business Day next preceding the Settlement Date with respect to such Called

Principal, in Federal Reserve Statistical Release H.15(519) (or any comparable successor publication) for actively traded U.S. Treasury securities having a constant maturity equal to the Remaining Average Life of such Called Principal as of such Settlement Date. Such implied yield shall be determined, if necessary, by (a) converting U.S. Treasury bill quotations to bond equivalent

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yields in accordance with accepted financial practice and (b) interpolating linearly between yields reported for various maturities. The Reinvestment Yield shall be rounded to that number of decimal places as appears in the coupon of the applicable Note.

"Remaining Average Life" shall mean, with respect to the Called Principal of any Note, the number of years (calculated to the nearest one-twelfth year) obtained by dividing (i) such Called Principal into (ii) the sum of the products obtained by multiplying (a) each Remaining Scheduled Payment of such Called Principal (but not of interest thereon) by (b) the number of years (calculated to the nearest one-twelfth year) which will elapse between the Settlement Date with respect to such Called Principal and the scheduled due date of such Remaining Scheduled Payment.

"Remaining Scheduled Payments" shall mean, with respect to the Called Principal of any Note, all payments of such Called Principal and interest thereon that would be due on or after the Settlement Date with respect to such Called Principal if no payment of such Called Principal were made prior to its scheduled due date.

"Settlement Date" shall mean, with respect to the Called Principal of any Note, the date on which such Called Principal is to be prepaid pursuant to paragraph 4 or is declared to be immediately due and payable pursuant to paragraph 7A, as the context requires.

"Yield-Maintenance Amount" shall mean, with respect to any Note, an amount equal to the excess, if any, of the Discounted Value of the Called Principal of such Note over the sum of (i) such Called Principal plus (ii) interest accrued thereon as of (including interest due on) the Settlement Date with respect to such Called Principal. The Yield-Maintenance Amount shall in no event be less than zero.

10B. Other Terms.

"Acceptance" shall have the meaning specified in paragraph 2G.

"Acceptance Day" shall have the meaning specified in paragraph 2G.

"Acceptance Window" shall have the meaning specified in paragraph 2G.

"Accepted Note" shall have the meaning specified in paragraph 2G.

"Acquisition" shall mean the acquisition of (i) a controlling equity interest in another Person (including the purchase of an option, warrant or convertible or similar type security to acquire such a controlling interest at the time it becomes exercisable by the holder thereof), whether by purchase of such equity interest or upon exercise of an option or warrant for, or conversion of securities into, such equity interest, or (ii) assets of another Person which constitute all or substantially all of the assets of such Person or of a line or lines of business conducted by such Person.

"Affiliate" shall mean any Person (i) which directly or indirectly through one or more intermediaries controls, or is controlled by, or is under common control with the Company; or (ii) which beneficially owns or holds 5% or more of the aggregate voting rights for all of Company's classes or outstanding Voting Stock (or in the case of a Person which is not a corporation, 5% or more of the aggregate voting rights of such Person) of the Company, or 5% or more of any class of the outstanding Voting Stock (or in the case of a Person which is

corporation, 5% or more of the aggregate voting rights of such Person) of which is beneficially owned or held by the Company. The term "control" means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a Person, whether through ownership of voting stock, by contract or otherwise.

"Amendment Closing Day" shall have the meaning specified in paragraph 3.

"Authorized Officer" shall mean (i) in the case of the Company, its chief executive officer, its president and chief operating officer, its chief financial officer, any vice president of the Company designated as an "Authorized Officer" of the Company in the Information Schedule attached hereto or any vice president of the Company designated as an "Authorized Officer" of the Company for the purpose of this Agreement in an Officer's Certificate executed by the Company's chief executive officer or chief financial officer and delivered to Prudential, and (ii) in the case of Prudential, any officer of Prudential designated as its "Authorized Officer" in the Information Schedule or any officer of Prudential designated as its "Authorized Officer" for the purpose of this Agreement in a certificate executed by one of its Authorized Officers. Any action taken under this Agreement on behalf of the Company by any individual who on or after the date of this Agreement shall have been an Authorized Officer of the Company and whom Prudential reasonably in good faith believes to be an Authorized Officer of the Company at the time of such action shall be binding on the Company even though such individual shall have ceased to be an Authorized Officer of the Company, and any action taken under this Agreement on behalf of Prudential by any individual who on or after the date of this Agreement shall have been an Authorized Officer of Prudential and whom the Company reasonably in good faith believes to be an Authorized Officer of Prudential at the time of such action shall be binding on Prudential even though such individual shall have ceased to be an Authorized Officer of Prudential.

"Available Facility Amount" shall have the meaning specified in paragraph 2B.

"Bank Agreement" shall mean the Revolving Credit Agreement, dated as of April 19, 2002, among the Company, the lenders party thereto and SunTrust Bank, as Administrative Agent, as it may be amended, modified or supplemented, or replaced or refinanced, from time to time.

"Bankruptcy Law" shall have the meaning specified in clause (viii) of paragraph 7A.

"Business Day" shall mean any day other than (i) a Saturday or a Sunday, (ii) a day on which commercial banks in States of New York and Florida are required or authorized to be closed and (iii) for purposes of paragraph 2E hereof only, a day on which Prudential is not open for business.

"Cancellation Date" shall have the meaning specified in paragraph 2J(4).

"Cancellation Fee" shall have the meaning specified in paragraph 2J(4).

"Capital Stock" shall mean (a) in the case of a corporation, capital stock, (b) in the case of an association or business entity, any and all shares, interests, participations, rights or other equivalents (however designated) of capital stock, (c) in the case of a partnership, partnership interests (whether general or limited), (d) in the case of a limited liability company, membership

interests and (e) any other interest or participation that confers on a Person the right to receive a share of the profits and losses of, or distributions of assets of, the issuing Person.

"Capitalized Lease Obligation" shall mean any rental obligation which, under generally accepted accounting principles, is or will be required to be capitalized on the books of the Company or any Subsidiary, taken at the amount thereof accounted for as indebtedness (net of interest expenses) in accordance with such principles.

"CERCLA" shall mean the Comprehensive Environmental Response, Compensation and Liability Act.

"CERCLIS" shall mean the Comprehensive Environmental Response, Compensation and Liability Inventory System established pursuant to CERCLA.

"Change in Control" shall mean, at any time:

(a) with respect to the Company:

(i) any "person" or "group" (each as used in Sections 13(d)(3) and 14(d)(2) of the Exchange Act) other than Albert Nahmad and Alna Capital Associates (each an "Existing Control Group") either (A) becomes the "beneficial owner" (as defined in Rule 13d-3 of the Exchange Act), directly or indirectly, of Voting Stock of the Company (or securities convertible into or exchangeable for such Voting Stock) representing twenty-five percent (25%) or more of the combined voting power of all Voting Stock of the Company (on a fully diluted basis) or (B) otherwise has the ability, directly or indirectly, to elect a majority of the board of directors of the Company (provided, that if an event described in this clause (i) shall occur solely by reason of the death of one or more members of the Existing Control Group, then a "Change of Control" shall not be deemed to have occurred so long as the Voting Stock of the decedent is owned of record by the estate or immediate family of such decedent);

(ii) during any period of up to twenty-four (24) consecutive months, commencing on April 19, 2002, individuals who at the beginning of such twenty-four (24)-month period were directors of the Company shall cease for any reason (other than the death, disability or retirement of a director or of an officer of the Company that is serving as a director at such time so long as another officer of the Company replaces such Person as a director) to constitute a majority of the board of directors of the Company; or

(iii) any Person or two or more Persons acting in concert other than the Existing Control Group shall have acquired by contract or otherwise, or shall have consummated a contract or arrangement that results in its or their acquisition of

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the power to exercise, directly or indirectly, a controlling influence on the management or policies of the Company; or

(iv) with respect to any Major Subsidiary,

(1) the Company shall cease to own, directly or indirectly, at least 100% of the Voting Stock of each currently existing Major Subsidiary or any other Subsidiary that is or becomes a Major Subsidiary after the date hereof; or

(vii) any Person or two or more Persons acting in concert other than the Company shall have acquired by contract or

otherwise, or shall have consummated a contract or arrangement that results in its or their acquisition of the power to exercise, directly or indirectly, a controlling influence on the management or policies of such Major Subsidiary.

"Closing Day" shall mean with respect to any Accepted Note, the Business Day specified for the closing of the purchase and sale of such Accepted Note in the Request for Purchase of such Accepted Note, provided that (i) if the Company and the Purchaser which is obligated to purchase such Accepted Note agree on an earlier Business Day for such closing, the "Closing Day" for such Accepted Note shall be such earlier Business Day, and (ii) if the closing of the purchase and sale of such Accepted Note is rescheduled pursuant to paragraph 2I, the Closing Day for such Accepted Note, for all purposes of this Agreement except references to "original Closing Day" in paragraph 2J(3), shall mean the Rescheduled Closing Day with respect to such Accepted Note.

"Code" shall mean the Internal Revenue Code of 1986, as amended from time to time, and the rules and regulations promulgated thereunder from time to time.

"Confirmation of Acceptance" shall have the meaning specified in paragraph 2G.

"Consolidated" shall mean, with respect to any item of financial information, the item of financial information for the Company and its Subsidiaries consolidated in accordance with generally accepted accounting principles.

"Consolidated Current Assets" shall mean, as of any date, the sum of (a) cash and cash equivalents that would be reflected on the Company's consolidated balance sheet as of such date prepared in accordance with generally accepted accounting principles, (b) accounts receivable (including the current portion of any notes receivable) that would be reflected on the Company's consolidated balance sheet as of such date prepared in accordance with generally accepted accounting principles, and (c) inventory that would be reflected on the Company's consolidated balance sheet as of such date prepared in accordance with generally accepted accounting principles.

"Consolidated Debt" shall mean, as of any date of determination, without duplication, all Debt of the Company and its Subsidiaries (other than as described in subsection (j) under the definition of "Debt" herein), determined on a consolidated basis in accordance with generally

accepted accounting principles. For purposes of determining "Consolidated Debt," the principal amount of any Synthetic Lease Obligation shall be deemed to be the amount that would be reflected on the balance sheet of the Company and its Subsidiaries if such Synthetic Lease Obligation were characterized as a capital lease rather than an operating lease.

"Consolidated EBIT" shall mean, for the Company and its Subsidiaries for any period ending on the date of computation thereof, an amount equal to the sum of (a) Consolidated Net Income for such period plus (b) to the extent deducted in determining Consolidated Net Income for such period, (i) Consolidated Interest Expense, (ii) income tax expense, (iii) for the period ended September 30, 2001 only, a one-time restructuring charge in the amount of \$6,022,000, and (iv) for any period ending on or prior to June 30, 2002, any non-cash charges resulting from the implementation of FAS 142, determined on a consolidated basis in accordance with generally accepted accounting principles in each case for such period; provided, however, that with respect to an acquisition that is accounted for as a "purchase", for the period of four full consecutive fiscal quarters of the Company ending next following the date of such acquisition, "Consolidated EBIT" shall include the results of operations of the Person or assets so acquired, which amounts shall be determined on a historical pro forma basis as if such acquisition had been consummated as a



"pooling of interests".

"Consolidated EBITDA" shall mean, for the Company and its Subsidiaries for any period ending on the date of computation thereof, an amount equal to the sum of (a) Consolidated Net Income for such period plus (b) to the extent deducted in determining Consolidated Net Income for such period, (i) Consolidated Interest Expense, (ii) income tax expense, (iii) depreciation and amortization and (iv) for the period ended September 30, 2001 only, a one-time restructuring charge in the amount of \$6,022,000, and (iv) for any period ending on or prior to June 30, 2002, any non-cash charges resulting from the implementation of FAS 142, determined on a consolidated basis in accordance with generally accepted accounting principles in each case for such period; provided, however, that with respect to an acquisition that is accounted for as a "purchase", for the period of four full consecutive fiscal quarters of the Company ending next following the date of such acquisition, "Consolidated EBITDA" shall include the results of operations of the Person or assets so acquired, which amounts shall be determined on a historical pro forma basis as if such acquisition had been consummated as a "pooling of interests".

"Consolidated Interest Expense" shall mean, for the Company and its Subsidiaries for any period ending on the date of computation thereof, determined on a consolidated basis in accordance with generally accepted accounting principles, the sum of (a) total cash interest expense, including without limitation, the interest component of any payments in respect of Capitalized Lease Obligations during such period (whether or not actually paid during such period) plus (b) the net amount payable (or minus the net amount receivable) under Hedging Agreements during such period (whether or not actually paid or received during such period).

"Consolidated Net Income" shall mean, for any period, the net income (or loss) of the Company and its Subsidiaries for such period determined on a consolidated basis in accordance with generally accepted accounting principles, but excluding therefrom (to the extent otherwise included therein) (a) any extraordinary gains or losses, (b) any gains attributable to write-ups of assets, (c) any equity interest of the Company or any Subsidiary in the unremitted earnings of

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any Person that is not a Subsidiary and (d) any income (or loss) of any Person accrued prior to the date it becomes a Subsidiary or is merged into or consolidated with the Company or any Subsidiary on the date that such Person's assets are acquired by the Company or any Subsidiary.

"Consolidated Net Worth" shall mean, as of any date, (a) the total assets of the Company and its Subsidiaries that would be reflected on the Company's consolidated balance sheet as of such date prepared in accordance with generally accepted accounting principles, after eliminating (i) all amounts properly attributable to minority interests, if any, in the stock and surplus of Subsidiaries and (ii) any non-cash asset impairment charges taken by Company solely as a result of the application to Company's financial statements of FAS 142, minus (b) the total liabilities of the Company and its Subsidiaries that would be reflected on the Company's consolidated balance sheet as of such date prepared in accordance with generally accepted accounting principles.

"Consolidated Total Assets" shall mean the aggregate amount carried as total assets on the books of the Company and its Subsidiaries, on a consolidated basis and after eliminating all inter-company items, in accordance with generally accepted accounting principles.

"Consolidated Total Capitalization" shall mean, at any time, the sum of (i) Consolidated Debt at such time plus (ii) Consolidated Net Worth at such time.

"Consolidated Total Revenues" shall mean, for the Company and its Subsidiaries for any period ending on the date of computation thereof,

determined on a consolidated basis in accordance with generally accepted accounting principles, the total revenues of the Company and its Subsidiaries for such period.

"Debt" with respect to any Person means, at any time, without duplication,

- (a) its liabilities for borrowed money;
- (b) its liabilities for the deferred purchase price of property or services other than trade payables incurred in the ordinary course of business; provided, that trade payables overdue by more than one hundred twenty (120) days shall be included in this definition except to the extent that any of such trade payables are being disputed in good faith and by appropriate measures);
- (c) all liabilities created or arising under any conditional sale or other title retention agreement(s) relating to property acquired by such Person;
- (d) its Capitalized Lease Obligations;
- (e) all liabilities, contingent or otherwise, in respect of letters of credit, acceptances or similar extensions of credit;
- (f) all liabilities for borrowed money secured by any Lien with respect to any property owned by such Person (whether or not it has assumed or otherwise become liable for such liabilities);

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- (g) any Guaranty of such Person with respect to liabilities of a type described in any of clauses (a) through (f) hereof;
- (h) all liabilities, contingent or otherwise, to purchase, redeem, retire or otherwise acquire for value any common stock of such Person;
- (i) Off-Balance Sheet Liabilities;
- (j) liabilities under any Hedging Agreements; and
- (k) all Securitization Transactions.

Debt of any Person shall include the Debt of any other entity (including any partnership in which such Person is a general partner) to the extent such Person is liable therefor as a result of such Person's ownership interest in or other relationship with such entity, except to the extent the terms of such Debt provide that such Person is not liable therefor.

"Delayed Delivery Fee" shall have the meaning specified in paragraph 2J(3).

"Eligible Securities" shall mean the following obligations and any other obligations previously approved in writing by the Required Holders:

- (a) Government Securities;
- (b) certificates of deposits, bankers' acceptances and time deposits maturing within 180 days from the date of acquisition thereof and issued or guaranteed by or placed with, and money market deposit accounts issued or offered by, any domestic office of any commercial bank organized under the laws of the United States or of any state thereof which has a combined capital surplus and undivided profits of not less than \$500,000,000;

(c) fully collateralized repurchase agreements with a term of not more than thirty (30) days for securities described in clause (a) above and entered into with a financial institution satisfying the criteria described in clause (b) above;

(d) commercial paper having the highest rating, at the time of acquisition thereof, of S&P or Moody's and in either case maturing within six (6) months from the date of acquisition thereof;

(e) shares of mutual funds which invest solely in any one or more of the obligations described in clauses (a) through (e) above;

(f) subject to the limitation set forth in paragraph 6H, equity or debt securities which are listed on a national securities exchange or freely traded in the over-the-counter market so long as the fair market value of such securities do not exceed in the aggregate \$5,000,000.

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"Environmental Authority" shall mean any foreign, federal, state, local or regional government that exercises any duly authorized form of jurisdiction or authority under any Environmental Requirement.

"Environmental Judgments and Orders" shall mean all judgments, decrees or orders arising from or in any way associated with any Environmental Requirements, whether or not entered upon consent or written agreements with an Environmental Authority or other duly authorized entity arising from or in any way associated with any Environmental Requirement, whether or not incorporated in a judgment, degree or order.

"Environmental Liabilities" shall mean any liabilities, contingent or otherwise (including any liability for damages, costs of environmental investigation and remediation, costs of administrative oversight, fines, natural resource damages, penalties or indemnities), of the Company or any Subsidiary directly or indirectly resulting from or based upon (a) any actual or alleged violation of any Environmental Law, (b) the generation, use, handling, transportation, storage, treatment or disposal of any Hazardous Materials, (c) any actual or alleged exposure to any Hazardous Materials, (d) the Release or threatened Release of any Hazardous Materials or (e) any contract, agreement or other consensual arrangement pursuant to which liability is assumed or imposed with respect to any of the foregoing.

"Environmental Notices" shall mean any written communication from any Environmental Authority stating possible or alleged noncompliance with or possible or alleged liability under any Environmental Requirement, including without limitation any complaints, citations, demands or requests from any Environmental Authority for correction of any purported violation of any Environmental Requirements or any investigation concerning any purported violation of any Environmental Requirements. Environmental Notices also shall mean (i) any written communication from any other Person threatening litigation or administrative proceedings against or involving the Company relating to alleged violation of any Environmental Requirements and (ii) any complaint, petition or similar documents filed by any other Person commencing litigation or administrative proceedings against or involving the Company relating to alleged violation of any Environmental Requirements.

"Environmental Proceedings" shall mean any judicial or administrative proceedings arising from or in any way associated with any Environmental Requirement.

"Environmental Releases" shall mean releases (as defined in CERCLA or under any applicable state or local environmental law or regulation) of Hazardous Materials. Environmental Releases does not include releases for which no remediation or reporting is required by applicable Environmental Requirements and which do not present a danger to health, safety or the environment.

"Environmental Requirements" shall mean any applicable local, state or federal law, rule, regulation, permit, order, decision, determination or requirement relating in any way to Hazardous Materials or to health, safety or the environment.

"Equity Issuance" shall mean any issuance by the Company or any Subsidiary to any Person which is not a Guarantor of (a) shares of its Capital

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Stock, (b) any shares of its Capital Stock pursuant to the exercise of options or warrants or (c) any shares of its Capital Stock pursuant to the conversion of any debt securities to equity (excluding in the case of clauses (a) and (b) hereof the issuance of any such shares by the Company under or in connection with its employee stock purchase plan or pursuant to the exercise of employee or director stock options).

"ERISA" shall mean the Employee Retirement Income Security Act of 1974, as amended.

"ERISA Affiliate" shall mean any corporation which is a member of the same controlled group of corporations as the Company within the meaning of Section 414(b) of the Code, or any trade or business which is under common control with the Company within the meaning of section 414(c) of the Code.

"ERISA Event" shall mean (a) any "reportable event", as defined in Section 4043 of ERISA or the regulations issued thereunder with respect to a Plan (other than an event for which the 30-day notice period is waived); (b) the existence with respect to any Plan of an "accumulated funding deficiency" (as defined in Section 412 of the Code or Section 302 of ERISA), whether or not waived; (c) the filing pursuant to Section 412(d) of the Code or Section 303(d) of ERISA of an application for a waiver of the minimum funding standard with respect to any Plan; (d) the incurrence by the Company or any of its ERISA Affiliates of any liability under Title IV of ERISA with respect to the termination of any Plan; (e) the receipt by the Company or any ERISA Affiliate from the PBGC or a plan administrator appointed by the PBGC of any notice relating to an intention to terminate any Plan or Plans or to appoint a trustee to administer any Plan; (f) the incurrence by the Company or any of its ERISA Affiliates of any liability with respect to the withdrawal or partial withdrawal from any Plan or Multiemployer Plan; or (g) the receipt by the Company or any ERISA Affiliate of any notice, or the receipt by any Multiemployer Plan from the Company or any ERISA Affiliate of any notice, concerning the imposition of Withdrawal Liability or a determination that a Multiemployer Plan is, or is expected to be, insolvent or in reorganization, within the meaning of Title IV of ERISA.

"ERISA Lien" shall mean any mortgage, pledge, security interest, encumbrance, deposit arrangement, lien (statutory or otherwise) or charge of any kind (including any agreement to give any of the foregoing) or any other type of preferential arrangement protecting a creditor or securing an obligation associated with the Employee Retirement Income Security Act of 1974.

"Event of Default" shall mean any of the events specified in paragraph 7A, provided that there has been satisfied any requirement in connection with such event for the giving of notice, or the lapse of time, or the happening of any further condition, event or act, and "Default" shall mean any of such events, whether or not any such requirement has been satisfied.

"Exchange Act" shall mean the Securities Exchange Act of 1934, as amended.

"Facility" shall have the meaning specified in paragraph 2B.

"Facility Fee" shall have the meaning specified in paragraph 2J(1).

"Fair Market Value" shall mean, at any time, the sale value of property that would be realized in an arm's-length sale at such time between an informed and willing buyer, and an informed and willing seller, under no compulsion to buy or sell, respectively.

"Governmental Authority" shall mean any Federal, state, municipal, local, national or other governmental department, commission, board, bureau, court, agency or instrumentality or political subdivision thereof or any entity or officer exercising executive, legislative, judicial, regulatory or administrative functions of or pertaining to any government or any court, in each case whether associated with a State of the United States, the United States, or a foreign entity or government.

"Government Securities" shall mean direct obligations of, or obligations the timely payment of principal and interest on which are fully and unconditionally guaranteed by, the United States of America (or by any agency thereof to the extent such obligations are backed by the full faith and credit of the United States), in each case maturing within one year from the date of acquisition thereof.

"Guarantors" shall mean, collectively, the Subsidiaries of the Company listed on Schedule 10B and any Subsidiary that becomes a Guarantor in accordance with paragraph 5D hereof.

"Guaranty" or "Guarantee" shall mean, with respect to any Person, any obligation (except the endorsement in the ordinary course of business of negotiable instruments for deposit or collection) of such Person guaranteeing or in effect guaranteeing any indebtedness, dividend or other obligation of any other Person in any manner, whether directly or indirectly, including (without limitation) obligations incurred through an agreement, contingent or otherwise, by such Person:

- (i) to purchase such indebtedness or obligation or any property constituting security therefor;
- (ii) to advance or supply funds for the purchase or payment of such indebtedness or obligation, or to maintain any working capital or other balance sheet condition or any income statement condition of any Person or otherwise to advance or make available funds for the purchase or payment of such indebtedness or obligation;
- (iii) to lease properties or to purchase properties or services primarily for the purpose of assuring the owner of such indebtedness or obligation of the ability of any other Person to make payment of the indebtedness or obligation; or
- (iv) otherwise to assure the owner of such indebtedness or obligation against loss in respect thereof.

In any computation of the indebtedness or other liabilities of the obligor under any Guaranty, the indebtedness or other obligations that are the subject of such Guaranty shall be assumed to be direct obligations of such obligor.

"Guaranty Agreement" shall mean any one of the Guaranty Agreements.

"Guaranty Agreements" shall mean collectively, each Guaranty Agreement, in substantially the form of Exhibit E hereto, dated as of the date hereof (in the case of the Guarantors listed on Schedule 10(B) or dated the date upon which a Subsidiary of the Company becomes a Guarantor in accordance with paragraph 5D, executed and delivered by each Guarantor in each case in connection with this

Agreement, as such Guaranty Agreement may be amended, restated modified or supplemented from time to time in accordance with its terms.

"Hazardous Materials" shall mean (a) hazardous waste as defined in the Resource Conservation and Recovery Act of 1976, or in any applicable federal, state or local law or regulation, (b) hazardous substances, as defined in CERCLA, or in any applicable state or local law or regulation, (c) gasoline, or any other petroleum product or by-product, (d) toxic substances, as defined in the Toxic Substances Control Act of 1976, or in any applicable federal, state or local law or regulation or (e) insecticides, fungicides, or rodenticides, as defined in the Federal Insecticide, Fungicide, and Rodenticide Act of 1975, or in any applicable federal, state or local law or regulation, as each such Act, statute or regulation may be amended from time to time.

"Hedge Treasury Note(s)" shall mean, with respect to any Accepted Note, the United States Treasury Note or Notes whose duration (as determined by Prudential) most closely matches the duration of such Accepted Note.

"Hedging Agreements" shall mean interest rate swap, cap or collar agreements, interest rate future or option contracts, currency swap agreements, currency future or option contracts, foreign exchange agreements, commodity agreements and other similar agreements or arrangements designed to protect against fluctuations in interest rates, currency values or commodity values.

"Hostile Tender Offer" shall mean, with respect to the use of proceeds of any Note, any offer to purchase, or any purchase of, shares of capital stock of any corporation or equity interests in any other entity, or securities convertible into or representing the beneficial ownership of, or rights to acquire, any such shares or equity interests, if such shares, equity interests, securities or rights are of a class which is publicly traded on any securities exchange or in any over-the-counter market, other than purchases of such shares, equity interest, securities or rights representing less than 5% of the equity interests or beneficial ownership of such corporation or other entity for portfolio investment purposes, and such offer or purchase has not been duly approved by the board of directors of such corporation or the equivalent governing body of such other entity prior to the date on which the Company makes the Request for Purchase of such Note.

"including" shall mean, unless the context clearly requires otherwise, "including without limitation".

"Institutional Investors" shall mean (i) any bank, savings bank, savings and loan association or insurance company, (ii) any pension plan or portfolio or investment fund managed or administered by any bank, savings bank, savings and loan association or insurance company,

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(iii) any investment company owned by any bank, savings bank, savings and loan association or insurance company, the majority of the shares of the capital stock of which are traded on a national securities exchange or in the National Association of Securities Dealers automated quotation system, or (iv) any investment banking company.

"Intangibles" shall mean goodwill, patents, trademarks, trade names, organization expense, licenses, franchises, exploration permits and import and export permits and other like intangibles, determined in accordance with generally accepted accounting principles.

"Interest Coverage Ratio" shall mean as of any date of determination with respect to the Company, the ratio of (a) Consolidated EBIT as of such date to (b) Consolidated Interest Expense as of such date.

"Investment" shall mean, when used with respect to any Person, any direct or indirect advance, loan or other extension of credit or capital contribution by such Person (by means of transfers of property to others or

payments for property or services for the account or use of others, or otherwise) to any other Person, or any direct or indirect purchase or other acquisition or beneficial ownership by such Person of, or of a beneficial interest in, Capital Stock, partnership interests, bonds, notes, debentures or other securities issued by any other Person or the assumption of any liability of any other Person.

"Issuance Period" shall have the meaning specified in paragraph 2C.

"Issued Series A Note" shall have the meaning specified in paragraph 1A.

"Lien" shall mean any interest in property securing any obligation owed to, or a claim by, a Person other than the owner of the property, whether such interest is based on the common law, statute or contract, and including but not limited to the lien or security interest arising from a mortgage, encumbrance, pledge, security agreement, conditional sale or trust receipt or a lease, consignment or bailment for security purposes. For the purposes of this Agreement, the Company and any Subsidiary shall be deemed to be the owner of any property which it has acquired or holds subject to a conditional sale agreement, financing lease, or other arrangement pursuant to which title to the property has been retained by or vested in some other Person for security purposes.

"Major Distribution Agreements" shall mean those agreements identified on Schedule 8P.

"Major Subsidiary" shall mean, collectively, (a) Air Systems Distributors, Inc., a Florida corporation, Atlantic Service & Supply, Inc., a Delaware corporation, Baker Distributing Company, a Florida corporation, CAD Watsco, Inc., a Florida corporation, Coastline Distribution, Inc., a Delaware corporation, Comfort Supply, Inc., a Delaware corporation, CP Distributors, Inc., a Florida corporation, Gemaire Distributors, Inc., a Florida corporation, H.B. Adams Distributors, Inc., a Florida corporation, Heat, Incorporated, a New Hampshire corporation, Heating & Cooling Supply, Inc., a California corporation, Homans Associates Inc., a Massachusetts corporation, Three States Supply, Inc., a Tennessee corporation, and Weathertrol Supply Company, a North Carolina corporation, and (b) any other direct or indirect

Subsidiary of the Company having at any time: (i) assets in an amount equal to at least 5% of the Consolidated Total Assets of the Company and its Subsidiaries determined as of the last day of the most recent fiscal quarter of the Company as reflected in the Company's most recent financial statements required by paragraphs 5A(1)(i) or (ii); or (ii) revenues or net income in an amount equal to at least 5% of the Consolidated Total Revenues or Consolidated Net Income of the Company and its Subsidiaries for the 12-month period ending on the last day of the most recent fiscal quarter of the Company as reflected in the Company's most recent financial statements required by paragraphs 5A(1)(i) or (ii).

"Material Adverse Effect" shall mean, with respect to any event, act, condition or occurrence of whatever nature (including any adverse determination in any litigation, arbitration, or governmental investigation or proceeding), whether singly or in conjunction with any other event or events, act or acts, condition or conditions, occurrence or occurrences whether or not related, a material adverse change in, or a material adverse effect on, (a) the business, results of operations, financial condition, assets, liabilities or prospects of the Company and of the Company and its Subsidiaries, taken as a whole, (b) the ability of the Company to perform any of its obligations under this Agreement, the Note or any other Related Document, (c) the rights and remedies of the Purchasers under this Agreement, the Notes or any other Related Document or (d) the legality, validity or enforceability of any of the Related Documents.

"Material Debt" shall mean Debt (other than the Notes) or obligations in respect of one or more Hedging Agreements, to a single Person and such Person's Affiliates of an aggregate principal amount exceeding \$1,000,000. For

purposes of determining "Material Debt," the "principal amount" of the obligations of the Company or any Subsidiary in respect to any Hedging Agreement at any time shall be the maximum aggregate amount (giving effect to any netting agreements) that the Company or such Subsidiary would be required to pay if such Hedging Agreement were terminated at such time.

"Moody's" shall mean Moody's Investors Service, Inc. or any successor thereto.

"Material Provision" shall have the meaning specified in paragraph 5J.

"Multiemployer Plan" shall mean any Plan which is a "multiemployer plan" (as such term is defined in Section 4001(a)(3) of ERISA).

"Net Cash Proceeds" shall mean the aggregate cash proceeds received by the Company or any Subsidiary in respect of any Equity Issuance or Securitization Transaction, net of (a) direct costs (including, without limitation, legal, accounting and investment banking fees and sales commissions), and (b) taxes paid or payable as a result thereof; it being understood that "Net Cash Proceeds" shall include, without limitation, any cash received upon the sale or other disposition of any non-cash consideration received by the Company or any Subsidiary in any Equity Issuance or Securitization Transaction.

"Notes" shall have the meaning specified in paragraph 1.

"Off-Balance Sheet Liabilities" of any Person shall mean (a) any repurchase obligation or liability of such Person with respect to accounts or notes receivable sold by such Person, (b)

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any liability of such Person under any sale and leaseback transactions which do not create a liability on the balance sheet of such Person, (c) any Synthetic Lease Obligation or (d) any obligation arising with respect to any other transaction which is the functional equivalent of or takes the place of borrowing but which does not constitute a liability on the balance sheet of such Person.

"Officer's Certificate" shall mean a certificate signed in the name of the Company by its President, one of its Vice Presidents or its Treasurer.

"Person" shall mean and include an individual, a partnership, a joint venture, limited liability company, a corporation, a trust, an unincorporated organization and a government or any department or agency thereof.

"Plan" shall mean any employee pension benefit plan (as such term is defined in Section 3 of ERISA) which is or has been established or maintained, or to which contributions are or have been made, by the Company or any ERISA Affiliate.

"Priority Debt" shall mean with respect to any Person, at any time, without duplication, the sum of

(i) Debt of each Subsidiary (other than (a) Debt described in clause (vii) of paragraph 6B(2), (b) Debt held by the Company, any Guarantor or another wholly-owned Subsidiary, or (c) Debt of any Subsidiary which constitutes Debt of such Subsidiary because it is a Guaranty of Debt of the Company); and

(ii) Debt of such Subsidiary secured by any Lien other than a Lien described in clauses (ii), (iii) or (v) of paragraph 6B(1).

"Properties" shall mean all real property owned, leased or otherwise used or occupied by the Company or any Subsidiary, wherever located.



"Prudential" shall mean The Prudential Insurance Company of America.

"Prudential Affiliate" shall mean (i) any corporation or other entity controlling, controlled by, or under common control with, Prudential and (ii) any managed account or investment fund which is managed by Prudential or a Prudential Affiliate described in clause (i) of this definition. For purposes of this definition the terms "control", "controlling" and "controlled" shall mean the ownership, directly or through subsidiaries, of a majority of a corporation's or other entity's Voting Stock or equivalent voting securities or interests.

"Purchasers" shall mean with respect to any Accepted Notes, Prudential and/or the Prudential Affiliate(s), which are purchasing such Accepted Notes.

"QPAM Exemption" shall mean Prohibited Transaction Class Exemption 84-14 issued by the United States Department of Labor.

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"Receivables" shall mean accounts receivable (including, without limitation, all rights to payment created or arising from the sales of goods, leases of goods or the rendition of services, no matter how evidenced and whether or not earned by performance).

"Related Documents" shall mean this Agreement, any Note, each Guaranty Agreement and any document or instrument executed in connection with any of the foregoing.

"Rentals" shall mean for any period of determination all fixed rents or charges (including as such all payments during any such period of determination which the lessee is obligated to make on termination of the lease or surrender of the property) payable by the Company or a Subsidiary (as lessee, sublessee, licensee, franchisee or the like) for such period under a lease, license, or other agreement for the use or possession of real or personal property, tangible or intangible, as determined in accordance with generally accepted accounting principles.

"Request for Purchase" shall have the meaning specified in paragraph 2E.

"Required Holder(s)" shall mean the holder or holders of at least 66-2/3% of the aggregate principal amount of the Notes or of a Series of Notes, as the context may require, from time to time outstanding.

"Rescheduled Closing Day" shall have the meaning specified in paragraph 2I.

"Responsible Officer" shall mean the chief executive officer, chief operating officer, chief financial officer or chief accounting officer of the Company, general counsel of the Company or any other officer of the Company involved principally in its financial administration or its controllership function.

"S&P" shall mean Standard & Poor's Rating Group or any successor thereto.

"Securities Act" shall mean the Securities Act of 1933, as amended.

"Securitization Transaction" shall mean (a) any transfer by the Company or any Subsidiary of Receivables or interests therein and all collateral securing such Receivables, all contracts and contract rights and all guarantees or other obligations in respect of such Receivables, all other assets that are customarily transferred or in respect of which security interests are customarily granted in connection with asset securitization transactions involving such Receivables and all proceeds of any of the foregoing (i) to a trust, partnership, corporation or other entity (other than the Company or a

Subsidiary other than a SPE Subsidiary), which transfer is funded in whole or in part, directly or indirectly, by the incurrence or issuance by the transferee or any successor transferee of indebtedness or other securities that are to receive payments from, or that represent interests in, the cash flow derived from such Receivables or interests in Receivables, or (ii) directly to one or more investors or other purchasers (other than the Company or any Subsidiary), or (b) any transaction in which the Company or a Subsidiary incurs Debt or other obligations secured by Liens on Receivables. The "amount" or "principal amount" of any Securitization Transaction shall be deemed at any time to be (x) in the case of a transaction described in clause (a) of the preceding sentence, the aggregate principal or stated amount of the Debt or other securities referred to in such clause or, if there shall be no such

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principal or stated amount, the uncollected amount of the Receivables transferred pursuant to such Securitization Transaction net of any such Receivables that have been written off as uncollectible, and (y) in the case of a transaction described in clause (b) of the preceding sentence, the aggregate outstanding principal amount of the Debt secured by Liens on the subject Receivables.

"Series" shall have the meaning specified in paragraph 1.

"Shelf Note(s)" shall have the meaning specified in paragraph 1B.

"Significant Holder" shall mean (i) Prudential, so long as Prudential or any Prudential Affiliate shall hold (or be committed under this Agreement to purchase) any Note, or (ii) any other holder of at least 10% of the aggregate principal amount of the Notes of any Series from time to time outstanding.

"Solvent" or "Solvency" shall mean, with respect to any Person as of a particular date, that on such date (a) such Person is able to realize upon its assets and pay its debts and other liabilities, contingent obligations and other commitments as they mature in the normal course of business, (b) such Person does not intend to, and does not believe that it will, incur debts or liabilities beyond such Person's ability to pay as such debts and liabilities mature in their ordinary course, (c) such Person is not engaged in a business or a transaction, and is not about to engage in a business or a transaction, for which such Person's properties and assets would constitute unreasonably small capital after giving due consideration to the prevailing practice in the industry in which such Person is engaged or is to engage, (d) the fair value of the properties and assets of such Person is greater than the total amount of liabilities, including, without limitation, contingent liabilities, of such Person and (e) the present fair saleable value of the properties and assets of such Person is not less than the amount that will be required to pay the probable liability of such Person on its debts as they become absolute and matured. In computing the amount of contingent liabilities at any time, it is intended that such liabilities will be computed at the amount that, in light of all the facts and circumstances existing at such time, represents the amount that can reasonably be expected to become an actual or matured liability.

"SPE Subsidiary" shall mean any Subsidiary formed solely for the purpose of, and that engages only in, one or more Securitization Transactions.

"Subsidiary" shall mean, with respect to any Person (the "parent"), any corporation, partnership, joint venture, limited liability company, association or other entity the accounts of which would be consolidated with those of the parent in the parent's consolidated financial statements if such financial statements were prepared in accordance with generally accepted accounting principles as of such date, as well as any other corporation, partnership, joint venture, limited liability company, association or other entity (a) of which securities or other ownership interests representing more than fifty percent (50%) of the equity or more than fifty percent (50%) of the ordinary voting power, or in the case of a partnership, more than fifty percent (50%) of the general partnership interests are, as of such date, owned, Controlled or held,

or (b) that is, as of such date, otherwise Controlled, by the parent or one or more subsidiaries of the parent or by the parent and one or more subsidiaries of the parent. Unless otherwise indicated, all references to "Subsidiary" hereunder shall mean a Subsidiary of the Company.

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"Substantial Part" shall mean, with respect to any transfer, assets which (i) (A) together with all other assets disposed of in the same fiscal year constitute 10% or more of Consolidated Total Assets determined as of the end of the immediately preceding fiscal year or (B) have contributed 10% or more of Consolidated Net Income for any of the three most recently completed fiscal years and (ii) from the date hereof the aggregate book value or, if higher, Fair Market Value of all Disposed assets exceed 25% of Consolidated Total Assets.

"Synthetic Lease" shall mean a lease transaction under which the parties intend that (a) the lease will be treated as an "operating lease" by the lessee pursuant to Statement of Financial Accounting Standards No. 13, as amended, and (b) the lessee will be entitled to various tax and other benefits ordinarily available to owners (as opposed to lessees) of like property.

"Synthetic Lease Obligations" shall mean, with respect to any Person, the sum of (a) all remaining rental obligations of such Person as lessee under Synthetic Leases that are attributable to principal and, without duplication, (b) all rental and purchase price payment obligations of such Person under such Synthetic Leases assuming such Person exercises the option to purchase the lease property at the end of the lease term.

"Third Party" shall mean all lessees, sublessees, licensees and other users of the Properties, excluding those users of the Properties in the ordinary course of the Company's business (consistent with its practices on the Amendment Closing Day) and on a temporary basis.

"Transferee" shall mean any direct or indirect transferee of all or any part of any Note purchased by any Purchaser under this Agreement.

"Voting Stock" shall mean, with respect to any Person, Capital Stock issued by such Person the holders of which are ordinarily, in the absence of contingencies, entitled to vote for the election of directors (or persons performing similar functions) of such Person, even though the right to vote has been suspended by the happening of such a contingency.

10C. Accounting Principles, Terms and Determinations. All references in this Agreement to "generally accepted accounting principles" shall be deemed to refer to generally accepted accounting principles in effect in the United States at the time of application thereof. Unless otherwise specified herein, all accounting terms used herein shall be interpreted, all determinations with respect to accounting matters hereunder shall be made, and all unaudited financial statements and certificates and reports as to financial matters required to be furnished hereunder shall be prepared, in accordance with generally accepted accounting principles applied on a basis consistent with the most recent audited financial statements delivered pursuant to clause (ii) of paragraph 5A or, if no such statements have been so delivered, the most recent audited financial statements referred to in clause (i) of paragraph 8B.

#### 11. MISCELLANEOUS.

11A. Payments. The Company agrees that, so long as any Purchaser shall hold any Note, it will make payments of principal of, interest on, and any Yield-Maintenance Amount payable with respect to, such Note, which comply with the terms of this Agreement, by wire transfer of immediately available funds for credit (not later than 12:00 noon, New York City

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local time, on the date due) to (i) the account or accounts of such Purchaser specified in the Confirmation of Acceptance with respect to such Note in the case of any Shelf Note or (ii) such other account or accounts in the United States as such Purchaser may from time to time designate in writing, notwithstanding any contrary provision herein or in any Note with respect to the place of payment. Each Purchaser agrees that, before disposing of any Note, it will make a notation thereon (or on a schedule attached thereto) of all principal payments previously made thereon and of the date to which interest thereon has been paid. The Company agrees to afford the benefits of this paragraph 11A to any Transferee which shall have made the same agreement as the Purchasers have made in this paragraph 11A.

11B. Expenses. The Company agrees, whether or not the transactions contemplated hereby shall be consummated, to pay, and save Prudential, each Purchaser and any Transferee harmless against liability for the payment of, all out-of-pocket expenses arising in connection with such transactions, including:

(i) all taxes (together in each case with interest and penalties, if any), other than state, federal, local or foreign income taxes, intangible taxes, or franchise taxes, including without limitation, all stamp, recording and other similar taxes, which may be payable with respect to the execution and delivery of this Agreement or the execution, delivery or acquisition of any Note;

(ii) all document production and duplication charges and the fees and expenses of any special counsel engaged by the Purchasers in connection with this Agreement, the transactions contemplated hereby and any subsequent proposed modification of, or proposed consent under, this Agreement, whether or not such proposed modification shall be effected or proposed consent granted; provided, however, that in connection with the fees and expenses of legal counsel of the Purchasers incurred prior to the Amendment Closing Day, the Purchasers shall agree to use the Facility Fee paid by the Company under paragraph 2J(1) to pay all or a portion of such fees and expenses; and

(iii) the costs and expenses, including fees and expenses of legal counsel incurred by you, any other Purchaser or any Transferee in connection with the restructuring, refinancing or "work out" of this Agreement or the Notes or the transactions contemplated hereby or thereby or in enforcing (or determining whether or how to enforce) any rights under this Agreement or the Notes or in responding to any subpoena or other legal process or informal investigative demand issued in connection with this Agreement or the Notes or the transactions contemplated hereby or by reason of your or any Transferee's having acquired any Note, including without limitation costs and expenses incurred in any bankruptcy case.

Notwithstanding the foregoing, the Company shall not be liable for any counsel fees incurred by any Purchaser or Transferee arising in connection with a transfer in the ordinary course of any Note or portion thereof or interest therein by Prudential or any other Purchaser to any Transferee. The obligations of the Company under this paragraph 11B shall survive the transfer of any Note or portion thereof or interest therein by any Purchaser or any Transferee and the payment of any Note.

11C. Consent to Amendments. This Agreement may be amended, and the Company may take any action herein prohibited, or omit to perform any act herein required to be performed by it, if the Company shall obtain the written consent to such amendment, action or omission to act, of the Required Holder(s) of the Notes of each Series except that, (i) with the written consent of the holders of all Notes of a particular Series, and if an Event of Default shall have occurred and be continuing, of the holders of all Notes of all Series, at the time outstanding (and not without such written consents), the Notes of such Series

may be amended or the provisions thereof waived to change the maturity thereof, to change or affect the principal thereof, or to change or affect the rate or time of payment of interest on or any Yield-Maintenance Amount payable with respect to the Notes of such Series, (ii) without the written consent of the holder or holders of all Notes at the time outstanding, no amendment to or waiver of the provisions of this Agreement shall change or affect the provisions of paragraph 7A or this paragraph 11C insofar as such provisions relate to proportions of the principal amount of the Notes of any Series, or the rights of any individual holder of Notes, required with respect to any declaration of Notes to be due and payable or with respect to any consent, amendment, waiver or declaration, (iii) with the written consent of Prudential (and not without the written consent of Prudential) the provisions of paragraph 2 may be amended or waived (except insofar as any such amendment or waiver would affect any rights or obligations with respect to the purchase and sale of Notes which shall have become Accepted Notes prior to such amendment or waiver), and (iv) with the written consent of all of the Purchasers which shall have become obligated to purchase Accepted Notes of any Series (and not without the written consent of all such Purchasers), any of the provisions of paragraphs 2 and 3 may be amended or waived insofar as such amendment or waiver would affect only rights or obligations with respect to the purchase and sale of the Accepted Notes of such Series or the terms and provisions of such Accepted Notes. Each holder of any Note at the time or thereafter outstanding shall be bound by any consent authorized by this paragraph 11C, whether or not such Note shall have been marked to indicate such consent, but any Notes issued thereafter may bear a notation referring to any such consent. No course of dealing between the Company and the holder of any Note nor any delay in exercising any rights hereunder or under any Note shall operate as a waiver of any rights of any holder of such Note. As used herein and in the Notes, the term "this Agreement" and references thereto shall mean this Agreement as it may from time to time be amended or supplemented. Prior to its effectiveness, any amendment, waiver or consent shall be in writing and executed by the Company and the Required Holders or the holders of all Notes, as applicable.

11D. Form and Registration; Transfer and Exchange; Transfer Restrictions; Lost Notes.

11D(1) Form and Registration. The Notes are issuable as registered notes without coupons in denominations of at least \$1,000,000, except as may be necessary to reflect any principal amount not evenly divisible by \$1,000,000. The Company shall keep at its principal office a register in which the Company shall provide for the registration of Notes and of transfers of Notes. Upon surrender for registration of transfer of any Note at the principal office of the Company, the Company shall, at its expense, execute and deliver one or more new Notes of like tenor and of a like aggregate principal amount, registered in the name of such transferee or transferees.

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11D(2) Transfer and Exchange of Notes. At the option of the holder of any Note, such Note may be exchanged for other Notes of like tenor and of any authorized denominations, of a like aggregate principal amount, upon surrender of the Note to be exchanged at the principal office of the Company. Whenever any Notes are so surrendered for exchange, the Company shall, at its expense, execute and deliver the Notes which the holder making the exchange is entitled to receive. Each installment of principal payable on each installment date upon each new Note issued upon any such transfer or exchange shall be in the same proportion to the unpaid principal amount of such new Note as the installment of principal payable on such date on the Note surrendered for registration of transfer or exchange bore to the unpaid principal amount of such Note. No reference need be made in any such new Note to any installment or installments of principal previously due and paid upon the Note surrendered for registration of transfer or exchange. Every Note surrendered for registration of transfer or exchange shall be duly endorsed, or be accompanied by a written instrument of transfer duly executed, by the holder of such Note or such holder's attorney duly authorized in writing. Any Note or Notes issued in exchange for any Note or upon transfer thereof shall carry the rights to unpaid interest and interest to

accrue which were carried by the Note so exchanged or transferred, so that neither gain nor loss of interest shall result from any such transfer or exchange.

11D(3) Lost Notes. Upon receipt of written notice from the holder of any Note of the loss, theft, destruction or mutilation of such Note and, in the case of any such loss, theft or destruction, upon receipt of such holder's unsecured indemnity agreement, in form and substance reasonably satisfactory to the Company, or in the case of any such mutilation upon surrender and cancellation of such Note, the Company will make and deliver a new Note, of like tenor, in lieu of the lost, stolen, destroyed or mutilated Note.

11E. Persons Deemed Owners; Participations. Prior to due presentment for registration of transfer, the Company may treat the Person in whose name any Note is registered as the owner and holder of such Note for the purpose of receiving payment of principal of and interest on, and any Yield-Maintenance Amount payable with respect to, such Note and for all other purposes whatsoever, whether or not such Note shall be overdue, and the Company shall not be affected by notice to the contrary. Subject to the preceding sentence, the holder of any Note may from time to time grant participations in all or any part of such Note to any Person on such terms and conditions as may be determined by such holder in its sole and absolute discretion.

11F. Survival of Representations and Warranties; Entire Agreement. All representations and warranties contained herein or made in writing by or on behalf of the Company in connection herewith shall survive the execution and delivery of this Agreement and the Notes, the transfer by any Purchaser of any Note or portion thereof or interest therein and the payment of any Note, and may be relied upon by any Transferee, regardless of any investigation made at any time by or on behalf of any Purchaser or any Transferee. Subject to the preceding sentence, this Agreement and the Notes embody the entire agreement and understanding between the parties hereto with respect to the subject matter hereof and supersede all prior agreements and understandings relating to such subject matter.

11G. Successors and Assigns. All covenants and other agreements in this Agreement contained by or on behalf of any of the parties hereto shall bind and inure to the benefit of the

respective successors and assigns of the parties hereto (including, without limitation, any Transferee) whether so expressed or not.

11H. Independence of Covenants. All covenants hereunder shall be given independent effect so that if a particular action or condition is prohibited by any one of such covenants, the fact that it would be permitted by an exception to, or otherwise be in compliance within the limitations of, another covenant shall not avoid the occurrence of a Default or Event of Default if such action is taken or such condition exists.

11I. Notices. All written communications provided for hereunder (other than communications provided for under paragraph 2) shall be sent by first class mail or nationwide overnight delivery service (with charges prepaid) and (i) if to any Purchaser, addressed as specified for such communications in the Purchaser Schedule attached to the applicable Confirmation of Acceptance (in the case of any Shelf Notes) or at such other address as any such Purchaser shall have specified to the Company in writing, (ii) if to any other holder of any Note, addressed to it at such address as it shall have specified in writing to the Company or, if any such holder shall not have so specified an address, then addressed to such holder in care of the last holder of such Note which shall have so specified an address to the Company and (iii) if to the Company, addressed to it at 2665 South Bayshore Drive, Suite 901, Coconut Grove, Florida 33133, Attention: Barry Logan, telephone 305-714-4102, telecopy 305-858-4492, provided, however, that any such communication to the Company may also, at the option of the Person sending such communication, be delivered by any other means

either to the Company at its address specified above or to any Authorized Officer of the Company. Any communication pursuant to paragraph 2 shall be made by the method specified for such communication in paragraph 2, and shall be effective to create any rights or obligations under this Agreement only if, in the case of a telephone communication, an Authorized Officer of the party conveying the information and of the party receiving the information are parties to the telephone call, and in the case of a telecopier communication, the communication is signed by an Authorized Officer of the party conveying the information, addressed to the attention of an Authorized Officer of the party receiving the information, and in fact received at the telecopier terminal the number of which is listed for the party receiving the communication in the Information Schedule or at such other telecopier terminal as the party receiving the information shall have specified in writing to the party sending such information.

11J. Payments Due on Non-Business Days. Anything in this Agreement or the Notes to the contrary notwithstanding, any payment of principal of or interest on, or Yield-Maintenance Amount payable with respect to, any Note that is due on a date other than a Business Day shall be made on the next succeeding Business Day. If the date for any payment is extended to the next succeeding Business Day by reason of the preceding sentence, the period of such extension shall be included in the computation of the interest payable on such Business Day.

11K. Severability. Any provision of this Agreement which is prohibited or unenforceable in any jurisdiction shall, as to such jurisdiction, be ineffective to the extent of such prohibition or unenforceability without invalidating the remaining provisions hereof, and any such prohibition or unenforceability in any jurisdiction shall not invalidate or render unenforceable such provision in any other jurisdiction.

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11L. Descriptive Headings. The descriptive headings of the several paragraphs of this Agreement are inserted for convenience only and do not constitute a part of this Agreement.

11M. Satisfaction Requirement. If any agreement, certificate or other writing, or any action taken or to be taken, is by the terms of this Agreement required to be satisfactory to any Purchaser, to any holder of Notes or to the Required Holder(s), the determination of such satisfaction shall be made by such Purchaser, such holder or the Required Holder(s), as the case may be, in the sole and exclusive judgment (exercised in good faith) of the Person or Persons making such determination.

11N. Governing Law; Submission to Jurisdiction. This Agreement shall be construed and enforced in accordance with, and the rights of the Parties shall be governed by, the Internal Law of the State of New York. THE COMPANY HEREBY SUBMITS TO THE JURISDICTION OF THE SUPREME COURT OF THE STATE OF NEW YORK LOCATED IN NEW YORK COUNTY, NEW YORK AND THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK AND IRREVOCABLY AGREES THAT, SUBJECT TO THE SOLE AND ABSOLUTE ELECTION OF THE REQUIRED HOLDER(S) AND TO THE EXTENT PERMITTED BY APPLICABLE LAW, ALL ACTIONS OR PROCEEDINGS RELATING TO THIS AGREEMENT OR THE NOTES SHALL BE LITIGATED IN SUCH COURTS, AND THE COMPANY WAIVES ANY OBJECTION WHICH IT MAY HAVE BASED ON IMPROPER VENUE OR FORUM NON CONVENIENS TO THE CONDUCT OF ANY PROCEEDING IN ANY SUCH COURTS.

11O. Severalty of Obligations. The sales of Notes to the Purchasers are to be several sales, and the obligations of Prudential and the Purchasers under this Agreement are several obligations. No failure by Prudential or any Purchaser to perform its obligations under this Agreement shall relieve Prudential, any other Purchaser or the Company of any of its obligations hereunder, and neither Prudential nor any Purchaser shall be responsible for the obligations of, or any action taken or omitted by, any other such Person hereunder.

11P. Counterparts. This Agreement may be executed in any number of counterparts, each of which shall be an original, but all of which together shall constitute one instrument.

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11Q. Rank. The parties hereto, for their own benefit and not for the benefit or for the purpose of creating any duty, obligation or liability to any other Person, expressly designate that the right to payment of the Notes shall be pari passu to the Bank Agreement in right of payment and performance.

11R. Binding Agreement. When this Agreement is executed and delivered by the Company and Prudential, it shall become a binding agreement between the Company and Prudential. This Agreement shall also inure to the benefit of each Purchaser which shall have executed and delivered a Confirmation of Acceptance, and each such Purchaser shall be bound by this Agreement to the extent provided in such Confirmation of Acceptance.

Very truly yours,

WATSCO, INC.

By: /s/ Ana M. Menendez

-----  
Name: Ana M. Menendez  
Title: Treasurer

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The foregoing Agreement is hereby accepted as of the date first above written.

THE PRUDENTIAL INSURANCE COMPANY OF AMERICA

By: /s/ Billy Greer

-----  
Vice President

PRUCO LIFE INSURANCE COMPANY  
OF NEW JERSEY

By: /s/ Billy Greer

-----  
Vice President

HARTFORD LIFE INSURANCE COMPANY

By: Prudential Private Placement Investors,  
L.P., as Investment Advisor  
By: Prudential Private Placement Investors,  
Inc., General Partner

By: /s/ Billy Greer

-----  
Vice President

MEDICA HEALTH PLAN

By: Prudential Private Placement Investors,  
L.P., as Investment Advisor  
By: Prudential Private Placement Investors,



Inc., General Partner

By: /s/ Billy Greer

-----  
Vice President

WATSCO, INC. AND SUBSIDIARIES  
SELECTED CONSOLIDATED FINANCIAL DATA

Years Ended December 31, (In thousands, except per share data)	2002 (1)	2001 (2)	2000 (3)	1999	1998 (4)
<b>OPERATIONS</b>					
Revenue	\$ 1,181,136	\$ 1,238,646	\$ 1,310,166	\$ 1,249,550	\$ 1,062,265
Gross profit	287,276	299,040	306,780	295,116	241,924
Operating income	50,924	48,324	45,815	59,439	54,066
Income from continuing operations	28,536	24,441	19,114	29,481	26,972
Income from continuing operations adjusted for SFAS No. 142	28,536	26,726	21,382	31,533	28,617
<b>SHARE DATA</b>					
Diluted earnings per share from continuing operations	\$1.07	\$0.90	\$0.69	\$0.99	\$0.94
Diluted earnings per share from continuing operations adjusted for SFAS No. 142	1.07	0.98	0.77	1.06	1.00
Cash dividends declared per share:					
Common Stock	\$0.115	\$0.10	\$0.10	\$0.10	\$0.10
Class B Common Stock	0.115	0.10	0.10	0.10	0.10
Weighted average shares outstanding for diluted earnings per share	26,674	27,251	27,793	29,741	28,690
Common stock outstanding	26,032	26,745	26,497	27,907	28,032
<b>BALANCE SHEET INFORMATION</b>					
Total assets	\$ 503,719	\$ 520,820	\$ 563,470	\$ 588,180	\$ 535,323
Long-term obligations	80,233	101,900	140,878	159,415	172,301
Shareholders' equity	329,201	322,420	304,164	301,716	274,568

- (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.
- (2) During 2001, the Company recorded restructuring and other non-cash charges of \$5,795 (\$3,691 or \$0.14 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 and other non-cash charges of \$13,169 (\$8,270 or \$0.30 per share on an after-tax basis), as more fully described in Note 8 to the consolidated financial statements.
- (4) Excludes the results of the Company's manufacturing operation, which was accounted for as a discontinued operation in 1998.

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 97% of 2002 revenue and presently operates from 276 locations in 31 states and a national temporary staffing and permanent placement services ("Staffing") segment, which accounted for 3% of 2002 revenue.

The following table sets forth, as a percentage of revenue, the Company's consolidated statement of income data for the years ended December 31, 2002, 2001 and 2000.

	2002	2001	2000
Revenue	100.0%	100.0%	100.0%
Cost of sales	75.7	75.9	76.3
Cost of sales - restructuring	-	-	.3
Gross profit	24.3	24.1	23.4
Selling, general and administrative expenses	20.0	19.7	19.3
Goodwill amortization	-	.3	.3
Restructuring costs	-	.2	.3
Operating income	4.3	3.9	3.5
Interest expense	(.6)	(.8)	(1.0)
Investment write-down	-	-	(.1)
Income taxes	(1.3)	(1.1)	(.9)
Net income	2.4%	2.0%	1.5%

The following table sets forth revenue (in thousands) by business segment for the years ended December 31, 2002, 2001 and 2000.

	2002		2001		2000	
Distribution	\$ 1,147,561	97%	\$ 1,194,587	96%	\$ 1,243,208	95%
Staffing	33,575	3%	44,059	4%	66,958	5%
Total revenue	\$ 1,181,136	100%	\$ 1,238,646	100%	\$ 1,310,166	100%

The following narratives include the results of operations acquired during 2002 and 2000. 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.

#### MATTERS AFFECTING COMPARABILITY

The following matters affect the comparability of results between 2002, 2001 and 2000.

During 2001 and 2000, 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 and 2000 Restructuring Plans are complete as of December 31, 2002. Refer to Note 8 to the consolidated financial statements and in this section under "Restructuring and Non-cash Charges" 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

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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. Had the provision of SFAS No. 142 been applicable to the years ended December 31, 2001 and 2000, diluted earnings per share would have been 98 cents and 77 cents, respectively. 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, 2003, the Company performed the required annual impairment test and determined there was no impairment. Refer to Note 9 to the consolidated financial statements for further information.

#### 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, continue to be 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. On a same-store basis and excluding restructuring charges incurred in 2002 and 2001, the Company's Distribution segment gross profit decreased \$10.2 million, or 4%.

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 reversing \$1.3 million 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.

#### CONSOLIDATED COMPARISON OF YEAR ENDED DECEMBER 31, 2001 WITH YEAR ENDED DECEMBER 31, 2000

Revenue in 2001 decreased \$71.5 million, or 5%, as compared to 2000. Revenue results were primarily impacted by the closure of locations, the discontinuance of certain under performing product lines in the Distribution segment and lower sales demand in the Staffing segment.

Distribution segment revenue in 2001 decreased \$48.6 million, or 4%, over 2000. On a same-store basis, revenue in the Distribution segment decreased \$29.2 million, or 2%, over 2000, including a \$13.2 million or 1.2% same-store sales decline in residential and light commercial HVAC products. The decrease in revenue also includes the closure of 42 distribution locations, the discontinuance of certain under performing product lines during 2001 and 2000 and an 18% decline in sales to the manufactured housing market, which represented 9% of the Distribution segment's revenue in 2001.

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Staffing segment revenue in 2001 decreased \$22.9 million, or 34%, over 2000. This decrease was primarily attributable to lower sales demand due to economic softness experienced in the United States in 2001 and the effect of seven location closures during 2001. On a same-store basis, revenue in 2001 decreased \$16.3 million, or 27%, over 2000.

Gross profit in 2001 decreased \$7.7 million, or 3%, over 2000, primarily as a result of the aforementioned revenue decrease offset by gross profit margin improvement in the Distribution segment. Gross profit margin increased to 24.1% in 2001 from 23.4% in 2000, primarily as a result of improved pricing disciplines and improved vendor programs in the Distribution segment. Excluding restructuring charges, gross profit margin increased to 24.1% in 2001 from 23.7% in 2000. On a same-store basis and excluding restructuring charges incurred in 2001 and 2000, the Company's Distribution segment gross profit decreased \$5 million, or .2%.

Selling, general and administrative expenses in 2001 decreased \$8.9 million, or 4%, over 2000, primarily due to the cost savings attributable to the closure of 42 locations in the Distribution segment and seven locations in the Staffing segment. Selling, general and administrative expenses, excluding restructuring charges of \$2.9 million and \$4.2 million, in 2001 and 2000, respectively, as a percent of revenue increased to 20.0% in 2001 from 19.6% in 2000. 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 incurred in 2001 and 2000, the Company's Distribution segment selling, general and administrative expenses decreased \$3.6 million or 2% and as a percent of revenue selling, general and administrative expenses increased to 18.9% in 2001 from 18.7% in 2000.

A write-down of \$2.2 million was recorded in 2000 for an impairment of an investment in marketable securities of one of the Company's primary competitors.

Interest expense, net in 2001 decreased \$3.3 million, or 25%, from 2000 primarily due to 20% lower average daily borrowings during the year and lower interest rates.

The effective tax rate declined to 36.3% in 2001 from 37.2% in 2000 due to various tax initiatives.

#### RESTRUCTURING AND NON-CASH CHARGES

During 2001 and 2000, 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 activities related to the 2001 and 2000 Restructuring Plans discussed below are complete as of December 31, 2002.

##### 2001 Restructuring Plan

In September 2001, the Company's Board of Directors approved plans to integrate the Distribution segment's manufactured housing subsidiaries, close six distribution locations, close seven staffing locations and exit certain licensee relationships in the Staffing segment (the "2001 Restructuring Plan"). During the second quarter of 2002, based on a continued reassessment of the 2001 Restructuring Plan and activities, the Company determined that three of the six distribution locations should remain open. In the Staffing segment, all seven locations were closed and the licensee relationships were terminated in 2001.

In connection with the 2001 Restructuring Plan, the Company recorded restructuring pre-tax charges of \$3.4 million (\$2.2 million after-tax or 8 cents per share on a diluted basis) during the third quarter of 2001 in accordance with Emerging Issues Task Force ("EITF") Issue 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs Incurred in a Restructuring)," SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," and Securities and Exchange Commission Staff Accounting Bulletin ("SAB") No. 100, "Restructuring & Impairment Charges." The pre-tax charges are comprised of \$1.4 million related to non-cancelable lease obligations, \$1.3 million related to the write-down of assets impaired as a result of the restructuring activities, \$.4 million for facility exit costs and \$.3 million for an inventory valuation reserve for discontinued product lines. The portion of the restructuring charge that relates to the valuation of inventory to be disposed of has been classified in cost of sales in the consolidated statement of income for the year ended December 31, 2001. During the year ended December 31, 2001, the Company reversed restructuring charges of \$.2 million, primarily due to lease buy-outs settled at more favorable terms than expected.

Also during the third quarter of 2001, the Company recorded non-cash charges of \$1.1 million for the write-off of an asset related to a supply arrangement in the Distribution segment, \$.8 million for additional accounts receivable valuation reserves in the Staffing segment and \$.7 million related to a terminated licensee's workers compensation program in the Staffing segment. Non-cash charges are included in selling, general and administrative expenses, except for the charge related to the worker's compensation program, which is included in cost of sales in the consolidated statement of income for the year ended December 31, 2001.

On an after-tax basis, restructuring and other non-cash charges were \$3.7 million for the year ended December 31, 2001 (14 cents per share on a diluted basis).

During the year ended December 31, 2002, the Company reversed restructuring charges of \$.5 million, primarily due to lease buy-outs settled at more favorable terms than expected and incurred an additional \$.2 million for inventory valuation reserves for discontinued product lines.

## 2000 Restructuring Plan

In December 2000, the Company's Board of Directors approved plans adopted by certain operating subsidiaries to close under performing locations, reduce market overlap, dispose of inventory related to discontinued product lines and eliminate other unproductive SKUs (the "2000 Restructuring Plan"). In connection with the 2000 Restructuring Plan, 25 distribution locations closed during 2000 and 7 distribution locations closed during 2001.

The Company recorded restructuring charges of \$8.5 million (\$5.3 million after-tax or 19 cents per share on a diluted basis) during the fourth quarter of 2000. A portion of the restructuring charge (\$4.3 million on a pre-tax basis) related to the valuation of inventory to be disposed of and is classified in cost of sales in the Company's consolidated statement of income for the year ended December 31, 2000.

Also during the fourth quarter of 2000, the Company recorded non-cash charges of \$.8 million related to additional inventory reserves in cost of sales, \$1.7 million related to accounts receivable valuation reserves in selling, general and administrative expenses and \$2.2 million related to the write-down of an impaired investment in one of the Company's primary competitors in other expense. See Note 1 to the consolidated financial statements for additional information regarding the Company's policy on accounting for investment securities.

On an after-tax basis, restructuring and other non-cash charges were \$8.3 million for the year ended December 31, 2000 (30 cents per share on a diluted basis).

## 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 peak 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, the timing and extent of common stock repurchases and dividend policy.

In April 2002, the Company executed a bank-syndicated, unsecured revolving credit agreement that provides for borrowings of up to \$225.0 million, expiring in April 2005. The April 2002 agreement replaced the Company's previous revolving credit agreement that would have expired on August 8, 2002. At December 31, 2002 and 2001, \$50.0 and \$70.0 million, respectively were outstanding under a then existing revolving credit agreement. Borrowings under the revolving credit 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% and .5% at December 31, 2002 and 2001, respectively). The Company pays a variable commitment fee on the unused portion of the commitment. The revolving credit agreement contains 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 and dividends in addition to other restrictions. The Company is in compliance with such covenants at December 31, 2002.

The Company has a \$125.0 million private placement shelf facility. In October 2002, the Company extended the maturity of the facility to January 2006. 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 facility. On February 7, 2001, the Company issued \$30.0 million Senior Series A Notes ("Notes") bearing 7.07% interest under its private

placement shelf facility. 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 Company used the net proceeds from the issuance of the Notes for the repayment of a portion of its outstanding indebtedness under its then existing revolving credit facility.

At December 31, 2002, the Company had two interest rate swap agreements to manage its net exposure to interest rate changes related to a portion of the borrowings under the revolving credit agreement. The interest rate swap agreements effectively convert a portion of 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 for further information and MD&A section "Qualitative and Quantitative Disclosures about Market Risk."

At December 31, 2002, the Company is contingently liable under standby letters of credit aggregating approximately \$5.8 million that were 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 at December 31, 2002.

Working capital decreased to \$259.1 million at December 31, 2002 from \$269.7 million at December 31, 2001. This decrease was primarily due to reductions in accounts receivable and inventory, partially offset by a reduction in accrued liabilities. The accounts receivable decrease in 2002 correlates to the revenue decrease in 2002 and the impact of improved collection efforts in the Distribution segment. Accordingly, days sales in accounts receivable improved to 42 in 2002 from 44 in 2001. Inventory at December 31, 2002 decreased compared to December 31, 2001 primarily due to lower inventory levels required from lower sales levels in 2002 and the effect of the disposal of certain discontinued and under performing product lines in connection with the Company's 2001 and 2000 Restructuring Plans. Inventory turns improved to 4.9 in 2002 from 4.8 in 2001.

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, primarily due to the aforementioned reductions in working capital. Net cash provided by operating activities was \$52.6 million in 2001 compared to \$49.1 million in 2000, an increase of \$3.5 million, also due to reductions in working capital.

Net cash used in investing activities increased to \$4.1 million in 2002 from \$3.3 million in 2001, primarily as a result of acquisitions during 2002, offset by the proceeds received from the sale of property and equipment. Net cash used in investing activities decreased to \$3.3 million in 2001 from \$10.1 million in 2000 primarily as a result of decreases in capital expenditures in 2001.

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 authorized the repurchase, at management's discretion, of up to 7.5 million shares of the Company's common stock in the open market or via private transactions. Shares repurchased under the program are accounted for using the cost method and result in a reduction of shareholders' equity. The Company purchased 1.6 million shares at a cost of \$24.5 million in 2002, .3 million shares at a cost of \$3.2 million in 2001 and 1.8 million shares at a cost of \$17.6 million in 2000. In aggregate, the Company



has repurchased 5.0 million shares of Common Stock and Class B Common Stock at a cost of \$59.6 million.

Cash dividends of 11.5 cents and 10 cents per share were paid in 2002 and 2001, respectively. In January 2003, the Company's Board of Directors approved an increase in the quarterly cash dividend to 4 cents per share from 3 cents per share. 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, future prospects and other factors deemed relevant by the Company's Board of Directors.

The Company has adequate availability of capital from operations, its existing revolving credit agreement and private placement shelf facility to fund present operations and anticipated growth, including expansion in its current and targeted market areas. The Company continually evaluates potential acquisitions and has held discussions with a number of acquisition candidates; however, the Company currently has no binding agreement with respect to any 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.

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The following summarizes the Company's contractual obligations at December 31, 2002:

	Payments due by Period (in millions)			
	Within 1 Year	2-3 Years	4-5 Years	After 5 Years
Non-cancelable operating lease obligations	\$ 24,769	\$ 32,607	\$ 14,442	\$ 6,075
Long-term debt	-	10,000	20,000	-
Minimum royalty payments	-	2,000	2,000	4,000
Bank and other debt	272	233	-	-
<b>Total</b>	<b>\$ 25,041</b>	<b>\$ 44,840</b>	<b>\$ 36,442</b>	<b>\$ 10,075</b>

The Company also had standby letters of credit outstanding amounting to \$5.8 million at December 31, 2002.

#### GENERAL CONSIDERATIONS

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.

#### QUALITATIVE AND QUANTITATIVE 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, 2002, the Company's two interest rate swaps aggregate a notional value of \$50.0 with a maturity of \$20.0 million in 2003 and \$30.0 million in 2007. An interest rate swap with a notional value of \$10.0 million matured in 2002. 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%.

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 adoption of SFAS No. 133 on January 1, 2001 resulted in a cumulative pre-tax reduction to OCI of \$1.0 million (\$.6 million after-tax). The Company has also recorded a loss in OCI relating to the change in value of the cash flow hedges of \$1.3 million, net of income tax benefit of \$.7 for the year ended December 31, 2002 and \$1.5 million, net of income tax benefit of \$.9 million for the year ended December 31, 2001. The fair market values of the derivative financial instruments are liabilities of \$5.4 million and \$3.4 million at December 31, 2002 and 2001, respectively, and are recorded in other liabilities in the Company's consolidated balance sheets.

During the years ended December 31, 2002 and 2001, the Company reclassified \$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 other comprehensive income to current period earnings (recorded as interest expense, net in the consolidated statement of income). The net deferred loss recorded in accumulated other comprehensive income will be reclassified to earnings on a quarterly basis as interest payments occur. As of December 31, 2002, approximately \$2.0 million in deferred losses on derivative instruments accumulated in other comprehensive income is expected to be reclassified to earnings during the next twelve months using a current three month LIBOR-based average receive rate (1.36% at December 31, 2002).

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 swaps were derived from implied forward three-month LIBOR curves. The variability on earnings and cash flows aggregated approximately \$5.0 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 payments. When preparing these estimates, management considers a number of factors, including past transactions with customers, creditworthiness of specific customers, historical trends and other information. The allowance for doubtful accounts was \$3.8 million and \$6.3 million at December 31, 2002 and 2001, respectively. Although the Company believes its allowance is sufficient, if the financial condition of the Company's customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. 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 and slow-moving inventories are reduced to estimated net realizable value. The Company's accounting for excess and slow-moving 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. When preparing these estimates, management considers historical results, inventory levels, current operating trends and sales forecasts. 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 and slow-moving inventories may be adjusted.

## 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. 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 market value multiples. The initial impairment review as of the transition date of January 1, 2002 was completed in the second quarter and resulted in no goodwill impairment charge. Also, on January 1, 2003, the Company performed the required annual impairment test and determined there was no impairment. See Note 1 and 9 to the consolidated financial statements for further information. As previously discussed, operating results of the Staffing segment have been negatively impacted by economic softness experienced in the past two years. The carrying amount of goodwill at December 31, 2002 for the Staffing segment was \$4.0 million. 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.

## 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 \$.5 million as of December 31, 2002 due to uncertainties related to the ability to utilize some of the deferred tax assets, primarily consisting of federal net operating loss carryforwards of \$.3 million, which will expire in 2004, and state net operating loss carryforwards of \$4.1 million, which will expire in varying amounts through 2017. 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. 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. Any adjustment to the deferred tax asset and any related valuation allowance could materially impact the Company's consolidated financial position and results of operations.

Although management believes that the estimates discussed above are reasonable and the related calculations conform to generally accepted accounting principles, actual results could differ from these estimates and such differences could be material.

## NEW ACCOUNTING PRONOUNCEMENTS

Effective January 1, 2002, the Company adopted SFAS No. 142 "Goodwill and Intangible Assets." SFAS No. 142 eliminates the current requirement to amortize

goodwill and indefinite-lived intangible assets, addresses the amortization of intangible assets with a defined life and addresses impairment testing and recognition for goodwill and intangible assets. Pursuant to SFAS No. 142, intangible assets must be periodically tested for impairment (see Note 9 to the consolidated financial statements).

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

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after June 15, 2002. The Company does not believe that the adoption of SFAS No. 143 will have a significant impact on its consolidated financial statements.

Effective January 1, 2002, the Company adopted SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 replaces SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed of" and the accounting and reporting provisions of Accounting Principles Board Opinion ("APB") No. 30, "Reporting the Results of Operations - Unusual and Infrequently Occurring Events and Transactions." SFAS No. 144 also amends Accounting Research Bulletin No. 51, "Consolidated Financial Statements," to eliminate the exception to consolidation of a subsidiary for which control is likely to be temporary. SFAS No. 144 establishes a single accounting model for assets to be disposed of by sale whether previously held and used or newly acquired. SFAS No. 144 retains the provisions of APB No. 30 for presentation of discontinued operations in the income statement, but broadens the presentation to include a component of an entity. The adoption of SFAS No. 144 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 Company plans to adopt SFAS No. 146 effective January 1, 2003 and does not expect that the adoption will have a material impact on its consolidated financial statements.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure." SFAS No. 148 amends SFAS No. 123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition to SFAS No. 123's fair value method of accounting for stock-based employee compensation. SFAS No. 148 also amends the disclosure provisions of SFAS No. 123 and APB No. 28, "Interim Financial Reporting," to require disclosures in the summary of significant accounting policies of the effects of an entity's accounting policy with respect to stock-based employee compensation on reported net income and earnings per share in annual and interim financial statements. SFAS No. 148 does not amend SFAS No. 123 to require companies to account for employee stock options using the fair value method. The Company adopted the disclosure provisions required in SFAS No. 148 effective December 31, 2002 and has provided the necessary disclosure in Notes 1 and 6 to the consolidated financial statements.

In January 2003, the FASB issued EITF Issue No. 02-16 ("02-16"), "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor." EITF No. 02-16 addresses accounting and reporting issues related to how

a reseller should account for cash consideration received from vendors. Generally, cash consideration received from vendors is presumed to be a reduction of the prices of the vendor's products or services and should, therefore, be characterized as a reduction of cost of sales when recognized in the customer's income statement. However, under certain circumstances this presumption may be overcome and recognition as revenue or as a reduction of other costs in the income statement may be appropriate. EITF No. 02-16 also addresses the accounting for a rebate or refund of a specified amount of cash consideration that is payable if the customer completes a specified cumulative level of purchases or remains a customer for a specified period. EITF No. 02-16 permits customers to recognize a rebate or refund of a specified amount of cash consideration that is payable if the customer completes a specified cumulative level of purchases or remains a customer for a specified period as a reduction of cost of sales, if the customer can reasonably estimate the amount of the rebate or refund on a systematic and rationale allocation. EITF No. 02-16 is effective for fiscal periods beginning after December 15, 2002. The Company does not expect that the adoption of EITF No. 02-16 will have a material effect on the Company's consolidated financial position or results of operations.

#### SAFE HARBOR STATEMENT

This annual report contains statements which, to the extent they are not historical fact, constitute "forward-looking statements" under the securities laws. All forward-looking statements involve risks, uncertainties and other factors that may cause the actual results, performance or achievements of the Company to differ materially from those contemplated or projected, forecasted, estimated, budgeted, expressed or implied by or in such forward-looking statements. The forward-looking statements in this document are intended to be subject to the safe harbor protection provided under the securities laws. For additional information identifying some other important factors which may affect the Company's operations and markets 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".

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

(IN THOUSANDS, EXCEPT PER SHARE DATA)	YEARS ENDED DECEMBER 31,		
	2002	2001	2000
Revenue	\$ 1,181,136	\$ 1,238,646	\$ 1,310,166
Cost of sales	893,614	939,278	999,117
Cost of sales - restructuring	246	328	4,269
Gross profit	287,276	299,040	306,780
Selling, general and administrative expenses	236,891	247,847	256,753
Restructuring activities	(539)	2,869	4,212
Operating income	50,924	48,324	45,815
Other expense:			
Interest expense, net	7,190	9,955	13,211
Investment write-down	-	-	2,169
Total other expense	7,190	9,955	15,380
Income before income taxes	43,734	38,369	30,435
Income taxes	15,198	13,928	11,321
Net income	\$ 28,536	\$ 24,441	\$ 19,114
Earnings per share:			
Basic	\$ 1.12	\$ 0.94	\$ 0.72
Diluted	\$ 1.07	\$ 0.90	\$ 0.69

Weighted average shares and equivalent shares used to calculate earnings per share:

Basic	25,558	25,946	26,549
Diluted	26,674	27,251	27,793

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

WATSCO, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS

(IN THOUSANDS, EXCEPT SHARE DATA)	DECEMBER 31,	
	2002	2001
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 25,880	\$ 9,132
Accounts receivable, net	129,396	143,301
Inventories	176,407	185,943
Other current assets	13,878	18,823
Total current assets	345,561	357,199
Property and equipment, net	25,850	30,703
Goodwill, net	125,536	124,737
Other assets	6,772	8,181
	\$ 503,719	\$ 520,820
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Current portion of long-term obligations	\$ 272	\$ 429
Accounts payable	59,965	58,127
Accrued liabilities	26,215	28,985
Total current liabilities	86,452	87,541
Long-term obligations:		
Borrowings under revolving credit agreement	50,000	70,000
Long-term notes	30,000	30,000
Bank and other debt	233	1,900
Total long-term obligations	80,233	101,900
Deferred income taxes and other liabilities	7,833	8,959
Commitments and contingencies (Notes 11 and 12)		
Shareholders' equity:		
Common Stock, \$0.50 par value, 60,000,000 shares authorized in 2002 and 2001 and 27,468,289 and 26,780,912 shares issued in 2002 and 2001, respectively	13,734	13,391
Class B Common Stock, \$0.50 par value, 10,000,000 shares authorized in 2002 and 2001 and 3,533,676 and 3,322,980 shares issued in 2002 and 2001, respectively	1,767	1,661
Paid-in capital	216,124	210,859
Unearned compensation related to outstanding restricted stock	(9,067)	(9,772)
Accumulated other comprehensive loss, net of tax	(3,399)	(2,062)
Retained earnings	169,649	143,487
Treasury stock, at cost, 4,970,213 and 3,359,313 shares of common stock in 2002 and 2001, respectively	(59,607)	(35,144)
Total shareholders' equity	329,201	322,420
	\$ 503,719	\$ 520,820

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

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(IN THOUSANDS, EXCEPT SHARE DATA)	Common Stock and		Paid-In Capital	Unearned Compensation	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Treasury Stock	Total
	Class B Shares	Common Stock Amount						
Balance at December 31, 1999	27,907,077	\$ 14,627	\$ 202,106	\$ (5,998)	\$ (669)	\$ 105,971	\$ (14,321)	\$ 301,716
Net income						19,114		19,114
Changes in value of investments, net of income taxes					774			774
Comprehensive income								19,888
Contribution to 401(k) plan	85,906	43	947					990
Issuances from exercise of stock options and employee stock purchase plan	171,419	85	1,161					1,246
Tax benefit from exercise of stock options			276					276
Issuances of restricted shares of common stock	127,000	63	1,144	(1,207)				-
Forfeitures of restricted shares of common stock	(45,000)	(22)	(763)	785				-
Amortization of unearned compensation				389				389
Common stock dividends, \$0.10 per share						(2,737)		(2,737)
Purchase of treasury stock	(1,749,313)						(17,604)	(17,604)
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

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

WATSCO, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)	Years Ended December 31,		
	2002	2001	2000
Cash flows from operating activities:			
Net income	\$ 28,536	\$ 24,441	\$ 19,114



Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	7,295	7,900	8,259
Amortization of goodwill	-	3,587	3,612
Amortization of unearned compensation	816	596	389
Provision for doubtful accounts	5,317	6,319	5,386
Non-cash restructuring activities	(293)	2,938	6,981
Investment write-down	-	-	2,169
Deferred income taxes	1,351	(1,838)	1,241
Non-cash stock contribution to 401(k) plan	839	900	990
Tax benefit from exercise of stock options	5,153	167	276
Changes in operating assets and liabilities, net of effects of acquisitions:			
Accounts receivable	9,999	14,150	(2,362)
Inventories	10,211	19,534	12,970
Accounts payable and accrued liabilities	(5,634)	(25,830)	(5,751)
Other, net	3,271	(291)	(4,214)
-----			
Net cash provided by operating activities	66,861	52,573	49,060
-----			
Cash flows from investing activities:			
Capital expenditures	(4,539)	(4,624)	(7,032)
Proceeds from sale of property and equipment	2,338	1,285	-
Business acquisitions, net of cash acquired	(1,864)	-	(896)
Other, net	-	35	(2,175)
-----			
Net cash used in investing activities	(4,065)	(3,304)	(10,103)
-----			
Cash flows from financing activities:			
Net repayments under revolving credit agreement	(20,000)	(68,000)	(17,000)
Proceeds from issuance of long-term notes	-	30,000	-
Net repayments of bank and other debt	(1,824)	(1,901)	(5,565)
Net proceeds from issuances of common stock	4,031	840	1,246
Common stock dividends	(3,017)	(2,638)	(2,737)
Payment of debt acquisition costs	(775)	-	-
Purchase of treasury stock	(24,463)	(3,219)	(17,604)
-----			
Net cash used in financing activities	(46,048)	(44,918)	(41,660)
-----			
Net increase (decrease) in cash and cash equivalents	16,748	4,351	(2,703)
Cash and cash equivalents at beginning of year	9,132	4,781	7,484
-----			
Cash and cash equivalents at end of year	\$ 25,880	\$ 9,132	\$ 4,781
=====			

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

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

1. 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 97% of 2002 consolidated revenue and presently operates from 276 locations in 31 states and a national temporary staffing and permanent employment services ("Staffing") segment, which accounted for 3% of 2002 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, its wholly-owned subsidiaries and a majority-owned subsidiary. All significant intercompany accounts and transactions have been eliminated.

Use of Estimates

The preparation of 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, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates include valuation reserves for accounts receivable and inventory, income taxes, self-insurance and restructuring. Actual results could differ from those estimates.

#### Revenue Recognition

The Company recognizes revenue in accordance with Securities and Exchange Commission Staff Accounting Bulletin ("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 101 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.

#### 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.

#### New Accounting Pronouncements

Effective January 1, 2002, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 142 "Goodwill and Intangible Assets." SFAS No. 142 eliminates the current requirement to amortize goodwill and indefinite-lived intangible assets, addresses the amortization of intangible assets with a defined life and addresses impairment testing and recognition for goodwill and intangible assets. Pursuant to SFAS No. 142, intangible assets must be periodically tested for impairment (see Note 9).

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 Company does not believe that the adoption of SFAS No. 143 will have a significant impact on its consolidated financial statements.

Effective January 1, 2002, the Company adopted SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 replaces SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be

Disposed of" and the accounting and reporting provisions of Accounting Principles Board Opinion ("APB") No. 30, "Reporting the Results of Operations - Unusual and Infrequently Occurring Events and Transactions." SFAS No. 144 also amends Accounting Research Bulletin No. 51, "Consolidated Financial Statements,"

to eliminate the exception to consolidation of a subsidiary for which control is likely to be temporary. SFAS No. 144 establishes a single accounting model for assets to be disposed of by sale whether previously held and used or newly acquired. SFAS No. 144 retains the provisions of APB No. 30 for presentation of discontinued operations in the income statement, but broadens the presentation to include a component of an entity. The adoption of SFAS No. 144 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 Company plans to adopt SFAS No. 146 effective January 1, 2003 and does not expect that the adoption will have a material impact on its consolidated financial statements.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure." SFAS No. 148 amends SFAS No. 123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition to SFAS No. 123's fair value method of accounting for stock-based employee compensation. SFAS No. 148 also amends the disclosure provisions of SFAS No. 123 and APB No. 28, "Interim Financial Reporting," to require disclosures in the summary of significant accounting policies of the effects of an entity's accounting policy with respect to stock-based employee compensation on reported net income and earnings per share in annual and interim financial statements. SFAS No. 148 does not amend SFAS No. 123 to require companies to account for employee stock options using the fair value method. The Company adopted the disclosure provisions required in SFAS No. 148 effective December 31, 2002. See Note 6 for a description of the Company's stock-based compensation plans.

The Company applies the intrinsic value-based method of accounting prescribed by APB No. 25, "Accounting for Stock Issued to Employees," and related interpretations, in accounting for its fixed plan stock options. 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. SFAS No. 123, "Accounting for Stock-Based Compensation," 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. 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 earnings and earnings per share would be as follows:

Years Ended December 31,	2002	2001	2000
Net income, as reported	\$ 28,536	\$ 24,441	\$ 19,114
Deduct:			
Stock-based compensation expense determined under fair value based method, net of tax	2,766	4,187	4,261
Net income, pro forma	\$ 25,770	\$ 20,254	\$ 14,853
Basic earnings per share			
As reported	\$ 1.12	\$ 0.94	\$ 0.72
Pro forma	\$ 1.01	\$ 0.78	\$ 0.56
Diluted earnings per share			
As reported	\$ 1.07	\$ 0.90	\$ 0.69
Pro forma	\$ 0.97	\$ 0.74	\$ 0.53

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 2002, 2001 and 2000 was \$9.37, \$8.16 and \$6.56, respectively, and was estimated using the Black-Scholes option valuation model with the following weighted-average assumptions:

Years Ended December 31,	2002	2001	2000
Expected life in years	6.5	7.2	7.7
Risk-free interest rate	3.8%	5.1%	5.1%
Expected volatility	59.4%	67.5%	71.5%
Dividend yield	0.7%	0.7%	0.8%

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.

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In January 2003, the FASB issued EITF Issue No. 02-16 ("02-16"), "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor." EITF No. 02-16 addresses accounting and reporting issues related to how a reseller should account for cash consideration received from vendors. Generally, cash consideration received from vendors is presumed to be a reduction of the prices of the vendor's products or services and should, therefore, be characterized as a reduction of cost of sales when recognized in the customer's income statement. However, under certain circumstances this presumption may be overcome and recognition as revenue or as a reduction of other costs in the income statement may be appropriate. EITF No. 02-16 also addresses the accounting for a rebate or refund of a specified amount of cash consideration that is payable if the customer completes a specified cumulative level of purchases or remains a customer for a specified period. EITF No. 02-16 permits customers to recognize a rebate or refund of a specified amount of cash consideration that is payable if the customer completes a specified cumulative level of purchases or remains a customer for a specified period as a reduction of cost of sales, if the customer can reasonably estimate the amount of the rebate or refund on a systematic and rationale allocation. EITF No. 02-16 is effective for fiscal periods beginning after December 15, 2002. The Company does not expect that the adoption of EITF No. 02-16 will have a material effect on the Company's consolidated financial position or results of operations.

#### 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.

#### 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 \$7,295, \$7,900 and \$8,259 for the years ended December 31, 2002, 2001 and 2000, respectively.

#### Recoverability of Long-Lived Assets

The Company evaluates the recoverability of long-lived asset when events or circumstances indicate that the carrying amount of long-lived assets is not recoverable. When events or circumstances indicate that the carrying amount of long-lived assets is not 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. 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 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 whether or not the book value of goodwill has been 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).

#### Investment Securities

Investments in marketable equity securities of \$170 and \$204 at December 31, 2002 and 2001, respectively, are included in other 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 \$76 and \$95 in 2002 and 2001, respectively, net of income tax expense of \$41 and \$56 in 2002 and 2001, respectively. During the year ended December 31, 2000, the Company recorded a \$2,169 write-down related to the permanent impairment of an investment in marketable securities. The marketable securities were 75,166 shares in stock of a then publicly traded company. The Company's original basis was \$29.26 per share and had declined to 41 cents per share at December 31, 2000. In accordance with SFAS No. 115, "Accounting for Certain Investments in Equity Securities," the Company determined that the investment had been permanently impaired based on the probability of recovering the original investment, the financial condition and prospects of the entity and other factors. In May 2001, all of the outstanding shares of the issuer's common stock were sold following a merger at a tender offer price of 45 cents per share.

#### Advertising Costs

Advertising costs are expensed as incurred. Advertising expense amounted to \$4,674, \$4,305 and \$4,833 for the years ended December 31, 2002, 2001 and 2000, respectively.

#### 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:

Years Ended December 31,	2002	2001	2000
Weighted average shares outstanding	25,557,653	25,946,110	26,549,211
Dilutive stock options and restricted shares of common stock	1,116,112	1,304,941	1,243,821
Shares for diluted earnings per share	26,673,765	27,251,051	27,793,032
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	1,504,607	1,994,350	2,886,251

#### Derivative Instruments

The Company adopted 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 at December 31, 2002, 2001 and 2000. The changes in components of other comprehensive income for available-for-sale and derivative instruments for the years ended December 31, 2002, 2001 and 2000, respectively, are as follows:

Years Ended December 31,	2002	2001	2000
Unrealized loss on derivative instruments, net of income tax benefit of \$700 and \$894, in 2002 and 2001, respectively	\$ (1,315)	\$ (1,528)	\$ -
Cumulative effect of accounting change of derivative instruments, net of income tax benefit of \$372	-	(629)	-
Unrealized holding losses of available-for-sales securities arising during the period, net of income tax benefit of \$12, \$4 and \$27, respectively	(22)	(11)	(45)
Reclassification adjustment for losses realized from the write-down of available-for-sale securities, net of income tax of \$1 and \$480, respectively	-	1	819
Changes in value of available-for-sale securities and derivative instruments, net of income taxes	\$ (1,337)	\$ (2,167)	\$ 774

### Shipping & Handling

In July 2000, the Emerging Issues Task Force ("EITF") issued 00-10, "Accounting for Shipping and Handling Fees and Costs." EITF 00-10 became effective in the fourth quarter of 2000. EITF 00-10 prohibits the netting of shipping and handling costs against shipping and handling revenue. EITF 00-10 permits companies to adopt a policy of including shipping and handling costs in cost of sales or other income statement line items. Shipping and handling costs included in selling, general and administrative expenses amounted to \$5,214, \$5,697 and \$6,438 for the years ended December 31, 2002, 2001 and 2000, respectively.

### Restructuring

The Company records restructuring liabilities at the time the Board of Directors approves and commits to a restructuring plan that identifies all significant actions to be taken and the expected completion date of the plan is within a reasonable period of time. The Restructuring liabilities include those restructuring costs that can be reasonably estimated, are not associated with or do not benefit activities that will be continued and are not associated with or are not incurred to generate revenue after the plan's commitment date. Restructuring costs are incurred as a direct result of the plan and are incremental to other costs incurred by the Company in the conduct of its activities prior to the commitment date or existed prior to the commitment date under a contractual obligation that will either continue after the exit plan is completed with no economic benefit to the Company or reflect a penalty to cancel a contractual obligation. See Note 8 for further information regarding the Company's restructuring programs.

### Reclassifications

Certain reclassifications have been made to the 2001 and 2000 consolidated financial statements to conform to the 2002 presentation.

## 2. SUPPLIER CONCENTRATION

The Company has distribution agreements with five key equipment suppliers. Purchases from these five suppliers comprised 46%, 45% and 46% of all purchases made in 2002, 2001 and 2000, respectively. The Company's largest supplier accounted for 17%, 16% and 16% of all purchases made in 2002, 2001 and 2000, 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:

December 31,	2002	2001
Land, buildings and improvements	\$ 15,567	\$ 17,616
Machinery, vehicles and equipment	31,396	31,624
Furniture and fixtures	19,805	19,482
Corporate aircraft	7,542	6,271
	74,310	74,993
Less: accumulated depreciation and amortization	(48,460)	(44,290)
	\$ 25,850	\$ 30,703

## 4. LONG-TERM OBLIGATIONS

### Revolving Credit Agreement

In April 2002, the Company executed a bank-syndicated, unsecured revolving credit agreement which provides for borrowings of up to \$225,000, expiring in

April 2005. The April 2002 agreement replaced the Company's previous revolving credit agreement that would have expired on August 8, 2002. At December 31, 2002 and 2001, \$50,000 and \$70,000, respectively, were outstanding under a then existing revolving credit agreement. Borrowings under the revolving credit 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% and .5% at December 31, 2002 and 2001, respectively). The Company pays a variable commitment fee on the unused portion of the commitment. The revolving credit agreement contains 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 and dividends in addition to other restrictions. The Company is in compliance with such covenants at December 31, 2002. See Note 11 for details related to interest rate swap agreements designated as hedges.

Long-term Notes

The Company has a \$125,000 private placement shelf facility. In October 2002, the Company extended the maturity of the facility to January 2006. 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. On February 7, 2001, the Company issued \$30,000 Senior Series A Notes ("Notes") bearing 7.07% interest under its private placement shelf facility. 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 Company used the net proceeds from the issuance of the Notes for the repayment of a portion of its outstanding indebtedness under its then existing revolving credit facility.

Bank and Other Debt

Bank and other debt (net of current portion) of \$233 and \$1,900 at December 31, 2002 and 2001, respectively, primarily consists of promissory notes issued for business acquisitions and capital leases on equipment. Interest rates on bank and other debt range from 4% to 13% and mature at varying dates through 2005. Annual maturities of bank and other debt for the years subsequent to December 31, 2002 are \$272 in 2003, \$226 in 2004 and \$7 in 2005.

Total cash payments for interest were \$7,165, \$9,888 and \$12,499 for the years ended December 31, 2002, 2001 and 2000, respectively.

5. INCOME TAXES

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

Years Ended December 31,	2002	2001	2000
Federal	\$ 15,420	\$ 14,587	\$ 11,087
State	(222)	(659)	234
	\$ 15,198	\$ 13,928	\$ 11,321
Current	\$ 13,847	\$ 15,766	\$ 10,080
Deferred	1,351	(1,838)	1,241
	\$ 15,198	\$ 13,928	\$ 11,321

Following is a reconciliation of the effective income tax rate:

Years Ended December 31,	2002	2001	2000
Federal statutory rate	35.0%	35.0%	35.0%



Change in valuation allowance	(2.8)	-	-
State income taxes, net of federal benefit	2.6	1.3	2.2
	-----	-----	-----
	34.8%	36.3%	37.2%
	=====	=====	=====

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

December 31,	2002	2001
-----		
Deferred tax assets:		
Depreciation and amortization	\$ 327	\$ (101)
Accounts receivable reserves	1,546	2,295
Capitalized inventory costs and inventory reserves	1,520	4,740
Unrealized loss on derivative instruments	2,006	1,243
Net operating loss carryforwards of subsidiaries	4,330	3,053
Other	1,268	363
	-----	-----
	10,997	11,593
Less valuation allowance	(505)	(1,758)
	-----	-----
Total deferred tax assets	10,492	9,835
-----		
Deferred tax liabilities:		
Deductible goodwill	(6,937)	(4,886)
Other	(905)	(948)
	-----	-----
Total deferred tax liabilities	(7,842)	(5,834)
	-----	-----
Net deferred tax assets (1)	\$ 2,650	\$ 4,001
	=====	=====

(1) Net deferred tax assets of \$3,185 and \$7,615 have been included in the consolidated balance sheets in "Other current assets" at December 31, 2002 and 2001, 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 \$505 of valuation allowance at December 31, 2002 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 \$1,253 is reflected as a reduction in the provision for income taxes during 2002. At December 31, 2002, the Company had federal net operating loss carryforwards of \$696, which expire in the year 2004, and state net operating loss carryforwards of \$106,000, which expire in varying amounts from 2003 through 2017. These amounts are available to offset future taxable income.

Total cash payments for income taxes were \$6,973, \$13,280 and \$11,247 for the years ended December 31, 2002, 2001 and 2000, respectively.

## 6. STOCK BASED COMPENSATION AND BENEFIT PLANS

### Stock Option Plans

In June 2001, the Company's shareholders approved the 2001 Incentive Compensation Plan ("2001 Plan"). The 2001 Plan is administered by the Compensation Committee (the "Committee") of the Board of Directors. 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 Committee. Under the 2001 Plan, awards

for an aggregate of 3,000,000 shares of Common Stock and Class B Common Stock may be granted. Options as to 445,475 shares of Common Stock, net of cancellations and 200,000 shares of Class B Common Stock have been granted through December 31, 2002. There were 2,227,733 shares of common stock reserved for future grants as of December 31, 2002 under the 2001 Plan.

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 Committee 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 Committee 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 Committee 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.

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 3,075,638 of common stock are outstanding under the 1991 Plan at December 31, 2002. Options under the 1991 Plan are for a term of ten years and are exercisable as determined by the Committee. During 2002, 4,446 shares of Common Stock and 195,912 shares of Class B Common Stock with an aggregate market value of \$3,367 were delivered to the Company as payment for stock option exercises. Under the 1991 Plan, the Committee may waive the vesting period and permit options to be exercised immediately.

A summary of option activity is shown below:

	2002		2001		2000	
	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
Outstanding on January 1,	5,003,809	\$ 10.48	4,923,096	\$ 10.78	4,157,833	\$ 11.23
Granted	206,625	14.30	655,325	11.46	1,121,289	9.39
Exercised	(1,243,533)	5.43	(69,301)	6.95	(91,275)	5.84
Forfeited	(252,788)	14.12	(505,311)	15.11	(264,751)	13.75
Outstanding on December 31,	3,714,113	\$ 12.13	5,003,809	\$ 10.48	4,923,096	\$ 10.78
Options exercisable at end of year	2,682,088	\$ 12.42	3,428,980	\$ 10.07	3,158,851	\$ 10.01

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The following sets forth certain information with respect to those stock options outstanding on December 31, 2002:

	Options Outstanding			Options Exercisable		
	Number Outstanding at December 31, 2002	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life	Number Exercisable at December 31, 2002	Weighted-Average Exercise Price	
\$2.32 - \$5.00	236,251	\$ 3.93	1.0	236,251	\$ 3.93	
\$5.01 - \$10.00	899,800	8.34	6.2	575,600	8.23	
\$10.01-\$15.00	1,366,575	12.46	7.3	761,575	12.84	
\$15.01-\$20.00	1,206,237	16.72	4.8	1,103,712	16.09	
\$20.01-\$23.17	5,250	21.08	4.5	4,950	20.96	
	3,714,113	\$ 12.13	5.8	2,682,088	\$ 12.42	

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#### 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 2002, 2001 and 2000 employees purchased 52,795, 31,681 and 77,822 shares of Common Stock at an average price of \$12.39, \$10.38 and \$8.54 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 1,478, 1,767 and 2,322 for the years ended December 31, 2002, 2001 and 2000, respectively. At December 31, 2002, 189,733 shares remained available for purchase under the plan.

#### Restricted Stock

During 2002 and 2001, the Company granted 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 2002, 2001 and 2000, 10,441, 30,000 and 45,000 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 \$816, \$596 and \$389 for the years ended December 31, 2002, 2001 and 2000, respectively.

#### 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, 2002, 2001 and 2000, the Company's aggregate contribution to the plan was \$848, \$909 and \$998, respectively.

### 7. ACQUISITIONS

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, accordingly, their results of operations have been included in the consolidated statement of income beginning on the dates of acquisition.

During 2000, the Company completed the acquisition of a refrigeration equipment distributor in Florida for cash consideration of \$896.

The Company's reported revenue, net income and diluted earnings per share would not be materially different if the above acquisitions had occurred on January 1, 2000.

### 8. RESTRUCTURING AND NON-CASH CHARGES

During 2001 and 2000, 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 activities related to the 2001 and 2000 Restructuring Plans discussed below are complete as of December 31, 2002.

#### 2001 Restructuring Plan

In September 2001, the Company's Board of Directors approved plans to integrate the Distribution segment's manufactured housing subsidiaries, close six distribution locations, close seven staffing locations and exit certain licensee relationships in the Staffing segment (the "2001 Restructuring Plan"). During the second quarter of 2002, based on a continued reassessment of the 2001 Restructuring Plan and activities, the Company determined that three of the six distribution locations should remain open. In the Staffing segment, all seven locations were closed and the licensee relationships were terminated in 2001.

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 in accordance with EITF Issue 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs Incurred in a Restructuring)," SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," and SAB No. 100, "Restructuring & Impairment Charges." The portion of the restructuring charge that relates to the valuation of inventory to be disposed of (\$328 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.

Also during the third quarter of 2001, the Company recorded non-cash charges of \$1,085 for the write-off of an asset related to a supply arrangement in the Distribution segment, \$827 for additional accounts receivable valuation reserves in the Staffing segment and \$686 related to a terminated licensee's workers compensation program in the Staffing segment. Non-cash charges are included in selling, general and administrative expenses, except for the charge related to the worker's compensation program, which is included in cost of sales in the Company's consolidated statement of income for the year ended December 31, 2001.

On an after-tax basis, the restructuring and other non-cash charges were \$3,691 for the year ended December 31, 2001.

#### 2000 Restructuring Plan

In December 2000, the Company's Board of Directors approved plans adopted by certain operating subsidiaries to close under performing locations, reduce market overlap, dispose of inventory related to discontinued product lines and eliminate other unproductive SKUs (the "2000 Restructuring Plan"). In connection with the 2000 Restructuring Plan, 25 distribution locations closed during 2000 and 7 distribution locations closed during 2001.

The Company recorded restructuring charges of \$8,481 (\$5,326 after-tax) during the fourth quarter of 2000. A portion of the restructuring charge (\$4,269 on a pre-tax basis) related to the valuation of inventory to be disposed of and is classified in cost of sales in the Company's consolidated statement of income for the year ended December 31, 2000.

Also during the fourth quarter of 2000, the Company recorded non-cash charges of \$788 related to additional inventory reserves in cost of sales, \$1,731 related to accounts receivable valuation reserves in selling, general and administrative expenses and \$2,169 related to the write-down of an impaired investment in one of the Company's primary competitors in other expense. See Note 1 for additional information regarding the Company's policy on accounting for investment securities.

On an after-tax basis, restructuring and other non-cash charges were \$8,270 for the year ended December 31, 2000.

The following table summarizes the activity in restructuring liabilities or valuation reserves during the years ended December 31, 2002, 2001 and 2000 for the 2001 and 2000 Restructuring Plans:

	Balance January 1	Restructuring Charges	Utilized		Change in Estimate	Balance December 31
			Cash	Non-cash		
2002 Activity:						
Noncancelable lease obligations	\$ 1,091	\$ -	\$ (605)	\$ -	\$ (486)	\$ -
Discontinued product lines	328	-	-	(574)	246	-
Other	294	-	(241)	-	(53)	-
	\$ 1,713	\$ -	\$ (846)	\$ (574)	\$ (293)	\$ -
2001 Activity:						
Discontinued product lines	\$ 3,484	\$ 328	\$ -	\$ (3,484)	\$ -	\$ 328
Noncancelable lease obligations	1,194	1,424	(1,224)	-	(303)	1,091
Other	409	358	(524)	(25)	76	294
Asset write-down	68	1,314	-	(1,382)	-	-
	\$ 5,155	\$ 3,424	\$ (1,748)	\$ (4,891)	\$ (227)	\$ 1,713
2000 Activity:						
Discontinued product lines	\$ -	\$ 4,269	\$ -	\$ (785)	\$ -	\$ 3,484
Noncancelable lease obligations	-	1,541	(347)	-	-	1,194
Write-down of accounts receivable	-	924	-	(894)	-	30
Employee severance and benefits	-	326	(272)	-	-	54
Write-down of property and equipment	-	185	-	(147)	-	38
Other	-	1,236	(881)	-	-	355
	\$ -	\$ 8,481	\$ (1,500)	\$ (1,826)	\$ -	\$ 5,155

The restructuring charges were determined based on formal plans approved by the Company's Board of Directors using the best information available to it at the time. The Company's restructuring activities have resulted in a simplified operating structure that should enhance future profitability.

#### 9. GOODWILL & OTHER INTANGIBLE ASSETS

On January 1, 2002, the Company adopted the provisions of SFAS No. 142. SFAS No. 142 eliminates the requirement to amortize goodwill and indefinite-lived intangible assets, addresses the amortization of intangible assets with a defined life and addresses the impairment testing and recognition for goodwill and intangible assets. To apply the provisions of SFAS No. 142, the Company is required to identify its reporting units. 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. In accordance with the transition provisions of SFAS No. 142, the Company was required to perform an initial impairment review of goodwill as of the transition date of January 1, 2002. This test involved the use of estimates to determine the fair value of the Company's reporting units with which goodwill was associated and compared to the carrying value of the reporting unit. 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.

On January 1, 2003, the Company performed the required annual goodwill impairment test and determined there was no impairment.

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 market value multiples. The operating results of the Staffing segment have been negatively impacted by economic softness experienced in the past two 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. There can be no assurance that goodwill impairment will not occur in the future.

Net income and basic and diluted earnings per share, adjusted to exclude amounts no longer being amortized are as follow:

Year Ended December 31,	2002	2001	2000
Reported net income	\$ 28,536	\$ 24,441	\$ 19,114
Adjustments:			
Goodwill amortization expense	-	3,587	3,612
Income tax effect	-	(1,302)	(1,344)
Adjusted net income	\$ 28,536	\$ 26,726	\$ 21,382
Basic earnings per share:			
Reported	\$ 1.12	\$ 0.94	\$ 0.72
Adjusted	\$ 1.12	\$ 1.03	\$ 0.81
Diluted earnings per share:			
Reported	\$ 1.07	\$ 0.90	\$ 0.69
Adjusted	\$ 1.07	\$ 0.98	\$ 0.77

The changes in the carrying amount of goodwill for the year ended December 31, 2002 are as follow:

	Distribution	Staffing	Total
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

See Note 7 for additional information regarding acquisitions made in 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 authorized the repurchase, at management's discretion, of up to 7,500,000 shares of the Company's stock in the open market or via private transactions. Shares repurchased under the program are accounted for using the cost method and result in a reduction of shareholders' equity. The Company purchased 1,610,900 shares at a cost of \$24,463 in 2002, 263,800 shares at a cost of \$3,219 in 2001 and 1,749,313 shares at a cost of \$17,604 in 2000. In aggregate since the inception of the repurchase plan in 1999, the Company has repurchased 4,970,213 shares of Common Stock and Class B Common Stock at a cost of \$59,607.

#### 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, 2002 and 2001, 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

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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, 2002 and 2001, the Company's interest rate swap portfolio consisted of swaps aggregating a notional value of \$50,000 and \$60,000, 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 2002 and 2001. All interest rate swaps are effective as cash flow hedges and therefore there is no effect on current earnings from hedge ineffectiveness.

The adoption of SFAS No. 133 on January 1, 2001 resulted in a cumulative pre-tax reduction to OCI of \$1,001 (\$629 after-tax). The Company also recorded a loss in OCI relating to the change in value of the cash flow hedges of \$1,315, net of income tax benefit of \$700 for the year ended December 31, 2002 and \$1,528, net of income tax benefit of \$894 for the year ended December 31, 2001. The fair market values of the derivative financial instruments are liabilities of \$5,438 and \$3,424 at December 31, 2002 and 2001, respectively, and are recorded in other liabilities in the Company's consolidated balance sheets.

During the years ended December 31, 2002 and 2001, the Company reclassified \$1,613, net of income tax benefit of \$859 and \$786, net of income tax benefit of \$448, respectively from accumulated other comprehensive income to current period earnings (recorded in interest expense, net in the consolidated statements of income). The net deferred loss recorded in accumulated other comprehensive income will be reclassified to earnings on a quarterly basis as interest payments occur. As of December 31, 2002, approximately \$2,007 in deferred losses on derivative instruments accumulated in other comprehensive income is expected to be reclassified to earnings during the next twelve months using a current three month LIBOR-based average receive rate (1.36% at December 31, 2002).

At December 31, 2002 and 2001, respectively, the Company is contingently liable under standby letters of credit aggregating approximately \$5,819 and \$3,400, respectively, that were 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 past transactions with customers, the credit worthiness of specific customers, historical trends and other information. At December 31, 2002 and 2001, the allowance for doubtful accounts was \$3,758 and \$6,321, respectively. Although the Company believes its allowance is sufficient, if the financial condition of the Company's customers were to 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, 2002, the Company is obligated under non-cancelable operating leases of real property and equipment used in its operations for minimum annual rentals of \$24,769 in 2003, \$18,983 in 2004, \$13,624 in 2005, \$8,619 in 2006, \$5,823 in 2007 and \$6,075 thereafter. Rental expense for the years ended December 31, 2002, 2001 and 2000 was \$27,490, \$27,962 and \$26,462, respectively.

### Minimum Royalty Payments

At December 31, 2002, 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 97%, 96% and 95% of revenue in 2002, 2001 and 2000, 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.

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.

No single customer accounted for more than 10% of the Company's revenue in 2002, 2001 and 2000.

Years ended December 31,	2002	2001	2000
-----			
Revenue:			
Distribution	\$ 1,147,561	\$ 1,194,587	\$ 1,243,208
Staffing	33,575	44,059	66,958
	-----	-----	-----
	\$ 1,181,136	\$ 1,238,646	\$ 1,310,166
=====			
Operating income:			
Distribution	\$ 64,626	\$ 60,659	\$ 53,098
Staffing	(1,739)	(2,265)	2,975
Corporate expenses	(11,963)	(10,070)	(10,258)
	-----	-----	-----
	\$ 50,924	\$ 48,324	\$ 45,815
=====			
Depreciation and amortization:			
Distribution	\$ 6,648	\$ 10,713	\$ 11,020
Staffing	301	548	607
Corporate	346	226	244
	-----	-----	-----
	\$ 7,295	\$ 11,487	\$ 11,871
=====			
Restructuring and non-cash charges:			
Distribution	\$ (277)	\$ 3,272	\$ 11,000
Staffing	(16)	2,523	-
Corporate	-	-	2,169
	-----	-----	-----
	\$ (293)	\$ 5,795	\$ 13,169
=====			
Assets:			
Distribution	\$ 446,411	\$ 476,499	\$ 522,157
Staffing	10,379	10,836	16,579
Corporate	46,929	33,485	24,734
	-----	-----	-----
	\$ 503,719	\$ 520,820	\$ 563,470
=====			
Capital expenditures:			
Distribution	\$ 3,380	\$ 4,366	\$ 6,505
Staffing	237	228	455
Corporate	922	30	72
	-----	-----	-----
	\$ 4,539	\$ 4,624	\$ 7,032
=====			

#### 14. RELATED PARTY TRANSACTIONS

At December 31, 2002, the Company and a member of the Board of Directors had a 75% and 25% equity interest, respectively, in A2 Jet Leasing LLC ("A2 Jet Leasing"), a company which performs aircraft leasing services to the Company, the member of the Board of Directors and his affiliates and unaffiliated third parties. During 2002, 2001 and 2000, A2 Jet Leasing recovered \$770, \$702 and \$416, 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 owned by the member of the Board of Directors for total cash consideration of \$1,294.

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 2002, 2001 and 2000, the Company paid this firm \$44, \$42 and \$29, respectively, for services performed.

On April 15, 2002, the Company granted a loan in the amount of \$160 to the Company's Chief Financial Officer for the purchase of a primary residence. The loan bears interest at 5%, payable annually, and matures on April 15, 2007. 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 and does not involve more than normal risk of collectibility.

#### 15. SUBSEQUENT EVENTS

In January 2003, the Company's Board of Directors approved an increase in the quarterly cash dividend to \$.04 per share from \$.03 per share. On an annualized basis the dividend rate will be \$.16 per share. The first dividend at the new rate was paid on January 31, 2003.

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#### REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Directors and Shareholders  
Watsco, Inc.

We have audited the accompanying consolidated balance sheet of Watsco, Inc. and subsidiaries as of December 31, 2002, and the related consolidated statements of income, shareholders' equity and cash flows for the year 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 audit. The consolidated financial statements of Watsco, Inc. as of December 31, 2001 and for each of the two years in the period 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 audit 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 audit provides a reasonable basis for our opinion.

In our opinion, the 2002 financial statements referred to above present fairly, in all material respects, the consolidated financial position of Watsco, Inc. and subsidiaries at December 31, 2002, and the consolidated results of their operations and their cash flows for the year 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. as of December 31, 2001, and for each of the two years in the period 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 and 2000 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 those periods 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 and 2000 in Note 9 are appropriate. However, we were not engaged to audit, review, or apply any procedures to the 2001 and 2000 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 and 2000 financial statements taken as a whole.

ERNST & YOUNG LLP

Miami, Florida  
February 14, 2003

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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 to 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 as of December 31, 2001 and for each of the two years in the period 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 and 2000 consolidated financial statements. These revisions to the 2001 and 2000 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).

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

(In thousands, except per share data)	1ST QUARTER	2ND QUARTER	3RD QUARTER	4TH QUARTER	TOTAL
-----					
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 (2)	\$ 3,042	\$ 12,466	\$ 11,842	\$ 1,186	\$ 28,536
=====					
Diluted earnings per share (2), (4)	\$ 0.11	\$ 0.46	\$ 0.45	\$ 0.05	\$ 1.07
=====					
YEAR ENDED DECEMBER 31, 2001					
Revenue (1)	\$ 278,113	\$351,149	\$ 336,008	\$ 273,376	\$ 1,238,646
Gross profit	68,762	84,011	80,721	65,546	299,040
-----					
Net income	\$ 2,366	\$ 12,984	\$ 8,080	\$ 1,011	\$ 24,441
Net income adjusted for SFAS No. 142	2,921	13,548	8,650	1,607	26,726
=====					
Diluted earnings per share (3), (4)	\$ 0.09	\$ 0.48	\$ 0.29	\$ 0.04	\$ 0.90
Diluted earnings per share adjusted for SFAS No. 142 (3), (4)	0.11	0.50	0.32	0.06	\$ 0.98
=====					

- (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) 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.
- (3) During the 3rd Quarter of 2001, the Company recorded restructuring and other non-cash charges of \$3,691 or \$0.14 per share on an after-tax basis, as more fully described in Note 8 to the consolidated financial

statements.

- (4) 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.

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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, 2002, 2001 and 2000. At March 20, 2003, excluding shareholders with stock in street name, the Company had 470 Common Stock shareholders of record and 212 Class B Common Stock shareholders of record.

	COMMON		CLASS B		CASH DIVIDENDS	
	HIGH	LOW	HIGH	LOW	COMMON	CLASS B
=====						
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
=====						
YEAR ENDED DECEMBER 31, 2000:						
Fourth quarter	\$ 12.04	\$ 8.89	\$ 11.81	\$ 9.00	\$ .025	\$ .025
Third quarter	13.94	10.05	13.63	10.25	.025	.025
Second quarter	15.75	10.44	15.94	10.50	.025	.025
First quarter	12.50	8.38	12.81	8.88	.025	.025
=====						

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## REGISTRANT'S SUBSIDIARIES

The following table sets forth, at March 27, 2003, 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.

Active Subsidiaries: -----	State of Incorporation -----
Distribution:	
A2 Jet Leasing, LLC	Florida
ACDoctor.com Inc.	Texas
Air Supply Distributing LLC	California
Air Systems Distributors, Inc.	Florida
Atlantic Service & Supply LLC	Delaware
Baker Distributing Company LLC	Delaware
Coastline Distribution LLC	Delaware
Cool Holdings LLC	Delaware
Comfort Supply, Inc.	Delaware
Comfort Products Distributing LLC	Delaware
Gemair Distributors LLC	Delaware
HBA Distributors LLC	Delaware
Heat Incorporated LLC	New Hampshire
Heating & Cooling Supply LLC	California
Homans Associates 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 Staffing Systems, Inc.	Delaware
Dunhill Staffing Systems of Milwaukee, Inc.	Wisconsin
Dunhill Temporary Systems, Inc.	New York
Dunhill Temporary Systems of Indianapolis, Inc.	Indiana

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. 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 report dated February 14, 2003, with respect to the 2002 consolidated financial statements and schedule of Watsco, Inc. included in this Annual Report (Form 10-K) for the year ended December 31, 2002.

/s/ Ernst & Young LLP

Miami, Florida,  
March 31, 2003.

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 statements as of December 31, 2001 and December 31, 2000, included in the Annual Report on Form 10-K for the year ended December 31, 2002.

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  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report on Form 10-K of Watsco, Inc. (the "Company") for the year ended December 31, 2002 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Albert H. Nahmad, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 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 present, in all material respects, the financial condition and results of operations of the Company.

/s/ Albert H. Nahmad

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Albert H. Nahmad  
Chief Executive Officer  
March 31, 2003

CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report on Form 10-K of Watsco, Inc. (the "Company") for the year ended December 31, 2002 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Barry S. Logan, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 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 present, in all material respects, the financial condition and results of operations of the Company.

/s/ Barry S. Logan  
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Barry S. Logan  
Chief Financial Officer  
March 31, 2003