

**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, 2019

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

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common stock, \$0.50 par value	WSO	New York Stock Exchange
Class B common stock, \$0.50 par value	WSOB	New York Stock Exchange

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 every Interactive Data File required to be submitted 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 such files). Yes  No

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

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>
		Emerging growth company	<input type="checkbox"/>

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 registrant's common stock outstanding as of October 28, 2019 comprised (i) 32,647,671 shares of Common stock, \$0.50 par value per share, excluding 4,823,988 treasury shares and (ii) 5,453,477 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,	
	2019	2018	2019	2018
Revenues	<b>\$1,394,915</b>	\$1,296,007	<b>\$3,698,047</b>	\$3,555,327
Cost of sales	<b>1,060,224</b>	976,998	<b>2,801,612</b>	2,684,719
Gross profit	<b>334,691</b>	319,009	<b>896,435</b>	870,608
Selling, general and administrative expenses	<b>212,902</b>	200,408	<b>589,523</b>	565,519
Other income	<b>3,530</b>	3,696	<b>7,939</b>	8,491
Operating income	<b>125,319</b>	122,297	<b>314,851</b>	313,580
Interest expense, net	<b>1,434</b>	1,047	<b>3,422</b>	2,375
Income before income taxes	<b>123,885</b>	121,250	<b>311,429</b>	311,205
Income taxes	<b>24,230</b>	24,364	<b>60,060</b>	63,678
Net income	<b>99,655</b>	96,886	<b>251,369</b>	247,527
Less: net income attributable to non-controlling interest	<b>16,175</b>	17,723	<b>42,697</b>	44,188
Net income attributable to Watsco, Inc.	<b>\$ 83,480</b>	<b>\$ 79,163</b>	<b>\$ 208,672</b>	<b>\$ 203,339</b>

Earnings per share for Common and Class B common stock:								
Basic	\$	<u>2.20</u>	\$	2.12	\$	<u>5.54</u>	\$	5.44
Diluted	\$	<u>2.20</u>	\$	<u>2.11</u>	\$	<u>5.54</u>	\$	<u>5.43</u>

See accompanying notes to condensed consolidated unaudited financial statements.

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

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Net income	<b>\$99,655</b>	\$ 96,886	<b>\$251,369</b>	\$247,527
Other comprehensive (loss) income, net of tax				
Foreign currency translation adjustment	<b>(3,038)</b>	4,269	<b>7,264</b>	(7,422)
Unrealized gain (loss) on cash flow hedging instruments	<b>255</b>	231	<b>(798)</b>	762
Reclassification of gain on cash flow hedging instruments into earnings	<b>(140)</b>	(915)	<b>(542)</b>	(57)
Other comprehensive (loss) income	<b>(2,923)</b>	3,585	<b>5,924</b>	(6,717)
Comprehensive income	<b>96,732</b>	100,471	<b>257,293</b>	240,810
Less: comprehensive income attributable to non-controlling interest	<b>15,146</b>	19,006	<b>44,693</b>	41,708
Comprehensive income attributable to Watsco, Inc.	<b>\$81,586</b>	\$ 81,465	<b>\$212,600</b>	\$199,102

See accompanying notes to condensed consolidated unaudited financial statements.

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

	September 30, 2019 (Unaudited)	December 31, 2018
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	<b>\$ 60,150</b>	\$ 82,894
Accounts receivable, net	<b>640,802</b>	501,908
Inventories	<b>970,475</b>	837,129
Other current assets	<b>19,400</b>	19,875
Total current assets	<b>1,690,827</b>	1,441,806
Property and equipment, net	<b>97,926</b>	91,046
Operating lease right-of-use assets	<b>225,366</b>	—
Goodwill	<b>407,009</b>	391,998
Intangible assets, net	<b>171,310</b>	147,851
Other assets	<b>100,621</b>	88,332
	<b>\$ 2,693,059</b>	\$ 2,161,033
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Current portion of other long-term obligations	<b>\$ 67,587</b>	\$ 246
Accounts payable	<b>311,317</b>	200,229
Accrued expenses and other current liabilities	<b>163,384</b>	157,091
Total current liabilities	<b>542,288</b>	357,566
Long-term obligations:		
Borrowings under revolving credit agreement	<b>169,300</b>	135,200
Operating lease liabilities, net of current portion	<b>157,503</b>	—
Other long-term obligations, net of current portion	<b>1,863</b>	552
Total long-term obligations	<b>328,666</b>	135,752
Deferred income taxes and other liabilities	<b>69,083</b>	66,002
Commitments and contingencies		
Watsco, Inc. shareholders' equity:		
Common stock, \$0.50 par value	<b>18,734</b>	18,476
Class B common stock, \$0.50 par value	<b>2,751</b>	2,691

Preferred stock, \$0.50 par value	—	—
Paid-in capital	894,917	832,121
Accumulated other comprehensive loss, net of tax	(42,040)	(45,968)
Retained earnings	656,187	627,969
Treasury stock, at cost	(87,440)	(87,440)
Total Watsco, Inc. shareholders' equity	1,443,109	1,347,849
Non-controlling interest	309,913	253,864
Total shareholders' equity	1,753,022	1,601,713
	<u>\$ 2,693,059</u>	<u>\$ 2,161,033</u>

See accompanying notes to condensed consolidated unaudited financial statements.

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

<i>(In thousands, except share and per share data)</i>	Common Stock, Class B Common Stock and Preferred Stock Shares	Common Stock, Class B Common Stock and Preferred Stock Amount	Paid-In Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Treasury Stock	Non- controlling Interest	Total
<b>Balance at December 31, 2018</b>	<b>37,461,643</b>	<b>\$ 21,167</b>	<b>\$832,121</b>	<b>\$ (45,968)</b>	<b>\$627,969</b>	<b>\$(87,440)</b>	<b>\$ 253,864</b>	<b>\$1,601,713</b>
Net income					35,037		8,767	43,804
Other comprehensive income				2,783			1,412	4,195
Issuances of non-vested restricted shares of common stock	77,049	39	(39)					—
Forfeitures of non-vested restricted shares of common stock	(5,000)	(3)	3					—
Common stock contribution to 401(k) plan	30,715	15	4,259					4,274
Stock issuances from exercise of stock options and employee stock purchase plan	8,925	4	1,121					1,125
Retirement of common stock	(2,985)	(1)	(427)					(428)
Share-based compensation			4,537					4,537
Cash dividends declared and paid on Common and Class B common stock, \$1.60 per share					(59,965)			(59,965)
<b>Balance at March 31, 2019</b>	<b>37,570,347</b>	<b>\$ 21,221</b>	<b>\$841,575</b>	<b>\$ (43,185)</b>	<b>\$603,041</b>	<b>\$(87,440)</b>	<b>\$ 264,043</b>	<b>\$1,599,255</b>
Net income					90,155		17,755	107,910
Other comprehensive income				3,039			1,613	4,652
Issuances of non-vested restricted shares of common stock	26,354	13	(13)					—
Stock issuances from exercise of stock options and employee stock purchase plan	15,807	9	1,942					1,951
Retirement of common stock	(3,608)	(2)	(553)					(555)
Share-based compensation			4,324					4,324
Cash dividends declared and paid on Common and Class B common stock, \$1.60 per share					(60,213)			(60,213)
Common stock issued for Dunphrey & Associates Supply Co., Inc.	50,952	25	7,425					7,450
Investment in unconsolidated entity							988	988
Decrease in non-controlling interest in Carrier Enterprise II			(25,768)				(6,632)	(32,400)
<b>Balance at June 30, 2019</b>	<b>37,659,852</b>	<b>\$ 21,266</b>	<b>\$828,932</b>	<b>\$ (40,146)</b>	<b>\$632,983</b>	<b>\$(87,440)</b>	<b>\$ 277,767</b>	<b>\$1,633,362</b>
Net income					83,480		16,175	99,655
Other comprehensive (loss)				(1,894)			(1,029)	(2,923)
Issuances of non-vested restricted shares of common stock	37,834	19	(19)					—
Forfeitures of non-vested restricted shares of common stock	(5,337)	(3)	3					—
Stock issuances from exercise of stock options and employee stock purchase plan	36,374	19	4,510					4,529
Retirement of common stock	(4,030)	(2)	(667)					(669)
Share-based compensation			3,706					3,706
Cash dividends declared and paid on Common and Class B common stock, \$1.60 per share					(60,276)			(60,276)
Common stock issued for Peirce-Phelps, Inc.	372,543	186	58,452					58,638
Investment in Peirce-Phelps, Inc.							17,000	17,000
<b>Balance at September 30, 2019</b>	<b>38,097,236</b>	<b>\$ 21,485</b>	<b>\$894,917</b>	<b>\$ (42,040)</b>	<b>\$656,187</b>	<b>\$(87,440)</b>	<b>\$ 309,913</b>	<b>\$1,753,022</b>

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<i>(In thousands, except share and per share data)</i>	Common Stock, Class B Common Stock and Preferred Stock Shares	Common Stock, Class B Common Stock and Preferred Stock Amount	Paid-In Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Treasury Stock	Non- controlling Interest	Total
<b>Balance at December 31, 2017</b>	<b>37,228,715</b>	<b>\$ 21,050</b>	<b>\$804,008</b>	<b>\$ (34,221)</b>	<b>\$594,556</b>	<b>\$(87,440)</b>	<b>\$ 253,024</b>	<b>\$1,550,977</b>
Cumulative-effect adjustment				301	(301)			—
Net income					34,219		8,158	42,377
Other comprehensive loss				(3,649)			(2,092)	(5,741)
Issuances of non-vested restricted shares of common stock	91,609	46	(46)					—
Forfeitures of non-vested restricted shares of common stock	(3,000)	(2)	2					—
Common stock contribution to 401(k) plan	17,318	9	2,936					2,945
Stock issuances from exercise of stock options and employee stock purchase plan	37,130	19	4,322					4,341
Retirement of common stock	(5,041)	(3)	(911)					(914)
Share-based compensation			4,400					4,400
Cash dividends declared and paid on Common and Class B common stock, \$1.25 per share					(46,581)			(46,581)
Distributions to non-controlling interest							(2,178)	(2,178)
<b>Balance at March 31, 2018</b>	<b>37,366,731</b>	<b>\$ 21,119</b>	<b>\$814,711</b>	<b>\$ (37,569)</b>	<b>\$581,893</b>	<b>\$(87,440)</b>	<b>\$ 256,912</b>	<b>\$1,549,626</b>
Net income					89,957		18,307	108,264
Other comprehensive loss				(2,890)			(1,671)	(4,561)
Issuances of non-vested restricted shares of common stock	8,500	4	(4)					—
Forfeitures of non-vested restricted shares of common stock	(5,000)	(2)	2					—
Stock issuances from exercise of stock options and employee stock purchase plan	11,935	6	1,595					1,601
Retirement of common stock	(14,534)	(7)	(2,492)					(2,499)
Share-based compensation			3,747					3,747
Cash dividends declared and paid on Common and Class B common stock, \$1.45 per share					(54,184)			(54,184)
<b>Balance at June 30, 2018</b>	<b>37,367,632</b>	<b>\$ 21,120</b>	<b>\$817,559</b>	<b>\$ (40,459)</b>	<b>\$617,666</b>	<b>\$(87,440)</b>	<b>\$ 273,548</b>	<b>\$1,601,994</b>
Net income					79,163		17,723	96,886
Other comprehensive income				2,302			1,283	3,585
Issuances of non-vested restricted shares of common stock	10,000	5	(5)					—
Forfeitures of non-vested restricted shares of common stock	(2,000)	(1)	1					—
Stock issuances from exercise of stock options and employee stock purchase plan	10,835	5	1,294					1,299
Retirement of common stock	(9,206)	(5)	(1,626)					(1,631)
Share-based compensation			3,671					3,671
Cash dividends declared and paid on Common and Class B common stock, \$1.45 per share					(54,186)			(54,186)
Common stock issued for Alert Labs, Inc.	47,103	24	8,156					8,180
Investment in unconsolidated entity							752	752
<b>Balance at September 30, 2018</b>	<b>37,424,364</b>	<b>\$ 21,148</b>	<b>\$829,050</b>	<b>\$ (38,157)</b>	<b>\$642,643</b>	<b>\$(87,440)</b>	<b>\$ 293,306</b>	<b>\$1,660,550</b>

See accompanying notes to condensed consolidated unaudited financial statements.

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

	Nine Months Ended September 30,	
	2019	2018
Cash flows from operating activities:		
Net income	<b>\$ 251,369</b>	<b>\$ 247,527</b>

Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	17,983	16,500
Share-based compensation	11,992	11,769
Non-cash contribution to 401(k) plan	4,274	2,945
Deferred income tax provision	2,765	3,925
Other income from investment in unconsolidated entity	(7,939)	(8,491)
Other, net	1,260	927
Changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable	(102,813)	(126,181)
Inventories	(74,448)	(50,566)
Accounts payable and other liabilities	99,627	(23,286)
Other, net	(6,539)	(5,004)
Net cash provided by operating activities	197,531	70,065
Cash flows from investing activities:		
Business acquisitions, net of cash acquired	(47,343)	(5,828)
Capital expenditures	(14,007)	(12,897)
Investment in unconsolidated entity	(4,940)	(3,760)
Proceeds from sale of property and equipment	1,295	143
Net cash used in investing activities	(64,995)	(22,342)
Cash flows from financing activities:		
Dividends on Common and Class B common stock	(180,454)	(154,951)
Purchase of additional ownership from non-controlling interest	(32,400)	—
Repurchases of common stock to satisfy employee withholding tax obligations	(1,528)	(3,782)
Net repayments of other long-term obligations	(920)	(182)
Distributions to non-controlling interest	—	(2,178)
Proceeds from non-controlling interest for investment in unconsolidated entity	988	752
Net proceeds from issuances of common stock	7,480	5,979
Proceeds from non-controlling interest for investment in Peirce-Phelps, Inc.	17,000	—
Net proceeds under revolving credit agreement	34,100	94,600
Net cash used in financing activities	(155,734)	(59,762)
Effect of foreign exchange rate changes on cash and cash equivalents	454	(845)
Net decrease in cash and cash equivalents	(22,744)	(12,884)
Cash and cash equivalents at beginning of period	82,894	80,496
Cash and cash equivalents at end of period	\$ 60,150	\$ 67,612
<b>Supplemental cash flow information:</b>		
Common stock issued for Peirce-Phelps, Inc.	\$ 58,638	—
Common stock issued for Dunphrey & Associates Supply Co., Inc.	\$ 7,450	—
Common stock issued for Alert Labs, Inc.	—	\$ 8,180

See accompanying notes to condensed consolidated unaudited financial statements.

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WATSCO, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS  
September 30, 2019  
(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, 2019 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 2018 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, 2019 are not necessarily indicative of the results to be expected for the year ending December 31, 2019. 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 generally evenly distributed throughout the year, subject to weather and

economic conditions, including their effect on the number of housing completions.

## 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 loss contingencies and the valuation of goodwill, indefinite-lived intangible assets and long-lived intangible assets. While we believe that these estimates are reasonable, actual results could differ from such estimates.

## Recently Adopted Accounting Standards

### *Leases*

In February 2016, the Financial Accounting Standards Board (“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. In July 2018, the FASB issued updated guidance that provides an additional transition method of adoption that allows entities to initially apply the standard at the adoption date and recognize a cumulative-effect adjustment to the opening balance of retained earnings. The adoption of this standard and its related amendments (collectively, the “New Lease Standard”) on January 1, 2019 did not result in the recognition of a cumulative adjustment to opening retained earnings under the additional transition method, nor did it have a significant impact on our consolidated statements of income or cash flows. See Note 2.

## Recently Issued Accounting Standards Not Yet Adopted

### *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 on our consolidated financial statements.

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## 2. LEASES

### **Adoption of New Lease Standard**

We adopted the New Lease Standard on January 1, 2019 using the additional transition method described in Note 1 to these condensed consolidated unaudited financial statements. Results for reporting periods beginning on and after January 1, 2019 are presented under the New Lease Standard. Prior periods have not been restated. The New Lease Standard had a material impact on our consolidated balance sheet due to the recognition of right-of-use (“ROU”) assets and lease liabilities for operating leases, while accounting for finance leases remained substantially unchanged.

### *Practical Expedients*

We elected the package of practical expedients that did not require us to reassess (1) whether existing contracts contain embedded leases, (2) the lease classification of existing leases, and (3) whether initial direct costs for existing leases would qualify for capitalization under the New Lease Standard. We also elected the practical expedients related to short-term leases and separating lease components from non-lease components for all underlying asset classes.

### **Operating and Finance Leases**

We have operating leases for real property, vehicles and equipment, and finance leases primarily for vehicles. Operating leases are included in operating lease right-of-use assets, current portion of long-term obligations, and operating lease liabilities in our consolidated balance sheet. Finance leases are not considered significant to our consolidated balance sheet or consolidated statement of income. Finance lease ROU assets at September 30, 2019 of \$2,960 are included in property and equipment, net in our condensed consolidated unaudited balance sheet. Finance lease liabilities at September 30, 2019 of \$3,047 are included in current portion of other long-term obligations and other long-term obligations, net of current portion in our condensed consolidated unaudited balance sheet.

ROU assets represent our right to use an underlying asset for the lease term, and lease liabilities represent our obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized at commencement date based on the present value of lease payments over the lease term. As most of our leases do not provide an implicit rate, we use our incremental borrowing rate based on the information available at commencement dates of the respective leases in determining the present value of the applicable lease payments.

Operating lease ROU assets also include any leasepre-payments made and exclude lease incentives. Certain of our leases include variable payments, which are excluded from lease ROU assets and lease liabilities and expensed as incurred. Our leases have remaining lease terms of 1-10 years, some of which include options to extend the leases for up to five years. The exercise of lease renewal options is at our sole discretion, and our lease ROU assets and liabilities reflect only the options we are reasonably certain that we will exercise. Certain real property lease agreements have lease and non-lease components, which are generally accounted for as a single lease component. Lease expense for lease payments is recognized on a straight-line basis over the lease term. Lease payments for short-term leases, which are 12 months or less without a purchase option that is likely to be exercised, are recognized as lease cost on a straight-line basis over the lease term.

The components of operating lease expense were as follows:

	Quarter ended September 30, 2019	Nine months ended September 30, 2019
Lease cost	\$ 18,887	\$ 54,647
Short-term lease cost	2,489	7,098
Variable lease cost	216	531
Sublease income	(81)	(162)
Total operating lease cost	<u>\$ 21,511</u>	<u>\$ 62,114</u>

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Supplemental balance sheet information related to operating leases were as follows:

<u>September 30,</u>	2019
ROU assets	\$ 225,366
Current portion of long-term obligations	\$ 66,403
Operating lease liabilities	157,503
Total operating lease liabilities	<u>\$ 223,906</u>
Weighted Average Remaining Lease Term (in years)	4.0 years
Weighted Average Discount Rate	4.54%

Supplemental cash flow information related to operating leases were as follows:

<u>Nine Months Ended September 30,</u>	2019
Operating cash flows for the measurement of operating lease liabilities	\$ 55,214
Operating lease right-of-use assets obtained in exchange for operating lease obligations	\$274,366

At September 30, 2019, maturities of operating lease liabilities over each of the next five years and thereafter were as follows:

Remainder of 2019	\$ 19,553
2020	72,188
2021	59,390
2022	43,563
2023	28,167
Thereafter	23,617
Total lease payments	246,478
Less imputed interest	22,572
Total lease liability	<u>\$223,906</u>

At September 30, 2019, we had additional operating leases, primarily for real property, that had not yet commenced. Such leases had estimated future minimum rental commitments of approximately \$1,600. These operating leases subsequently commenced on October 1, 2019 with lease terms of five years. These undiscounted amounts are not included in the table above.

Prior to the adoption of the New Lease Standard, rental commitments on an undiscounted basis were approximately \$19,300 at December 31, 2018 under non-cancelable operating leases and were payable as follows: \$70,400 in 2019, \$55,100 in 2020, \$41,300 in 2021, \$28,500 in 2022, \$15,700 in 2023, and \$8,300 thereafter.

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### 3. REVENUES

#### Disaggregation of Revenues

The following table presents our revenues disaggregated by primary geographical regions and major product lines within our single reporting segment:

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
<b>Primary Geographical Regions:</b>				
United States	\$1,232,564	\$1,134,852	\$3,258,283	\$3,125,814
Canada	85,422	87,251	222,429	218,730
Latin America and the Caribbean	76,929	73,904	217,335	210,783
	<u>\$1,394,915</u>	<u>\$1,296,007</u>	<u>\$3,698,047</u>	<u>\$3,555,327</u>



<b>Major Product Lines:</b>				
HVAC equipment	68%	68%	68%	68%
Other HVAC products	29%	28%	28%	28%
Commercial refrigeration products	3%	4%	4%	4%
	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

#### 4. 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,	
	2019	2018	2019	2018
<b>Basic Earnings per Share:</b>				
Net income attributable to Watsco, Inc. shareholders	\$ 83,480	\$ 79,163	\$ 208,672	\$ 203,339
Less: distributed and undistributed earnings allocated to non-vested restricted common stock	6,973	6,451	17,326	16,600
Earnings allocated to Watsco, Inc. shareholders	<u>\$ 76,507</u>	<u>\$ 72,712</u>	<u>\$ 191,346</u>	<u>\$ 186,739</u>
Weighted-average common shares outstanding - Basic	34,755,627	34,339,859	34,544,425	34,301,672
Basic earnings per share for Common and Class B common stock	\$ 2.20	\$ 2.12	\$ 5.54	\$ 5.44
Allocation of earnings for Basic:				
Common stock	\$ 70,836	\$ 67,201	\$ 177,075	\$ 172,571
Class B common stock	5,671	5,511	14,271	14,168
	<u>\$ 76,507</u>	<u>\$ 72,712</u>	<u>\$ 191,346</u>	<u>\$ 186,739</u>
<b>Diluted Earnings per Share:</b>				
Net income attributable to Watsco, Inc. shareholders	\$ 83,480	\$ 79,163	\$ 208,672	\$ 203,339
Less: distributed and undistributed earnings allocated to non-vested restricted common stock	6,971	6,448	17,325	16,593
Earnings allocated to Watsco, Inc. shareholders	<u>\$ 76,509</u>	<u>\$ 72,715</u>	<u>\$ 191,347</u>	<u>\$ 186,746</u>
Weighted-average common shares outstanding - Basic	34,755,627	34,339,859	34,544,425	34,301,672
Effect of dilutive stock options	33,328	59,530	25,294	64,850
Weighted-average common shares outstanding - Diluted	<u>34,788,955</u>	<u>34,399,389</u>	<u>34,569,719</u>	<u>34,366,522</u>
Diluted earnings per share for Common and Class B common stock	\$ 2.20	\$ 2.11	\$ 5.54	\$ 5.43
Anti-dilutive stock options not included above	183,083	79,316	220,013	39,751

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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, 2019 and 2018, our outstanding Class B common stock was convertible into 2,576,336 and 2,602,528 shares of our Common stock, respectively.

#### 5. OTHER COMPREHENSIVE (LOSS) INCOME

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

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Foreign currency translation adjustment	\$ (3,038)	\$ 4,269	\$ 7,264	\$ (7,422)
Unrealized gain (loss) on cash flow hedging instruments	351	316	(1,093)	1,043
Income tax (expense) benefit	(96)	(85)	295	(281)
Unrealized gain (loss) on cash flow hedging instruments, net of tax	<u>255</u>	<u>231</u>	<u>(798)</u>	<u>762</u>
Reclassification of gain on cash flow hedging instruments into earnings	(191)	(1,253)	(742)	(78)
Income tax expense	51	338	200	21
Reclassification of gain on cash flow hedging instruments into earnings, net of tax	<u>(140)</u>	<u>(915)</u>	<u>(542)</u>	<u>(57)</u>
Other comprehensive (loss) income	<u>\$ (2,923)</u>	<u>\$ 3,585</u>	<u>\$ 5,924</u>	<u>\$ (6,717)</u>

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

<i>Nine Months Ended September 30,</i>	2019	2018
Foreign currency translation adjustment:		
Beginning balance	\$ (46,604)	\$ (33,499)
Current period other comprehensive income (loss)	<u>4,732</u>	<u>(4,660)</u>

Ending balance	<u>(41,872)</u>	<u>(38,159)</u>
Cash flow hedging instruments:		
Beginning balance	636	(421)
Current period other comprehensive (loss) income	(479)	457
Reclassification adjustment	(325)	(34)
Ending balance	<u>(168)</u>	<u>2</u>
Equity securities:		
Beginning balance	—	(301)
Cumulative-effect adjustment to retained earnings	—	301
Ending balance	<u>—</u>	<u>—</u>
Accumulated other comprehensive loss, net of tax	<u><u>\$(42,040)</u></u>	<u><u>\$(38,157)</u></u>

## 6. PURCHASE OF OWNERSHIP INTEREST FROM JOINT VENTURE

Effective May 31, 2019, we purchased an additional 20% ownership interest in Homans Associates II LLC (“Homans”) from Carrier Enterprise Northeast, LLC (“Carrier Enterprise II”) for cash consideration of \$32,400, which increased our ownership in Homans to 100%. Homans previously operated as a division of Carrier Enterprise II and subsequent to the purchase operates as a stand-alone subsidiary of the Company with 16 locations in the Northeastern U.S.

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## 7. 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 a 34.9% ownership interest in Russell Sigler, Inc. (“RSI”), an HVAC distributor 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 \$3,600, of which we contributed \$50,880 and Carrier contributed \$12,720. Effective June 29, 2018, Carrier Enterprise I acquired an additional 1.4% ownership interest in RSI, which increased Carrier Enterprise I’s ownership interest in RSI to 36.3% for cash consideration of \$3,760 that was paid on July 5, 2018, of which we contributed \$3,008 and Carrier contributed \$752. Effective April 22, 2019, Carrier Enterprise I acquired an additional 1.8% ownership interest in RSI for cash consideration of \$4,940, of which we contributed \$3,952 and Carrier contributed \$988. This acquisition increased Carrier Enterprise I’s ownership interest in RSI to 38.1%.

Carrier Enterprise I is a party to a shareholders’ agreement (the “Shareholders’ Agreement”) with RSI and its 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 a multiple of 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 38.1% 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.

## 8. ACQUISITIONS

On April 2, 2019, one of our wholly owned subsidiaries acquired certain assets and assumed certain liabilities of Dunphey & Associates Supply Co., Inc., a distributor of air conditioning and heating products operating from seven locations in New Jersey, New York and Connecticut. The purchase price was composed of cash consideration of \$16,781 and the issuance of 50,952 shares of Common stock having a fair value of \$7,450.

On August 1, 2019, Carrier Enterprise I acquired substantially all of the assets and assumed certain of the liabilities of Peirce-Phelps, Inc. (“PPI”), an HVAC distributor operating from 19 locations in Pennsylvania, New Jersey, and Delaware, for \$85,000 less certain average revolving indebtedness. Consideration for the net purchase price consisted of \$10,000 in cash, 372,543 shares of Common stock having a fair value of \$8,638 and the payment of certain average revolving indebtedness. Carrier contributed cash of \$17,000 to Carrier Enterprise I in connection with the acquisition of PPI. The preliminary fair value estimate of working capital acquired of approximately \$59,000 consists mainly of inventory and accounts receivable partially offset by accounts payable and accrued expenses and other liabilities. We expect to finalize certain procedures related to the opening balance sheet and adjustments to estimates of fair value of net assets acquired by December 31, 2019. Any acquired goodwill as a result of this acquisition will be deductible for tax purposes.

The results of operations of these acquisitions have been included in the consolidated financial statements from their respective dates of acquisition. The pro forma effect of these acquisitions were not deemed significant to the consolidated financial statements.

## 9. DERIVATIVES

We enter into foreign currency forward and option 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, 2019, all 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, 2019 was

\$40,400, and such contracts have varying terms expiring through June 2020.

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

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Gain (loss) recorded in accumulated other comprehensive loss	\$ 351	\$ 316	\$ (1,093)	\$ 1,043
Gain reclassified from accumulated other comprehensive loss into earnings	\$ (191)	\$ (1,253)	\$ (742)	\$ (78)

At September 30, 2019, we expected an estimated \$385 pre-tax loss to be reclassified into earnings to reflect the fixed prices obtained from foreign exchange hedging within the next 12 months.

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### Derivatives Not Designated as Hedging Instruments

We have also entered into foreign currency forward and option contracts that are either not designated as hedges or did not qualify for hedge accounting. These derivative instruments were effective economic hedges for all 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, 2019 was \$12,300, and such contracts have varying terms expiring through November 2019.

We recognized gains (losses) of \$128 and \$(108) from foreign currency forward and option contracts not designated as hedging instruments in our condensed consolidated unaudited statements of income for the quarters ended September 30, 2019 and 2018, respectively. We recognized losses of \$175 and \$299 from foreign currency forward and option contracts not designated as hedging instruments in our condensed consolidated unaudited statements of income for the nine months ended September 30, 2019 and 2018, respectively.

The following table summarizes the fair value of derivative instruments, which consist solely of foreign exchange contracts, included in other current assets and accrued expenses and other current liabilities in our condensed consolidated unaudited balance sheets. See Note 10.

	Asset Derivatives		Liability Derivatives	
	September 30, 2019	December 31, 2018	September 30, 2019	December 31, 2018
Derivatives designated as hedging instruments	\$ 45	\$ 1,262	\$ 250	\$ 3
Derivatives not designated as hedging instruments	—	58	44	11
Total derivative instruments	\$ 45	\$ 1,320	\$ 294	\$ 14

## 10. 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, 2019 Using		
			Level 1	Level 2	Level 3
<b>Assets:</b>					
Derivative financial instruments	Other current assets	\$ 45	\$ —	\$ 45	\$ —
Equity securities	Other assets	\$ 318	\$ 318	\$ —	\$ —
<b>Liabilities:</b>					
Derivative financial instruments	Accrued expenses and other current liabilities	\$ 294	\$ —	\$ 294	\$ —

  

	Balance Sheet Location	Total	Fair Value Measurements at December 31, 2018 Using		
			Level 1	Level 2	Level 3
<b>Assets:</b>					
Derivative financial instruments	Other current assets	\$ 1,320	\$ —	\$ 1,320	\$ —
Equity securities	Other assets	\$ 279	\$ 279	\$ —	\$ —
<b>Liabilities:</b>					
Derivative financial instruments	Accrued expenses and other current liabilities	\$ 14	\$ —	\$ 14	\$ —

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:

*Equity securities* – these 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 and option contracts. See Note 9. 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, 2019.

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## 11. SHAREHOLDERS' EQUITY

### Common Stock Dividends

We paid cash dividends of \$1.60, \$1.45, \$4.80, and \$4.15 per share of both Common stock and Class B common stock during the quarters and nine months ended September 30, 2019 and 2018, respectively.

### Non-Vested Restricted Stock

During the quarter and nine months ended September 30, 2019, 3,231 shares of Common and Class B common stock with an aggregate fair market value of \$535, and 9,824 shares of Common and Class B common stock with an aggregate fair market value of \$1,518, respectively, 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 and nine months ended September 30, 2018, 8,830 shares of Common stock with an aggregate fair market value of \$1,562, and 21,754 shares of Common stock with an aggregate fair market value of \$3,775, respectively, 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

Cash received from Common stock issued as a result of stock options exercised during the quarters and nine months ended September 30, 2019 and 2018, was \$3,986, \$856, \$6,229, and \$4,837, respectively.

During the quarter and nine months ended September 30, 2019, 799 shares of Common stock with an aggregate fair market value of \$34 were withheld as payment in lieu of cash for stock option exercises. These shares were retired upon delivery. During the quarter and nine months ended September 30, 2018, 376 shares of Common stock with an aggregate fair market value of \$9, and 7,027 shares of Common stock with an aggregate fair market value of \$1,269, respectively, were withheld as payment in lieu of cash for stock option exercises. These shares were retired upon delivery.

### Employee Stock Purchase Plan

During the quarters ended September 30, 2019 and 2018, we received net proceeds of \$418 and \$382, respectively, for shares of Common stock issued under our employee stock purchase plan. During the nine months ended September 30, 2019 and 2018, we received net proceeds of \$1,251 and \$1,142, respectively, for shares of Common stock issued under our employee stock purchase plan.

## 12. COMMITMENTS AND CONTINGENCIES

### Litigation, Claims and Assessments

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

### Self-Insurance

Self-insurance reserves are maintained relative to company-wide casualty insurance and health benefit programs. The level of exposure from catastrophic events is limited by the purchase of stop-loss and aggregate liability reinsurance coverage. When estimating the self-insurance liabilities and related reserves, management considers a number of factors, which include historical claims experience, demographic factors, severity factors, and valuations provided by independent third-party actuaries. Management reviews its assumptions with its independent third-party actuaries to evaluate whether the self-insurance reserves are adequate. If actual claims or adverse development of loss reserves occur and exceed these estimates, additional reserves may be required. Reserves in the amounts of \$4,022 and \$2,311 at September 30, 2019 and December 31, 2018, respectively, were established related to such programs and are included in accrued expenses and other current liabilities in our condensed consolidated unaudited balance sheets.

## 13. RELATED PARTY TRANSACTIONS

Purchases from Carrier and its affiliates comprised 60% and 64% of all inventory purchases made during the quarters ended September 30, 2019 and 2018, respectively. Purchases from Carrier and its affiliates comprised 61% and 63% of all inventory purchases made during the nine months ended September 30, 2019 and 2018, respectively. At September 30, 2019 and December 31, 2018, approximately \$120,000 and \$71,000, 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

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statements of income for the quarters and nine months ended September 30, 2019 and 2018 included approximately \$24,000, \$28,000, \$68,000, and \$65,000, 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 Senior Chairman of Greenberg Traurig, P.A., which serves as our principal outside counsel for compliance and acquisition-related legal services. During the quarters and nine months ended September 30, 2019 and 2018, we paid this firm \$175, \$0, \$175, and \$18 for services performed, respectively, and no amount was payable at September 30, 2019.

A member of our Board of Directors is the Chairman and Chief Executive Officer of Moss & Associates LLC, which served as general contractor for the remodeling of our Miami headquarters that was completed in 2018. We paid Moss & Associates LLC \$0 and \$124 for construction services performed during the quarters and nine months ended September 30, 2018, respectively.

## **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," "goal," "designed," 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, both in the United States and in the international markets we serve;
- 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 patterns and 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 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, 2018, 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 our forward-looking statements by these cautionary factors.

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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, 2018.

### **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, 2019, we operated from 603 locations in 38 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, a majority of which we operate 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 evenly distributed throughout the year and depends largely on housing completions and weather and economic conditions.

### 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. We have an 80% controlling interest in Carrier Enterprise I, and Carrier has a 20% non-controlling interest.

In 2011, we formed a second joint venture with Carrier, in which Carrier contributed 28 of its company-owned locations in the Northeast U.S., and we contributed 14 locations in the Northeast U.S., and we then purchased Carrier’s distribution operations in Mexico, which included seven locations. Collectively, the Northeast locations and the Mexico operations are referred to as Carrier Enterprise II. We have an 80% controlling interest in Carrier Enterprise II, and Carrier has a 20% non-controlling interest. Effective May 31, 2019, we purchased an additional 20% ownership interest in Homans Associates II LLC (“Homans”) from Carrier Enterprise II, following which we owned 100% of Homans. Homans previously operated as a division of Carrier Enterprise II and now operates as one of our stand-alone-subidiaries.

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 2018 Annual Report on Form 10-K, as filed with the SEC on February 28, 2019. We believe that there have been no significant changes during the quarter ended September 30, 2019 to the critical accounting policies disclosed in our Annual Report on Form 10-K for the year ended December 31, 2018.

### New Accounting Standards

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

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### 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, 2019 and 2018:

	Quarter Ended		Nine Months Ended	
	September 30,	September 30,	September 30,	September 30,
	2019	2018	2019	2018
Revenues	<b>100.0%</b>	100.0%	<b>100.0%</b>	100.0%
Cost of sales	<b>76.0</b>	75.4	<b>75.8</b>	75.5
Gross profit	<b>24.0</b>	24.6	<b>24.2</b>	24.5
Selling, general and administrative expenses	<b>15.3</b>	15.5	<b>15.9</b>	15.9
Other income	<b>0.3</b>	0.3	<b>0.2</b>	0.2
Operating income	<b>9.0</b>	9.4	<b>8.5</b>	8.8
Interest expense, net	<b>0.1</b>	0.1	<b>0.1</b>	0.1
Income before income taxes	<b>8.9</b>	9.4	<b>8.4</b>	8.8
Income taxes	<b>1.7</b>	1.9	<b>1.6</b>	1.8
Net income	<b>7.1</b>	7.5	<b>6.8</b>	7.0
Less: net income attributable to non-controlling interest	<b>1.2</b>	1.4	<b>1.2</b>	1.2
Net income attributable to Watsco, Inc.	<b>6.0%</b>	6.1%	<b>5.6%</b>	5.7%

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

The following narratives reflect our acquisition of the HVAC distribution business of Peirce-Phelps, Inc. (“PPI”) in August 2019, Dunphey & Associates

Supply Co., Inc. (“DASCO”) in April 2019, Alert Labs Inc. (“Alert Labs”) in August 2018, and our acquisition of an HVAC distributor in November 2018 as well as the purchase of additional 1.8% and 1.4% ownership interests in Russell Sigler, Inc. (“RSI”) in April 2019 and June 2018, respectively, and the purchase of an additional 20% ownership interest in Homans effective May 31, 2019.

In the following narratives, computations and other information referring to “same-store basis” exclude the effects of locations closed, acquired, or locations opened, unless they are within close geographical proximity to existing locations, during the immediately preceding 12 months. At September 30, 2019 and 2018, respectively, 10 and 8 locations opened were near existing locations and were therefore included in “same-store basis” information.

The table below summarizes the changes in our locations for the 12 months ended September 30, 2019:

	Number of Locations
September 30, 2018	568
Opened	2
Acquired	3
Closed	(2)
December 31, 2018	571
Opened	14
Acquired	26
Closed	(8)
September 30, 2019	<u>603</u>

### Third Quarter of 2019 Compared to Third Quarter of 2018

#### Revenues

Revenues for the third quarter of 2019 increased \$98.9 million, or 8%, including \$58.7 million from locations opened and acquired during the preceding 12 months, offset by \$4.2 million from locations closed. Sales of HVAC equipment (68% of sales) increased 8%, sales of other HVAC products (29% of sales) increased 11% and sales of commercial refrigeration products (3% of sales) increased 1%. On a same-store basis, revenues increased \$44.4 million, or 3%, as compared to the same period in 2018, reflecting a 4% increase in sales of HVAC equipment (69% of sales), which included a 6% increase in residential HVAC equipment, a 2% increase in sales of other HVAC products (27% of sales) and 1% increase of commercial refrigeration products (4% of sales). For residential HVAC equipment, the increase in revenues was primarily due to strong demand for the replacement of residential HVAC equipment, realization of price increases and a higher mix of high-efficiency air conditioning and heating systems, which sell at higher unit prices, resulting in a 4% increase in volume and a 2% increase in the average selling price.

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#### Gross Profit

Gross profit for the third quarter of 2019 increased \$15.7 million, or 5%, primarily as a result of increased revenues. Gross profit margin for the quarter ended September 30, 2019 declined 60 basis-points to 24.0% versus 24.6% for the same period in 2018, primarily due to the benefit of mid-year pricing actions taken by our HVAC equipment suppliers in 2018, which did not recur in 2019.

#### Selling, General and Administrative Expenses

Selling, general and administrative expenses for the third quarter of 2019 increased \$12.5 million, or 6%, primarily due to increased revenues. Selling, general and administrative expenses as a percent of revenues for the quarter ended September 30, 2019 decreased to 15.3% versus 15.5% for the same period in 2018. Selling, general and administrative expenses included \$1.5 million of additional costs for 2019 in excess of 2018 for ongoing technology initiatives, driven in part by our acquisition of Alert Labs in August 2018. On a same-store basis, selling, general and administrative expenses were flat as compared to the same period in 2018.

#### Other Income

Other income of \$3.5 million and \$3.7 million for the third quarters of 2019 and 2018, respectively, represented our share of the net income of RSI.

#### Interest Expense, Net

Interest expense, net for the third quarter of 2019 increased \$0.4 million, or 37%, primarily as a result of increase in average outstanding borrowings, partially offset by a lower effective interest rate due to higher interest income for the 2019 period, as compared to the same period in 2018.

#### Income Taxes

Income taxes decreased to \$24.2 million for the third quarter of 2019, as compared to \$24.4 million for the third quarter of 2018, and represent 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; therefore, Carrier is responsible for its proportionate share of income taxes attributable to its share of earnings from these joint ventures. The effective income tax rates attributable to us were 22.2% and 23.3% for the quarters ended September 30, 2019 and 2018, respectively. The decrease was primarily due to the refinement of estimated global intangible low-taxed income (“GILTI”) of foreign subsidiaries in the third quarter of 2019 due to the finalization of federal and state income tax regulations.

#### Net Income Attributable to Watsco, Inc.

Net income attributable to Watsco for the quarter ended September 30, 2019 increased \$4.3 million, or 5%, compared to the same period in 2018. The increase was primarily driven by higher revenues and gross profit, reduced selling, general and administrative expenses as a percentage of revenues and a

decrease in net income attributable to the non-controlling interest related to our purchase of the additional 20% interest in Homans.

## **Nine Months Ended September 30, 2019 Compared to Nine Months Ended September 30, 2018**

### *Revenues*

Revenues for the nine months ended September 30, 2019 increased \$142.7 million, or 4%, including \$85.6 million from locations opened and acquired during the preceding 12 months, offset by \$10.4 million from locations closed. Sales of HVAC equipment (68% of sales) increased 8%, sales of other HVAC products (28% of sales) increased 3% and sales of commercial refrigeration products (4% of sales) decreased 1%. On a same-store basis, revenues increased \$67.5 million, or 2%, as compared to the same period in 2018, reflecting a 3% increase in sales of HVAC equipment (68% of sales), which included a 4% increase in residential HVAC equipment, a 1% decrease in sales of other HVAC products (28% of sales) and a 1% decrease in commercial refrigeration products (4% of sales). For residential HVAC equipment, the increase in same-store revenues was primarily due to realization of price increases and a higher mix of high-efficiency air conditioning and heating systems, which sell at higher unit prices, and demand for the replacement of residential HVAC equipment, resulting in a 2% increase in the average selling price and a 2% increase in volume.

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### *Gross Profit*

Gross profit for the nine months ended September 30, 2019 increased \$25.8 million, or 3%, primarily as a result of increased revenues. Gross profit margin for the nine months ended September 30, 2019 declined 30 basis-points to 24.2% versus 24.5% for the same period in 2018, primarily due to the benefit of mid-year pricing actions taken by our HVAC equipment suppliers in 2018, which did not recur in 2019.

### *Selling, General and Administrative Expenses*

Selling, general and administrative expenses for the nine months ended September 30, 2019 increased \$24.0 million, or 4%, primarily due to increased revenues. Selling, general and administrative expenses as a percentage of revenues remained consistent at 15.9% for the nine months ended September 30, 2019 as compared to the same period in 2018. Selling, general and administrative expenses included \$4.3 million of additional costs for 2019 in excess of 2018 for ongoing technology initiatives, driven in part by our acquisition of Alert Labs in August 2018. On a same-store basis, selling, general and administrative expenses increased 1% as compared to the same period in 2018.

### *Other Income*

Other income of \$7.9 million and \$8.5 million for the nine months ended September 30, 2019 and 2018, respectively, represented our share of the net income of RSI.

### *Interest Expense, Net*

Interest expense, net for the nine months ended September 30, 2019 increased \$1.0 million, or 44%, primarily as a result of an increase in average outstanding borrowings, partially offset by a lower effective interest rate due to higher interest income for the 2019 period, as compared to the same period in 2018.

### *Income Taxes*

Income taxes decreased to \$60.1 million for the nine months ended September 30, 2019, as compared to \$63.7 million for the nine months ended September 30, 2018, and represent 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; therefore, Carrier is responsible for its proportionate share of income taxes attributable to its share of earnings from these joint ventures. The effective income tax rates attributable to us were 22.1% and 23.6% for the nine months ended September 30, 2019 and September 30, 2018, respectively. The decrease was primarily due to lower estimated foreign withholding taxes and the refinement of estimated GILTI of foreign subsidiaries in the nine months ended September 30, 2019 due to the finalization of federal and state income tax regulations.

### *Net Income Attributable to Watsco, Inc.*

Net income attributable to Watsco for the nine months ended September 30, 2019 increased \$5.3 million, or 3%, compared to the same period in 2018. The increase was primarily driven by higher revenues and gross profit, a reduction in income taxes, and a decrease in net income attributable to the non-controlling interest related to our purchase of the additional 20% interest in Homans, partially offset by higher selling, general and administrative expenses and interest expense as discussed above.

## **Liquidity and Capital Resources**

We assess our liquidity in terms of our ability to generate cash to execute our business strategy and fund operating and investing activities, taking into consideration the seasonal demand 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 revolving credit facility;
- 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.

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### [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. Additionally, we may also generate cash through the issuance and sale of our Common stock.

As of September 30, 2019, we had \$60.2 million of cash and cash equivalents, of which \$43.9 million was held by foreign subsidiaries. The repatriation of cash balances from our foreign subsidiaries could have adverse tax impacts or be subject to capital controls; however, these balances are generally available to fund the ordinary business operations of our foreign subsidiaries without legal or other restrictions.

We believe that our operating cash flows, cash on hand, and funds available for borrowing under our revolving credit agreement are 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. LIBOR is the subject of recent proposals for reform that currently provide for the phase-out of LIBOR by 2021. The consequences of these developments with respect to LIBOR cannot be entirely predicted but could result in an increase in the cost of our debt, as it is currently anticipated that lenders will replace LIBOR with an alternative rate that may exceed what would have been the comparable LIBOR rate. Disruptions in the credit and capital markets, including the expected transition from LIBOR, could also result in increased borrowing costs and/or reduced borrowing capacity under our revolving credit agreement.

### [Working Capital](#)

Working capital increased to \$1,148.5 million at September 30, 2019 from \$1,084.2 million at December 31, 2018, reflecting higher levels of accounts receivable and inventories, primarily due to new locations opened and acquired, as well as additional inventory acquired in anticipation of the transition to new energy conservation standards for residential furnace fans that became effective on July 3, 2019. These increases were partially offset by the timing of accounts payable and accrued liabilities as well as the current portion of lease liabilities recognized as current liabilities as a result of the adoption of the New Lease Standard on January 1, 2019.

### [Cash Flows](#)

The following table summarizes our cash flow activity for the nine months ended September 30, 2019 and 2018 (in millions):

	2019	2018	Change
Cash flows provided by operating activities	\$ 197.5	\$ 70.1	\$127.4
Cash flows used in investing activities	\$ (65.0)	\$ (22.3)	\$ (42.7)
Cash flows used in financing activities	\$ (155.7)	\$ (59.8)	\$ (95.9)

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](#)

The increase in net cash provided by operating activities was primarily due to the comparative timing of payments for accrued expenses and other current liabilities in 2019 versus 2018.

### [Investing Activities](#)

Net cash used in investing activities was higher primarily due to cash consideration paid for those acquisitions described above.

### [Financing Activities](#)

The increase in net cash used in financing activities was primarily attributable to lower net proceeds under our revolving credit agreement, the purchase of an additional 20% ownership interest in Homans for \$32.4 million and an increase in dividends paid, partially offset by \$17.0 million in proceeds from the non-controlling interest for their contribution to the acquisition of the HVAC distribution business of PPI in 2019.

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### [Revolving Credit Agreement](#)

We maintain an unsecured, \$500.0 million syndicated multicurrency revolving credit agreement, which we use 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 facility has a seasonal component from October 1 to March 31, during which the borrowing capacity was reduced to \$400.0 million at our discretion. Included in the credit facility are a \$100.0 million swingline subfacility, a \$10.0 million letter of credit subfacility, a \$75.0 million alternative currency borrowing sublimit and an \$8.0 million Mexican borrowing sublimit. The credit agreement matures on

December 5, 2023.

At September 30, 2019 and December 31, 2018, \$169.3 million and \$135.2 million, 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, 2019.

#### Purchase of Additional Ownership Interest from Joint Venture

Effective May 31, 2019, we purchased an additional 20% ownership interest in Homans from Carrier Enterprise II for cash consideration of \$32.4 million, which increased our ownership in Homans to 100%. Homans previously operated as a division of Carrier Enterprise II and subsequent to the purchase operates as a stand-alone subsidiary of the Company with 16 locations in the Northeastern U.S.

#### Investment in Unconsolidated Entity

On June 21, 2017, Carrier Enterprise I acquired a 34.9% 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. Effective June 29, 2018, Carrier Enterprise I acquired an additional 1.4% ownership interest in RSI, which increased Carrier Enterprise I's ownership interest in RSI to 36.3%. Total cash consideration of \$3.8 million was paid on July 5, 2018, of which we contributed \$3.0 million and Carrier contributed \$0.8 million. Effective April 22, 2019, Carrier Enterprise I acquired an additional 1.8% ownership interest in RSI, which increased Carrier Enterprise I's ownership interest in RSI to 38.1% for cash consideration of \$4.9 million, of which we contributed \$3.9 million and Carrier contributed \$1.0 million.

Carrier Enterprise I is a party to a shareholders' agreement (the "Shareholders' Agreement") with RSI and its 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 a multiple of 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. At September 30, 2019, the estimated purchase amount we would be contingently liable for was approximately \$131.0 million. 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

On April 2, 2019, one of our wholly owned subsidiaries acquired certain assets and assumed certain liabilities of DASCO, a distributor of air conditioning and heating products operating from seven locations in New Jersey, New York and Connecticut. The purchase price was composed of cash consideration of \$16.8 million and the issuance of 50,952 shares of Common stock having a fair value of \$7.5 million.

On August 1, 2019, Carrier Enterprise I acquired substantially all of the assets and assumed certain of the liabilities of PPI, an HVAC distributor operating from 19 locations in Pennsylvania, New Jersey, and Delaware, for \$85 million less certain average revolving indebtedness. Consideration for the net purchase price consisted of \$10.0 million in cash, 372,543 shares of Common stock having a fair value of \$58.6 million and the payment of certain average revolving indebtedness. Carrier contributed cash of \$17.0 million to Carrier Enterprise I in connection with the acquisition of PPI. The preliminary fair value estimate of working capital acquired of approximately \$59.0 million consists mainly of inventory and accounts receivable partially offset by accounts payable and accrued expenses and other liabilities. We expect to finalize certain procedures related to the opening balance sheet and adjustments to estimates of fair value of net assets acquired by December 31, 2019. Any acquired goodwill as a result of this acquisition will be deductible for tax purposes.

We continually evaluate potential acquisitions and/or joint ventures and investments in unconsolidated entities. We routinely hold discussions with several 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.

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### Common Stock Dividends

We paid cash dividends of \$4.80 and \$4.15 per share of Common stock and Class B common stock during the nine months ended September 30, 2019 and 2018, respectively. On October 1, 2019, our Board of Directors declared a regular quarterly cash dividend of \$1.60 per share of both Common and Class B common stock that was paid on October 31, 2019 to shareholders of record as of October 15, 2019. Future dividends and/or changes in dividend rates are at the sole discretion of the Board of Directors and depend upon factors including, but not limited to, cash flow generated by operations, profitability, financial condition, cash requirements, and future prospects.

### 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. We last repurchased shares under this plan in 2008. 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, 2019, 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, 2018.

## 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”), Executive Vice President (“EVP”) 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, EVP 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, EVP 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, 2019, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. In accordance with the rules and regulations of the SEC, we have not yet assessed the internal control over financial reporting of PPI or DASCO, which collectively represented approximately 6% of our total consolidated assets at September 30, 2019 and approximately 2% of our consolidated revenues for the nine months ended September 30, 2019. From the respective acquisition dates of August 1, 2019 and April 2, 2019 to September 30, 2019, the processes and systems of PPI and DASCO did not impact the internal controls over financial reporting for our other consolidated subsidiaries.

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

Information with respect to this item may be found in Note 12 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, 2019 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, 2018.

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### ITEM 6. EXHIBITS

31.1 #	<a href="#">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.</a>
31.2 #	<a href="#">Certification of Executive 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.</a>
31.3 #	<a href="#">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.</a>
32.1 +	<a href="#">Certification of Chief Executive Officer, Executive 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.</a>
101.INS #	Inline XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.
101.SCH #	Inline XBRL Taxonomy Extension Schema Document.
101.CAL #	Inline XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF #	Inline XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB #	Inline XBRL Taxonomy Extension Label Linkbase Document.
101.PRE #	Inline XBRL Taxonomy Extension Presentation Linkbase Document.
104	The cover page from the Company’s Quarterly Report on Form 10-Q for the quarter ended September 30, 2019, formatted in Inline XBRL.

# filed herewith.

+ furnished herewith.

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### 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 1, 2019

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

## 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 1, 2019

/s/ Albert H. Nahmad

Albert H. Nahmad

Chief Executive Officer

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

I, Barry S. Logan, certify that:

1. I have reviewed this 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 1, 2019

/s/ Barry S. Logan

Barry S. Logan

Executive Vice President – Planning & Strategy

## 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 1, 2019

/s/ Ana M. Menendez

Ana M. Menendez

Chief Financial Officer

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

In connection with the Quarterly Report on Form 10-Q of Watsco, Inc. (“Watsco”) for the quarter and nine months ended September 30, 2019, 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 Executive Vice President – Planning & Strategy 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 1, 2019

/s/ Barry S. Logan

Barry S. Logan  
Executive Vice President – Planning & Strategy  
November 1, 2019

/s/ Ana M. Menendez

Ana M. Menendez  
Chief Financial Officer  
November 1, 2019

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.