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

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2017

or

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

For the Transition Period From __________ to __________

Commission file number 1-5581

I.R.S. Employer Identification Number 59-0778222

WATSCO, INC.

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer	☒	Accelerated filer	☐
Non-accelerated filer	☐	Smaller reporting company	☐
		Emerging growth company	☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES ☐ NO ☒

The number of shares of each class of our common stock outstanding as of November 3, 2017 was (i) 30,513,744 shares of Common stock, $0.50 par value per share, excluding 6,287,650 treasury shares, and (ii) 5,228,395 shares of Class B common stock, $0.50 par value per share, excluding 48,263 treasury shares.

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WATSCO, INC. AND SUBSIDIARIES

QUARTERLY REPORT ON FORM 10-Q

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PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS

WATSCO, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED UNAUDITED STATEMENTS OF INCOME
(In thousands, except per share data)

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Revenues	**$1,229,591**	$1,241,232	**$3,377,610**	$3,307,091
Cost of sales	**933,696**	939,028	**2,552,881**	2,500,579
Gross profit	**295,895**	302,204	**824,729**	806,512
Selling, general and administrative expenses	**183,728**	182,904	**534,515**	518,954
Other income	**2,294**	—	**2,294**	—
Operating income	**114,461**	119,300	**292,508**	287,558
Interest expense, net	**2,117**	996	**5,019**	3,036
Income before income taxes	**112,344**	118,304	**287,489**	284,522
Income taxes	**32,325**	37,786	**82,855**	88,406
Net income	**80,019**	80,518	**204,634**	196,116
Less: net income attributable to non-controlling interest	**14,990**	17,419	**39,668**	42,859
Net income attributable to Watsco, Inc.	**$ 65,029**	$ 63,099	**$ 164,966**	$ 153,257
Earnings per share for Common and Class B common stock:				
Basic	**$ 1.82**	$ 1.78	**$ 4.62**	$ 4.33
Diluted	**$ 1.82**	$ 1.78	**$ 4.62**	$ 4.32

See accompanying notes to condensed consolidated unaudited financial statements.

WATSCO, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED UNAUDITED STATEMENTS OF COMPREHENSIVE INCOME
(In thousands)

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Net income	**$80,019**	$80,518	**$204,634**	$196,116
Other comprehensive income (loss), net of tax				
Foreign currency translation adjustment	**9,385**	(3,453)	**17,310**	11,433
Unrealized (loss) gain on cash flow hedging instruments	**(934)**	391	**(1,021)**	(1,484)
Reclassification of loss (gain) on cash flow hedging instruments into earnings	**64**	94	**(797)**	492
Unrealized gain on available-for-sale securities	**13**	12	**16**	3
Other comprehensive income (loss)	**8,528**	(2,956)	**15,508**	10,444
Comprehensive income	**88,547**	77,562	**220,142**	206,560
Less: comprehensive income attributable to non-controlling interest	**18,201**	16,291	**45,518**	46,931
Comprehensive income attributable to Watsco, Inc.	**$70,346**	$61,271	**$174,624**	$159,629

See accompanying notes to condensed consolidated unaudited financial statements.

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

	September 30, 2017 (Unaudited)	December 31, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 66,667**	$ 56,010
Accounts receivable, net	**568,457**	475,974
Inventories	**786,056**	685,011
Other current assets	**17,761**	23,161
Total current assets	**1,438,941**	1,240,156
Property and equipment, net	**91,483**	90,502
Goodwill	**382,969**	379,737
Intangible assets, net	**163,013**	158,564
Other assets	**71,813**	5,690
	$ 2,148,219	$ 1,874,649
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current portion of other long-term obligations	**$ 244**	$ 200
Accounts payable	**296,349**	185,482
Accrued expenses and other current liabilities	**163,806**	129,206
Total current liabilities	**460,399**	314,888
Long-term obligations:		
Borrowings under revolving credit agreement	**284,700**	235,294
Other long-term obligations, net of current portion	**345**	348
Total long-term obligations	**285,045**	235,642
Deferred income taxes and other liabilities	**70,740**	72,371
Commitments and contingencies		
Watsco, Inc. shareholders' equity:		
Common stock, $0.50 par value	**18,350**	18,341
Class B common stock, $0.50 par value	**2,687**	2,610
Preferred stock, $0.50 par value	**—**	—
Paid-in capital	**582,789**	592,350
Accumulated other comprehensive loss, net of tax	**(33,872)**	(43,530)
Retained earnings	**595,980**	550,482
Treasury stock, at cost	**(113,795)**	(114,425)
Total Watsco, Inc. shareholders' equity	**1,052,139**	1,005,828
Non-controlling interest	**279,896**	245,920
Total shareholders' equity	**1,332,035**	1,251,748
	$ 2,148,219	$ 1,874,649

See accompanying notes to condensed consolidated unaudited financial statements.

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

	Nine Months Ended September 30, 2017	Nine Months Ended September 30, 2016
Cash flows from operating activities:		
Net income	**$ 204,634**	$ 196,116
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**16,509**	15,078
Share-based compensation	**9,599**	8,359
Deferred income tax provision	**4,101**	3,984
Non-cash contribution to 401(k) plan	**2,428**	2,348
Other income from investment in unconsolidated entity	**(2,294)**	—
Other, net	**103**	1,901
Changes in operating assets and liabilities:		
Accounts receivable	**(89,394)**	(96,692)
Inventories	**(97,685)**	(63,480)
Accounts payable and other liabilities	**137,211**	83,549
Other, net	**(507)**	(4,863)
Net cash provided by operating activities	**184,705**	146,300
Cash flows from investing activities:		
Investment in unconsolidated entity	**(63,600)**	—
Capital expenditures	**(13,829)**	(8,989)
Proceeds from sale of property and equipment	**139**	675
Net cash used in investing activities	**(77,290)**	(8,314)
Cash flows from financing activities:		
Dividends on Common and Class B common stock	**(119,468)**	(90,298)
Purchase of additional ownership from non-controlling interest	**(42,688)**	—
Distributions to non-controlling interest	**(6,799)**	(26,027)
Net proceeds (repayments) of other long-term obligations	**41**	(110)
Net proceeds from issuances of common stock	**3,115**	4,962
Net proceeds from the sale of Common stock	**5,391**	—
Proceeds from non-controlling interest for investment in unconsolidated entity	**12,720**	—
Net proceeds (repayments) under revolving credit agreement	**49,406**	(25,900)
Net cash used in financing activities	**(98,282)**	(137,373)
Effect of foreign exchange rate changes on cash and cash equivalents	**1,524**	68
Net increase in cash and cash equivalents	**10,657**	681
Cash and cash equivalents at beginning of period	**56,010**	35,229
Cash and cash equivalents at end of period	**$ 66,667**	$ 35,910

See accompanying notes to condensed consolidated unaudited financial statements.

WATSCO, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS
September 30, 2017
(In thousands, except share and per share data)

1. BASIS OF PRESENTATION

Basis of Consolidation

Watsco, Inc. (collectively with its subsidiaries, “Watsco,” “we,” “us” or “our”) was incorporated in Florida in 1956 and is the largest distributor of air conditioning, heating and refrigeration equipment and related parts and supplies (“HVAC/R”) in the HVAC/R distribution industry in North America. The accompanying September 30, 2017 interim condensed consolidated unaudited financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures normally included in the annual financial statements prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) have been condensed or omitted pursuant to those rules and regulations, but we believe the disclosures made are adequate to make the information presented not misleading. In the opinion of management, all adjustments, consisting of normal and recurring adjustments, necessary for a fair presentation have been included in the condensed consolidated unaudited financial statements included herein. These statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in our 2016 Annual Report on Form 10-K.

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

The results of operations for the quarter and nine months ended September 30, 2017 are not necessarily indicative of the results to be expected for the year ending December 31, 2017. Sales of residential central air conditioners, heating equipment and parts and supplies are seasonal. Furthermore, results of operations can be impacted favorably or unfavorably based on weather patterns, primarily during the Summer and Winter selling seasons. Demand related to the residential central air conditioning replacement market is typically highest in the second and third quarters, and demand for heating equipment is usually highest in the fourth quarter. Demand related to the new construction market is fairly consistent during the year, subject to weather and economic conditions, including their effect on the number of housing completions.

Equity Method Investments

Investments in which we have the ability to exercise significant influence, but do not control, are accounted for under the equity method of accounting and are included in other assets in our consolidated balance sheets. Under this method of accounting, our proportionate share of the net income or loss of the investee is included in other income in our consolidated statements of income.

Reclassifications

Certain reclassifications of prior year amounts have been made to conform to the 2017 presentation. These reclassifications had no effect on net income or earnings per share as previously reported.

Use of Estimates

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

New Accounting Standards

Revenue Recognition

In May 2014, the Financial Accounting Standards Board (the “FASB”) issued a standard on revenue recognition that provides a single, comprehensive revenue recognition model for all contracts with customers. The standard is principle-based and provides a five-step model to determine the measurement of revenue and timing of when it is recognized. This standard may be applied using either of the following transition methods: (i) a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients or (ii) a modified retrospective approach with the cumulative effect of initially adopting the standard recognized at the date of adoption, which requires additional footnote disclosures. This standard is effective for our interim and annual reporting periods beginning on January 1, 2018.

Based on our initial assessment, we expect similar performance obligations to result under this guidance as compared with deliverables and separate units of accounting currently identified. As a result, we expect the timing of our revenue recognition to generally remain the same. We continue to evaluate the impact the standard has on our determination of whether we act as principal or agent in certain vendor arrangements, representing less than 3% of our consolidated revenues, as well as analyze certain customer incentives. While we have not yet completed our evaluation process, at this time we have not identified any material impacts to our consolidated net income, balance sheet or cash flows.

Measurement of Inventory

In July 2015, the FASB issued guidance that simplifies the measurement of inventory by replacing the lower of cost or market test with a lower of cost and net realizable value test. The guidance applies to all inventory that is measured using first-in, first-out or average cost methods. This guidance must be applied prospectively and became effective for interim and annual reporting periods beginning after December 15, 2016. The adoption of this guidance did not have an impact on our consolidated financial statements.

Classification of Deferred Taxes

In November 2015, the FASB issued guidance that requires deferred tax assets and liabilities to be classified as noncurrent in a classified balance sheet. This guidance may be applied either prospectively or retrospectively and became effective for interim and annual reporting periods beginning after December 15, 2016. The adoption of this guidance on January 1, 2017 using the prospective approach did not have a material impact on our consolidated financial statements.

Leases

In February 2016, the FASB issued guidance on accounting for leases, which requires lessees to recognize most leases on their balance sheets for the rights and obligations created by those leases. The guidance requires enhanced disclosures regarding the amount, timing and uncertainty of cash flows arising from leases. This guidance will be applied using a modified retrospective approach and is effective for interim and annual periods beginning after December 15, 2018 with early adoption permitted. We will adopt this guidance on January 1, 2019. While we are still evaluating the impact of adopting this guidance on our consolidated financial statements, including the option to elect certain practical expedients, we expect that, upon adoption, the right-of-use assets and lease liabilities recorded could be material to our consolidated balance sheets. However, we do not expect a material impact to our consolidated statements of income.

Intangibles—Goodwill and Other

In January 2017, the FASB issued guidance to simplify the subsequent measurement of goodwill by eliminating Step 2 from the goodwill impairment test. Under this updated standard, an entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value, but the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. An entity also should consider income tax effects from any tax-deductible goodwill on the carrying amount of the reporting unit when measuring the goodwill impairment loss, if any. This guidance is effective prospectively and is effective for interim and annual periods beginning after December 15, 2019 with early adoption permitted. We do not expect the adoption of this guidance to have a material impact to our consolidated financial statements.

Stock Compensation

In May 2017, the FASB issued guidance to clarify when to account for a change to the terms or conditions of a share-based payment award as a modification. Under the new guidance, modification accounting is required only if the fair value, the vesting conditions or the classification of the award (as equity or liability) changes as a result of the change in terms or conditions. This guidance is effective prospectively and is effective for interim and annual periods beginning after December 15, 2017 with early adoption permitted. We do not expect the adoption of this guidance to have a material impact to our consolidated financial statements.

Derivatives and Hedging

In August 2017, the FASB issued guidance to simplify the accounting for hedging derivatives. This guidance is effective prospectively and is effective for interim and annual periods beginning after December 15, 2018 with early adoption permitted. We do not expect the adoption of this guidance to have a material impact to our consolidated financial statements.

2. EARNINGS PER SHARE

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

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Basic Earnings per Share:				
Net income attributable to Watsco, Inc. shareholders	**$ 65,029**	$ 63,099	**$ 164,966**	$ 153,257
Less: distributed and undistributed earnings allocated to non-vested restricted common stock	**5,470**	5,081	**13,844**	12,388
Earnings allocated to Watsco, Inc. shareholders	**$ 59,559**	$ 58,018	**$ 151,122**	$ 140,869
Weighted-average common shares outstanding - Basic	**32,712,151**	32,613,995	**32,679,334**	32,567,073
Basic earnings per share for Common and Class B common stock	**$ 1.82**	$ 1.78	**$ 4.62**	$ 4.33
Allocation of earnings for Basic:				
Common stock	**$ 54,627**	$ 53,186	**$ 138,594**	$ 129,120
Class B common stock	**4,932**	4,832	**12,528**	11,749
	$ 59,559	$ 58,018	**$ 151,122**	$ 140,869
Diluted Earnings per Share:				
Net income attributable to Watsco, Inc. shareholders	**$ 65,029**	$ 63,099	**$ 164,966**	$ 153,257
Less: distributed and undistributed earnings allocated to non-vested restricted common stock	**5,468**	5,078	**13,840**	12,383
Earnings allocated to Watsco, Inc. shareholders	**$ 59,561**	$ 58,021	**$ 151,126**	$ 140,874
Weighted-average common shares outstanding - Basic	**32,712,151**	32,613,995	**32,679,334**	32,567,073
Effect of dilutive stock options	**34,215**	36,158	**32,516**	34,042
Weighted-average common shares outstanding - Diluted	**32,746,366**	32,650,153	**32,711,850**	32,601,115
Diluted earnings per share for Common and Class B common stock	**$ 1.82**	$ 1.78	**$ 4.62**	$ 4.32
Anti-dilutive stock options not included above	**12,571**	3,565	**33,156**	18,876

Diluted earnings per share for our Common stock assumes the conversion of all of our Class B common stock into Common stock as of the beginning of the fiscal year; therefore, no allocation of earnings to Class B common stock is required. At September 30, 2017 and 2016, our outstanding Class B common stock was convertible into 2,709,194 and 2,716,320 shares of our Common stock, respectively.

3. OTHER COMPREHENSIVE INCOME (LOSS)

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

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Foreign currency translation adjustment	**$ 9,385**	$(3,453)	**$17,310**	$11,433
Unrealized (loss) gain on cash flow hedging instruments	**(1,280)**	536	**(1,399)**	(2,033)
Income tax benefit (expense)	**346**	(145)	**378**	549
Unrealized (loss) gain on cash flow hedging instruments, net of tax	**(934)**	391	**(1,021)**	(1,484)
Reclassification of loss (gain) on cash flow hedging instruments into earnings	**88**	129	**(1,092)**	674
Income tax (benefit) expense	**(24)**	(35)	**295**	(182)
Reclassification of loss (gain) on cash flow hedging instruments into earnings, net of tax	**64**	94	**(797)**	492
Unrealized gain on available-for-sale securities	**20**	19	**25**	4
Income tax expense	**(7)**	(7)	**(9)**	(1)
Unrealized gain on available-for-sale securities, net of tax	**13**	12	**16**	3
Other comprehensive income (loss)	**$ 8,528**	$(2,956)	**$15,508**	$10,444

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

Nine Months Ended September 30,	2017	2016
Foreign currency translation adjustment:		
Beginning balance	**$(43,459)**	$(47,204)
Current period other comprehensive income	**10,733**	6,964
Ending balance	**(32,726)**	(40,240)
Cash flow hedging instruments:		
Beginning balance	**215**	600
Current period other comprehensive loss	**(613)**	(890)
Less reclassification adjustment	(478)	295
Ending balance	**(876)**	5
Available-for-sale securities:		
Beginning balance	**(286)**	(300)
Current period other comprehensive income	**16**	3
Ending balance	**(270)**	(297)
Accumulated other comprehensive loss, net of tax	**$(33,872)**	$(40,532)

4. DEBT

We maintain an unsecured, syndicated revolving credit agreement that provides for borrowings of up to $600,000. Borrowings are used to fund seasonal working capital needs and for other general corporate purposes, including acquisitions, dividends (if and as declared by our Board of Directors), capital expenditures, stock repurchases and issuances of letters of credit. The credit agreement matures on July 1, 2019. Included in the credit facility are a $90,000 swingline subfacility, a letter of credit subfacility and a $75,000 multicurrency borrowing sublimit. On January 24, 2017, we entered into an amendment to this credit agreement, which reduced the letter of credit subfacility from $50,000 to $10,000 and modified certain definitions.

At September 30, 2017 and December 31, 2016, $284,700 and $235,294, respectively, were outstanding under the revolving credit agreement. The revolving credit agreement contains customary affirmative and negative covenants, including financial covenants with respect to consolidated leverage and interest coverage ratios, and other customary restrictions. We believe we were in compliance with all covenants at September 30, 2017.

5. PURCHASE OF ADDITIONAL OWNERSHIP INTEREST IN JOINT VENTURE

In 2011, we formed a joint venture with Carrier Corporation ("Carrier"), Carrier Enterprise Northeast LLC, which we refer to as Carrier Enterprise II. Carrier Enterprise II had sales of approximately $500,000 in 2016 from 41 locations in the northeastern United States and 12 locations in Mexico. We initially owned a 60% controlling interest in Carrier Enterprise II. On November 29, 2016, we purchased an additional 10% ownership interest for cash consideration of $42,909, and, on February 13, 2017, we purchased an additional 10% ownership interest for cash consideration of $42,688, which together increased our controlling interest in Carrier Enterprise II to 80%.

6. INVESTMENT IN UNCONSOLIDATED ENTITY

On June 21, 2017, our first joint venture with Carrier, Carrier Enterprise, LLC, which we refer to as Carrier Enterprise I, acquired an approximately 35% ownership interest in Russell Sigler, Inc. ("RSI"), an HVAC distributor with annual sales of approximately $650,000 operating from 30 locations in the Western U.S. We have an 80% controlling interest in Carrier Enterprise I, and Carrier has a 20% non-controlling interest. Carrier Enterprise I acquired its ownership interest in RSI for cash consideration of $63,600, of which we contributed $50,880 and Carrier contributed $12,720. Carrier Enterprise I entered into a shareholders agreement (the "Shareholders Agreement") with RSI and RSI's other shareholders. Pursuant to the Shareholders Agreement, RSI's shareholders have the right to sell, and Carrier Enterprise I has the obligation to purchase, their respective shares of RSI for a purchase price determined based on either book value or EBIT, the latter of which Carrier Enterprise I used to calculate the price paid for its investment in RSI. RSI's shareholders may transfer their respective shares of RSI common stock only to members of the Sigler family or to Carrier Enterprise I, and, at any time from and after the date on which Carrier Enterprise I owns 85% or more of RSI's outstanding common stock, it has the right, but not the obligation, to purchase from RSI's shareholders the remaining outstanding shares of RSI common stock. Additionally, Carrier Enterprise I has the right to appoint two of RSI's six board members. Given Carrier Enterprise I's 35% voting equity interest in RSI and its right to appoint two out of RSI's six board members, this investment in RSI is accounted for under the equity method.

7. DERIVATIVES

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

Cash Flow Hedging Instruments

We enter into foreign currency forward contracts that are designated as cash flow hedges. The settlement of these derivatives results in reclassifications from accumulated other comprehensive loss to earnings for the period in which the settlement of these instruments occurs. The maximum period for which we hedge our cash flow using these instruments is 12 months. Accordingly, at September 30, 2017, all of our open foreign currency forward contracts had maturities of one year or less. The total notional value of our foreign currency exchange contracts designated as cash flow hedges at September 30, 2017 was $29,200, and such contracts have varying terms expiring through June 2018.

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

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
(Loss) gain recorded in accumulated other comprehensive loss	**$(1,280)**	$536	**$(1,399)**	$(2,033)
Loss (gain) reclassified from accumulated other comprehensive loss into earnings	**$ 88**	$129	**$(1,092)**	$ 674

At September 30, 2017, we expected an estimated $2,001 pre-tax loss to be reclassified into earnings to reflect the fixed prices obtained from foreign exchange hedging within the next 12 months.

Derivatives Not Designated as Hedging Instruments

We have also entered into foreign currency forward contracts that are either not designated as hedges or did not qualify for hedge accounting. These derivative instruments were effective economic hedges for all of the periods presented. The fair value gains and losses on these contracts are recognized in earnings as a component of selling, general and administrative expenses. The total notional value of our foreign currency exchange contracts not designated as hedging instruments at September 30, 2017 was $7,900, and such contracts have varying terms expiring through November 2017.

We recognized a (loss) gain of $(502) and $75 from foreign currency forward contracts not designated as hedging instruments in our condensed consolidated unaudited statements of income for the quarters ended September 30, 2017 and 2016, respectively. We recognized losses of $912 and $389 from foreign currency forward contracts not designated as hedging instruments in our condensed consolidated unaudited statements of income for the nine months ended September 30, 2017 and 2016, respectively.

The following table summarizes the fair value of derivative instruments, which consist solely of foreign currency forward contracts, included in other current assets and accrued expenses and other current liabilities in our condensed consolidated unaudited balance sheets. See Note 8.

	Asset Derivatives		Liability Derivatives	
	September 30, 2017	**December 31, 2016**	**September 30, 2017**	**December 31, 2016**
Derivatives designated as hedging instruments	**$ 84**	$ 227	**$ 1,346**	$ 35
Derivatives not designated as hedging instruments	**114**	14	**32**	4
Total derivative instruments	**$ 198**	$ 241	**$ 1,378**	$ 39

8. FAIR VALUE MEASUREMENTS

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

	Balance Sheet Location	Total	Fair Value Measurements at September 30, 2017 Using		
			Level 1	Level 2	Level 3
Assets:					
Available-for-sale securities	Other assets	**$ 306**	**$ 306**	**$ —**	**$ —**
Derivative financial instruments	Other current assets	**$ 198**	**$ —**	**$ 198**	**$ —**
Liabilities:					
Derivative financial instruments	Accrued expenses and other current liabilities	**$1,378**	**$ —**	**$1,378**	**$ —**

	Balance Sheet Location	Total	Fair Value Measurements at December 31, 2016 Using		
			Level 1	Level 2	Level 3
Assets:					
Available-for-sale securities	Other assets	$ 281	$ 281	$ —	$ —
Derivative financial instruments	Other current assets	$ 241	$ —	$ 241	$ —
Liabilities:					
Derivative financial instruments	Accrued expenses and other current liabilities	$ 39	$ —	$ 39	$ —

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

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

Derivative financial instruments – these derivatives are foreign currency forward contracts. See Note 7. Fair value is based on observable market inputs, such as forward rates in active markets; therefore, we classify these derivatives within Level 2 of the valuation hierarchy.

There were no transfers in or out of Level 1 and Level 2 during the nine months ended September 30, 2017.

9. SHAREHOLDERS' EQUITY

At-the-Market Offering Program

On August 23, 2017, we entered into a sales agreement with Robert W. Baird & Co. Inc. (the "Agent"), which we refer to as the Sales Agreement, pursuant to which we may issue and sell shares of our Common stock, from time to time, having a maximum aggregate offering price of up to $250,000 through the Agent. Sales, if any, may be made in one or more negotiated transactions or transactions that are deemed to be "at the market" offerings as defined in Rule 415 under the Securities Act of 1933. The offering of shares in accordance with the Sales Agreement has been registered pursuant to our automatically effective shelf registration statement on Form S-3 (File No. 333-207831).

We intend to use the net proceeds, if any, from the sale of shares pursuant to the Sales Agreement for general corporate purposes, which may include, without limitation, the acquisition of complementary businesses, the repayment of outstanding indebtedness, capital expenditures and working capital. The Sales Agreement contains customary representations, warranties and covenants. We believe we were in compliance with all covenants at September 30, 2017.

During the quarter and nine months ended September 30, 2017, we sold 35,000 shares of Common stock under the Sales Agreement for net proceeds of $5,391, after $49 of compensation paid to the Agent. Direct costs of $285 incurred in connection with the offering were charged against the proceeds from the sale of Common stock and were accounted for as a reduction of paid-in capital. At September 30, 2017, $244,560 remained available for sale under the Sales Agreement.

Common Stock Dividends

We paid cash dividends of $1.25, $0.85, $3.35 and $2.55 per share of Common stock and Class B common stock during the quarters and nine months ended September 30, 2017 and 2016, respectively.

Non-Vested Restricted Stock

During the quarters ended September 30, 2017 and 2016, we granted 9,000 and 23,803 shares of non-vested restricted stock, respectively. During the nine months ended September 30, 2017 and 2016, we granted 164,899 and 135,981 shares of non-vested restricted stock, respectively.

During the quarter ended September 30, 2017, 12,354 shares of Common stock with an aggregate fair market value of $1,893 were withheld as payment in lieu of cash to satisfy tax withholding obligations in connection with the vesting of non-vested restricted stock. During the nine months ended September 30, 2017, 32,454 shares of Common stock with an aggregate fair market value of $4,664 were withheld as payment in lieu of cash to satisfy tax withholding obligations in connection with the vesting of non-vested restricted stock. These shares were retired upon delivery. During the quarter ended September 30, 2016, an aggregate of 2,936 shares of Common stock with an aggregate fair market value of $419 were withheld as payment in lieu of cash to satisfy tax withholding obligations in connection with the vesting of non-vested restricted stock. During the nine months ended September 30, 2016, an aggregate of 30,413 shares of Common and Class B common stock with an aggregate fair market value of $3,967 were withheld as payment in lieu of cash to satisfy tax withholding obligations in connection with the vesting of non-vested restricted stock. These shares were retired upon delivery.

Exercise of Stock Options

During the quarters ended September 30, 2017 and 2016, 9,084 and 23,584 stock options, respectively, were exercised for Common stock. During the nine months ended September 30, 2017 and 2016, 25,084 and 58,084 stock options, respectively, were exercised for Common stock. Cash received from common stock issued as a result of stock options exercised during the quarters and nine months ended September 30, 2017 and 2016, was $801, $1,834, $2,111 and $4,092, respectively.

During the quarter and nine months ended September 30, 2017, 350 shares of Common stock with an aggregate fair market value of $53 were withheld as payment in lieu of cash for stock option exercises and related tax withholdings. During the quarter and nine months ended September 30, 2016, 348 shares of Common stock with an aggregate fair market value of $51 were withheld as payment in lieu of cash for stock option exercises and related tax withholdings. These shares were retired upon delivery.

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Employee Stock Purchase Plan

During the quarters ended September 30, 2017 and 2016, 2,718 and 2,084 shares of Common stock were issued under our employee stock purchase plan for which we received net proceeds of $402 and $286, respectively. During the nine months ended September 30, 2017 and 2016, 6,977 and 6,915 shares of Common stock were issued under our employee stock purchase plan for which we received net proceeds of $1,004 and $870, respectively.

401(k) Plan

During the nine months ended September 30, 2017 and 2016, we issued 16,389 and 20,045 shares of Common stock, respectively, to our profit sharing retirement plan, representing the Common stock discretionary matching contribution of $2,428 and $2,348, respectively.

Non-controlling Interest

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

Non-controlling interest at December 31, 2016	$245,920
Net income attributable to non-controlling interest	39,668
Contribution for unconsolidated entity	12,720
Foreign currency translation adjustment	6,577
Decrease in non-controlling interest in Carrier Enterprise II	(17,463)
Distributions to non-controlling interest	(6,799)
Loss recorded in accumulated other comprehensive loss	(408)
Gain reclassified from accumulated other comprehensive loss into earnings	(319)
Non-controlling interest at September 30, 2017	**$279,896**

10. COMMITMENTS AND CONTINGENCIES

Litigation, Claims and Assessments

In December 2015, a purported Watsco shareholder, Nelson Gaskins (the "Plaintiff"), filed a derivative lawsuit in the U.S. District Court for the Southern District of Florida (the "Court") against Watsco's Board of Directors. The Company was a nominal defendant. The lawsuit alleged breach of fiduciary duties regarding CEO incentive compensation and sought to recover alleged excessive incentive compensation and unspecified damages. The Court dismissed this action, and the Plaintiff filed a notice of appeal to the U.S. Court of Appeals for the Eleventh Circuit (the "Appellate Court"). In May 2017, the Appellate Court dismissed the Plaintiff's appeal and the action with prejudice. Neither the Plaintiff nor the Plaintiff's lawyers received any payment from, or on behalf of, Watsco or its Directors in connection with this lawsuit and the related appeal.

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

Self-Insurance

Self-insurance reserves are maintained relative to company-wide casualty insurance and health benefit programs. The level of exposure from catastrophic events is limited by the purchase of stop-loss and aggregate liability reinsurance coverage. When estimating the self-insurance liabilities and related reserves, management considers a number of factors, which include historical claims experience, demographic factors, severity factors and valuations provided by independent third-party actuaries. Management reviews its assumptions with its independent third-party actuaries to evaluate whether the self-insurance reserves are adequate. If actual claims or adverse development of loss reserves occur and exceed these estimates, additional reserves may be required. Reserves in the amounts of $2,757 and $2,951 at September 30, 2017 and December 31, 2016, respectively, were established related to such programs and are included in accrued expenses and other current liabilities in our condensed consolidated unaudited balance sheets.

11. RELATED PARTY TRANSACTIONS

Purchases from Carrier and its affiliates comprised 62% of all inventory purchases made during both the quarters ended September 30, 2017 and 2016. Purchases from Carrier and its affiliates comprised 62% of all inventory purchases made during both the nine months ended September 30, 2017 and 2016. At September 30, 2017 and December 31, 2016, approximately $134,000 and $63,000, respectively, was payable to Carrier and its affiliates, net of receivables. Our joint ventures with Carrier also sell HVAC products to Carrier and its affiliates. Revenues in our condensed consolidated unaudited statements of income for the quarters and nine months ended September 30, 2017 and 2016 included approximately $19,000, $17,000, $51,000 and $46,000, respectively, of sales to Carrier and its affiliates. We believe these transactions are conducted on terms equivalent to an arm's-length basis in the ordinary course of business.

A member of our Board of Directors is the Chairman and Chief Executive Officer of Moss & Associates LLC, which serves as general contractor for the remodeling of our Miami headquarters. We paid Moss & Associates LLC $58 and $702 for construction services performed during the quarter and nine months ended September 30, 2017, respectively, and $180 was payable at September 30, 2017.

A member of our Board of Directors is the Senior Chairman of Greenberg Traurig, P.A., which serves as our principal outside counsel and receives customary fees for legal services. During the quarter and nine months ended September 30, 2017, we paid this firm $71 and $291, respectively, for services performed and $67 was payable at September 30, 2017.

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

Forward-Looking Statements

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

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

We believe these forward-looking statements are reasonable; however, you should not place undue reliance on any forward-looking statements, which are based on current expectations. For additional information regarding other important factors that may affect our operations and could cause actual results to vary materially from those anticipated in the forward-looking statements, please see the discussion included in Item 1A "Risk Factors" of our Annual Report on Form 10-K for the year ended December 31, 2016, as well as the other documents and reports that we file with the SEC. Forward-looking statements speak only as of the date the statements were made. We assume no obligation to update forward-looking information or the discussion of such risks and uncertainties to reflect actual results, changes in assumptions or changes in other factors affecting forward-looking information, except as required by applicable law. We qualify any and all of our forward-looking statements by these cautionary factors.

The following information should be read in conjunction with the condensed consolidated unaudited financial statements, including the notes thereto, included under Part I, Item 1 of this Quarterly Report on Form 10-Q. In addition, reference should be made to our audited consolidated financial statements and notes thereto and related Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended December 31, 2016.

Company Overview

Watsco, Inc. was incorporated in Florida in 1956, and, together with its subsidiaries (collectively, "Watsco," or "we," "us" or "our") is the largest distributor of air conditioning, heating and refrigeration equipment and related parts and supplies ("HVAC/R") in the HVAC/R distribution industry in North America. At September 30, 2017, we operated from 562 locations in 37 U.S. States, Canada, Mexico and Puerto Rico with additional market coverage on an export basis to portions of Latin America and the Caribbean.

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

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

Joint Ventures with Carrier Corporation

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

In 2011, we formed a second joint venture with Carrier and completed two additional transactions. In April 2011, Carrier contributed 28 of its company-owned locations in the Northeast U.S., and we contributed 14 locations in the Northeast U.S. In July 2011, we purchased Carrier's distribution operations in Mexico, which included seven locations. Collectively, the Northeast locations and the Mexico operations are referred to as Carrier Enterprise II. On November 29, 2016, we purchased an additional 10% ownership interest in Carrier Enterprise II, and, on February 13, 2017, we again purchased an additional 10% ownership interest in Carrier Enterprise II, which together increased our controlling interest to 80%.

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

Critical Accounting Policies

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

Our critical accounting policies are included in our 2016 Annual Report on Form 10-K, as filed with the SEC on February 21, 2017. We believe that there have been no significant changes during the quarter ended September 30, 2017 to the critical accounting policies disclosed in our Annual Report on Form 10-K for the year ended December 31, 2016.

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Recent Accounting Pronouncements

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

Results of Operations

The following table summarizes information derived from our condensed consolidated unaudited statements of income, expressed as a percentage of revenues, for the quarters and nine months ended September 30, 2017 and 2016:

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Revenues	**100.0%**	100.0%	**100.0%**	100.0%
Cost of sales	**75.9**	75.7	**75.6**	75.6
Gross profit	**24.1**	24.3	**24.4**	24.4
Selling, general and administrative expenses	**14.9**	14.7	**15.8**	15.7
Other income	**0.2**	—	**0.1**	—
Operating income	**9.3**	9.6	**8.7**	8.7
Interest expense, net	**0.2**	0.1	**0.1**	0.1
Income before income taxes	**9.1**	9.5	**8.5**	8.6
Income taxes	**2.6**	3.0	**2.5**	2.7
Net income	**6.5**	6.5	**6.1**	5.9
Less: net income attributable to non-controlling interest	**1.2**	1.4	**1.2**	1.3
Net income attributable to Watsco, Inc.	**5.3%**	5.1%	**4.9%**	4.6%

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

In the following narratives, computations and other information referring to “same-store basis” exclude the effects of locations acquired or locations opened or closed during the immediately preceding 12 months unless they are within close geographical proximity to existing locations. At September 30, 2017 and 2016, 34 and 17 locations, respectively, were excluded from “same-store basis” information. The table below summarizes the changes in our locations for the 12 months ended September 30, 2017:

	Number of Locations
September 30, 2016	568
Opened	2
Closed	(5)
December 31, 2016	565
Opened	12
Closed	(15)
September 30, 2017	**562**

Third Quarter of 2017 Compared to Third Quarter of 2016

Revenues

Revenues for the third quarter of 2017 decreased $11.6 million, or 1%, including $8.2 million from locations closed during the preceding 12 months, offset by $1.9 million from locations opened. On a same-store basis, revenues decreased $5.3 million, or were flat, as compared to the same period in 2016, reflecting flat sales of HVAC equipment (68% of sales), a 4% decrease in sales of other HVAC products (27% of sales) and a 4% decrease in sales of commercial refrigeration products (5% of sales). The decrease in same-store revenues reflects disruptions from natural disasters which impacted certain of our largest markets during August and September 2017. More than 300 locations experienced some impact with 190 temporary location closures, including locations in key markets in Florida, Texas, Georgia and Puerto Rico.

Gross Profit

Gross profit for the third quarter of 2017 decreased $6.3 million, or 2%, primarily as a result of lower revenues. Gross profit margin for the quarter ended September 30, 2017 declined 20 basis-points to 24.1% versus 24.3% for the same period in 2016, primarily due to a shift in sales mix toward HVAC equipment, which generate a lower gross profit margin than non-equipment products.

Selling, General and Administrative Expenses

Selling, general and administrative expenses for the third quarter of 2017 remained flat as compared to the same period in 2016. Selling, general and administrative expenses as a percent of revenues for the quarter ended September 30, 2017 increased to 14.9% versus 14.7% for the same period in 2016. On a same-store basis, selling, general and administrative expenses increased 3% as compared to the same period in 2016. The increase in selling, general and administrative expenses was primarily due to our inability to leverage fixed operating costs as compared to 2016.

Other Income

Other income of $2.3 million for the third quarter of 2017 represents our share of the net income from our investment in Russell Sigler, Inc. ("RSI"), in which we purchased an approximately 35% ownership interest in June 2017.

Interest Expense, Net

Net interest expense for the third quarter of 2017 increased $1.1 million, or 113%, primarily as a result of an increase in average outstanding borrowings and a higher effective interest rate for the 2017 period, in each case under our revolving credit facility, as compared to the same period in 2016.

Income Taxes

Income taxes decreased to $32.3 million for the third quarter of 2017 as compared to $37.8 million for the third quarter of 2016 and are a composite of the income taxes attributable to our wholly owned operations and income taxes attributable to the Carrier joint ventures, which are primarily taxed as partnerships for income tax purposes. The effective income tax rates attributable to us were 32.8% and 36.8% for the quarters ended September 30, 2017 and 2016, respectively. The decrease was primarily due to higher share-based payment deductions in 2017 as compared to the same period in 2016.

Net Income Attributable to Watsco, Inc.

Net income attributable to Watsco for the quarter ended September 30, 2017 increased $1.9 million, or 3%, compared to the same period in 2016. The increase was primarily driven by other income and income taxes, as discussed above, and by a reduction in the net income attributable to the non-controlling interest related to Carrier Enterprise II following our purchases of additional 10% ownership interests in both November 2016 and February 2017.

Nine Months Ended September 30, 2017 Compared to Nine Months Ended September 30, 2016

Revenues

Revenues for the nine months ended September 30, 2017 increased $70.5 million, or 2%, including $3.5 million from locations opened during the preceding 12 months, offset by $19.1 million from locations closed. On a same-store basis, revenues increased $86.1 million, or 3%, as compared to the same period in 2016, reflecting a 3% increase in sales of HVAC equipment (67% of sales), a 1% increase in sales of commercial refrigeration products (5% of sales) and flat sales of other HVAC products (28% of sales). The increase in same-store revenues was primarily due to demand for the replacement of residential HVAC equipment.

Gross Profit

Gross profit for the nine months ended September 30, 2017 increased $18.2 million, or 2%, primarily as a result of increased revenues. Gross profit margin for the nine months ended September 30, 2017 remained consistent at 24.4% as compared to the same period in 2016.

Selling, General and Administrative Expenses

Selling, general and administrative expenses for the nine months ended September 30, 2017 increased $15.6 million, or 3%, primarily due to increased revenues. Selling, general and administrative expenses as a percent of revenues for the nine months ended September 30, 2017 and 2016 increased to 15.8% versus 15.7% for the same period in 2016. On a same-store basis, selling, general and administrative expenses increased 4% as compared to the same period in 2016. Selling, general and administrative expenses included $0.6 million of additional costs for 2017 in excess of 2016 for ongoing technology initiatives.

Other Income

Other income of $2.3 million for the nine months ended September 30, 2017 represents our share of the net income from our investment in RSI, in which we purchased an approximately 35% ownership interest in June 2017.

Interest Expense, Net

Net interest expense for the nine months ended September 30, 2017 increased $2.0 million, or 65%, primarily as a result of an increase in average outstanding borrowings and a higher effective interest rate for the 2017 period, in each case under our revolving credit facility, as compared to the same period in 2016.

Income Taxes

Income taxes decreased to $82.9 million for the nine months ended September 30, 2017 as compared to $88.4 million for the nine months ended September 30, 2016 and are a composite of the income taxes attributable to our wholly owned operations and income taxes attributable to the Carrier joint ventures, which are primarily taxed as partnerships for income tax purposes. The effective income tax rates attributable to us were 33.0% and 36.0% for the nine months ended September 30, 2017 and 2016, respectively. The decrease was primarily due to higher share-based payment deductions in 2017 as compared to the same period in 2016.

Net Income Attributable to Watsco, Inc.

Net income attributable to Watsco for the nine months ended September 30, 2017 increased $11.7 million, or 8%, compared to the same period in 2016. The increase was primarily driven by higher revenues and other income, as discussed above, and by a reduction in the net income attributable to the non-controlling interest related to Carrier Enterprise II following our purchases of additional 10% ownership interests in both November 2016 and February 2017.

Liquidity and Capital Resources

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

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

Sources and Uses of Cash

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

As of September 30, 2017, we had $66.7 million of cash and cash equivalents, of which $54.0 million was held by foreign subsidiaries. The repatriation of cash balances from our foreign subsidiaries could have adverse tax consequences or be subject to capital controls; however, these balances are generally available without legal restrictions to fund ordinary business operations of our foreign subsidiaries.

We believe that our operating cash flows, cash on hand, funds available for borrowing under our revolving credit agreement and funds available from sales of our Common stock under our at-the-market offering program will be sufficient to meet our liquidity needs in the foreseeable future. However, there can be no assurance that our current sources of available funds will be sufficient to meet our cash requirements.

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

Working Capital

Working capital increased to $978.5 million at September 30, 2017 from $925.3 million at December 31, 2016, reflecting higher levels of accounts receivable and inventories, primarily due to the seasonality of our business.

Cash Flows

The following table summarizes our cash flow activity for the nine months ended September 30, 2017 and 2016:

	2017	2016	Change
Cash flows provided by operating activities	**$184.7**	$ 146.3	$ 38.4
Cash flows used in investing activities	**$ (77.3)**	$ (8.3)	$(69.0)
Cash flows used in financing activities	**$ (98.3)**	$(137.4)	$ 39.1

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

Operating Activities

Net cash provided by operating activities increased primarily due to the timing of payments for accounts payable and other liabilities and from a buildup of inventory in anticipation of future demand related to the restoration and replacement activities after the natural disasters experienced in certain of our largest markets during August and September, partially offset by a lower increase in accounts receivable primarily driven by timing of collections during the nine months ended September 30, 2017.

Investing Activities

Net cash used in investing activities increased primarily due to the purchase of an ownership interest in RSI for $63.6 million and an increase in capital expenditures in 2017.

Financing Activities

Net cash used in financing activities decreased primarily due to higher borrowings under our revolving credit agreement, lower distributions to the non-controlling interest, $12.7 million in proceeds from the non-controlling interest for its contribution to the purchase of an ownership interest in RSI and $5.4 million in proceeds from the sale of common stock, partially offset by the purchase of an additional 10% ownership interest in Carrier Enterprise II for $42.7 million and an increase in dividends paid in 2017.

Revolving Credit Agreement

We maintain an unsecured, syndicated revolving credit agreement that provides for borrowings of up to $600.0 million. Borrowings are used to fund seasonal working capital needs and for other general corporate purposes, including acquisitions, dividends (if and as declared by our Board of Directors), capital expenditures, stock repurchases and issuances of letters of credit. The credit agreement matures on July 1, 2019. Included in the credit facility are a $90.0 million swingline subfacility, a letter of credit subfacility and a $75.0 million multicurrency borrowing sublimit. On January 24, 2017, we entered into an amendment to this credit agreement, which reduced the letter of credit subfacility from $50.0 million to $10.0 million and modified certain definitions. At September 30, 2017 and December 31, 2016, $284.7 million and $235.3 million were outstanding under the revolving credit agreement, respectively. The revolving credit agreement contains customary affirmative and negative covenants, including financial covenants with respect to consolidated leverage and interest coverage ratios, and other customary restrictions. We believe we were in compliance with all covenants at September 30, 2017.

Purchase of Additional Ownership Interest in Joint Venture

On November 29, 2016, we purchased an additional 10% ownership interest in Carrier Enterprise II for cash consideration of $42.9 million, and, on February 13, 2017, we purchased an additional 10% ownership interest in Carrier Enterprise II for cash consideration of $42.7 million, which together increased our controlling interest in Carrier Enterprise II to 80%. We used borrowings under our revolving credit agreement to finance these acquisitions.

Investment in Unconsolidated Entity

On June 21, 2017, Carrier Enterprise I acquired an approximately 35% ownership interest in RSI, an HVAC distributor operating from 30 locations in the Western U.S., for cash consideration of $63.6 million, of which we contributed $50.9 million and Carrier contributed $12.7 million. Carrier Enterprise I entered into a shareholders agreement (the “Shareholders Agreement”) with RSI and RSI’s other shareholders. Pursuant to the Shareholders Agreement, RSI’s shareholders have the right to sell, and Carrier Enterprise I has the obligation to purchase, their respective shares of RSI for a purchase price determined based on either book value or EBIT, the latter of which Carrier Enterprise I used to calculate the price paid for its investment in RSI. RSI’s shareholders may transfer their respective shares of RSI common stock only to members of the Sigler family or to Carrier Enterprise I, and, at any time from and after the date on which Carrier Enterprise I owns 85% or more of RSI's outstanding common stock, it has the right, but not the obligation, to purchase from RSI's shareholders the remaining outstanding shares of RSI common stock. We believe that our operating cash flows, cash on hand and funds available for borrowing under our revolving credit agreement will be sufficient to purchase any additional ownership interests in RSI.

Acquisitions

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

Common Stock Dividends

We paid cash dividends of $3.35 and $2.55 per share of Common stock and Class B common stock during the nine months ended September 30, 2017 and 2016, respectively. On October 2, 2017, our Board of Directors declared a regular quarterly cash dividend of $1.25 per share of Common and Class B common stock that was paid on October 31, 2017 to shareholders of record as of October 16, 2017. Future dividends and/or changes in dividend rates will be at the sole discretion of the Board of Directors and will depend upon such factors as cash flow generated by operations, profitability, financial condition, cash requirements, future prospects and other factors deemed relevant by our Board of Directors.

At-the-Market Offering Program

On August 23, 2017, we entered into a sales agreement with Robert W. Baird & Co. Inc. (the "Agent"), which we refer to as the Sales Agreement, pursuant to which we may issue and sell shares of our Common stock, from time to time, having a maximum aggregate offering price of up to $250.0 million through the Agent. Sales, if any, may be made in one or more negotiated transactions or transactions that are deemed to be "at the market" offerings as defined in Rule 415 under the Securities Act of 1933. The offering of shares in accordance with the Sales Agreement has been registered pursuant to our automatically effective shelf registration statement on Form S-3 (File No. 333-207831).

We intend to use the net proceeds, if any, from the sale of shares pursuant to the Sales Agreement for general corporate purposes, which may include, without limitation, the acquisition of complementary businesses, the repayment of outstanding indebtedness, capital expenditures and working capital. The Sales Agreement contains customary representations, warranties and covenants. We believe we were in compliance with all covenants at September 30, 2017.

During the quarter and nine months ended September 30, 2017, we sold 35,000 shares of Common stock under the Sales Agreement for net proceeds of $5.4 million. Direct costs of $0.3 million incurred in connection with the offering were charged against the proceeds from the sale of Common stock and were accounted for as a reduction of paid-in capital. At September 30, 2017, $244.6 million remained available for sale under the Sales Agreement.

Company Share Repurchase Program

In September 1999, our Board of Directors authorized the repurchase, at management's discretion, of up to 7,500,000 shares of common stock in the open market or via private transactions. Shares repurchased under the program are accounted for using the cost method and result in a reduction of shareholders' equity. No shares were repurchased during the quarters ended September 30, 2017 or 2016. In aggregate, 6,370,913 shares of Common and Class B common stock have been repurchased at a cost of $114.4 million since the inception of the program. At September 30, 2017, there were 1,129,087 shares remaining authorized for repurchase under the program.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes to the information regarding market risk provided in Item 7A, Quantitative and Qualitative Disclosures about Market Risk, of our Annual Report on Form 10-K for the year ended December 31, 2016.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

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

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

Changes in Internal Control over Financial Reporting

We are continuously seeking to improve the efficiency and effectiveness of our operations and of our internal controls. This results in refinements to processes throughout the Company. However, there were no changes in internal controls over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended September 30, 2017, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

Information about risk factors for the quarter ended September 30, 2017 does not differ materially from that set forth in Part I, Item 1A, of our Annual Report on Form 10-K for the year ended December 31, 2016.

ITEM 6. EXHIBITS

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

filed herewith.
+ furnished herewith.

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INDEX TO EXHIBITS

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+ furnished herewith.

SIGNATURE

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

WATSCO, INC.
(Registrant)

Date: November 7, 2017

By: /s/ Ana M. Menendez
Ana M. Menendez
Chief Financial Officer (on behalf of the Registrant and as Principal Financial Officer)

Exhibit 31.1

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

I, Albert H. Nahmad, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Watsco, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant’s other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and

5. The registrant’s other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: November 7, 2017

/s/ Albert H. Nahmad

Albert H. Nahmad
Chief Executive Officer

Exhibit 31.2

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

I, Barry S. Logan, certify that:

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

Date: November 7, 2017

/s/ Barry S. Logan

Barry S. Logan
Senior Vice President

Exhibit 31.3

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

I, Ana M. Menendez, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Watsco, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 7, 2017

/s/ Ana M. Menendez
Ana M. Menendez
Chief Financial Officer

Exhibit 32.1

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

In connection with the Quarterly Report on Form 10-Q of Watsco, Inc. ("Watsco") for the quarter and nine months ended September 30, 2017, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Albert H. Nahmad, as Chief Executive Officer of Watsco, Barry S. Logan, as Senior Vice President of Watsco and Ana M. Menendez, as Chief Financial Officer of Watsco, each hereby certifies, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that, to our knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Watsco.

/s/ Albert H. Nahmad
Albert H. Nahmad
Chief Executive Officer
November 7, 2017

/s/ Barry S. Logan
Barry S. Logan
Senior Vice President
November 7, 2017

/s/ Ana M. Menendez
Ana M. Menendez
Chief Financial Officer
November 7, 2017

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

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