

**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 March 31, 2023

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

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:

<u>Title of each class</u>	<u>Trading Symbol(s)</u>	<u>Name of each exchange on which registered</u>
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, a non-accelerated filer, a smaller reporting company, or an 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 May 1, 2023 comprised (i) 33,421,892 shares of Common stock, \$0.50 par value per share, excluding 4,823,988 treasury shares and (ii) 5,533,667 shares of Class B common stock, \$0.50 par value per share, excluding 48,263 treasury shares.



WATSCO, INC. AND SUBSIDIARIES

QUARTERLY REPORT ON FORM 10-Q

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

	Quarters Ended March 31,	
	2023	2022
Revenues	\$1,550,641	\$ 1,523,570
Cost of sales	1,102,484	1,073,212
Gross profit	448,157	450,358
Selling, general and administrative expenses	287,057	283,354
Other income	3,640	4,045
Operating income	164,740	171,049
Interest expense, net	615	558
Income before income taxes	164,125	170,491
Income taxes	33,754	35,601
Net income	130,371	134,890
Less: net income attributable to non-controlling interest	20,298	21,592
Net income attributable to Watsco, Inc.	\$ 110,073	\$ 113,298
Earnings per share for Common and Class B common stock:		
Basic	\$ 2.84	\$ 2.91
Diluted	\$ 2.83	\$ 2.90

See accompanying notes to condensed consolidated unaudited financial statements.

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

	<u>Quarters Ended March 31,</u>	
	<u>2023</u>	<u>2022</u>
Net income	\$ 130,371	\$ 134,890
Other comprehensive income, net of tax		
Foreign currency translation adjustment	260	4,381
Other comprehensive income	260	4,381
Comprehensive income	130,631	139,271
Less: comprehensive income attributable to non-controlling interest	20,388	23,038
Comprehensive income attributable to Watsco, Inc.	<u>\$ 110,243</u>	<u>\$ 116,233</u>

See accompanying notes to condensed consolidated unaudited financial statements.

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

	March 31, 2023	December 31, 2022
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 140,955	\$ 147,505
Accounts receivable, net	811,264	747,110
Inventories, net	1,614,294	1,370,173
Other current assets	31,302	33,951
Total current assets	<u>2,597,815</u>	<u>2,298,739</u>
Property and equipment, net	126,582	125,424
Operating lease right-of-use assets	325,878	317,314
Goodwill	430,743	430,711
Intangible assets, net	174,290	175,191
Investment in unconsolidated entity	136,442	132,802
Other assets	8,864	8,033
	<u>\$3,800,614</u>	<u>\$3,488,214</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term obligations	\$ 92,536	\$ 90,597
Borrowings under revolving credit agreement	—	56,400
Accounts payable	593,148	456,128
Accrued expenses and other current liabilities	267,399	303,397
Total current liabilities	<u>953,083</u>	<u>906,522</u>
Long-term obligations:		
Borrowings under revolving credit agreement	197,600	—
Operating lease liabilities, net of current portion	239,309	232,144
Finance lease liabilities, net of current portion	11,230	11,388
Total long-term obligations	<u>448,139</u>	<u>243,532</u>
Deferred income taxes and other liabilities	91,095	89,882
Commitments and contingencies		
Watsco, Inc. shareholders' equity:		
Common stock, \$0.50 par value	19,122	19,054
Class B common stock, \$0.50 par value	2,791	2,757
Preferred stock, \$0.50 par value	—	—
Paid-in capital	997,316	973,060
Accumulated other comprehensive loss, net of tax	(47,540)	(47,710)
Retained earnings	1,044,619	1,029,516
Treasury stock, at cost	(87,440)	(87,440)
Total Watsco, Inc. shareholders' equity	<u>1,928,868</u>	<u>1,889,237</u>
Non-controlling interest	379,429	359,041
Total shareholders' equity	<u>2,308,297</u>	<u>2,248,278</u>
	<u>\$3,800,614</u>	<u>\$3,488,214</u>

See accompanying notes to condensed consolidated unaudited financial statements.

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
Balance at December 31, 2022	38,749,887	\$ 21,811	\$973,060	\$ (47,710)	\$1,029,516	\$(87,440)	\$ 359,041	\$2,248,278
Net income					110,073		20,298	130,371
Other comprehensive income				170			90	260
Issuances of restricted shares of common stock	116,510	58	(58)					—
Forfeitures of restricted shares of common stock	(2,000)	(1)	1					—
Common stock contribution to 401(k) plan	35,533	18	8,844					8,862
Stock issuances from exercise of stock options and employee stock purchase plan	75,186	38	12,947					12,985
Issuance of Class B common stock	632	—	200					200
Retirement of common stock	(21,702)	(11)	(6,441)					(6,452)
Share-based compensation			8,763					8,763
Cash dividends declared and paid on Common and Class B common stock, \$2.45 per share					(94,970)			(94,970)
Balance at March 31, 2023	<u>38,954,046</u>	<u>\$ 21,913</u>	<u>\$997,316</u>	<u>\$ (47,540)</u>	<u>\$1,044,619</u>	<u>\$(87,440)</u>	<u>\$ 379,429</u>	<u>\$2,308,297</u>

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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
Balance at December 31, 2021	38,799,632	\$ 21,836	\$1,003,932	\$ (34,176)	\$760,796	\$(87,440)	\$ 332,467	\$1,997,415
Net income					113,298		21,592	134,890
Other comprehensive income				2,935			1,446	4,381
Issuances of restricted shares of common stock	105,882	53	(53)					—
Common stock contribution to 401(k) plan	21,532	11	6,726					6,737
Stock issuances from exercise of stock options and employee stock purchase plan	24,850	12	4,408					4,420
Share-based compensation			8,667					8,667
Cash dividends declared and paid on Common and Class B common stock, \$1.95 per share					(75,795)			(75,795)
Balance at March 31, 2022	38,951,896	\$ 21,912	\$1,023,680	\$ (31,241)	\$798,299	\$(87,440)	\$ 355,505	\$2,080,715

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)

	Quarters Ended March 31,	
	2023	2022
Cash flows from operating activities:		
Net income	\$ 130,371	\$ 134,890
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	8,183	7,593
Share-based compensation	6,701	7,974
Non-cash contribution to 401(k) plan	8,862	6,737
Provision for doubtful accounts	1,043	1,061
Other income from investment in unconsolidated entity	(3,640)	(4,045)
Other, net	1,160	1,417
Changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable, net	(64,691)	(91,775)
Inventories, net	(240,758)	(273,703)
Accounts payable and other liabilities	101,813	107,755
Other, net	3,535	474
Net cash used in operating activities	(47,421)	(101,622)
Cash flows from investing activities:		
Capital expenditures	(7,505)	(8,324)
Business acquisitions, net of cash acquired	(2,989)	(47)
Proceeds from sale of property and equipment	56	153
Net cash used in investing activities	(10,438)	(8,218)
Cash flows from financing activities:		
Dividends on Common and Class B common stock	(94,970)	(75,795)
Net (repayments) proceeds under prior revolving credit agreement	(56,400)	173,500
Repurchases of common stock to satisfy employee withholding tax obligations	(2,216)	—
Net repayments of finance lease liabilities	(880)	(713)
Payment of fees related to revolving credit agreement	(580)	—
Net proceeds from issuances of common stock	8,747	4,420
Net proceeds under current revolving credit agreement	197,600	—
Net cash provided by financing activities	51,301	101,412
Effect of foreign exchange rate changes on cash and cash equivalents	8	767
Net decrease in cash and cash equivalents	(6,550)	(7,661)
Cash and cash equivalents at beginning of period	147,505	118,268
Cash and cash equivalents at end of period	\$ 140,955	\$ 110,607

See accompanying notes to condensed consolidated unaudited financial statements.

WATSCO, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS
March 31, 2023
(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 March 31, 2023 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 2022 Annual Report on Form 10-K.

The condensed consolidated unaudited financial statements include the accounts of Watsco, all of its wholly owned subsidiaries, the accounts of four joint ventures with Carrier Global Corporation, which we refer to as Carrier, the accounts of Carrier InterAmerica Corporation, of which we have an 80% controlling interest, and Carrier has a 20% non-controlling interest, and our 38.1% investment in Russell Sigler, Inc., which is accounted for under the equity method of accounting. All significant intercompany balances and transactions have been eliminated in consolidation.

The results of operations for the quarter ended March 31, 2023 are not necessarily indicative of the results to be expected for the year ending December 31, 2023. Sales of residential central air conditioners, heating equipment, and parts and supplies are seasonal. Furthermore, profitability can be impacted favorably or unfavorably based on weather patterns, particularly 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 first and fourth quarters. Demand related to the new construction sectors throughout most of the markets we serve tends to be fairly evenly distributed throughout the year and depends largely on housing completions and related weather and economic conditions.

Equity Method Investments

Investments in which we have the ability to exercise significant influence, but do not control, are accounted for under the equity method of accounting and are included in investment in unconsolidated entity in our condensed consolidated unaudited balance sheets. Under this method of accounting, our proportionate share of the net income or loss of the investee is included in other income in our condensed consolidated unaudited statements of income. The excess, if any, of the carrying amount of our investment over our ownership percentage in the underlying net assets of the investee is attributed to certain fair value adjustments with the remaining portion recognized as goodwill.

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, net realizable value adjustments to inventories, income taxes, reserves related to loss contingencies and the valuation of goodwill, indefinite-lived intangible assets, and long-lived assets. While we believe that these estimates are reasonable, actual results could differ from such estimates.

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2. REVENUES

Disaggregation of Revenues

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

<i>Quarters Ended March 31,</i>	2023	2022
Primary Geographical Regions:		
United States	\$1,395,004	\$1,371,340
Canada	81,263	89,423
Latin America and the Caribbean	74,374	62,807
	<u>\$1,550,641</u>	<u>\$1,523,570</u>
Major Product Lines:		
HVAC equipment	68%	67%
Other HVAC products	28%	29%
Commercial refrigeration products	4%	4%
	<u>100%</u>	<u>100%</u>

3. EARNINGS PER SHARE

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

<i>Quarters Ended March 31,</i>	2023	2022
Basic Earnings per Share:		
Net income attributable to Watsco, Inc. shareholders	\$ 110,073	\$ 113,298
Less: distributed and undistributed earnings allocated to restricted common stock	7,414	10,311
Earnings allocated to Watsco, Inc. shareholders	<u>\$ 102,659</u>	<u>\$ 102,987</u>
Weighted-average common shares outstanding – Basic	36,192,597	35,348,977
Basic earnings per share for Common and Class B common stock	\$ 2.84	\$ 2.91
Allocation of earnings for Basic:		
Common stock	\$ 93,489	\$ 95,521
Class B common stock	9,170	7,466
	<u>\$ 102,659</u>	<u>\$ 102,987</u>
Diluted Earnings per Share:		
Net income attributable to Watsco, Inc. shareholders	\$ 110,073	\$ 113,298
Less: distributed and undistributed earnings allocated to restricted common stock	7,411	10,297
Earnings allocated to Watsco, Inc. shareholders	<u>\$ 102,662</u>	<u>\$ 103,001</u>
Weighted-average common shares outstanding – Basic	36,192,597	35,348,977
Effect of dilutive stock options	109,231	155,403
Weighted-average common shares outstanding – Diluted	<u>36,301,828</u>	<u>35,504,380</u>
Diluted earnings per share for Common and Class B common stock	\$ 2.83	\$ 2.90
Anti-dilutive stock options not included above	169,916	143,372

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 March 31, 2023 and 2022, our outstanding Class B common stock was convertible into 3,232,844, and 2,562,448 shares of our Common stock, respectively.

4. OTHER COMPREHENSIVE INCOME

Other comprehensive income consists of the foreign currency translation adjustment associated with our Canadian operations' use of the Canadian dollar as their functional currency.

The change in accumulated other comprehensive loss, net of tax, was as follows:

<u>Quarters Ended March 31,</u>	<u>2023</u>	<u>2022</u>
Foreign currency translation adjustment:		
Beginning balance	\$ (47,710)	\$(34,176)
Current period other comprehensive income	170	2,935
Ending balance	<u>\$ (47,540)</u>	<u>\$(31,241)</u>

5. ACQUISITION

Capitol District Supply Co., Inc.

On March 3, 2023, one of our wholly owned subsidiaries acquired Capitol District Supply Co., Inc., a distributor of air conditioning and heating products with annual sales of approximately \$13,000, operating from three locations in New York. Consideration for the purchase consisted of \$1,282 in cash, net of cash acquired of \$144, and \$1,851 for repayment of indebtedness.

The results of operations of this acquisition have been included in the condensed consolidated unaudited financial statements from its date of acquisition. The pro forma effect of this acquisition was not deemed significant to the condensed consolidated unaudited financial statements.

6. DEBT

On March 16, 2023, we entered into an unsecured, five-year \$600,000 syndicated multicurrency revolving credit agreement, which replaced in its entirety our prior five-year \$560,000 unsecured revolving credit agreement that was nearing maturity. Proceeds from the new facility were used to repay the \$235,500 outstanding under the prior facility. Additional proceeds may be used for, among other things, funding seasonal working capital needs and 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 revolving credit facility has a seasonal component from October 1 to March 31, during which the borrowing capacity may be reduced to \$500,000 at our discretion (which effectively reduces fees payable in respect of the unused portion of the commitment). Included in the revolving credit facility are a \$125,000 swingline loan sublimit, a \$10,000 letter of credit sublimit, a \$75,000 alternative currency borrowing sublimit, and an \$10,000 Mexican borrowing subfacility. The credit agreement matures on March 16, 2028.

Borrowings under the revolving credit facility bear interest at either Term Secured Overnight Financing Rate ("SOFR") or Daily Simple SOFR-based rates plus 0.10%, plus a spread which ranges from 100.0 to 137.5 basis-points (Term SOFR and Daily Simple SOFR plus 100.0 basis-points at March 31, 2023), depending on our ratio of total debt to EBITDA, or on rates based on the highest of the Federal Funds Effective Rate plus 0.5%, the Prime Rate or Term SOFR plus 1.0%, in each case plus a spread which ranges from 0 to 50.0 basis-points (0 basis-points at March 31, 2023), depending on our ratio of total debt to EBITDA. We pay a variable commitment fee on the unused portion of the commitment under the revolving credit agreement, ranging from 12.5 to 27.5 basis-points (12.5 basis-points at March 31, 2023). We paid fees of \$580 in connection with entering into the revolving credit agreement, which are being amortized ratably through the maturity of the facility in March 2028.

At March 31, 2023, \$197,600 was outstanding under the revolving credit agreement. The revolving credit agreement contains customary affirmative and negative covenants, including financial covenants with respect to consolidated leverage and interest coverage ratios, and other customary restrictions. We believe we were in compliance with all covenants at March 31, 2023.

7. 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.

Derivatives Not Designated as Hedging Instruments

We have 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 of the periods presented. The fair value gains and losses on these contracts are recognized in earnings as a component of selling, general and administrative expenses. The total notional value of our foreign currency exchange contracts not designated as hedging instruments at March 31, 2023 was \$14,100, and such contracts expired in April 2023.

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We recognized losses of \$394 and \$323 from foreign currency forward and option contracts not designated as hedging instruments in our condensed consolidated unaudited statements of income for the quarters ended March 31, 2023 and 2022, respectively.

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

	Asset Derivatives		Liability Derivatives	
	March 31, 2023	December 31, 2022	March 31, 2023	December 31, 2022
Derivatives designated as hedging instruments	\$ —	\$ —	\$ —	\$ —
Derivatives not designated as hedging instruments	—	—	35	—
Total derivative instruments	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 35</u>	<u>\$ —</u>

8. FAIR VALUE MEASUREMENTS

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

	Balance Sheet Location	Total	Fair Value Measurements at March 31, 2023 Using		
			Level 1	Level 2	Level 3
Assets:					
Equity securities	Other assets	\$ 678	\$ 678	—	—
Private equities	Other assets	\$1,000	—	—	\$1,000
Liabilities:					
Derivative financial instruments	Accrued expenses and other current liabilities	\$ 35	—	\$ 35	—

	Balance Sheet Location	Total	Fair Value Measurements at December 31, 2022 Using		
			Level 1	Level 2	Level 3
Assets:					
Equity securities	Other assets	\$ 678	\$ 678	—	—
Private equities	Other assets	\$1,000	—	—	\$1,000

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.

Private equities – other investment in which fair value inputs are unobservable and are therefore classified within Level 3 of the fair value hierarchy.

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

9. SHAREHOLDERS' EQUITY

At-the-Market Offering Program

On February 25, 2022, we entered into an amended and restated sales agreement with Robert W. Baird & Co. Inc. and Goldman Sachs & Co. LLC, which enables the Company to issue and sell shares of Common stock in one or more negotiated transactions or transactions that are deemed to be “at the market” offerings as defined in Rule 415 under the Securities Act of 1933, as amended (the “Securities Act”), for a maximum aggregate offering amount of up to \$300,000 (the “ATM Program”). The offer and sale of our Common stock pursuant to the ATM Program has been registered under the Securities Act pursuant to our automatically effective shelf registration statement on Form S-3 (File No. 333-260758). As of March 31, 2023, no shares of Common stock had been sold under the ATM Program.

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Common Stock Dividends

We paid cash dividends of \$2.45 and \$1.95 per share on both Common and Class B common stock during the quarters ended March 31, 2023 and 2022, respectively.

Restricted Stock

During the quarter ended March 31, 2023, a total of 6,047 shares of Common and Class B common stock with an aggregate fair market value of \$1,664 were withheld as payment in lieu of cash to satisfy tax withholding obligations in connection with the vesting of restricted stock. These shares were retired upon delivery.

Exercise of Stock Options

Cash received from the exercise of stock options during the quarters ended March 31, 2023 and 2022 was \$8,168 and \$3,955, respectively.

During quarter ended March 31, 2023, a total of 15,655 shares of Common stock with an aggregate fair market value of \$4,788 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 March 31, 2023 and 2022, we received net proceeds of \$579 and \$465, respectively, for shares of our Common stock purchased under our employee stock purchase plan.

10. 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 several 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 \$12,590 and \$12,256 at March 31, 2023 and December 31, 2022, respectively, were established related to such programs and are included in accrued expenses and other current liabilities in our condensed consolidated unaudited balance sheets.

11. RELATED PARTY TRANSACTIONS

Purchases from Carrier and its affiliates comprised 62% and 56% of all inventory purchases made during the quarters ended March 31, 2023 and 2022, respectively. At March 31, 2023 and December 31, 2022, approximately \$205,000 and \$88,000, respectively, was payable to Carrier and its affiliates, net of receivables. We also sell HVAC products to Carrier and its affiliates. Revenues in our condensed consolidated unaudited statements of income for the quarters ended March 31, 2023 and 2022 included approximately \$22,000 and \$21,000, 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 ended March 31, 2023 and 2022, fees for services performed were \$13 and \$32, respectively, and \$4 and \$1 was payable at March 31, 2023 and December 31, 2022, 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, including conditions that impact the supply chain;
- fluctuations in certain commodity costs;
- consumer spending;
- consumer debt levels;
- the resurgence of the COVID-19 pandemic;
- 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;
- the effect of inflation;
- foreign currency exchange rate fluctuations;
- international 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 "Economic and Marketplace Dynamics" in the discussion below, Item 1A "Risk Factors" of our Annual Report on Form 10-K for the year ended December 31, 2022, as well as the other documents and reports that we file with the SEC. Forward-looking statements speak only as of the date the statements were made. We assume no obligation to update forward-looking information or the discussion of such risks and uncertainties to reflect actual results, changes in assumptions, or changes in other factors affecting forward-looking information, except as required by applicable law. We qualify any and all of our forward-looking statements by these cautionary factors.

The following information should be read in conjunction with the condensed consolidated unaudited financial statements, including the notes thereto, included under Part I, Item 1 of this Quarterly Report on Form 10-Q. In addition, reference should be made to our audited consolidated financial statements and notes thereto, and related Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended December 31, 2022.

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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 March 31, 2023, we operated from 673 locations in 42 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, profitability can be impacted favorably or unfavorably based on weather patterns, particularly 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 first and fourth quarters. Demand related to the new construction sectors throughout most of the markets we serve tends to be fairly evenly distributed throughout the year and depends largely on housing completions and related weather and economic conditions.

Climate Change and Reductions in CO₂e Emissions

We believe that our business plays an important and significant role in the drive to lower CO₂e emissions. According to the United States Department of Energy, heating and air conditioning accounts for roughly half of household energy consumption in the United States. As such, replacing older, less efficient HVAC systems with higher efficiency systems is one of the most meaningful steps homeowners can take to reduce their electricity costs and carbon footprint.

The overwhelming majority of new HVAC systems that we sell replace systems that likely operate below current minimum efficiency standards in the United States and may use more harmful refrigerants that have been, or are being, phased-out. As consumers replace HVAC systems with new, higher-efficiency systems, homeowners will consume less energy, save costs and reduce their carbon footprint.

The sale of high-efficiency systems has long been a focus of ours, and we have invested in tools and technology intended to capture an increasingly richer sales mix over time. In addition, regulatory mandates will periodically increase the required minimum Seasonal Energy Efficiency Ratio rating, referred to as SEER, thus providing a catalyst for greater sales of higher-efficiency systems. Recently enacted regulations increased the current minimum SEER beginning in 2023 (generally, to 14 SEER from 13 SEER in the Northern U.S. and to 15 SEER from 14 SEER for the Southern U.S.).

We offer a broad variety of systems that operate above the minimum SEER standards, ranging from base-level efficiency to systems that exceed 20 SEER. Based on estimates validated by independent sources, we averted an estimated 15.8 million metric tons of CO₂e emissions from January 1, 2020 to December 31, 2022 through the sale of replacement residential HVAC systems at higher-efficiency standards.

Federal Tax Credits and State Incentives

Demand for higher-efficiency products, such as variable-speed systems and heat pumps, is expected to benefit from the passage of the U.S. Inflation Reduction Act of 2022 (the “IRA”) in August 2022. This legislation is intended, in part, to promote the replacement of existing systems in favor of high-efficiency heat pump systems that reduce greenhouse gas emissions, as compared to older systems, and thereby combat climate change. Programs under the IRA include enhanced tax credits for homeowners who install qualifying HVAC equipment and tax deductions for owners of commercial buildings that are upgraded to achieve defined energy savings. The IRA also sets aside \$4.3 billion for state-administered consumer rebate programs designed to promote energy savings for low and medium-income households, including HVAC systems. Further details, including qualifying products, specific programs, and other regulatory requirements contemplated by the IRA are being determined and are expected to be launched during 2023.

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Economic and Marketplace Dynamics

The ongoing global economic recovery from the COVID-19 pandemic has caused challenges resulting in inflationary pressure and supply chain disruptions. Certain of our manufacturers and suppliers continue to experience some level of supply chain disruptions caused by component availability, labor shortages, transportation delays, and other logistical challenges, resulting in longer lead times and constrained availability of HVAC/R products. These challenges were exacerbated by the regulatory transition to higher SEER products that became effective in 2023. Our ability to fulfill contractor demand at various points during the first quarter of 2023 was impacted by these supply chain disruptions, and we estimate the impact was approximately 3% of lost revenues. We cannot reasonably estimate the future impact of supply chain disruptions to the extent that these disruptions become more pronounced than current conditions. Despite these disruptions, we experienced modest growth in sales during the first quarter of 2023.

We continue to take proactive steps to limit the impact of these disruptions and are working closely with our suppliers to ensure availability of products. Also, we continue to actively monitor the situation and may take further actions that alter our business.

Critical Accounting Estimates

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 condensed consolidated unaudited 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 estimates are included in our Annual Report on Form 10-K for the year ended December 31, 2022, as filed with the SEC on February 24, 2023. We believe that there have been no significant changes during the quarter ended March 31, 2023 to the critical accounting estimates disclosed in our Annual Report on Form 10-K for the year ended December 31, 2022.

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 ended March 31, 2023 and 2022:

	<u>2023</u>	<u>2022</u>
Revenues	100.0%	100.0%
Cost of sales	71.1	70.4
Gross profit	28.9	29.6
Selling, general and administrative expenses	18.5	18.6
Other income	0.2	0.3
Operating income	10.6	11.2
Interest expense, net	0.0	0.0
Income before income taxes	10.6	11.2
Income taxes	2.2	2.3
Net income	8.4	8.9
Less: net income attributable to non-controlling interest	1.3	1.4
Net income attributable to Watsco, Inc.	<u>7.1%</u>	<u>7.4%</u>

Note: Due to rounding, percentages may not total 100.

The following narratives reflect our acquisition of Capitol District Supply Co., Inc. ("Capitol") in March 2023. We did not acquire any businesses during the quarter ended March 31, 2022.

In the following narratives, computations and other information referring to "same-store basis" exclude the effects of locations closed, acquired, or locations opened, in each case during the immediately preceding 12 months, unless such locations are within close geographical proximity to existing locations. At both March 31, 2023 and 2022, six locations that we opened during the immediately preceding 12 months were near existing locations and were therefore included in "same-store basis" information.

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The table below summarizes the changes in our locations for the 12 months ended March 31, 2023:

	Number of Locations
March 31, 2022	671
Opened	9
Closed	(7)
December 31, 2022	673
Opened	1
Acquired	3
Closed	(4)
March 31, 2023	673

Revenues

<i>(in millions)</i>	Quarters Ended March 31,		Change	
	2023	2022	\$	%
Revenues	\$ 1,550.6	\$ 1,523.6	\$ 27.0	2%

The increase in revenues for the first quarter of 2023 included \$1.0 million attributable to new locations acquired and \$3.2 million from other locations opened during the preceding 12 months, offset by \$1.6 million from locations closed.

<i>(in millions)</i>	Quarters Ended March 31,		Change	
	2023	2022	\$	%
Same-store sales	\$ 1,546.4	\$ 1,522.0	\$ 24.4	2%

The following table presents our revenues, as a percentage of sales, by major product lines and the related percentage change in revenues from the prior period:

	% of Sales		% Change	
	2023	2022	2023	2022
HVAC equipment	68%	67%	2%	32%
Other HVAC products	28%	29%	(2%)	32%
Commercial refrigeration products	4%	4%	12%	35%

HVAC equipment sales reflect a 3% decrease in residential products, which is comprised of unitary compressor-bearing systems, furnaces, and other indoor components, (2% decrease in U.S. markets and an 8% decrease in international markets) and a 23% increase in sales of commercial HVAC equipment (24% increase in U.S. markets and a 20% increase in international markets). Domestic sales of unitary compressor-bearing unitary systems grew 2%, reflecting a 7% decrease in units and a 9% increase in average selling price. Unit demand moderated in 2023 as compared to the same period in 2022, which had particularly strong growth.

Gross Profit

<i>(in millions)</i>	Quarters Ended March 31,		Change	
	2023	2022	\$	%
Gross profit	\$ 448.2	\$ 450.4	\$ (2.2)	0%
Gross margin	28.9%	29.6%		

Gross profit margin declined 70 basis-points primarily due to lower benefit of pricing actions taken by our HVAC equipment suppliers in 2023 as compared to the same period in 2022.

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Selling, General and Administrative Expenses

<i>(in millions)</i>	Quarters Ended March 31,		Change	
	2023	2022		
Selling, general and administrative expenses	\$ 287.1	\$ 283.4	\$3.7	1%
Selling, general and administrative expenses as a percentage of revenues	18.5%	18.6%		

Selling, general and administrative expenses for the first quarter of 2023 increased primarily due to increased revenues. On a same-store basis, selling, general and administrative expenses increased 1% as compared to 2022 and as a percentage of sales decreased to 18.5% versus 18.6% in 2022, primarily due to increased leverage on fixed costs driven by increased revenues.

Other Income

Other income of \$3.6 million and \$4.0 million for the first quarters of 2023 and 2022, respectively, represented our share of the net income of Russell Sigler, Inc. ("RSI"), in which we have a 38.1% equity interest.

Interest Expense, Net

Interest expense, net for the first quarter of 2023 increased \$0.1 million, or 10%, primarily due to a higher effective interest rate, partially offset by lower average outstanding borrowings, in each case under our revolving credit facility, for the 2023 period as compared to the same period in 2022.

Income Taxes

<i>(in millions)</i>	Quarters Ended March 31,		Change	
	2023	2022		
Income taxes	\$ 33.8	\$ 35.6	\$ (1.8)	(5%)
Effective income tax rate	23.3%	23.8%		

Income taxes represent a composite of the income taxes attributable to our wholly owned operations and income taxes attributable to our joint ventures with Carrier Global Corporation ("Carrier"), 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 decrease in the effective income tax rate was primarily due to higher share-based compensation deductions in 2023 as compared to the same period in 2022.

Net Income Attributable to Watsco, Inc.

Net income attributable to Watsco for the quarter ended March 31, 2023 decreased \$3.2 million, or 3%, compared to the same period in 2022. The decrease was primarily driven by lower gross profit, higher selling, general and administrative expenses, and lower other income, partially offset by a reduction in income taxes and a decrease in net income attributable to the non-controlling interest.

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.

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 in the short-term and the long-term, 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.

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As of March 31, 2023, we had \$141.0 million of cash and cash equivalents, of which \$123.2 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 restrictions.

We believe that our operating cash flows, cash on hand, funds available for borrowing under our revolving credit agreement, and funds available from sales of our Common stock under our ATM Program (as defined below), each of which is described below, will be sufficient to meet our liquidity needs for 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 the Secured Overnight Financing Rate (“SOFR”), which is one of the base rates under our revolving credit agreement. SOFR has limited historical data and is a secured lending rate, which could give rise to uncertainties and volatility in the benchmark rates. Additionally, disruptions in the credit and capital markets could also result in increased borrowing costs or reduced borrowing capacity under our revolving credit agreement.

Working Capital

Working capital increased to \$1,644.7 million at March 31, 2023 from \$1,392.2 million at December 31, 2022, due to: (i) higher inventory balances driven by the seasonal ramp-up in inventories in advance of our selling season, new inventory requirements pertaining to the transition to higher minimum efficiency levels for residential HVAC systems that went into effect on January 1, 2023, greater inventory carry as a consequence of various supply chain disruptions, and inflation; (ii) higher accounts receivable consistent with overall increased sales; and (iii) the classification of borrowings under our revolving credit agreement as long-term at March 31, 2023, which were offset by an increase in accounts payable consistent with the change in inventory.

Cash Flows

The following table summarizes our cash flow activity for the quarters ended March 31, 2023 and 2022 (in millions):

	2023	2022	Change
Cash flows used in operating activities	\$(47.4)	\$(101.6)	\$ 54.2
Cash flows used in investing activities	\$(10.4)	\$ (8.2)	\$ (2.2)
Cash flows provided by financing activities	\$ 51.3	\$ 101.4	\$(50.1)

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

Operating Activities

Net cash used in operating activities was lower primarily due to a decline in the level of seasonal increases in inventory and the timing of accounts receivable collections, partially offset by lower net income in 2023 as compared to 2022.

Investing Activities

Net cash used in investing activities was higher primarily due to cash consideration paid for our acquisition of Capitol in 2023.

Financing Activities

Net cash provided by financing activities decreased primarily due to lower borrowings and an increase in dividends paid in 2023.

Revolving Credit Agreement

On March 16, 2023, we entered into an unsecured, five-year \$600.0 million syndicated multicurrency revolving credit agreement, which replaced in its entirety our prior five-year \$560.0 million unsecured revolving credit agreement that was nearing maturity. Proceeds from the new facility were used to repay the \$235.5 million outstanding under the prior facility. Additional proceeds may be used for, among other things, funding 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 revolving credit facility has a seasonal component from October 1 to March 31, during which the borrowing capacity may be reduced to \$500.0 million at our discretion (which effectively reduces fees payable in respect of the unused portion of the commitment). Included in the revolving credit facility are a \$125.0 million swingline loan sublimit, a \$10.0 million letter of credit sublimit, a \$75.0 million alternative currency borrowing sublimit, and an \$10.0 million Mexican borrowing subfacility. The credit agreement matures on March 16, 2028.

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Borrowings under the revolving credit facility bear interest at either Term SOFR or Daily Simple SOFR-based rates plus 0.10%, plus a spread which ranges from 100.0 to 137.5 basis-points (Term SOFR and Daily Simple SOFR plus 100.0 basis-points at March 31, 2023), depending on our ratio of total debt to EBITDA, or on rates based on the highest of the Federal Funds Effective Rate plus 0.5%, the Prime Rate or Term SOFR plus 1.0%, in each case plus a spread which ranges from 0 to 50.0 basis-points (0 basis-points at March 31, 2023), depending on our ratio of total debt to EBITDA. We pay a variable commitment fee on the unused portion of the commitment under the revolving credit agreement, ranging from 12.5 to 27.5 basis-points (12.5 basis-points at March 31, 2023). We paid fees of \$0.6 million in connection with entering into the revolving credit agreement, which are being amortized ratably through the maturity of the facility in March 2028.

At March 31, 2023, \$197.6 million was outstanding under the revolving credit agreement. The revolving credit agreement contains customary affirmative and negative covenants, including financial covenants with respect to consolidated leverage and interest coverage ratios, and other customary restrictions. We believe we were in compliance with all covenants at March 31, 2023.

At-the-Market Offering Program

On February 25, 2022, we entered into an amended and restated sales agreement with Robert W. Baird & Co. Inc. and Goldman Sachs & Co. LLC, which enables the Company to issue and sell shares of Common stock in one or more negotiated transactions or transactions that are deemed to be “at the market” offerings as defined in Rule 415 under the Securities Act of 1933, as amended (the “Securities Act”), for a maximum aggregate offering amount of up to \$300.0 million (the “ATM Program”). The offer and sale of our Common stock pursuant to the ATM Program has been registered under the Securities Act pursuant to our automatically effective shelf registration statement on Form S-3 (File No. 333-260758). As of March 31, 2023, no shares of Common stock had been sold under the ATM Program.

Investment in Unconsolidated Entity

Carrier Enterprise I, one of our joint ventures with Carrier, in which we have an 80% controlling interest, has a 38.1% ownership interest in RSI, an HVAC distributor operating from 35 locations in the Western U.S. Our proportionate share of the net income of RSI is included in other income in our condensed consolidated unaudited statements of income.

Carrier Enterprise I is a party to a shareholders’ agreement (the “Shareholders’ Agreement”) with RSI and its shareholders, consisting of five family siblings, their children and affiliates related to them. 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 the higher of book value or a multiple of EBIT, the latter of which Carrier Enterprise I used to calculate the price for its 38.1% investment held 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 March 31, 2023, the estimated purchase amount we would be contingently liable for was approximately \$356.0 million. We believe that our operating cash flows, cash on hand, funds available for borrowing under our revolving credit agreement, or use of the ATM Program would be sufficient to purchase any additional ownership interests in RSI.

Acquisitions

On March 3, 2023, one of our wholly owned subsidiaries acquired Capitol, a distributor of air conditioning and heating products with annual sales of approximately \$13.0 million, operating from three locations in New York. Consideration for the purchase consisted of \$1.3 million in cash, net of cash acquired of \$0.1 million, and \$1.8 million for repayment of indebtedness.

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.

Common Stock Dividends

We paid cash dividends of \$2.45 and \$1.95 per share on Common and Class B common stock during the quarters ended March 31, 2023 and 2022, respectively. On April 3, 2023, our Board of Directors declared a regular quarterly cash dividend of \$2.45 per share of both Common and Class B common stock that was paid on April 28, 2023 to shareholders of record as of April 17, 2023. Future dividends and 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.

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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 March 31, 2023, there were 1,129,087 shares remaining authorized for repurchase under the program. The IRA includes, among other provisions, a 1% excise tax on stock repurchases effective January 1, 2023. In considering any further stock repurchases under our repurchase program, we intend to evaluate the impact of the IRA’s 1% excise tax.

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, 2022.

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 March 31, 2023, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

Information about risk factors for the quarter ended March 31, 2023 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, 2022.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Recent Sales of Unregistered Securities

On March 13, 2023, we issued 35,533 shares of our Common stock to our Profit Sharing Retirement Plan & Trust (the “Plan”) representing the employer match under the Plan for the plan year ended December 31, 2022, without registration. This issuance was exempt from registration under the Securities Act of 1933, as amended, pursuant to Section 3(a)(2) thereof. The Plan is a profit sharing retirement plan that is qualified under Section 401 of the Internal Revenue Code of 1986, as amended. The assets of the Plan are held in a single trust fund for the benefit of our employees, and the Plan does not hold assets for the benefit of the employees of any other employer. All of the contributions to the Plan from our employees have been invested in assets other than our Common stock. We have contributed all of the Common stock held by the Plan as a discretionary matching contribution, which, at the time of contribution, was lower in value than the employee contributions that the contribution matched.

[Table of Contents](#)**Issuer Purchases of Equity Securities**

<u>Period</u>	<u>Total Number of Shares Purchased ⁽¹⁾</u>	<u>Average Price Paid per Share</u>	<u>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</u>	<u>Maximum Dollar Value that May Yet Be Purchased Under the Plans or Programs</u>
January 1, 2023 to January 31, 2023	6,047	\$ 275.19	—	\$ —
February 1, 2023 to February 28, 2023	—	—	—	—
March 1, 2023 to March 31, 2023	—	—	—	—
Total	<u>6,047</u>	<u>\$ 275.19</u>	<u>—</u>	<u>\$ —</u>

- (1) During the quarter ended March 31, 2023, we purchased an aggregate of 6,047 shares of our common stock to satisfy the tax withholding obligations in connection with the vesting of restricted stock.

ITEM 6. EXHIBITS

INDEX TO EXHIBITS

10.1#*	Twenty-fourth Amendment dated January 1, 2023 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad.
10.2	Credit Agreement, dated as of March 16, 2023, by and among Watsco, Inc., Watsco Canada, Inc. and Carrier Enterprise Mexico, S. de R.L. de C.V., as Borrowers, the Other Lenders From Time to Time Party Thereto, Bank of America, N.A., as Administrative Agent, Swing Line Lender and L/C Issuer, JPMorgan Chase Bank, N.A. as Syndication Agent and U.S. Bank National Association and Wells Fargo Bank, National Association as Co-Documentation Agents (filed as Exhibit 10.1 to the Current Report on Form 8-K filed with the SEC on March 22, 2023 and incorporated herein by reference).
31.1 #	Certification of Chief Executive Officer pursuant to Securities Exchange Act Rules 13a- 15(e) and 15d-15(e) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2 #	Certification of 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.
31.3 #	Certification of Chief Financial Officer pursuant to Securities Exchange Act Rules 13a- 15(e) and 15d-15(e) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1 +	Certification of Chief Executive Officer, 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.
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 March 31, 2023, formatted in Inline XBRL.

filed herewith.

+ furnished herewith.

* Management contract or compensation plan or arrangement.

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: May 5, 2023

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

**TWENTY-FOURTH AMENDMENT
TO
EMPLOYMENT AGREEMENT**

This Twenty-fourth Amendment to Employment Agreement is made and entered into effective as of the 1st day of January 2023, by and between **WATSCO, INC.**, a Florida corporation (hereinafter called the “Company”), and **ALBERT H. NAHMAD** (hereinafter called the “Employee”).

RECITALS

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

WHEREAS, the Compensation Committee of the Company’s Board of Directors amended the Employment Agreement effective as of January 1, for each of 2001 through 2022; and

WHEREAS, the Compensation Committee of the Company’s Board of Directors has determined that the Employee’s Base Salary will be \$600,000 for calendar year 2023; and

WHEREAS, the Compensation Committee of the Company’s Board of Directors has determined the Employee’s use of the Company’s airplane for personal purposes for up to ninety (90) hours during the calendar year 2023. The Company shall pay all fuel and operational costs incident thereto. The value of the Employee’s usage of the Company’s airplane shall be treated as compensation for tax purposes; and

WHEREAS, the Compensation Committee of the Company’s Board of Directors has set the targets for the long-term performance-based compensation payable in the form of restricted shares by the Company to the Employee for the year 2023; and

WHEREAS, the long-term performance-based compensation payable by the Company to the Employee for the calendar year 2023 shall not exceed \$10 million.

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

1. All capitalized terms in this Twenty-fourth Amendment shall have the same meaning as in the Employment Agreement, unless otherwise specified.
2. The Employment Agreement is hereby amended by replacing “Exhibit A-1 — 2022 Performance Goals and Long-term Performance Based Compensation” with the attached “Exhibit A-1 — 2023 Performance Goals and Long-term Performance Based Compensation” thereto.
3. All other terms and conditions of the Employment Agreement shall remain the same.

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

WATSCO, INC.

By: /s/ Barry S. Logan
Barry S. Logan, Executive Vice President

EMPLOYEE

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

EXHIBIT A-1
2023 PERFORMANCE GOALS AND LONG-TERM PERFORMANCE BASED COMPENSATION

Overview

Watsco's compensation program is grounded by the guiding principle that compensation should be highly dependent upon long-term shareholder returns. This key tenet of our compensation philosophy has driven the unique design of our program for many years and has enabled our executive leadership team to stay solidly focused on long-term performance. We have generated a compounded annual growth rate for total shareholder return of 18% over the last 33 years.

The most unique aspect of the program is the use of restricted stock that requires an executive to spend his or her entire career with the Company in order to vest. We believe granting restricted stock effectively balances strategic risk-taking and long-term performance, creates an ownership culture, and aligns the interests of high-performing leaders with the interests of our shareholders. Additionally, we believe these awards help build a sustainable future by ensuring that our executives make the right long-term business decisions that will survive well past their retirement.

We began granting restricted stock awards in 1997. All the restricted shares we have granted to our leaders throughout the Company vest upon reaching retirement age (usually 62 or older). Based on data provided by Equilar, the duration of our cliff-vesting period is solely unique to Watsco. Vesting may also occur at an even later date for those who extend their careers beyond age 62. This means that our key leaders will not know the value and cannot realize the value of their equity awards until they have spent their career with the Company. As it relates to our CEO, on a weighted-average basis, his restricted share awards will vest in approximately 5.0 years.

In formulating the amount of a potential award, the Compensation Committee believes that the 'present-value' of an award versus the 'face-value' of an award is considerably less due to the unusually long vesting periods and associated risks of forfeiture.

Annual Performance-based Restricted Stock Award

The formula for determining the CEO's Annual Performance-based Restricted Stock Award has been consistent, and for 2023 is as follows:

	Amount of Restricted Stock Award
A. Earnings Per Share (EPS) ¹	
For each \$.01 increase if growth is below 5%	\$ 43,500
For each \$.01 increase if growth is at or above 5%	\$ 65,000
B. <u>Increase in Common Stock Price</u>	
If the closing price of a share of Common Stock on 12/31/23 does not exceed \$249.40	\$ 0
If the closing price of a share of Common Stock on 12/31/23 exceeds \$249.40 but does not equal or exceed \$299.28, for each \$0.01 increase in per share price of a share of Common Stock above \$249.40	\$ 1,200
If the closing price of a share of Common Stock on 12/31/23 equals or exceeds \$299.28, for each \$0.01 increase in per share price of a share of Common Stock above \$249.40	\$ 1,800

Other Considerations

The amount of Performance-Based Restricted Stock Award shall be subject to a cap of \$10 million.

The award shall be paid through the issuance of a number of restricted shares of Class B Common Stock of the Company (the "Shares") equal to the amount determined by dividing (x) the Performance-Based Restricted Stock Award Amount by (y) the closing price for the Class B Common Stock of the Company on the New York Stock Exchange as of the close of trading on December 31, 2023. The value of any fractional shares shall be paid in cash.

The restrictions on the Shares shall lapse on the first to occur of (i) October 15, 2029, (ii) termination of the Executive's employment with the Company by reason of Executive's disability or death, (iii) the Executive's termination of employment with the Company for Good Reason, (iv) the Company's termination of Executive's employment without Cause, or (v) the occurrence of a Change in Control of the Company ("Good Reason," "Cause," and "Change in Control" to be defined in a manner consistent with the most recent grant of Restricted Stock by the Company to the Executive).

¹ 2022 EPS without the impact caused by the vesting of restricted stock on October 15, 2022 (\$14.20) shall be used for purposes of computing 2023's EPS growth.

The Performance-Based Restricted Stock Award is being made by the Compensation Committee as performance awards of restricted stock pursuant to the Company's 2021 Incentive Compensation Plan or any successor plan (the "Incentive Plan") and are subject to the limitations contained in Section 5 of the Incentive Plan.

Effective as of January 1, 2023

COMPENSATION COMMITTEE

By: /s/ Denise Dickins

Denise Dickins, Chair

ACKNOWLEDGED AND ACCEPTED

By: /s/ Albert H. Nahmad

Albert H. Nahmad

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: May 5, 2023

/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: May 5, 2023

/s/ Barry S. Logan

Barry S. Logan

Executive Vice President

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

I, Ana M. Menendez, certify that:

1. I have reviewed this 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: May 5, 2023

/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 ended March 31, 2023, 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 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
May 5, 2023

/s/ Barry S. Logan

Barry S. Logan
Executive Vice President
May 5, 2023

/s/ Ana M. Menendez

Ana M. Menendez
Chief Financial Officer
May 5, 2023

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.