

**watsco**

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# **WATSCO** TWENTY FIVE YEARS LATER

2013 ANNUAL REPORT

Change seems to be happening faster today than most any time in human history. So we've taken the opportunity in this report to look back over the past 25 years to see what at Watsco, has changed, and what has not. And what we saw is that many things have changed which is good news. Equally, many other things have not. Which is also good news.

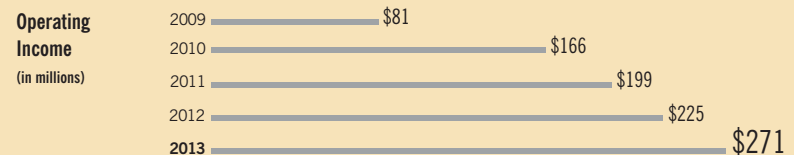
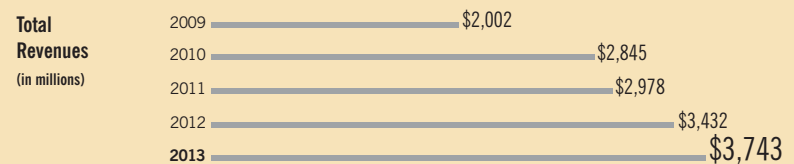
**Through change or no change, we at Watsco have built a solid track record for our shareholders. And we're proud of it.**

## FINANCIAL HIGHLIGHTS

| (in thousands, except per share data)              | 2009         | 2010         | 2011         | 2012         | 2013                |
|----------------------------------------------------|--------------|--------------|--------------|--------------|---------------------|
| Revenues                                           | \$ 2,001,815 | \$ 2,844,595 | \$ 2,977,759 | \$ 3,431,712 | <b>\$ 3,743,330</b> |
| Operating income                                   | 81,060       | 165,572      | 199,050      | 224,908      | <b>271,209</b>      |
| EBITDA <sup>(1)</sup>                              | 89,593       | 176,343      | 210,775      | 240,819      | <b>288,915</b>      |
| Net Income attributable to Watsco, Inc.            | 43,314       | 80,760       | 90,450       | 103,334      | <b>127,723</b>      |
| Diluted earnings per share                         | 1.40         | 2.49         | 2.74         | 2.70         | <b>3.68</b>         |
| Adjusted diluted earnings per share <sup>(2)</sup> | 1.40         | 2.49         | 2.74         | 3.03         | <b>3.68</b>         |
| Dividends per share                                | 1.89         | 2.04         | 2.23         | 7.48         | <b>1.15</b>         |
| Operating cash flow                                | 88,287       | 152,799      | 61,452       | 173,343      | <b>150,269</b>      |
| Total assets                                       | 1,160,613    | 1,237,227    | 1,268,148    | 1,682,055    | <b>1,669,531</b>    |
| Long-term obligations                              | 13,429       | 10,016       | —            | 316,196      | <b>230,557</b>      |
| Shareholders' equity                               | 894,808      | 928,896      | 1,001,710    | 1,022,040    | <b>1,127,392</b>    |

(1) EBITDA is defined as earnings before interest expense, net, income taxes, depreciation and amortization. Amortization of debt acquisition costs is included in interest expense, net.

(2) In October 2012, the Company paid a special dividend of \$5.00 per share. The calculation of adjusted diluted earnings per share excludes the impact of the special dividend.



# DEAR SHAREHOLDERS

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We are pleased to report record-setting performance in 2013:

- Revenues grew 9% to \$3.7 billion;
- Operating income increased 21% to \$271 million;
- Net income grew 24% to \$128 million; and
- Earnings per share increased 21% to \$3.68 per diluted share.

The Company also generated strong cash flow in 2013 and increased its quarterly dividend rate by 60%, while reducing debt by 27%. Our commitment of sharing cash flow through dividends continues and 2014 will mark the 40th consecutive year that Watsco shareholders have received quarterly dividends.

Watsco's 2013 performance builds on what we consider to be a terrific track record in terms of total shareholder returns. Compounded

annual total return to shareholders, which measures both capital appreciation and dividends, reached 30% over the last 5 years, 20% over the last 10 years and 19% over the last 25 years. Said another way, we have produced a total return of 7390% since beginning our distribution strategy in 1989. Yet we have much to accomplish as our market share in North America is just over 10%.

We are also very committed to our key manufacturer relationships and proud that we have gained meaningful market share in recent years. Profitable market share growth is a critical mission and the spirit of collaboration and partnership has driven good results. Our intensity and creativity to build further value and share growth for our partners continues to be a cornerstone of our company.

To that end, our strategy is focused on growing our network, expanding our product offering, bringing efficiencies to the distribution channel and providing additional conveniences to our HVAC/R contractor customers. We currently operate the largest and most dense branch network in the industry: 569 locations in the United States, Canada, Mexico and Puerto Rico, as well as a thriving export business covering the Caribbean and Latin America. Our international markets accounted for 15% of sales in 2013, and continue to be a source of future growth for the Company.

All of our locations, which are staffed by highly trained employees and stocked with high quality inventory, deliver unparalleled service and support to our contractor customers. With a singular focus on HVAC/R, we can respond rapidly to trends in product and industry conditions

and introduce innovations to capitalize on demand patterns. This, matched with our access to capital, strong vendor relationships and a culture of entrepreneurship, will allow us to build on what we have accomplished in the last 25 years.

As always, I want to extend my gratitude to our employees for their many contributions and recognize them for their ongoing commitment to provide great service to our contractor customers. Through their efforts, we are transforming an industry and have positioned Watsco as the leader in the marketplace.



Albert H. Nahmad  
President and Chief Executive Officer

Compounded annual total return to shareholders source: FactSet Data Systems as of December 31, 2013.

# LONG-TERM FOCUS

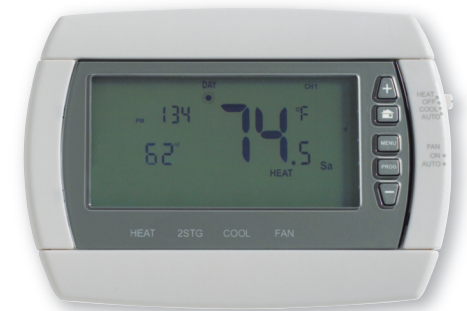
\_\_\_CHANGE  NO CHANGE

In 1989 we based our business model on distribution.  
It hasn't changed since.

1989



2013





1989

# LEADERSHIP

CHANGE  NO CHANGE

Albert Nahmad has been at the helm of WATSCO for more than 40 years — a rare milestone in the corporate world.



2013

# BUY & BUILD STRATEGY

— CHANGE  NO CHANGE

Since 1989, we've acquired 59 distributors throughout the Americas, unlocking their full value. A process we'll continue in the coming years.

1989



2013



1989

\$1

2013

\$73.90

# SHAREHOLDER RETURN

CHANGE  NO CHANGE

\$1 invested in 1989 in WATSCO would be valued at \$73.90 in 2013.



# FINANCIAL PERFORMANCE

X CHANGE    \_\_\_ NO CHANGE

WATSCO's outstanding performance over the last 25 years reflects the stability and consistency of our Company.

## REVENUES *(in millions)*

25 Year CAGR: 18%

1989

\$64

2013

\$3,743

# OPERATING INCOME (in millions)

25 Year CAGR: 22%

1989

\$2

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2013

\$271

# MARKET CAPITALIZATION (in millions)

25 Year CAGR: 23%

1989

\$22

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2013

\$3,339

# FINANCIAL REVIEW

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## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### FORWARD-LOOKING STATEMENTS

This 2013 Annual Report to shareholders contains or incorporates by reference statements that are not historical in nature and that are intended to be, and are hereby identified as, "forward-looking statements" as defined in the Private Securities Litigation Reform Act of 1995, including statements regarding, among other items, (i) economic conditions, (ii) business and acquisition strategies, (iii) potential acquisitions and/or joint ventures, (iv) financing plans and (v) industry, demographic and other trends affecting our financial condition or results of operations. These forward-looking statements are based largely on management's current expectations and are subject to a number of risks, uncertainties and changes in circumstances, certain of which are beyond their control.

Actual results could differ materially from these forward-looking statements as a result of several factors, including, but not limited to:

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

In light of these uncertainties, there can be no assurance that the forward-looking information contained herein will be realized or, even if realized, in whole or in part, that the information will have the expected consequences to, or effects on, our business or operations. For additional information identifying other important factors that may affect our operations and could cause actual results to vary materially from those anticipated in the forward-looking statements, see our SEC filings, including but not limited to, the discussion included in Item 1A "Risk Factors" of our Annual Report on Form 10-K for the year ended December 31, 2013. Forward-looking statements speak only as of the date the statement was 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.

The following information should be read in conjunction with the information contained in Item 1A, "Risk Factors" and the consolidated financial statements, including the notes thereto, included under Item 8, "Financial Statements and Supplementary Data" of our Annual Report on Form 10-K for the year ended December 31, 2013.

### COMPANY OVERVIEW

Watsco, Inc. and its subsidiaries (collectively, "Watsco," or "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. At December 31, 2013, we

operated from 569 locations in 38 U.S. states, Canada, Mexico and Puerto Rico with additional market coverage on an export basis to Latin America and the Caribbean.

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

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

### JOINT VENTURES WITH CARRIER CORPORATION

In 2009, we formed a joint venture with Carrier Corporation ("Carrier"), which we refer to as Carrier Enterprise I, in which Carrier contributed 95 of its company-owned locations in 13 Sun Belt states and Puerto Rico and its export division in Miami, Florida, and we contributed 15 locations that distributed Carrier products. On July 2, 2012, we exercised our option to acquire an additional 10% ownership interest in Carrier Enterprise I, which increased our ownership interest to 70%. We have an option to purchase from Carrier an additional 10% interest in Carrier Enterprise I, which becomes exercisable in July 2014.

In 2011, we formed a second joint venture with Carrier and completed two additional transactions. In April 2011, Carrier contributed 28 of its company-owned locations in eight Northeast U.S. states, and we contributed 14 locations in the Northeast U.S. In July 2011, we purchased Carrier's distribution operations in Mexico, which included seven locations. Collectively, the Northeast locations and the Mexico operations are referred to as Carrier Enterprise II. We have a 60% controlling interest in Carrier Enterprise II, and Carrier has a 40% noncontrolling interest. Neither we nor Carrier has any options to purchase additional ownership interests in Carrier Enterprise II.

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% noncontrolling interest. Neither we nor UTC Canada has any options to purchase additional ownership interests in Carrier Enterprise III.

### CRITICAL ACCOUNTING POLICIES

Management's discussion and analysis of financial condition and results of operations is based upon the consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amount of 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 significant accounting policies are discussed in Note 1 to our consolidated financial statements included with this Annual Report on Form 10-K. Management believes that the following accounting policies include a higher degree of judgment and/or complexity and, thus, are considered to be critical accounting policies. Management has discussed the development and selection of critical accounting poli-

cies with the Audit Committee of the Board of Directors and the Audit Committee has reviewed the disclosures relating to them.

#### Allowance for Doubtful Accounts

An allowance for doubtful accounts is maintained for estimated losses resulting from the inability of customers to make required payments. We typically do not require our customers to provide collateral.

Accounting for doubtful accounts contains uncertainty because management must use judgment to assess the collectability of these accounts. When preparing these estimates, management considers a number of factors, including the aging of a customer's account, past transactions with customers, creditworthiness of specific customers, historical trends and other information. Our business is seasonal and our customers' businesses are also seasonal. Sales are lowest during the first and fourth quarters and past due accounts receivable balances as a percentage of total trade receivables generally increase during these quarters. We review our accounts receivable reserve policy periodically, reflecting current risks, trends and changes in industry conditions.

The allowance for doubtful accounts was \$5.7 million and \$10.5 million at December 31, 2013 and 2012, respectively, a decrease of \$4.8 million. Accounts receivable balances greater than 90 days past due as a percent of accounts receivable at December 31, 2013 decreased to 1.8% compared to 3.9% at December 31, 2012. These decreases are primarily attributable to an increase in net sales and an increase in write-offs coupled with an improvement in the underlying quality of our accounts receivable portfolio at December 31, 2013.

Although we believe the allowance for doubtful accounts is sufficient, a decline in economic conditions could lead to the deterioration in the financial condition of customers, resulting in an impairment of their ability to make payments and additional allowances may be required that could materially impact our consolidated results of operations. We believe our exposure to concentrations of credit risk is limited due to the large number of customers comprising our customer base and their dispersion across many different geographical regions. Additionally, we mitigate credit risk through credit insurance programs.

#### Inventory Valuation Reserves

Inventory valuation reserves are established in order to report inventories at the lower of weighted-average cost or market and the first-in, first-out method. As part of the valuation process, inventories are adjusted to reflect excess, slow-moving and damaged inventories at their estimated net realizable value. The valuation process for excess, slow-moving and damaged inventory contains uncertainty because management must make estimates and use judgment to determine the future salability of inventories. Inventory policies are reviewed periodically, reflecting current risks, trends and changes in industry conditions. A reserve for estimated inventory shrinkage is also maintained and reflects the results of cycle count programs and physical inventories. When preparing these estimates, management considers historical results, inventory levels and current operating trends.

#### Valuation of Goodwill and Indefinite Lived Intangible Assets

The recoverability of goodwill is evaluated at least annually and when events or changes in circumstances indicate that the carrying amount may not be recoverable. We have one reporting unit that is subject to goodwill impairment testing. In performing the goodwill impairment test, we use a two-step approach. The first step compares the reporting unit's fair value to its carrying value. If the carrying value exceeds the fair value, a second step is performed to measure the amount of impairment loss, if any. The identification and measurement of goodwill impairment involves the estimation of the fair value of our reporting unit and contains uncertainty because management must use judgment in determining appropriate assumptions to be used in the measurement of fair value. On January 1, 2014, we performed our annual goodwill impairment test and determined that the estimated fair value of our reporting unit significantly exceeded its carrying value.

The recoverability of indefinite lived intangibles is also evaluated on an annual basis or more often if deemed necessary. Indefinite lived intangibles not subject to amortization are assessed for impairment by comparing the fair value of the intangible asset to its carrying amount to determine if a write-down to fair value is required. Our annual impairment tests did not result in any impairment of our indefinite lived intangibles.

The estimates of fair value of our reporting unit and indefinite lived intangibles are based on the best information available as of the date of the assessment and incorporates management's assumptions about expected future cash flows and contemplates other valuation techniques. Future cash flows can be affected by changes in the industry, a declining economic environment or market conditions. There have been no events or circumstances from the date of our assessments that would have an impact on this conclusion. The carrying amount of goodwill and intangibles was \$596.5 million and \$616.8 million at December 31, 2013 and 2012, respectively. Although no impairment has been recorded to date, there can be no assurances that future impairments will not occur. An adjustment to the carrying value of goodwill and intangibles could materially impact the consolidated results of operations.

#### Self-Insurance Reserves

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. The estimation process contains uncertainty since management must use judgment to estimate the ultimate cost that will be incurred to settle reported claims and unreported claims for incidents incurred but not reported as of the balance sheet date. Reserves in the amounts of \$5.6 million and \$4.8 million at December 31, 2013 and 2012, respectively, were established related to such insurance programs.

#### Income Taxes

Income taxes are accounted for under the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial reporting basis and the tax basis of assets and liabilities at enacted tax rates expected to be in effect when such amounts are recovered or settled. The use of estimates by management is required to determine income tax expense, deferred tax assets and any related valuation allowance and deferred tax liabilities. A valuation allowance of \$0.1 million and \$0.4 million was recorded at December 31, 2013 and 2012, respectively, due to uncertainties related to the ability to utilize a portion of the deferred tax assets primarily arising from foreign net operating loss carryforwards. The valuation allowance is based on estimates of future taxable income by jurisdiction in which the deferred tax assets will be recoverable. These estimates can be affected by a number of factors, including possible tax audits or general economic conditions or competitive pressures that could affect future taxable income. Although management believes that the estimates are reasonable, the deferred tax asset and any related valuation allowance will need to be adjusted if management's estimates of future taxable income differ from actual taxable income. An adjustment to the deferred tax asset and any related valuation allowance could materially impact the consolidated results of operations.

#### RECENT ACCOUNTING PRONOUNCEMENTS

Refer to Note 1 to our consolidated financial statements included in this Annual Report on Form 10-K for a discussion of new accounting pronouncements.

## RESULTS OF OPERATIONS

The following table summarizes information derived from the audited consolidated statements of income expressed as a percentage of revenues for the years ended December 31, 2013, 2012 and 2011:

|                                                          | 2013   | 2012   | 2011   |
|----------------------------------------------------------|--------|--------|--------|
| Revenues                                                 | 100.0% | 100.0% | 100.0% |
| Cost of sales                                            | 76.0   | 76.3   | 75.5   |
| Gross profit                                             | 24.0   | 23.7   | 24.5   |
| Selling, general and administrative expenses             | 16.8   | 17.2   | 17.8   |
| Operating income                                         | 7.2    | 6.5    | 6.7    |
| Interest expense, net                                    | 0.1    | 0.1    | 0.2    |
| Income before income taxes                               | 7.1    | 6.4    | 6.5    |
| Income taxes                                             | 2.1    | 1.8    | 1.9    |
| Net income                                               | 5.0    | 4.6    | 4.6    |
| Less: net income attributable to noncontrolling interest | 1.6    | 1.6    | 1.6    |
| Net income attributable to Watsco, Inc.                  | 3.4%   | 3.0%   | 3.0%   |

The following narratives include the results of operations for businesses acquired during 2012 and 2011. The results of operations for these acquisitions have been included in our consolidated statements of income beginning on their respective dates of acquisition. See Note 9 to our consolidated financial statements included in this Annual Report on Form 10-K for the pro forma financial information combining our results of operations with the operations of Carrier Enterprise II and Carrier Enterprise III. The following narratives also reflect our acquisition of an additional 10% ownership interest in Carrier Enterprise I, which became effective on July 2, 2012. We did not acquire any businesses during 2013.

In the following narratives, computations and disclosure information referring to "same-store basis" exclude the effects of locations acquired or locations opened or closed during the immediately preceding 12 months unless they are within close geographical proximity to existing locations. At December 31, 2013 and 2012, 16 and 63 locations, respectively, were excluded from "same-store basis" information. The table below summarizes the changes in our locations for 2012 and 2013:

|                          | Number of Locations |
|--------------------------|---------------------|
| December 31, 2011        | 542                 |
| Acquired                 | 35                  |
| Opened                   | 12                  |
| Closed                   | (16)                |
| December 31, 2012        | 573                 |
| Opened                   | 6                   |
| Closed                   | (10)                |
| <b>December 31, 2013</b> | <b>569</b>          |

## 2013 COMPARED TO 2012

### Revenues

Revenues for 2013 increased \$311.6 million, or 9%, to \$3,743.3 million, including \$87.4 million attributable to the 35 new Carrier Enterprise III locations and \$2.5 million from other locations opened during the preceding 12 months, offset by \$7.9 million from locations closed. On a same-store basis, revenues increased \$229.6 million, or 7%, as compared to 2012, reflecting a 9% increase in sales of HVAC equipment (12% increase in residential HVAC equipment offset by a 2% decrease in commercial HVAC equipment), a 3% increase in sales of other HVAC products and a 3% increase in sales of commercial refrigeration products. The increase in same-store revenues is primarily due to strong demand for residential HVAC equipment.

### Gross Profit

Gross profit for 2013 increased \$84.9 million, or 10%, to \$899.3 million, primarily as a result of increased revenues. Gross profit margin improved 30 basis-points to 24.0% in 2013 from 23.7% in 2012. On a same-store basis, gross profit margin also improved 30 basis-points to 24.0% in 2013 from 23.7% in 2012, primarily due to higher realized gross margins for residential HVAC equipment and non-equipment products.

### Selling, General and Administrative Expenses

Selling, general and administrative expenses for 2013 increased \$38.6 million, or 7%, to \$628.0 million, primarily as a result of increased revenues. Selling, general and administrative expenses as a percent of revenues decreased to 16.8% for 2013 from 17.2% for 2012. The decrease in selling, general, and administrative expenses as a percentage of revenues was primarily due to leveraging of fixed operating costs as compared to 2012. Selling, general and administrative expenses in 2012 included \$1.2 million of acquisition-related costs. On a same-store basis, selling, general and administrative expenses increased 3% as compared to 2012.

### Operating Income

Operating income for 2013 increased \$46.3 million, or 21%, to \$271.2 million. Operating margin improved 70 basis-points to 7.2% in 2013 from 6.5% in 2012. On a same-store basis, operating income increased 19% compared to 2012.

### Interest Expense, Net

Net interest expense for 2013 increased \$1.2 million, or 25%, to \$5.8 million, primarily as a result of an increase in average outstanding borrowings, partially offset by a lower effective interest rate in 2013 as compared to 2012.

### Income Taxes

Income taxes increased to \$77.7 million for 2013, as compared to \$62.6 million for 2012 and are a composite of the income taxes attributable to our wholly owned operations and investments, and income taxes attributable to the Carrier joint ventures, which are taxed as partnerships for income tax purposes. The effective income tax rate attributable to us was 37.0% and 36.75% in 2013 and 2012, respectively. The increase was primarily due to higher effective tax rates for income generated by our United States subsidiaries.

### Net Income Attributable to Watsco, Inc.

Net income attributable to Watsco in 2013 increased \$24.4 million, or 24%, to \$127.7 million. The increase was primarily driven by higher revenues, expanded profit margins and reduced selling, general and administrative expenses as a percent of revenues as discussed above, and by a reduction in the net income attributable to the noncontrolling interest related to Carrier Enterprise I following our purchase of an additional 10% ownership interest in Carrier Enterprise I in July 2012.

## 2012 COMPARED TO 2011

### Revenues

Revenues for 2012 increased \$454.0 million, or 15%, to \$3,431.7 million, including \$351.4 million attributable to the 70 new Carrier Enterprise II and Carrier Enterprise III locations and \$10.1 million from other locations opened during the preceding 12 months, offset by \$11.9 million from locations closed. On a same-store basis, revenues increased \$104.4 million, or 4%, as compared to 2011, reflecting a 5% increase in sales of HVAC equipment, a 2% decrease in sales of other HVAC products and a 21% increase in sales of commercial refrigeration products. The increase in same-store revenues is primarily due to improving demand for the replacement of residential and commercial HVAC equipment.

### Gross Profit

Gross profit for 2012 increased \$86.1 million, or 12%, to \$814.4 million, primarily as a result of increased revenues. Gross profit margin declined 80 basis-points to 23.7% in 2012 from 24.5% in 2011. On a same-store basis, gross profit margin declined 90 basis-points to 23.6% in 2012 from 24.5% in 2011, due to decreased average selling prices for residential HVAC equipment and a shift in sales mix toward HVAC equipment and commercial products, which generate a lower gross profit margin than non-equipment products.

### Selling, General and Administrative Expenses

Selling, general and administrative expenses for 2012 increased \$60.2 million, or 11%, to \$589.5 million, primarily as a result of increased revenues. Selling, general and administrative expenses as a percent of revenues decreased to 17.2% for 2012 from 17.8% for 2011. The decrease in selling, general, and administrative expenses as a percentage of revenues was primarily due to leveraging of fixed operating costs as compared to 2011. Selling, general and administrative expenses in both 2012 and 2011 include \$1.2 million of acquisition-related costs. On a same-store basis, selling, general and administrative expenses were flat compared to 2011.

### Operating Income

Operating income for 2012 increased \$25.9 million, or 13%, to \$224.9 million. Operating margin declined 20 basis-points to 6.5% in 2012 from 6.7% in 2011. On a same-store basis, operating income increased 1% compared to 2011.

### Interest Expense, Net

Net interest expense for 2012 increased \$0.2 million, or 5%, to \$4.7 million, primarily as a result of an increase in average outstanding borrowings, partially offset by a lower effective interest rate in 2012 as compared to 2011.

### Income Taxes

Income taxes increased to \$62.6 million for 2012, as compared to \$56.9 million for 2011 and are a composite of the income taxes attributable to our wholly owned operations and investments, and income taxes attributable to the Carrier joint ventures, which are taxed as partnerships for income tax purposes. The effective income tax rate attributable to us was 36.75% and 38.0% in 2012 and 2011, respectively. The decrease was primarily due to lower effective tax rates for income generated by our foreign subsidiaries and certain non-recurring tax benefits realized in 2012.

### Net Income Attributable to Watsco, Inc.

Net income attributable to Watsco in 2012 increased \$12.9 million, or 14%, to \$103.3 million. The increase was primarily driven by higher revenues and reduced selling, general and administrative expenses as a percent of revenues, as discussed above, and by a reduction in the net income attributable to the noncontrolling interest related to Carrier Enterprise I following our purchase of an additional 10% ownership interest in Carrier Enterprise I in July 2012.

## 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 of HVAC/R products, which peaks in the months of May through August. Significant factors that could affect our liquidity

include the following:

- cash necessary to fund our business (primarily working capital requirements);
- the adequacy of our available bank line of credit;
- the ability to attract long-term capital with satisfactory terms;
- acquisitions;
- dividend payments;
- capital expenditures; and
- the timing and extent of common stock repurchases.

### Sources and Uses of Cash

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

As of December 31, 2013, we had \$19.5 million of cash and cash equivalents, of which, \$12.2 million was held by foreign subsidiaries. We believe that our operating cash flows, cash on hand and funds available for borrowing under our line of credit will be sufficient to meet our liquidity needs in the foreseeable future. However, there can be no assurance that our current sources of available funds will be sufficient to meet our cash requirements.

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

### Working Capital

Working capital increased to \$777.6 million at December 31, 2013 from \$733.1 million at December 31, 2012, reflecting higher levels of accounts receivable and inventories commensurate with our increase in overall business volume.

### Cash Flows

The following table summarizes our cash flow activity for 2013 and 2012:

|                                             | 2013       | 2012      | Change     |
|---------------------------------------------|------------|-----------|------------|
| Cash flows provided by operating activities | \$ 150.3   | \$ 173.3  | \$ (23.0)  |
| Cash flows used in investing activities     | \$ (14.3)  | \$ (92.3) | \$ 78.0    |
| Cash flows used in financing activities     | \$ (189.0) | \$ (23.1) | \$ (165.9) |

The individual items contributing to cash flow changes for the years presented are detailed in the consolidated statements of cash flows contained in this Annual Report on Form 10-K.

### Operating Activities

The decrease in net cash provided by operating activities was principally attributable to changes in operating assets and liabilities, which were primarily composed of lower levels of accounts payable and other liabilities due to approximately \$18.0 million in incremental vendor payments from a one-time change in payment terms related to Carrier Enterprise II and higher accounts receivable driven by increased sales volume in 2013.

### Investing Activities

The decrease in net cash used in investing activities is due to the purchase of our 60% controlling interest in Carrier Enterprise III for cash consideration of \$80.5 million in 2012, partially offset by higher capital expenditures in 2013.



### Financing Activities

The increase in net cash used in financing activities was primarily attributable to net repayments under our revolving credit agreement and an increase in distributions to the noncontrolling interest in 2013, partially offset by a decrease in dividends paid in 2013 and the exercise of our option to acquire an additional 10% ownership interest in Carrier Enterprise I for \$51.9 million in 2012.

### Revolving Credit Agreement

We maintain an unsecured, syndicated revolving credit agreement that provides for borrowings of up to \$500.0 million. Borrowings are used to fund seasonal working capital needs and for other general corporate purposes, including acquisitions, dividends, stock repurchases and issuances of letters of credit. Included in the facility are a \$65.0 million swingline subfacility, a \$50.0 million letter of credit subfacility and a \$75.0 million multicurrency borrowing sublimit.

On July 1, 2013, we entered into an amendment to the revolving credit agreement, which extended the maturity date from April 27, 2017 to July 1, 2018, reduced pricing, improved covenant flexibility to accommodate the seasonal nature of our working capital requirements and modified certain definitions. Borrowings under the amended credit facility bear interest at either LIBOR-based rates plus a spread, which ranges from 87.5 to 250.0 basis-points (LIBOR plus 125.0 basis-points at December 31, 2013), depending upon our ratio of total debt to EBITDA, or on rates based on the higher of the Prime rate or the Federal Funds Rate, in each case plus a spread which ranges from 0 to 150.0 basis-points (25.0 basis-points at December 31, 2013), depending upon 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 35.0 basis-points (17.5 basis-points at December 31, 2013).

At December 31, 2013 and 2012, \$230.0 million and \$316.2 million was outstanding under the revolving credit agreement, respectively. The revolving credit agreement contains customary affirmative and negative covenants, including financial covenants with respect to consolidated leverage and interest coverage ratios, and other customary restrictions. We believe we were in compliance with all covenants at December 31, 2013.

### Contractual Obligations

As of December 31, 2013, our significant contractual obligations were as follows (in millions):

| Contractual Obligations  | Payments due by Period |         |         |         |         |            |          | Total |
|--------------------------|------------------------|---------|---------|---------|---------|------------|----------|-------|
|                          | 2014                   | 2015    | 2016    | 2017    | 2018    | Thereafter |          |       |
| Operating leases (1)     | \$ 65.0                | \$ 54.5 | \$ 43.3 | \$ 28.3 | \$ 14.0 | \$ 8.4     | \$ 213.5 |       |
| Purchase obligations (2) | 7.5                    | —       | —       | —       | —       | —          | 7.5      |       |
| Total                    | \$ 72.5                | \$ 54.5 | \$ 43.3 | \$ 28.3 | \$ 14.0 | \$ 8.4     | \$ 221.0 |       |

(1) Represents future minimum payments associated with real property, equipment, vehicles and a corporate aircraft under non-cancelable operating leases. We are committed to pay a portion of the actual operating expenses under certain of these lease agreements and these operating expenses are excluded from the table above.

(2) Purchase obligations include amounts committed under purchase orders for goods with defined terms as to price, quantity and delivery. Purchase orders made in the ordinary course of business that are cancelable are excluded from the above table. Any amounts for which we are liable under purchase orders for goods received are reflected in Accounts Payable in our Consolidated Balance Sheets and are excluded from the above table.

Commercial obligations outstanding at December 31, 2013 under our revolving credit agreement consisted of borrowings totaling \$230.0 million with revolving maturities of 30 days.

### Off-Balance Sheet Arrangements

Refer to Note 12 to our consolidated financial statements, under the caption "Off-Balance Sheet Financial Instruments," for a discussion of standby letters of credit and performance bonds that we were contingently liable under at December 31, 2013.

### Acquisitions

On July 1, 2014, we intend to exercise our option to acquire an additional 10% ownership interest in Carrier Enterprise I for approximately \$93.0 million, following which we would have an 80% controlling interest in Carrier Enterprise I.

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

### Common Stock Dividends

We paid cash dividends of \$1.15, \$7.48 and \$2.23 per share of Common and Class B common stock in 2013, 2012 and 2011, respectively. On January 2, 2014, our Board of Directors declared a regular quarterly cash dividend of \$0.40 per share of Common and Class B common stock that was paid on January 31, 2014 to shareholders of record as of January 15, 2014. Future dividends and/or dividend rate increases will be at the sole discretion of the Board of Directors and will depend upon such factors as cash flow generated by operations, profitability, financial condition, cash requirements, future prospects and other factors deemed relevant by our Board of Directors.

### Company Share Repurchase Program

In September 1999, our Board of Directors authorized the repurchase, at management's discretion, of up to 7,500,000 shares of common stock in the open market or via private transactions. Shares repurchased under the program are accounted for using the cost method and result in a reduction of shareholders' equity. No shares were repurchased in 2013, 2012 or 2011. 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 December 31, 2013, there were 1,129,087 shares remaining authorized for repurchase under the program.

### QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

In the normal course of business we are exposed to fluctuations in foreign currency exchange rates and interest rates. To manage certain of these exposures, we use derivative financial instruments, including forward contracts and swaps. We do not use derivative financial instruments for trading purposes.

The principal foreign currency exchange rates to which we are exposed are the Canadian dollar and Mexican peso. Changes in exchange rates for these currencies may positively or negatively impact our results of operations. Revenues in these markets represent 9% and 3%, respectively, of our total revenues therefore, fluctuations in these exchange rates have not materially impacted our historical results of operations. However, as these markets grow and represent a higher percentage of our total revenues, our exposure to currency rate fluctuations could change in the future, and materially impact our results of operations.

We use foreign currency forward contracts to manage certain foreign currency transactional exposure from purchases by our Canadian operations in currencies other than their local currency. These instruments are not designated as hedging instruments. The total notional value of our foreign currency forward contracts as of December 31, 2013 was \$26.0 million, and such contracts have varying terms expiring through March 2014. See Note 12 to our consolidated financial statements, under the caption "Derivative Financial Instruments," included in this Annual Report on Form 10-K for further information.

Our revolving credit facility exposes us to interest rate risk because borrowings thereunder accrue interest at one or more variable rates. Our interest rate risk management objectives are to limit the impact of interest rate changes on earnings and cash flows and to lower overall borrowing costs. To achieve these objectives, we have historically entered into interest rate swap agreements with financial institutions that have investment grade credit ratings, thereby minimizing credit risk associated with these instruments. We do not currently hold any such swap agreements or any other derivative contracts that hedge our interest rate exposure, but we may enter into such instruments in the future.

We have evaluated our exposure to interest rates based on the amount of variable debt outstanding under our revolving credit agreement at December 31, 2013, and determined that a 100 basis-point change in interest rates would result in an impact to income before taxes of approximately \$2.3 million.



## Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f). Our internal control system was designed to provide reasonable assurance to our management and Board of Directors regarding the reliability of financial reporting and the preparation and fair presentation of our published consolidated financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective may not prevent or detect misstatements and can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and with the participation of our management, including our Chief Executive Officer, Senior Vice President and Chief Financial Officer, we conducted an assessment of the effectiveness of our internal control over financial reporting as of December 31, 2013. The assessment was based on criteria established in the framework *Internal Control — Integrated Framework (1992)*, issued by the Committee of Sponsoring Organizations ("COSO") of the Treadway Commission. Based on this assessment under the COSO framework, our management concluded that our internal control over financial reporting was effective as of December 31, 2013. The effectiveness of our internal control over financial reporting as of December 31, 2013 has been audited by KPMG LLP, an independent registered public accounting firm, as stated in their report that is included herein.

## Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders  
Watsco, Inc.:

We have audited Watsco, Inc.'s internal control over financial reporting as of December 31, 2013, based on criteria established in *Internal Control — Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Watsco, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Watsco, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on criteria established in *Internal Control — Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Watsco, Inc. and subsidiaries as of December 31, 2013 and 2012, and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2013, and our report dated February 27, 2014 expressed an unqualified opinion on those consolidated financial statements.

February 27, 2014  
Miami, Florida  
Certified Public Accountants

**KPMG LLP**  
KPMG LLP

## Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders  
Watsco, Inc.:

We have audited the accompanying consolidated balance sheets of Watsco, Inc. and subsidiaries as of December 31, 2013 and 2012, and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for each of the years in the three year period ended December 31, 2013. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Watsco, Inc. and subsidiaries as of December 31, 2013 and 2012, and the results of their operations and their cash flows for each of the years in the three year period ended December 31, 2013, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Watsco, Inc.'s internal control over financial reporting as of December 31, 2013, based on criteria established in *Internal Control – Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 27, 2014 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

February 27, 2014  
Miami, Florida  
Certified Public Accountants

**KPMG LLP**  
KPMG LLP

## CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)

| Years Ended December 31,                                 | 2013         | 2012         | 2011         |
|----------------------------------------------------------|--------------|--------------|--------------|
| Revenues                                                 | \$ 3,743,330 | \$ 3,431,712 | \$ 2,977,759 |
| Cost of sales                                            | 2,844,077    | 2,617,317    | 2,249,465    |
| Gross profit                                             | 899,253      | 814,395      | 728,294      |
| Selling, general and administrative expenses             | 628,044      | 589,487      | 529,244      |
| Operating income                                         | 271,209      | 224,908      | 199,050      |
| Interest expense, net                                    | 5,830        | 4,665        | 4,458        |
| Income before income taxes                               | 265,379      | 220,243      | 194,592      |
| Income taxes                                             | 77,660       | 62,642       | 56,850       |
| Net income                                               | 187,719      | 157,601      | 137,742      |
| Less: net income attributable to noncontrolling interest | 59,996       | 54,267       | 47,292       |
| Net income attributable to Watsco, Inc.                  | \$ 127,723   | \$ 103,334   | \$ 90,450    |
| Earnings per share for Common and Class B common stock:  |              |              |              |
| Basic                                                    | \$ 3.69      | \$ 2.70      | \$ 2.75      |
| Diluted                                                  | \$ 3.68      | \$ 2.70      | \$ 2.74      |

See accompanying notes to consolidated financial statements.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

| Years Ended December 31,                                                   | 2013       | 2012       | 2011       |
|----------------------------------------------------------------------------|------------|------------|------------|
| Net income                                                                 | \$ 187,719 | \$ 157,601 | \$ 137,742 |
| Other comprehensive (loss) income, net of tax                              |            |            |            |
| Foreign currency translation adjustment                                    | (16,365)   | (3,191)    | —          |
| Unrealized gain on available-for-sale securities arising during the period | 24         | 35         | 3          |
| Unrealized gain on derivative instrument arising during the period         | —          | —          | 238        |
| Other comprehensive (loss) income                                          | (16,341)   | (3,156)    | 241        |
| Comprehensive income                                                       | 171,378    | 154,445    | 137,983    |
| Less: comprehensive income attributable to noncontrolling interest         | 53,027     | 52,861     | 47,292     |
| Comprehensive income attributable to Watsco, Inc.                          | \$ 118,351 | \$ 101,584 | \$ 90,691  |

See accompanying notes to consolidated financial statements.

## CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

| December 31,                                                                                                                                                 | 2013         | 2012         |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------|--------------|
| <b>ASSETS</b>                                                                                                                                                |              |              |
| Current assets:                                                                                                                                              |              |              |
| Cash and cash equivalents                                                                                                                                    | \$ 19,478    | \$ 73,770    |
| Accounts receivable, net                                                                                                                                     | 399,565      | 377,655      |
| Inventories                                                                                                                                                  | 583,154      | 546,083      |
| Other current assets                                                                                                                                         | 18,905       | 17,943       |
| Total current assets                                                                                                                                         | 1,021,102    | 1,015,451    |
| Property and equipment, net                                                                                                                                  | 45,418       | 42,842       |
| Goodwill                                                                                                                                                     | 392,610      | 397,262      |
| Intangible assets, net                                                                                                                                       | 203,843      | 219,501      |
| Other assets                                                                                                                                                 | 6,558        | 6,999        |
|                                                                                                                                                              | \$ 1,669,531 | \$ 1,682,055 |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>                                                                                                                  |              |              |
| Current liabilities:                                                                                                                                         |              |              |
| Current portion of other long-term obligations                                                                                                               | \$ 107       | \$ 4         |
| Accounts payable                                                                                                                                             | 141,104      | 184,957      |
| Accrued expenses and other current liabilities                                                                                                               | 102,295      | 97,397       |
| Total current liabilities                                                                                                                                    | 243,506      | 282,358      |
| Long-term obligations:                                                                                                                                       |              |              |
| Borrowings under revolving credit agreement                                                                                                                  | 230,044      | 316,182      |
| Other long-term obligations, net of current portion                                                                                                          | 513          | 14           |
| Total long-term obligations                                                                                                                                  | 230,557      | 316,196      |
| Deferred income taxes and other liabilities                                                                                                                  | 68,076       | 61,461       |
| Commitments and contingencies                                                                                                                                |              |              |
| Watsco, Inc. shareholders' equity:                                                                                                                           |              |              |
| Common stock, \$0.50 par value, 60,000,000 shares authorized; 36,364,297 and 36,262,023 shares outstanding at December 31, 2013 and 2012, respectively       | 18,182       | 18,131       |
| Class B common stock, \$0.50 par value, 10,000,000 shares authorized; 4,733,737 and 4,630,200 shares outstanding at December 31, 2013 and 2012, respectively | 2,367        | 2,315        |
| Preferred stock, \$0.50 par value, 10,000,000 shares authorized; no shares issued                                                                            | —            | —            |
| Paid-in capital                                                                                                                                              | 606,384      | 592,820      |
| Accumulated other comprehensive loss, net of tax                                                                                                             | (11,474)     | (2,102)      |
| Retained earnings                                                                                                                                            | 339,362      | 251,475      |
| Treasury stock, at cost, 6,322,650 shares of Common stock and 48,263 shares of Class B common stock at both December 31, 2013 and 2012                       | (114,425)    | (114,425)    |
| Total Watsco, Inc. shareholders' equity                                                                                                                      | 840,396      | 748,214      |
| Noncontrolling interest                                                                                                                                      | 286,996      | 273,826      |
| Total shareholders' equity                                                                                                                                   | 1,127,392    | 1,022,040    |
|                                                                                                                                                              | \$ 1,669,531 | \$ 1,682,055 |

See accompanying notes to consolidated financial statements.

**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**

(In thousands, except share and per share data)

|                                                                                       | Common Stock,<br>Class B<br>Common Stock<br>and Preferred<br>Stock Shares | Common Stock,<br>Class B<br>Common Stock<br>and Preferred<br>Stock Amount | Paid-In<br>Capital | Accumulated<br>Other<br>Comprehensive<br>Loss | Retained<br>Earnings | Treasury<br>Stock  | Noncontrolling<br>Interest | Total              |
|---------------------------------------------------------------------------------------|---------------------------------------------------------------------------|---------------------------------------------------------------------------|--------------------|-----------------------------------------------|----------------------|--------------------|----------------------------|--------------------|
| <b>Balance at December 31, 2010</b>                                                   | <b>32,449,425</b>                                                         | <b>\$19,410</b>                                                           | <b>\$472,883</b>   | <b>\$(593)</b>                                | <b>\$387,186</b>     | <b>\$(114,425)</b> | <b>\$164,435</b>           | <b>\$928,896</b>   |
| Net income                                                                            |                                                                           |                                                                           |                    |                                               | 90,450               |                    | 47,292                     | 137,742            |
| Other comprehensive income                                                            |                                                                           |                                                                           |                    | 241                                           |                      |                    |                            | 241                |
| Issuances of non-vested (restricted) shares of common stock                           | 429,602                                                                   | 215                                                                       | (215)              |                                               |                      |                    |                            | —                  |
| Forfeitures of non-vested (restricted) shares of common stock                         | (30,500)                                                                  | (15)                                                                      | 15                 |                                               |                      |                    |                            | —                  |
| Common stock contribution to 401(k) plan                                              | 27,240                                                                    | 14                                                                        | 1,704              |                                               |                      |                    |                            | 1,718              |
| Stock issuances from exercise of stock options and employee stock purchase plan       | 139,717                                                                   | 69                                                                        | 5,484              |                                               |                      |                    |                            | 5,553              |
| Retirement of common stock                                                            | (10,143)                                                                  | (5)                                                                       | (612)              |                                               |                      |                    |                            | (617)              |
| Share-based compensation                                                              |                                                                           |                                                                           | 6,340              |                                               |                      |                    |                            | 6,340              |
| Excess tax benefit from share-based compensation                                      |                                                                           |                                                                           | 859                |                                               |                      |                    |                            | 859                |
| Cash dividends declared and paid on Common and Class B common stock, \$2.23 per share |                                                                           |                                                                           |                    |                                               | (73,276)             |                    |                            | (73,276)           |
| Return of capital contribution to noncontrolling interest                             |                                                                           |                                                                           |                    |                                               |                      |                    | (32,000)                   | (32,000)           |
| Fair value of noncontrolling interest                                                 |                                                                           |                                                                           |                    |                                               |                      |                    | 34,919                     | 34,919             |
| Share of carrying value of our locations contributed to joint venture                 |                                                                           |                                                                           |                    |                                               |                      |                    | 7,708                      | 7,708              |
| Fair value increment over carrying value of locations contributed to joint venture    |                                                                           |                                                                           | 7,061              |                                               |                      |                    |                            | 7,061              |
| Distributions to noncontrolling interest                                              |                                                                           |                                                                           |                    |                                               |                      |                    | (23,434)                   | (23,434)           |
| <b>Balance at December 31, 2011</b>                                                   | <b>33,005,341</b>                                                         | <b>19,688</b>                                                             | <b>493,519</b>     | <b>(352)</b>                                  | <b>404,360</b>       | <b>(114,425)</b>   | <b>198,920</b>             | <b>1,001,710</b>   |
| Net income                                                                            |                                                                           |                                                                           |                    |                                               | 103,334              |                    | 54,267                     | 157,601            |
| Other comprehensive loss                                                              |                                                                           |                                                                           |                    | (1,750)                                       |                      |                    | (1,406)                    | (3,156)            |
| Issuances of non-vested (restricted) shares of common stock                           | 111,301                                                                   | 56                                                                        | (56)               |                                               |                      |                    |                            | —                  |
| Common stock contribution to 401(k) plan                                              | 26,991                                                                    | 13                                                                        | 1,759              |                                               |                      |                    |                            | 1,772              |
| Stock issuances from exercise of stock options and employee stock purchase plan       | 157,664                                                                   | 79                                                                        | 7,084              |                                               |                      |                    |                            | 7,163              |
| Retirement of common stock                                                            | (29,987)                                                                  | (15)                                                                      | (2,214)            |                                               |                      |                    |                            | (2,229)            |
| Share-based compensation                                                              |                                                                           |                                                                           | 7,716              |                                               |                      |                    |                            | 7,716              |
| Excess tax benefit from share-based compensation                                      |                                                                           |                                                                           | 1,079              |                                               |                      |                    |                            | 1,079              |
| Cash dividends declared and paid on Common and Class B common stock, \$7.48 per share |                                                                           |                                                                           |                    |                                               | (256,219)            |                    |                            | (256,219)          |
| Common stock issued for Carrier Enterprise III                                        | 1,250,000                                                                 | 625                                                                       | 92,625             |                                               |                      |                    |                            | 93,250             |
| Fair value of noncontrolling interest in Carrier Enterprise III                       |                                                                           |                                                                           |                    |                                               |                      |                    | 104,244                    | 104,244            |
| Decrease in noncontrolling interest in Carrier Enterprise I                           |                                                                           |                                                                           | (8,692)            |                                               |                      |                    | (43,189)                   | (51,881)           |
| Distributions to noncontrolling interest                                              |                                                                           |                                                                           |                    |                                               |                      |                    | (39,010)                   | (39,010)           |
| <b>Balance at December 31, 2012</b>                                                   | <b>34,521,310</b>                                                         | <b>20,446</b>                                                             | <b>592,820</b>     | <b>(2,102)</b>                                | <b>251,475</b>       | <b>(114,425)</b>   | <b>273,826</b>             | <b>1,022,040</b>   |
| Net income                                                                            |                                                                           |                                                                           |                    |                                               | 127,723              |                    | 59,996                     | 187,719            |
| Other comprehensive loss                                                              |                                                                           |                                                                           |                    | (9,372)                                       |                      |                    | (6,969)                    | (16,341)           |
| Issuances of non-vested (restricted) shares of common stock                           | 124,043                                                                   | 62                                                                        | (62)               |                                               |                      |                    |                            | —                  |
| Forfeitures of non-vested (restricted) shares of common stock                         | (10,000)                                                                  | (5)                                                                       | 5                  |                                               |                      |                    |                            | —                  |
| Common stock contribution to 401(k) plan                                              | 22,551                                                                    | 11                                                                        | 1,678              |                                               |                      |                    |                            | 1,689              |
| Stock issuances from exercise of stock options and employee stock purchase plan       | 87,193                                                                    | 44                                                                        | 3,340              |                                               |                      |                    |                            | 3,384              |
| Retirement of common stock                                                            | (17,976)                                                                  | (9)                                                                       | (1,668)            |                                               |                      |                    |                            | (1,677)            |
| Share-based compensation                                                              |                                                                           |                                                                           | 8,760              |                                               |                      |                    |                            | 8,760              |
| Excess tax benefit from share-based compensation                                      |                                                                           |                                                                           | 1,511              |                                               |                      |                    |                            | 1,511              |
| Cash dividends declared and paid on Common and Class B common stock, \$1.15 per share |                                                                           |                                                                           |                    |                                               | (39,836)             |                    |                            | (39,836)           |
| Distributions to noncontrolling interest                                              |                                                                           |                                                                           |                    |                                               |                      |                    | (39,857)                   | (39,857)           |
| <b>Balance at December 31, 2013</b>                                                   | <b>34,727,121</b>                                                         | <b>\$20,549</b>                                                           | <b>\$606,384</b>   | <b>\$(11,474)</b>                             | <b>\$339,362</b>     | <b>\$(114,425)</b> | <b>\$286,996</b>           | <b>\$1,127,392</b> |

See accompanying notes to consolidated financial statements.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

| Years Ended December 31,                                                          | 2013             | 2012             | 2011             |
|-----------------------------------------------------------------------------------|------------------|------------------|------------------|
| <b>Cash flows from operating activities:</b>                                      |                  |                  |                  |
| Net income                                                                        | \$ 187,719       | \$ 157,601       | \$ 137,742       |
| Adjustments to reconcile net income to net cash provided by operating activities: |                  |                  |                  |
| Depreciation and amortization                                                     | 17,706           | 15,911           | 11,725           |
| Share-based compensation                                                          | 9,967            | 7,939            | 6,663            |
| Deferred income tax provision                                                     | 8,589            | 6,724            | 8,310            |
| Provision for doubtful accounts                                                   | 961              | 1,826            | 2,374            |
| Non-cash contribution for 401(k) plan                                             | 1,689            | 1,772            | 1,718            |
| (Gain) loss on sale of property and equipment                                     | (156)            | 103              | 171              |
| Excess tax benefits from share-based compensation                                 | (1,511)          | (1,079)          | (859)            |
| Changes in operating assets and liabilities, net of effects of acquisitions:      |                  |                  |                  |
| Accounts receivable                                                               | (25,846)         | (5,752)          | 11,987           |
| Inventories                                                                       | (40,575)         | (26,652)         | (22,489)         |
| Accounts payable and other liabilities                                            | (7,256)          | 11,873           | (98,611)         |
| Other, net                                                                        | (1,018)          | 3,077            | 2,721            |
| <b>Net cash provided by operating activities</b>                                  | <b>150,269</b>   | <b>173,343</b>   | <b>61,452</b>    |
| <b>Cash flows from investing activities:</b>                                      |                  |                  |                  |
| Capital expenditures                                                              | (14,580)         | (12,317)         | (13,925)         |
| Proceeds from sale of property and equipment                                      | 323              | 504              | 737              |
| Business acquisitions, net of cash acquired                                       | —                | (80,479)         | (43,455)         |
| <b>Net cash used in investing activities</b>                                      | <b>(14,257)</b>  | <b>(92,292)</b>  | <b>(56,643)</b>  |
| <b>Cash flows from financing activities:</b>                                      |                  |                  |                  |
| Net (repayments) proceeds under current revolving credit agreement                | (83,559)         | 316,748          | —                |
| Distributions to noncontrolling interest                                          | (69,494)         | (16,003)         | (26,469)         |
| Dividends on Common and Class B common stock                                      | (39,836)         | (256,219)        | (73,276)         |
| Payment of fees related to revolving credit agreement                             | (458)            | (2,116)          | (38)             |
| Purchase of additional ownership from noncontrolling interest                     | —                | (51,881)         | —                |
| Net (repayments) proceeds under prior revolving credit agreements                 | —                | (20,000)         | 10,000           |
| Return of capital contribution to noncontrolling interest                         | —                | —                | (32,000)         |
| Net proceeds from (repayments of) other long-term obligations                     | 602              | (1)              | (69)             |
| Excess tax benefits from share-based compensation                                 | 1,511            | 1,079            | 859              |
| Net proceeds from issuances of common stock                                       | 2,185            | 5,312            | 5,359            |
| <b>Net cash used in financing activities</b>                                      | <b>(189,049)</b> | <b>(23,081)</b>  | <b>(115,634)</b> |
| Effect of foreign exchange rate changes on cash and cash equivalents              | (1,255)          | 127              | —                |
| <b>Net (decrease) increase in cash and cash equivalents</b>                       | <b>(54,292)</b>  | <b>58,097</b>    | <b>(110,825)</b> |
| Cash and cash equivalents at beginning of year                                    | 73,770           | 15,673           | 126,498          |
| <b>Cash and cash equivalents at end of year</b>                                   | <b>\$ 19,478</b> | <b>\$ 73,770</b> | <b>\$ 15,673</b> |

### Supplemental cash flow information (Note 17)

See accompanying notes to consolidated financial statements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except share and per share data)

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Nature of Operations

Watsco, Inc. and its subsidiaries (collectively, "Watsco," which may be referred to as "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. At December 31, 2013, we operated from 569 locations in 38 U.S. states, Canada, Mexico and Puerto Rico with additional market coverage on an export basis to Latin America and the Caribbean.

#### Basis of Consolidation

The consolidated financial statements include the accounts of Watsco and all of its wholly owned subsidiaries and include 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.

#### Reclassifications

Certain reclassifications of prior year amounts have been made to conform to the 2013 presentation. These reclassifications had no effect on net income or earnings per share as previously reported.

#### Foreign Currency Translation and Transactions

Our operations in Mexico consider their functional currency to be the U.S. dollar because the majority of their transactions are denominated in U.S. dollars. Gains or losses resulting from transactions denominated in Mexican pesos are recognized in earnings within selling, general and administrative expenses in our consolidated statements of income.

The functional currency of our operations in Canada is the Canadian dollar. Foreign currency denominated assets and liabilities are translated into U.S. dollars at the exchange rates in effect at the balance sheet date, and income and expense items are translated at the average exchange rates in effect during the applicable period. The aggregate effect of foreign currency translation is recorded in accumulated other comprehensive loss in our consolidated balance sheets. Our net investment in our Canadian operations is recorded at the historical rate and the resulting foreign currency translation adjustments are included in accumulated other comprehensive loss in our consolidated balance sheets. Gains or losses resulting from transactions denominated in U.S. dollars are recognized in earnings within selling, general and administrative expenses in our consolidated statements of income.

#### Use of Estimates

The preparation of consolidated 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 consolidated financial statements and the reported amounts of revenues and expenses for the reporting period. Significant estimates include valuation reserves for accounts receivable, inventories and income taxes, reserves related to self-insurance programs and the valuation of goodwill and indefinite lived intangible assets. While we believe that these estimates are reasonable, actual results could differ from such estimates.

#### Cash Equivalents

All highly liquid instruments purchased with original maturities of three months or less are considered to be cash equivalents.

#### Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable primarily consist of trade receivables due from customers and are stated at the invoiced amount less an allowance for doubtful accounts. An allowance for doubtful accounts is main-

tained for estimated losses resulting from the inability of customers to make required payments. When preparing these estimates, we consider a number of factors, including the aging of a customer's account, past transactions with customers, creditworthiness of specific customers, historical trends and other information. Upon determination that an account is uncollectible, the receivable balance is written off. At December 31, 2013 and 2012, the allowance for doubtful accounts totaled \$5,737 and \$10,473, respectively.

#### Inventories

Inventories consist of air conditioning, heating and refrigeration equipment and related parts and supplies and are valued at the lower of cost or market using a weighted-average cost basis and the first-in, first-out methods. As part of the valuation process, inventories are adjusted to reflect excess, slow-moving and damaged inventories at their estimated net realizable value. Inventory policies are reviewed periodically, reflecting current risks, trends and changes in industry conditions. A reserve for estimated inventory shrinkage is also maintained to consider inventory shortages determined from cycle counts and physical inventories.

#### Vendor Rebates

We have arrangements with several vendors that provide rebates payable to us when we achieve any of a number of measures, generally related to the volume level of purchases. We account for such rebates as a reduction of inventory until we sell the product, at which time such rebates are reflected as a reduction of cost of sales in our consolidated statements of income. Throughout the year, we estimate the amount of the rebate based on our estimate of purchases to date relative to the purchase levels that mark our progress toward earning the rebates. We continually revise our estimates of earned vendor rebates based on actual purchase levels. At December 31, 2013 and 2012, we had \$9,333 and \$8,015, respectively, of rebates recorded as a reduction of inventory. Substantially all vendor rebate receivables are collected within three months immediately following the end of the year.

#### Marketable Securities

Investments in marketable equity securities are classified as available-for-sale and are included in other assets in our consolidated balance sheets. These equity securities are recorded at fair value using the specific identification method with unrealized holding losses, net of deferred taxes, included in accumulated other comprehensive loss within shareholders' equity. Dividend and interest income are recognized in the statements of income when earned.

#### Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization of property and equipment is computed using the straight-line method. Buildings and improvements are depreciated or amortized over estimated useful lives ranging from 3-40 years. Leasehold improvements are amortized over the shorter of the respective lease terms or estimated useful lives. Estimated useful lives for other depreciable assets range from 3-10 years.

#### Goodwill and Other Intangible Assets

Goodwill is recorded when the purchase price paid for an acquisition exceeds the fair value of the net identified tangible and intangible assets acquired. We evaluate goodwill for impairment annually or more frequently when an event occurs or circumstances change that indicate that the carrying value may not be recoverable. We test goodwill for impairment by first comparing the fair value of our reporting unit to its carrying value. If the fair value is determined to be less than the carrying value, a second step is performed to measure the amount of impairment loss.

Other intangible assets primarily consist of the value of trade names and trademarks, distributor agreements, customer relationships and non-compete agreements. Indefinite lived intangibles not subject to amortization are assessed for impairment at least annually, or more frequently if events or changes in circumstances indicate they may be impaired, by comparing the fair value of the intangible asset to its carrying amount to determine if a write-down to fair value is required. Finite lived intangible assets are amortized using the straight-line method over their respective estimated useful lives.

We perform our annual impairment tests each year and have determined there to be no impairment for

any of the periods presented. There were no events or circumstances identified from the date of our assessment that would require an update to our annual impairment tests.

#### Long-Lived Assets

Long-lived assets, other than goodwill, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. Recoverability is evaluated by determining whether the amortization of the balance over its remaining life can be recovered through undiscounted future operating cash flows. We measure the impairment loss based on projected discounted cash flows using a discount rate reflecting the average cost of funds and compared to the asset's carrying value. As of December 31, 2013, there were no such events or circumstances.

#### Fair Value Measurements

We carry various assets and liabilities at fair value in the consolidated balance sheets. Fair value is defined as the price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. Fair value measurements are classified based on the following fair value hierarchy:

- Level 1 Quoted prices in active markets for identical assets or liabilities. An active market for an asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2 Observable inputs other than Level 1 prices such as quoted prices in active markets for similar assets or liabilities; quoted prices in markets that are not active; or model-driven valuations or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3 Unobservable inputs for the asset or liability. These inputs reflect our own assumptions about the assumptions a market participant would use in pricing the asset or liability.

#### Revenue Recognition

Revenue primarily consists of sales of air conditioning, heating and refrigeration equipment and related parts and supplies and is recorded when shipment of products or delivery of services has occurred. Substantially all customer returns relate to products that are returned under warranty obligations underwritten by manufacturers, effectively mitigating our risk of loss for customer returns. Taxes collected from our customers and remitted to governmental authorities are presented in our consolidated statements of income on a net basis.

#### Advertising Costs

Advertising costs are expensed as incurred. Advertising expense for the years ended December 31, 2013, 2012 and 2011, was \$22,418, \$23,730 and \$25,052, respectively.

#### Shipping and Handling

Shipping and handling costs associated with inbound freight are capitalized to inventories and relieved through cost of sales as inventories are sold. Shipping and handling costs associated with the delivery of products is included in selling, general and administrative expenses. Shipping and handling costs for the years ended December 31, 2013, 2012 and 2011, was \$39,395, \$37,676 and \$30,234, respectively.

#### Share-Based Compensation

The fair value of stock option and non-vested (restricted) stock awards are expensed on a straight-line basis over the vesting period of the awards. Share-based compensation expense is included in selling, general and administrative expenses in our consolidated statements of income. Cash flows from the tax benefits resulting from tax deductions in excess of the compensation expense recognized for those options (windfall tax benefits) are classified as financing cash flows. Tax benefits resulting from tax deductions in excess of share-based compensation expense recognized are credited to paid-in capital in the consolidated balance sheets.



## Income Taxes

We record United States federal, state and foreign income taxes currently payable, as well as deferred taxes due to temporary differences between reporting income and expenses for financial statement purposes versus tax purposes. Deferred tax assets and liabilities reflect the temporary differences between the financial statement and income tax basis of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect of a change in tax rates is recognized as income or expense in the period that includes the enactment date. We and our eligible subsidiaries file a consolidated United States federal income tax return. As income tax returns are generally not filed until well after the closing process for the December 31 financial statements is complete, the amounts recorded at December 31 reflect estimates of what the final amounts will be when the actual income tax returns are filed for that calendar year. In addition, estimates are often required with respect to, among other things, the appropriate state income tax rates to use in the various states that we and our subsidiaries are required to file, the potential utilization of operating loss carryforwards and valuation allowances required, if any, for tax assets that may not be realizable in the future.

We recognize the financial statement benefit of a tax position only after determining that the relevant tax authority would more likely than not sustain the position following an audit. For tax positions meeting the "more-likely-than-not" threshold, the amount recognized in the financial statements is the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement with the relevant tax authority.

## Earnings per Share

We compute earnings per share using the two-class method. The two-class method of computing earnings per share is an earnings allocation formula that determines earnings per share for common stock and any participating securities according to dividends declared (whether paid or unpaid) and participation rights in undistributed earnings. Shares of our non-vested (restricted) stock are considered participating securities because these awards contain a non-forfeitable right to dividends irrespective of whether the awards ultimately vest. Under the two-class method, earnings per common share for our Common and Class B common stock is computed by dividing the sum of distributed earnings to common shareholders and undistributed earnings allocated to common shareholders by the weighted-average number of shares of Common and Class B common stock outstanding for the period. In applying the two-class method, undistributed earnings are allocated to Common stock, Class B common stock and participating securities based on the weighted-average shares outstanding during the period.

Diluted earnings per share reflects the dilutive effect of potential common shares from stock options. The dilutive effect of outstanding stock options is computed using the treasury stock method, which assumes any proceeds that could be obtained upon the exercise of stock options, would be used to purchase common stock at the average market price for the period. The assumed proceeds include the purchase price the optionee pays, the windfall tax benefit that we receive upon assumed exercise and the unrecognized compensation expense at the end of each period.

## Derivative Instruments

All derivatives, whether designated in hedging relationships or not, are required to be recorded on the balance sheet at fair value. If the derivative is designated as a fair value hedge, the changes in the fair value of the derivative and of the hedged item attributable to the hedged risk are recognized in earnings. If the derivative is designated as a cash flow hedge, the effective portions of changes in the fair value of the derivative are recorded in other comprehensive income and are recognized in the income statement when the hedged item affects earnings. Ineffective portions of changes in the fair value of cash flow hedges are recognized in earnings. See Note 12, under the caption "Derivative Financial Instruments."

## New Accounting Pronouncements

### Reporting Amounts Reclassified Out of Accumulated Other Comprehensive Income

On January 1, 2013, we adopted guidance issued by the Financial Accounting Standards Board ("FASB") that requires disclosure for amounts reclassified out of accumulated other comprehensive income by the respective line items of net income if the amount reclassified is required to be reclassified to net income in

its entirety in the reporting period. For amounts that are not required to be reclassified in their entirety to net income, a cross-reference to other disclosures that provide additional detail about those amounts is required. The adoption of this guidance did not have an impact on our consolidated financial statements.

### Presentation of Unrecognized Tax Benefits

In July 2013, the FASB issued guidance that requires the presentation of an unrecognized tax benefit as a reduction to a deferred tax asset for a net operating loss carryforward rather than as a liability when the uncertain tax position would reduce the net operating loss under the tax law of the applicable jurisdiction and the entity intends to use the deferred tax asset for that purpose. This guidance is effective prospectively for interim and annual reporting periods beginning after December 15, 2013. We do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

## 2. EARNINGS PER SHARE

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

| Years Ended December 31,                                                                       | 2013       | 2012       | 2011       |
|------------------------------------------------------------------------------------------------|------------|------------|------------|
| <b>Basic Earnings per Share:</b>                                                               |            |            |            |
| Net income attributable to Watsco, Inc. shareholders                                           | \$ 127,723 | \$ 103,334 | \$ 90,450  |
| Less: distributed and undistributed earnings allocated to non-vested (restricted) common stock | 9,064      | 17,656     | 6,045      |
| Earnings allocated to Watsco, Inc. shareholders                                                | \$ 118,659 | \$ 85,678  | \$ 84,405  |
| Weighted-average common shares outstanding - Basic                                             | 32,195,598 | 31,680,187 | 30,678,206 |
| Basic earnings per share for Common and Class B common stock                                   | \$ 3.69    | \$ 2.70    | \$ 2.75    |
| Allocation of earnings for Basic:                                                              |            |            |            |
| Common stock                                                                                   | \$ 108,690 | \$ 78,359  | \$ 76,574  |
| Class B common stock                                                                           | 9,969      | 7,319      | 7,831      |
|                                                                                                | \$ 118,659 | \$ 85,678  | \$ 84,405  |
| <b>Diluted Earnings per Share:</b>                                                             |            |            |            |
| Net income attributable to Watsco, Inc. shareholders                                           | \$ 127,723 | \$ 103,334 | \$ 90,450  |
| Less: distributed and undistributed earnings allocated to non-vested (restricted) common stock | 9,053      | 17,656     | 6,042      |
| Earnings allocated to Watsco, Inc. shareholders                                                | \$ 118,670 | \$ 85,678  | \$ 84,408  |
| Weighted-average common shares outstanding - Basic                                             | 32,195,598 | 31,680,187 | 30,678,206 |
| Effect of dilutive stock options                                                               | 62,470     | 64,212     | 75,085     |
| Weighted-average common shares outstanding - Diluted                                           | 32,258,068 | 31,744,399 | 30,753,291 |
| Diluted earnings per share for Common and Class B common stock                                 | \$ 3.68    | \$ 2.70    | \$ 2.74    |

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 December 31, 2013, 2012 and 2011, our outstanding Class B common stock was convertible into 2,704,832, 2,706,338 and 2,846,334 shares of our Common stock, respectively.

Diluted earnings per share excluded 1,066, 17,492 and 33,511 shares for the years ended December 31, 2013, 2012 and 2011, respectively, related to stock options with an exercise price per share greater than the average market value, resulting in an anti-dilutive effect on diluted earnings per share.

### 3. 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, changes in the unrealized gain on available-for-sale securities and the effective portion of a cash flow hedge that matured in October 2011. The tax effects allocated to each component of other comprehensive (loss) income are as follows:

| Years Ended December 31,                                     | 2013        | 2012       | 2011   |
|--------------------------------------------------------------|-------------|------------|--------|
| Foreign currency translation adjustment                      | \$ (16,365) | \$ (3,191) | \$ —   |
| Unrealized gain on available-for-sale securities             | \$ 39       | \$ 63      | \$ 6   |
| Income tax expense                                           | (15)        | (28)       | (3)    |
| Unrealized gain on available-for-sale securities, net of tax | \$ 24       | \$ 35      | \$ 3   |
| Unrealized gain on derivative instrument                     | \$ —        | \$ —       | \$ 384 |
| Income tax expense                                           | —           | —          | (146)  |
| Unrealized gain on derivative instrument, net of tax         | \$ —        | \$ —       | \$ 238 |
| Other comprehensive (loss) income                            | \$ (16,341) | \$ (3,156) | \$ 241 |

The changes in accumulated other comprehensive loss, net of tax, are as follows:

| Years Ended December 31,                         | 2013        | 2012       | 2011     |
|--------------------------------------------------|-------------|------------|----------|
| Foreign currency translation adjustment:         |             |            |          |
| Beginning balance                                | \$ (1,785)  | \$ —       | \$ —     |
| Current period other comprehensive loss          | (9,396)     | (1,785)    | —        |
| Ending balance                                   | \$ (11,181) | \$ (1,785) | \$ —     |
| Available-for-sale securities:                   |             |            |          |
| Beginning balance                                | \$ (317)    | \$ (352)   | \$ (355) |
| Current period other comprehensive income        | 24          | 35         | 3        |
| Ending balance                                   | \$ (293)    | \$ (317)   | \$ (352) |
| Derivative instrument:                           |             |            |          |
| Beginning balance                                | \$ —        | \$ —       | \$ (238) |
| Current period other comprehensive income        | —           | —          | 238      |
| Ending balance                                   | \$ —        | \$ —       | \$ —     |
| Accumulated other comprehensive loss, net of tax | \$ (11,474) | \$ (2,102) | \$ (352) |

### 4. SUPPLIER CONCENTRATION

We have four key suppliers of HVAC/R equipment products. Purchases from these four suppliers comprised 73%, 72% and 71% of all purchases made in 2013, 2012 and 2011, respectively. Our largest supplier, Carrier and its affiliates, accounted for 59%, 57% and 54% of all purchases made in 2013, 2012 and 2011, respectively. See Note 15. Any significant interruption by Carrier or the other key suppliers in the delivery of products could impair our ability to maintain current inventory levels or a termination of a distribution agreement could disrupt the operations of certain subsidiaries and could materially impact our consolidated results of operations and consolidated financial position.

### 5. PROPERTY AND EQUIPMENT

Property and equipment, net, consists of:

| December 31,                              | 2013      | 2012      |
|-------------------------------------------|-----------|-----------|
| Land                                      | \$ 1,131  | \$ 1,131  |
| Buildings and improvements                | 49,942    | 48,457    |
| Machinery, vehicles and equipment         | 64,012    | 57,130    |
| Furniture and fixtures                    | 20,523    | 18,251    |
|                                           | 135,608   | 124,969   |
| Accumulated depreciation and amortization | (90,190)  | (82,127)  |
|                                           | \$ 45,418 | \$ 42,842 |

Depreciation and amortization expense related to property and equipment included in selling, general and administrative expenses for the years ended December 31, 2013, 2012 and 2011, was \$11,677, \$10,986 and \$9,364, respectively.

### 6. DEBT

We maintain an unsecured, syndicated revolving credit agreement that provides for borrowings of up to \$500,000. Borrowings are used to fund seasonal working capital needs and for other general corporate purposes, including acquisitions, dividends, stock repurchases and issuances of letters of credit. Included in the facility are a \$65,000 swingline subfacility, a \$50,000 letter of credit subfacility and a \$75,000 multicurrency borrowing sublimit.

On July 1, 2013, we entered into an amendment to the revolving credit agreement, which extended the maturity date from April 27, 2017 to July 1, 2018, reduced pricing, improved covenant flexibility to accommodate the seasonal nature of our working capital requirements and modified certain definitions. Borrowings under the amended credit facility bear interest at either LIBOR-based rates plus a spread, which ranges from 87.5 to 250.0 basis-points (LIBOR plus 125.0 basis-points at December 31, 2013), depending upon our ratio of total debt to EBITDA, or on rates based on the higher of the Prime rate or the Federal Funds Rate, in each case plus a spread which ranges from 0 to 150.0 basis-points (25.0 basis-points at December 31, 2013), depending upon 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 35.0 basis-points (17.5 basis-points at December 31, 2013).

At December 31, 2013 and 2012, \$230,044 and \$316,182 was outstanding under the revolving credit agreement, respectively. The revolving credit agreement contains customary affirmative and negative covenants, including financial covenants with respect to consolidated leverage and interest coverage ratios, and other customary restrictions. We believe we were in compliance with all covenants at December 31, 2013.



## 7. INCOME TAXES

The components of income tax expense from our wholly-owned operations and investments and our controlling interest in joint ventures with Carrier are as follows:

| Years Ended December 31, | 2013      | 2012      | 2011      |
|--------------------------|-----------|-----------|-----------|
| U.S. Federal             | \$ 62,616 | \$ 50,919 | \$ 50,197 |
| State                    | 9,234     | 6,245     | 6,338     |
| Foreign                  | 5,810     | 5,478     | 315       |
|                          | \$ 77,660 | \$ 62,642 | \$ 56,850 |
| Current                  | \$ 69,071 | \$ 55,918 | \$ 48,540 |
| Deferred                 | 8,589     | 6,724     | 8,310     |
|                          | \$ 77,660 | \$ 62,642 | \$ 56,850 |

We calculate our income tax expense and our effective tax rate for 100% of income attributable to our wholly-owned operations and investments and for our controlling interest of income attributable to our joint ventures with Carrier, which are taxed as partnerships for income tax purposes.

Following is a reconciliation of the effective income tax rate:

| Years Ended December 31,                               | 2013  | 2012  | 2011  |
|--------------------------------------------------------|-------|-------|-------|
| U.S. federal statutory rate                            | 35.0% | 35.0% | 35.0% |
| State income taxes, net of federal benefit and other   | 3.3   | 2.5   | 3.1   |
| Tax effects on foreign income                          | (1.3) | (0.8) | (0.1) |
| Effective income tax rate attributable to Watsco, Inc. | 37.0  | 36.7  | 38.0  |
| Taxes attributable to noncontrolling interest          | (7.7) | (8.3) | (8.8) |
| Effective income tax rate                              | 29.3% | 28.4% | 29.2% |

The following is a summary of the significant components of our current and long-term deferred tax assets and liabilities:

| December 31,                                       | 2013        | 2012        |
|----------------------------------------------------|-------------|-------------|
| Current deferred tax assets:                       |             |             |
| Capitalized inventory costs and inventory reserves | \$ 2,883    | \$ 2,386    |
| Self-insurance reserves                            | 1,093       | 1,039       |
| Allowance for doubtful accounts                    | 882         | 1,084       |
| Other current deferred tax assets                  | 1,539       | 1,215       |
| Total current deferred tax assets (1)              | 6,397       | 5,724       |
| Long-term deferred tax assets:                     |             |             |
| Share-based compensation                           | 17,455      | 13,911      |
| Other long-term deferred tax assets                | 909         | 797         |
| Net operating loss carryforwards                   | 283         | 609         |
|                                                    | 18,647      | 15,317      |
| Valuation allowance                                | (75)        | (391)       |
| Total long-term deferred tax assets (2)            | 18,572      | 14,926      |
| Current deferred tax liabilities:                  |             |             |
| Other current deferred tax liabilities             | (1,304)     | (36)        |
| Total current deferred tax liabilities (1)         | (1,304)     | (36)        |
| Long-term deferred tax liabilities:                |             |             |
| Deductible goodwill                                | (76,519)    | (66,636)    |
| Depreciation                                       | (2,873)     | (3,100)     |
| Other long-term deferred tax liabilities           | (2,556)     | (1,322)     |
| Total long-term deferred tax liabilities (2)       | (81,948)    | (71,058)    |
| Net deferred tax liabilities                       | \$ (58,283) | \$ (50,444) |

(1) Current deferred tax assets and liabilities have been included in the consolidated balance sheets in other current assets.

(2) Long-term deferred tax assets and liabilities have been included in the consolidated balance sheets in deferred income taxes and other liabilities.

Amounts earned by foreign subsidiaries are generally subject to United States income taxation upon repatriation. United States income taxes have not been provided on undistributed earnings of our foreign subsidiaries. The cumulative undistributed earnings related to foreign operations were approximately \$55,000 at December 31, 2013. It is not practicable to estimate the amount of tax that might be payable. Our intention is to reinvest these earnings permanently or to repatriate the earnings only when it is tax effective to do so.

Management has determined that \$75 and \$391 of valuation allowance was necessary at December 31, 2013 and 2012, respectively, to reduce the deferred tax assets to the amount that will more likely than not be realized. At December 31, 2013, there were state and other net operating loss carryforwards of \$7,117, which expire in varying amounts from 2014 through 2026. These amounts are available to offset future taxable income. There were no federal net operating loss carryforwards at December 31, 2013.

We are subject to United States federal income tax, income tax of multiple state jurisdictions and foreign income tax. We are subject to tax audits in the various jurisdictions until the respective statutes of limitations expire. We are no longer subject to United States federal tax examinations for tax years prior to 2010. For the majority of states, we are no longer subject to tax examinations for tax years prior to 2009.

As of December 31, 2013 and 2012, the total amount of gross unrecognized tax benefits (excluding the federal benefit received from state positions) was \$3,135 and \$2,474, respectively. Of these totals,

\$2,038 and \$1,609, respectively, (net of the federal benefit received from state positions) represent the amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate. Our continuing practice is to recognize penalties within selling, general and administrative expenses and interest related to income tax matters in income tax expense in the consolidated statements of income. As of December 31, 2013 and 2012, the cumulative amount of estimated accrued interest and penalties resulting from such unrecognized tax benefits was \$630 and \$583, respectively, and is included in deferred income taxes and other liabilities in the accompanying consolidated balance sheets.

The changes in gross unrecognized tax benefits are as follows:

|                                                              |           |              |
|--------------------------------------------------------------|-----------|--------------|
| Balance at December 31, 2010                                 | \$        | 1,889        |
| Additions based on tax positions related to the current year |           | 542          |
| Reductions due to lapse of applicable statute of limitations |           | (7)          |
| <b>Balance at December 31, 2011</b>                          |           | <b>2,424</b> |
| Additions based on tax positions related to the current year |           | 416          |
| Reductions due to lapse of applicable statute of limitations |           | (366)        |
| <b>Balance at December 31, 2012</b>                          |           | <b>2,474</b> |
| Additions based on tax positions related to the current year |           | 673          |
| Reductions due to lapse of applicable statute of limitations |           | (12)         |
| <b>Balance at December 31, 2013</b>                          | <b>\$</b> | <b>3,135</b> |

## 8. SHARE-BASED COMPENSATION AND BENEFIT PLANS

### Share-Based Compensation Plan

The 2001 Incentive Compensation Plan (the "2001 Plan") provides for the award of a broad variety of share-based compensation alternatives such as non-vested (restricted) stock, non-qualified stock options, incentive stock options, performance awards, dividend equivalents, deferred stock and stock appreciation rights at no less than 100% of the market price on the date the award is granted. To date, awards under the 2001 Plan consist of non-qualified stock options and non-vested (restricted) stock. Under the 2001 Plan, we may grant awards for an aggregate of 4,000,000 shares of Common and Class B common stock. A total of 1,987,912 shares of Common stock, net of cancellations, and 1,752,642 shares of Class B common stock, net of cancellations, had been awarded under the 2001 Plan as of December 31, 2013. As of December 31, 2013, 259,446 shares of common stock were reserved for future grants under the 2001 Plan. Options under the 2001 Plan vest over two to four years of service and have contractual terms of five years. Awards of non-vested (restricted) stock, which are granted at no cost to the employee, vest upon attainment of a certain age, generally the employee's respective retirement age. Vesting may be accelerated in certain circumstances prior to the original vesting date.

The following is a summary of stock option activity under the 2001 Plan as of and for the year ended December 31, 2013:

|                                                 | Options        | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term (in years) | Aggregate Intrinsic Value |
|-------------------------------------------------|----------------|---------------------------------|--------------------------------------------------------|---------------------------|
| Options outstanding at December 31, 2012        | 324,150        | \$ 56.21                        |                                                        |                           |
| Granted                                         | 30,000         | 82.32                           |                                                        |                           |
| Exercised                                       | (79,450)       | 34.65                           |                                                        |                           |
| Forfeited                                       | (7,000)        | 65.31                           |                                                        |                           |
| Expired                                         | —              | —                               |                                                        |                           |
| <b>Options outstanding at December 31, 2013</b> | <b>267,700</b> | <b>\$ 65.30</b>                 | <b>2.65</b>                                            | <b>\$ 8,234</b>           |
| <b>Options exercisable at December 31, 2013</b> | <b>50,784</b>  | <b>\$ 60.13</b>                 | <b>2.12</b>                                            | <b>\$ 1,824</b>           |

The following is a summary of non-vested (restricted) stock activity as of and for the year ended December 31, 2013:

|                                                                       | Shares           | Weighted-Average Grant Date Fair Value |
|-----------------------------------------------------------------------|------------------|----------------------------------------|
| Non-vested (restricted) stock outstanding at December 31, 2012        | 2,373,249        | \$ 38.75                               |
| Granted                                                               | 124,043          | 80.21                                  |
| Forfeited                                                             | (10,000)         | 68.36                                  |
| <b>Non-vested (restricted) stock outstanding at December 31, 2013</b> | <b>2,487,292</b> | <b>\$ 40.70</b>                        |

The weighted-average grant date fair value of non-vested (restricted) stock granted during 2013, 2012 and 2011 was \$80.21, \$69.66 and \$63.87, respectively. The fair value of non-vested stock that vested during 2011 was \$672. No non-vested (restricted) stock vested during 2013 or 2012.

During 2011, 2,527 shares of Common stock with an aggregate fair market value of \$180 were withheld as payment in lieu of cash to satisfy tax withholding obligations in connection with the vesting of non-vested (restricted) stock.

### Share-Based Compensation Fair Value Assumptions

The fair value of each stock option award is estimated on the date of grant using the Black-Scholes option pricing valuation model based on the weighted-average assumptions noted in the table below. The fair value of each stock option award, which is subject to graded vesting, is expensed, net of estimated forfeitures, on a straight-line basis over the requisite service period for each separately vesting portion of the stock option. We use historical data to estimate stock option forfeitures. The expected term of stock option awards granted represents the period of time that stock option awards granted are expected to be outstanding and was calculated using the simplified method for plain vanilla options, which we believe provides a reasonable estimate of expected life based on our historical data. The risk-free rate for periods within the contractual life of the stock option award is based on the yield curve of a zero-coupon United States Treasury bond on the date the stock option award is granted with a maturity equal to the expected term of the stock option award. Expected volatility is based on historical volatility of our stock.

The following table presents the weighted-average assumptions used for stock options granted:

| Years Ended December 31, | 2013    | 2012    | 2011    |
|--------------------------|---------|---------|---------|
| Expected term in years   | 4.25    | 4.25    | 4.25    |
| Risk-free interest rate  | 0.82%   | 0.57%   | 1.12%   |
| Expected volatility      | 24.56%  | 31.40%  | 32.59%  |
| Expected dividend yield  | 2.20%   | 3.49%   | 3.48%   |
| Grant date fair value    | \$13.33 | \$12.90 | \$12.31 |

#### Exercise of Stock Options

The total intrinsic value of stock options exercised during 2013, 2012 and 2011 was \$2,753, \$5,641 and \$4,724, respectively. Cash received from Common stock issued as a result of stock options exercised during 2013, 2012 and 2011 was \$1,554, \$3,790 and \$4,530, respectively. During 2013 and 2012, 4,749 shares of Common stock with an aggregate fair market value of \$450 and 29,987 shares of Common stock with an aggregate fair market value of \$2,229, respectively, were withheld as payment in lieu of cash for stock option exercises and related tax withholdings. During 2013 and 2011, 13,227 shares of common stock with an aggregate fair market value of \$1,227 and 7,616 shares of Common stock with an aggregate fair market value of \$437, respectively, were delivered as payment in lieu of cash for stock option exercises and related tax withholdings. These shares were retired upon delivery. In connection with stock option exercises, the tax benefits realized from share-based compensation plans totaled \$1,557, \$1,245 and \$916, for the years ended December 31, 2013, 2012 and 2011, respectively.

#### Share-Based Compensation Expense

The following table provides information on share-based compensation expense:

| Years Ended December 31,         | 2013     | 2012     | 2011     |
|----------------------------------|----------|----------|----------|
| Stock options                    | \$ 884   | \$ 846   | \$ 612   |
| Non-vested (restricted) stock    | 9,083    | 7,093    | 6,051    |
| Share-based compensation expense | \$ 9,967 | \$ 7,939 | \$ 6,663 |

At December 31, 2013, there was \$848 of unrecognized pre-tax compensation expense related to stock options granted under the 2001 Plan, which is expected to be recognized over a weighted-average period of approximately 1.6 years. The total fair value of stock options that vested during 2013, 2012 and 2011 was \$822, \$315 and \$475, respectively.

At December 31, 2013, there was \$72,870 of unrecognized pre-tax compensation expense related to non-vested (restricted) stock, which is expected to be recognized over a weighted-average period of approximately 9.7 years, of which, approximately \$53,000 is related to awards granted to our Chief Executive Officer, which vest in approximately nine years upon his attainment of age 82. In the event that vesting is accelerated for any circumstance, as defined in the related agreements, the remaining unrecognized share-based compensation expense would be immediately recognized as a charge to earnings with a corresponding tax benefit. At December 31, 2013, we were obligated to issue 177,025 shares of non-vested (restricted) stock in connection with incentive compensation agreements.

#### Employee Stock Purchase Plan

The Watsco, Inc. Fourth Amended and Restated 1996 Qualified Employee Stock Purchase Plan (the "ESPP") provides for up to 1,500,000 shares of Common stock to be available for purchase by our full-time employees with at least 90 days of service. The plan allows participating employees to purchase shares of Common stock with a discount of 5% of the fair market value at specified times. During 2013, 2012 and 2011, employees purchased 5,844, 6,753 and 8,520 shares of Common stock at an average price of \$79.46, \$68.76 and \$59.44 per share, respectively. Cash dividends received by the ESPP were reinvested in Common stock and resulted in the issuance of 1,899, 15,411 and 5,097 additional shares during 2013, 2012 and 2011, respectively. We received net proceeds of \$631, \$1,522 and \$829,

respectively, during 2013, 2012 and 2011, for shares of our Common stock issued under the ESPP. At December 31, 2013, 525,152 shares remained available for purchase under the ESPP.

#### 401(k) Plan

We have a profit sharing retirement plan for our employees that is qualified under Section 401(k) of the Internal Revenue Code. Annual matching contributions are made based on a percentage of eligible employee compensation deferrals. The contribution has historically been made with the issuance of Common stock to the plan on behalf of our employees. For the years ended December 31, 2013, 2012 and 2011, we issued 22,551, 26,991 and 27,240 shares of Common stock to the plan representing the Common stock discretionary matching contribution of \$1,689, \$1,772 and \$1,718, respectively.

## 9. ACQUISITIONS

### Carrier Enterprise I

Carrier Enterprise, LLC ("Carrier Enterprise I") is a joint venture formed on July 1, 2009 with Carrier that operates a network of locations primarily throughout the Sun Belt. From its inception until July 2, 2012, we owned 60% of the joint venture and Carrier owned 40%. We had an option to purchase an additional 10% ownership interest in Carrier Enterprise I, which became exercisable on July 1, 2012. On July 2, 2012, we exercised this option and acquired an additional 10% ownership interest in Carrier Enterprise I for cash consideration of \$51,881. We have a second option to purchase an additional 10% interest in Carrier Enterprise I, which becomes exercisable beginning on July 1, 2014.

### Carrier Enterprise II

On April 29, 2011, we formed a second joint venture with Carrier to distribute Carrier, Bryant and Payne branded residential, light-commercial and applied-commercial HVAC products and related parts and supplies in the northeast U.S. Carrier contributed 28 of its company-operated northeastern locations to the newly formed joint venture and we contributed 14 of our northeast locations. We purchased a 60% controlling interest in the joint venture for a fair value of \$49,229. Total consideration paid by us for our 60% controlling interest in the joint venture was composed of cash consideration of \$34,460 and our contribution of 14 northeastern locations valued at \$14,769.

The purchase price resulted in the recognition of \$32,957 in goodwill and intangibles. The fair value of the identified intangible assets was \$20,600 and consisted of \$13,400 in trade names and distribution rights and \$7,200 in customer relationships to be amortized over a 12 year period. The tax basis of the acquired goodwill recognized is deductible for income tax purposes over 15 years.

The purchase price allocation is based upon a purchase price of \$49,229, which represents the fair value of our 60% controlling interest in the joint venture. The table below presents the allocation of the total consideration to tangible and intangible assets acquired, liabilities assumed and the noncontrolling interest from the acquisition of our 60% controlling interest in the joint venture based on the respective fair values as of April 29, 2011:

|                                       |           |
|---------------------------------------|-----------|
| Cash                                  | \$ 5      |
| Accounts receivable                   | 24,300    |
| Inventories                           | 39,003    |
| Other current assets                  | 773       |
| Property and equipment                | 4,402     |
| Goodwill                              | 12,357    |
| Intangibles                           | 20,600    |
| Other assets                          | 202       |
| Accounts payable and accrued expenses | (22,894)  |
| Noncontrolling interest               | (29,519)  |
| Total purchase price                  | \$ 49,229 |

The fair value of the noncontrolling interest was determined by applying a pro-rata value of the total invested capital adjusted for a discount for lack of control that market participants would consider when estimating the fair value of the noncontrolling interest. As a result of our contribution of 14 locations to the joint venture, \$7,708 representing 40% of the carrying value of the contributed locations was attributed to the noncontrolling interest and \$7,061 representing 40% of the difference between the fair value and carrying value of the contributed locations, was recognized as an increase to paid-in capital.

On July 29, 2011, we acquired a 60% controlling interest in Carrier's HVAC/R distribution operations in Mexico for cash consideration of \$9,000. Carrier's company-operated Mexico distribution network had revenues of approximately \$75,000 in 2010 and operated from seven locations. Products sold include Carrier's complete product line of HVAC equipment and commercial refrigeration products and supplies servicing both the residential and applied commercial markets. Collectively, the Northeast locations and the Mexico operations are referred to as "Carrier Enterprise II." Neither we nor Carrier has any options to purchase additional ownership interests in Carrier Enterprise II.

#### Carrier Enterprise III

On April 27, 2012, we completed the formation of a joint venture with UTC Canada Corporation ("UTC Canada"), an affiliate of Carrier, to distribute Carrier-manufactured HVAC products in Canada. The newly formed joint venture, Carrier Enterprise Canada, L.P. ("Carrier Enterprise III"), operates 35 locations throughout Canada. We have a 60% controlling interest in Carrier Enterprise III and Carrier has a 40% noncontrolling interest. Total consideration paid by us for our 60% controlling interest in Carrier Enterprise III comprised cash consideration of \$80,489 and the issuance to UTC Canada of 1,250,000 shares of Common stock, having a fair value of \$93,250. Neither we nor UTC Canada has any options to purchase additional ownership interests in Carrier Enterprise III.

The purchase price for Carrier Enterprise III resulted in the recognition of \$216,463 in goodwill and intangibles. The fair value of the identified intangible assets was \$151,172 and consisted of \$95,515 in trade names and distribution rights and \$55,657 in customer relationships to be amortized over a 15 year period. For Canadian income tax purposes, 75% of the tax basis of the acquired goodwill is amortized at a rate of 7% annually on a declining balance basis.

The purchase price allocation is based upon a purchase price of \$173,739, which represents the fair value of our 60% controlling interest in Carrier Enterprise III. The table below presents the allocation of the total consideration to tangible and intangible assets acquired, liabilities assumed and the noncontrolling interest from the acquisition of our 60% controlling interest in Carrier Enterprise III based on the respective fair values as of April 27, 2012:

|                                       |                   |
|---------------------------------------|-------------------|
| Cash                                  | \$ 10             |
| Accounts receivable                   | 46,718            |
| Inventories                           | 55,024            |
| Other current assets                  | 481               |
| Property and equipment                | 2,517             |
| Goodwill                              | 65,291            |
| Intangible assets                     | 151,172           |
| Other assets                          | 978               |
| Accounts payable and accrued expenses | (44,208)          |
| Noncontrolling interest               | (104,244)         |
| <b>Total purchase price</b>           | <b>\$ 173,739</b> |

The fair value of the noncontrolling interest was determined by applying a pro-rata value of the total invested capital adjusted for a discount for lack of control that market participants would consider when estimating the fair value of the noncontrolling interest.

The unaudited pro forma financial information, combining our results of operations with the operations of Carrier Enterprise II and Carrier Enterprise III as if the joint ventures had been formed on January 1, 2011, is as follows:

| Years Ended December 31,                                       | 2012         | 2011         |
|----------------------------------------------------------------|--------------|--------------|
| Revenues                                                       | \$ 3,526,621 | \$ 3,404,381 |
| Net income                                                     | 156,728      | 159,147      |
| Less: net income attributable to noncontrolling interest       | 54,153       | 60,380       |
| Net income attributable to Watsco, Inc.                        | \$ 102,575   | \$ 98,767    |
| Diluted earnings per share for Common and Class B common stock | \$ 2.64      | \$ 2.89      |

The foregoing unaudited pro forma financial information is presented for informational purposes only. The unaudited pro forma financial information from the beginning of the periods presented until the respective acquisition dates of the above-described Canadian, Northeast United States and Mexican operations includes adjustments to record income taxes related to our portion of Carrier Enterprise II and Carrier Enterprise III's income, amortization related to identified intangible assets with finite lives and interest expense on borrowings incurred to acquire our 60% controlling interests. This unaudited pro forma financial information does not include adjustments to add or remove certain corporate expenses of Carrier Enterprise II and Carrier Enterprise III, which may or may not be incurred in future periods, or adjustments for depreciation or synergies that may be realized subsequent to the acquisition dates. This unaudited pro forma financial information does not necessarily reflect our future results of operations or what the results of operations would have been had we acquired our 60% controlling interest in and operated Carrier Enterprise II and Carrier Enterprise III as of the beginning of the periods presented.

The results of operations of these acquired locations have been included in the consolidated financial statements from their respective dates of acquisition.

#### Transaction costs

Approximately \$1,200 of transaction costs is included in selling, general and administrative expenses in our consolidated statements of income for both the years ended December 31, 2012 and 2011, primarily associated with the closing and transition of Carrier Enterprise III and Carrier Enterprise II, respectively.

#### 10. GOODWILL AND OTHER INTANGIBLE ASSETS

The changes in the carrying amount of goodwill are as follows:

|                                         |                   |
|-----------------------------------------|-------------------|
| Balance at December 31, 2011            | \$ 319,440        |
| Acquired goodwill                       | 77,829            |
| Foreign currency translation adjustment | (7)               |
| Balance at December 31, 2012            | 397,262           |
| Foreign currency translation adjustment | (4,652)           |
| <b>Balance at December 31, 2013</b>     | <b>\$ 392,610</b> |

Other intangible assets are comprised of the following:

| December 31,                                    | Estimated<br>Useful Lives | 2013       | 2012       |
|-------------------------------------------------|---------------------------|------------|------------|
| Indefinite lived intangible assets -            |                           |            |            |
| Trade names, trademarks and distribution rights |                           | \$ 138,599 | \$ 144,683 |
| Finite lived intangible assets:                 |                           |            |            |
| Customer relationships                          | 10-15 years               | 80,865     | 84,410     |
| Trade name                                      | 10 years                  | 1,150      | 1,150      |
| Non-compete agreements                          | 7 years                   | 369        | 369        |
| Accumulated amortization                        |                           | (17,140)   | (11,111)   |
| Finite lived intangible assets, net             |                           | 65,244     | 74,818     |
|                                                 |                           | \$ 203,843 | \$ 219,501 |

Amortization expense related to finite lived intangible assets included in selling, general and administrative expenses for the years ended December 31, 2013, 2012 and 2011, was \$6,029, \$4,925 and \$2,361, respectively. Amortization of finite lived intangible assets for 2014 through 2018 is expected to be approximately \$5,900 per year.

## 11. SHAREHOLDERS' EQUITY

### Common Stock

Common stock and Class B common stock share equally in earnings and are identical in most other respects except (i) Common stock is entitled to one vote on most matters and each share of Class B common stock is entitled to ten votes; (ii) shareholders of Common stock are entitled to elect 25% of the Board of Directors (rounded up to the nearest whole number) and Class B shareholders are entitled to elect the balance of the Board of Directors; (iii) cash dividends may be paid on Common stock without paying a cash dividend on Class B common stock and no cash dividend may be paid on Class B common stock unless at least an equal cash dividend is paid on Common stock and (iv) Class B common stock is convertible at any time into Common stock on a one-for-one basis at the option of the shareholder.

### Preferred Stock

We are authorized to issue preferred stock with such designation, rights and preferences as may be determined from time to time by our Board of Directors. Accordingly, the Board of Directors is empowered, without shareholder approval, to issue preferred stock with dividend, liquidation, conversion, voting or other rights which could adversely affect the voting power or other rights of the holders of our Common stock and Class B common stock and, in certain instances, could adversely affect the market price of this stock. We had no preferred stock outstanding at December 31, 2013 and 2012.

### Stock Repurchase Plan

In September 1999, our Board of Directors authorized the repurchase, at management's discretion, of up to 7,500,000 shares of common stock in the open market or via private transactions. Shares repurchased under the program are accounted for using the cost method and result in a reduction of shareholders' equity. No shares were repurchased during 2013, 2012 or 2011. In aggregate, 6,322,650 shares of Common stock and 48,263 shares of Class B common stock have been repurchased at a cost of \$114,425 since the inception of the program. At December 31, 2013, there were 1,129,087 shares remaining authorized for repurchase under the program.

## 12. FINANCIAL INSTRUMENTS

### Recorded Financial Instruments

Recorded financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable, the current portion of long-term obligations, borrowings under our revolving credit agreement and debt instruments included in other long-term obligations. At December 31, 2013 and 2012, the fair values of cash and cash equivalents, accounts receivable, accounts payable and the current portion of long-term obligations approximated their carrying values due to the short-term nature of these instruments.

The fair values of variable rate borrowings under our revolving credit agreement and debt instruments included in long-term obligations also approximate their carrying value based upon interest rates available for similar instruments with consistent terms and remaining maturities.

### Derivative Financial Instruments

We routinely use certain derivatives instruments to hedge foreign currency exposure. Although these derivatives were not designated as hedges and/or did not qualify for hedge accounting, they were effective economic hedges for the periods presented. The changes in fair value of economic hedges are recognized in earnings. During 2013 and 2012, we entered into foreign currency forward contracts to offset the earnings impact that foreign currency exchange rate fluctuations would otherwise have had on certain monetary liabilities that are denominated in nonfunctional currencies. The changes in fair value of these foreign currency forward contracts were a gain (loss) of \$315 and \$(197) for 2013 and 2012, respectively, and are included in selling, general and administrative expenses in our consolidated statements of income. The total notional value of our foreign currency exchange contracts as of December 31, 2013 was \$26,000, and such contracts have varying terms expiring through March 2014. See Note 13.

We were party to an interest rate swap agreement with a notional amount of \$10,000 that matured in October 2011 and had been designated as a cash flow hedge. The swap effectively exchanged the variable rate of 30-day LIBOR to a fixed interest rate of 5.07%. For the year ended December 31, 2011, the hedging relationship was determined to be highly effective in achieving offsetting changes in cash flows. The net change in other comprehensive loss during 2011 reflected the reclassification of \$244, net of income tax benefit of \$155, of unrealized losses from accumulated other comprehensive loss to current period earnings (recorded in interest expense, net in the consolidated statement of income).

### Off-Balance Sheet Financial Instruments

At December 31, 2013 and 2012, we were contingently liable under standby letters of credit aggregating \$2,681 and \$3,098, respectively, which are primarily used as collateral to cover any contingency related to additional risk assessments pertaining to our self-insurance programs. Additionally, at December 31, 2013 and 2012, we were contingently liable under various performance bonds aggregating approximately \$800 and \$300, respectively, which are used as collateral to cover any contingencies related to our nonperformance under agreements with certain customers. We do not expect that any material losses or obligation will result from the issuance of the standby letters of credit or performance bonds because we expect to meet our obligations under our self-insurance programs and to certain customers in the ordinary course of business. Accordingly, the estimated fair value of these instruments is zero.

### Concentrations of Credit Risk

Financial instruments which potentially subject us to concentrations of credit risk consist principally of accounts receivable. Concentrations of credit risk are limited due to the large number of customers comprising the customer base and their dispersion across many different geographical regions. We also have access to credit insurance programs which are used as an additional means to mitigate credit risk.



### 13. 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 December 31, 2013 Using |         |         |
|----------------------------------|------------------------------------------------|-------|----------------------------------------------------|---------|---------|
|                                  |                                                |       | Level 1                                            | Level 2 | Level 3 |
| <b>Assets:</b>                   |                                                |       |                                                    |         |         |
| Available-for-sale securities    | Other assets                                   | \$265 | \$265                                              | —       | —       |
| Derivative financial instruments | Other current assets                           | \$118 | —                                                  | \$118   | —       |
| <b>Liabilities:</b>              |                                                |       |                                                    |         |         |
| Derivative financial instruments | Accrued expenses and other current liabilities | \$197 | —                                                  | \$197   | —       |

|                                  | Balance Sheet Location                         | Total | Fair Value Measurements at December 31, 2012 Using |         |         |
|----------------------------------|------------------------------------------------|-------|----------------------------------------------------|---------|---------|
|                                  |                                                |       | Level 1                                            | Level 2 | Level 3 |
| <b>Assets:</b>                   |                                                |       |                                                    |         |         |
| Available-for-sale securities    | Other assets                                   | \$226 | \$226                                              | —       | —       |
| <b>Liabilities:</b>              |                                                |       |                                                    |         |         |
| Derivative financial instruments | Accrued expenses and other current liabilities | \$197 | —                                                  | \$197   | —       |

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

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

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

There were no transfers in or out of Level 1 and Level 2 during 2013 or 2012.

### 14. 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 \$5,582 and \$4,844 at December 31, 2013 and 2012, respectively, were established related to such programs and are included in accrued expenses and other current liabilities in our consolidated balance sheets.

#### Variable Interest Entity

As of December 31, 2013, in conjunction with our casualty insurance programs, limited equity interests are held in a captive insurance entity. The programs permit us to self-insure a portion of losses, to gain access to a wide array of safety-related services, to pool insurance risks and resources in order to obtain more competitive pricing for administration and reinsurance and to limit risk of loss in any particular year. The entity meets the definition of Variable Interest Entity (“VIE”); however, we do not meet the requirements to include this entity in the consolidated financial statements. The maximum exposure to loss related to our involvement with this entity is limited to approximately \$4,400. See “Self-Insurance” above for further information on commitments associated with the insurance programs and Note 12, under the caption “Off-Balance Sheet Financial Instruments,” for further information on standby letters of credit. At December 31, 2013, there were no other entities that met the definition of a VIE.

#### Operating Leases

We are obligated under various non-cancelable operating lease agreements for real property, equipment, vehicles and a corporate aircraft used in our operations with varying terms through 2023. We are committed to pay a portion of the actual operating expenses under certain of these lease agreements. These operating expenses are not included in the table below. Some of these arrangements have free or escalating rent payment provisions. We recognize rent expense under such arrangements on a straight-line basis over the lease term.

At December 31, 2013, future minimum payments under non-cancelable operating leases over each of the next five years and thereafter were as follows:

|                               |                   |
|-------------------------------|-------------------|
| 2014                          | \$ 64,967         |
| 2015                          | 54,508            |
| 2016                          | 43,322            |
| 2017                          | 28,356            |
| 2018                          | 14,006            |
| Thereafter                    | 8,388             |
| <b>Total minimum payments</b> | <b>\$ 213,547</b> |

Rental expense for the years ended December 31, 2013, 2012 and 2011, was \$79,585, \$76,547 and \$70,933, respectively.

#### Purchase Obligations

At December 31, 2013, we were obligated under various non-cancelable purchase orders for goods aggregating approximately \$7,500, of which Carrier and its affiliates accounted for approximately \$5,600.

### 15. RELATED PARTY TRANSACTIONS

Purchases from Carrier and its affiliates comprised 59%, 57% and 54% of all inventory purchases made during 2013, 2012 and 2011, respectively. At December 31, 2013 and 2012, approximately \$53,000 and \$62,000, 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 consolidated statements of income for 2013, 2012 and 2011 include \$30,819, \$32,961 and \$23,710, respectively, of sales to Carrier and its affiliates. We believe these transactions are conducted at arm’s-length in the ordinary course of business.

Carrier Enterprise II entered into Transactional Services Agreements (“TSAs”) with Carrier, pursuant to which Carrier performed certain business processes on its behalf, including processes involving the use of certain information technologies. The services provided by Carrier pursuant to the TSAs terminated on April 30, 2012. The fees related to these TSAs were \$1,798 and \$1,139, respectively, for 2012 and 2011, and are included in selling, general and administrative expenses in our consolidated statements of income. At December 31, 2012, \$25 related to these TSAs was payable to Carrier and was included in

accrued expenses and other current liabilities in our consolidated balance sheet. Amounts outstanding were repaid in 2013 and no further services are required under the TSAs for Carrier Enterprise II.

Carrier Enterprise III entered into TSAs with UTC Canada, pursuant to which UTC Canada performed certain business processes on behalf of Carrier Enterprise III, including processes involving the use of certain information technologies, and UTC Canada entered into TSAs with Carrier Enterprise III, pursuant to which Carrier Enterprise III performed certain business processes on behalf of UTC Canada. The services provided pursuant to the TSAs terminated on December 31, 2012. The fees payable by Carrier Enterprise III to UTC Canada under one TSA were substantially offset by the fees payable to Carrier Enterprise III by UTC Canada under the other TSA.

At December 31, 2012, \$29,637 was payable to Carrier and UTC Canada for unpaid distributions declared to the noncontrolling interest. This amount was paid to Carrier and UTC Canada in February 2013. No amounts were outstanding at December 31, 2013.

#### 16. INFORMATION ABOUT GEOGRAPHIC AREAS

Our operations are primarily within the United States and Puerto Rico. Products are sold on an export-only basis to portions of Latin America and the Caribbean Basin. The following tables set forth revenues and long-lived assets by geographical area:

| Years Ended December 31, | 2013                | 2012                | 2011                |
|--------------------------|---------------------|---------------------|---------------------|
| <b>Revenues:</b>         |                     |                     |                     |
| United States            | \$ 3,325,114        | \$ 3,087,256        | \$ 2,938,907        |
| Canada                   | 318,165             | 240,254             | —                   |
| Mexico                   | 100,051             | 104,202             | 38,852              |
| <b>Total Revenues</b>    | <b>\$ 3,743,330</b> | <b>\$ 3,431,712</b> | <b>\$ 2,977,759</b> |

| December 31,                   | 2013              | 2012              |
|--------------------------------|-------------------|-------------------|
| <b>Long Lived Assets:</b>      |                   |                   |
| United States                  | \$ 429,202        | \$ 429,153        |
| Canada                         | 207,340           | 225,076           |
| Mexico                         | 5,329             | 5,376             |
| <b>Total Long-Lived Assets</b> | <b>\$ 641,871</b> | <b>\$ 659,605</b> |

Revenues are attributed to countries based on the location of the store from which the sale occurred. Long-lived assets consist of property and equipment, goodwill and intangible assets.

#### 17. SUPPLEMENTAL CASH FLOW INFORMATION

Supplemental cash flow information was as follows:

| Years Ended December 31,                                     | 2013      | 2012      | 2011      |
|--------------------------------------------------------------|-----------|-----------|-----------|
| Interest paid                                                | \$ 5,334  | \$ 2,802  | \$ 1,854  |
| Income taxes net of refunds                                  | \$ 73,168 | \$ 46,819 | \$ 45,137 |
| Common stock issued for Carrier Enterprise III               | \$ —      | \$ 93,250 | \$ —      |
| Net assets of locations contributed to Carrier Enterprise II | \$ —      | \$ —      | \$ 14,769 |

#### SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

| (In thousands, except per share data)                          | 1st<br>Quarter | 2nd<br>Quarter | 3rd<br>Quarter | 4th<br>Quarter | Total        |
|----------------------------------------------------------------|----------------|----------------|----------------|----------------|--------------|
| <b>Year Ended December 31, 2013</b>                            |                |                |                |                |              |
| Revenues (1)                                                   | \$ 713,633     | \$ 1,120,452   | \$ 1,081,893   | \$ 827,352     | \$ 3,743,330 |
| Gross profit                                                   | 175,446        | 266,680        | 258,597        | 198,530        | 899,253      |
| Net income attributable to Watsco, Inc.                        | \$ 13,385      | \$ 51,318      | \$ 45,699      | \$ 17,321      | \$ 127,723   |
| Earnings per share for Common and Class B common stock (2):    |                |                |                |                |              |
| Basic                                                          | \$ 0.39        | \$ 1.48        | \$ 1.32        | \$ 0.50        | \$ 3.69      |
| Diluted                                                        | \$ 0.39        | \$ 1.48        | \$ 1.32        | \$ 0.50        | \$ 3.68      |
| <b>Year Ended December 31, 2012</b>                            |                |                |                |                |              |
| Revenues (1)                                                   | \$ 633,512     | \$ 1,011,801   | \$ 1,020,859   | \$ 765,540     | \$ 3,431,712 |
| Gross profit                                                   | 150,622        | 238,475        | 242,505        | 182,793        | 814,395      |
| Net income attributable to Watsco, Inc.                        | \$ 8,466       | \$ 39,103      | \$ 41,005      | \$ 14,760      | \$ 103,334   |
| Earnings per share for Common and Class B common stock (2)(3): |                |                |                |                |              |
| Basic                                                          | \$ 0.23        | \$ 1.15        | \$ 1.19        | \$ 0.04        | \$ 2.70      |
| Diluted                                                        | \$ 0.23        | \$ 1.15        | \$ 1.19        | \$ 0.04        | \$ 2.70      |

(1) Sales of residential central air conditioners, heating equipment and parts and supplies are seasonal. 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 sectors throughout most of the markets is fairly consistent during the year, except for dependence on housing completions and related weather and economic conditions.

(2) Quarterly and year-to-date earnings per share are calculated on an individual basis; therefore, the sum of earnings per share amounts for the quarters may not equal earnings per share amounts for the year.

(3) On October 31, 2012, we paid a special dividend of \$5.00 per share of Common and Class B common stock that resulted in a \$0.37 per share and \$0.33 per share reduction in diluted earnings per share for the quarter and year ended December 31, 2012, respectively.

#### INFORMATION ON COMMON STOCK (UNAUDITED)

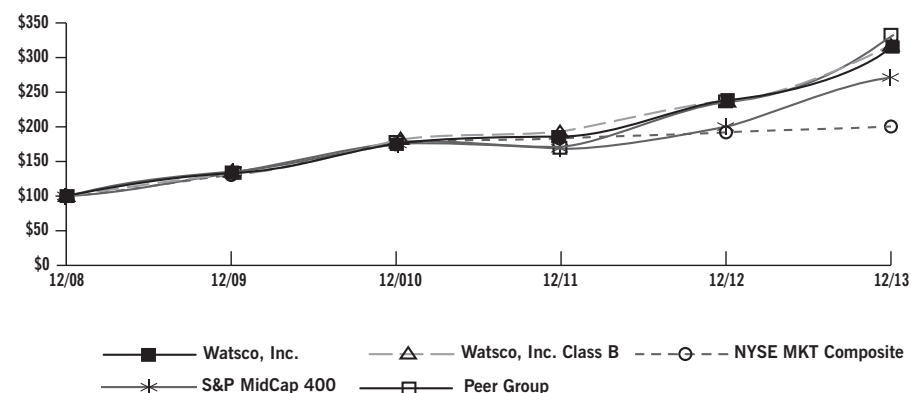
Our Common stock is traded on the New York Stock Exchange (“NYSE”) and the Professional Segment of NYSE Euronext in Paris under the ticker symbol WSO. Effective February 1, 2013, the listing of our Class B common stock transferred from the NYSE MKT to the NYSE, on which it trades under the ticker symbol WSOB. The following table presents the high and low prices of our Common stock and Class B common stock, as reported by the NYSE, and, with respect to our Class B common stock for the year ended December 31, 2012, the NYSE MKT. Also presented below are dividends paid per share for each quarter during the years ended December 31, 2013 and 2012. At February 21, 2014, there were 243 Common stock registered shareholders and 96 Class B common stock registered shareholders.

|                                      | Common   |          | Class B Common |          | Cash Dividend |         |
|--------------------------------------|----------|----------|----------------|----------|---------------|---------|
|                                      | High     | Low      | High           | Low      | Common        | Class B |
| <b>Year Ended December 31, 2013:</b> |          |          |                |          |               |         |
| First quarter                        | \$ 84.25 | \$ 74.13 | \$ 84.38       | \$ 74.50 | \$ 0.25       | \$ 0.25 |
| Second quarter                       | 89.16    | 77.72    | 89.48          | 78.19    | 0.25          | 0.25    |
| Third quarter                        | 95.39    | 85.58    | 96.00          | 85.59    | 0.25          | 0.25    |
| Fourth quarter                       | 97.47    | 91.73    | 97.15          | 92.72    | 0.40          | 0.40    |
| <b>Year Ended December 31, 2012:</b> |          |          |                |          |               |         |
| First quarter                        | \$ 74.97 | \$ 66.22 | \$ 74.00       | \$ 67.00 | \$ 0.62       | \$ 0.62 |
| Second quarter                       | 74.60    | 66.39    | 74.00          | 67.50    | 0.62          | 0.62    |
| Third quarter                        | 79.22    | 66.40    | 79.00          | 66.05    | 0.62          | 0.62    |
| Fourth quarter                       | 80.12    | 67.52    | 80.00          | 67.41    | 5.62          | 5.62    |

#### SHAREHOLDER RETURN PERFORMANCE (UNAUDITED)

The following graph compares the cumulative five-year total return attained by holders of our Common stock and Class B common stock relative to the cumulative total returns of the NYSE MKT Composite index, the S&P MidCap 400 index and a customized peer group of companies, which are: Beacon Roofing Supply, Inc., Lennox International Inc., Pool Corp and WESCO International, Inc. An investment of \$100 (with reinvestment of all dividends) is assumed to have been made in our common stock, in each index and in the peer group on December 31, 2008 and its relative performance is tracked through December 31, 2013.

COMPARISON OF 5-YEAR CUMULATIVE TOTAL RETURN\*  
Among Watsco, Inc., the NYSE MKT Composite Index, the S&P MidCap 400 Index and a Peer Group



\*\$100 invested on 12/31/08 in stock or index, including reinvestment of dividends.  
Fiscal year ending December 31.

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|                      | 12/08  | 12/09  | 12/10  | 12/11  | 12/12  | 12/13  |
|----------------------|--------|--------|--------|--------|--------|--------|
| Watsco, Inc.         | 100.00 | 133.29 | 177.97 | 191.77 | 242.73 | 315.48 |
| Watsco, Inc. Class B | 100.00 | 135.26 | 180.94 | 194.48 | 241.23 | 317.00 |
| NYSE MKT Composite   | 100.00 | 135.53 | 175.07 | 179.96 | 190.69 | 200.56 |
| S&P MidCap 400       | 100.00 | 137.38 | 173.98 | 170.96 | 201.53 | 269.04 |
| Peer Group           | 100.00 | 122.44 | 168.33 | 164.20 | 237.46 | 337.01 |



## 5-YEAR SUMMARY OF SELECTED CONSOLIDATED FINANCIAL DATA

The following selected consolidated financial data should be read in conjunction with the consolidated financial statements, including the notes thereto, included under Item 8 of Part II, "Financial Statements and Supplementary Data," and the information contained in Item 7 of Part II, "Management's Discussion and Analysis of Financial Condition and Results of Operations" of this Annual Report on Form 10-K for the year ended December 31, 2013.

| (In thousands, except per share data)                                 | 2013         | 2012 (1)     | 2011         | 2010         | 2009         |
|-----------------------------------------------------------------------|--------------|--------------|--------------|--------------|--------------|
| <b>FOR THE YEAR</b>                                                   |              |              |              |              |              |
| Revenues                                                              | \$ 3,743,330 | \$ 3,431,712 | \$ 2,977,759 | \$ 2,844,595 | \$ 2,001,815 |
| Gross profit                                                          | 899,253      | 814,395      | 728,294      | 673,241      | 480,832      |
| Operating income                                                      | 271,209      | 224,908      | 199,050      | 165,572      | 81,060       |
| Net income                                                            | 187,719      | 157,601      | 137,742      | 111,722      | 51,573       |
| Less: net income attributable to noncontrolling interest              | 59,996       | 54,267       | 47,292       | 30,962       | 8,259        |
| Net income attributable to Watsco, Inc.                               | \$ 127,723   | \$ 103,334   | \$ 90,450    | \$ 80,760    | \$ 43,314    |
| <b>Diluted earnings per share for Common and Class B common stock</b> |              |              |              |              |              |
|                                                                       | \$ 3.68      | \$ 2.70      | \$ 2.74      | \$ 2.49      | \$ 1.40      |
| <b>Cash dividends declared and paid per share:</b>                    |              |              |              |              |              |
| Common stock                                                          | \$ 1.15      | \$ 7.48      | \$ 2.23      | \$ 2.04      | \$ 1.89      |
| Class B common stock                                                  | \$ 1.15      | \$ 7.48      | \$ 2.23      | \$ 2.04      | \$ 1.89      |
| <b>Weighted-average Common and Class B common shares - Diluted</b>    |              |              |              |              |              |
|                                                                       | 32,258       | 31,744       | 30,753       | 30,579       | 28,521       |
| <b>AT YEAR END</b>                                                    |              |              |              |              |              |
| Total assets                                                          | \$ 1,669,531 | \$ 1,682,055 | \$ 1,268,148 | \$ 1,237,227 | \$ 1,160,613 |
| Total long-term obligations                                           | \$ 230,557   | \$ 316,196   | \$ —         | \$ 10,016    | \$ 13,429    |
| Total shareholders' equity                                            | \$ 1,127,392 | \$ 1,022,040 | \$ 1,001,710 | \$ 928,896   | \$ 894,808   |
| Number of employees                                                   | 4,800        | 4,600        | 4,300        | 4,000        | 4,100        |

(1) On October 31, 2012, we paid a special dividend of \$5.00 per share of Common and Class B common stock that resulted in a \$0.33 per share reduction in diluted earnings per share.

## Corporate & Shareholder Information

### CORPORATE OFFICE

Watsco, Inc. 2665 South Bayshore Drive, Suite 901 Miami, FL 33133  
Telephone: (305) 714-4100, Fax: (305) 858-4492, E-mail: info@watsco.com

### EXECUTIVE OFFICERS

**Albert H. Nahmad** President & Chief Executive Officer  
**Barry S. Logan** Senior Vice President & Secretary  
**Ana M. Menendez** Chief Financial Officer & Treasurer  
**Aaron J. Nahmad** Vice President of Strategy & Innovation

### BOARD OF DIRECTORS

**Albert H. Nahmad**<sup>(3)</sup> Chairman of the Board, President and Chief Executive Officer  
**Cesar L. Alvarez**<sup>(3)</sup> Co-Chairman, Greenberg Traurig, P.A.  
**David C. Darnell** Co-Chief Operating Officer, Bank of America  
**Denise Dickins**<sup>(1)</sup> Associate Professor of Accounting and Auditing, East Carolina University  
**Steven R. Fedrizzi** President and Chief Executive Officer, U.S. Green Building Council  
**Barry S. Logan** Senior Vice President & Secretary  
**Paul F. Manley**<sup>(1,2)</sup> Retired Executive Director, Holland & Knight  
**Bob L. Moss**<sup>(1, 2, 3)</sup> President, Bob L. Moss & Associates, Inc.  
**Aaron J. Nahmad**<sup>(3)</sup> Vice President of Strategy & Innovation

(1) Audit Committee (2) Compensation Committee (3) Nominating & Strategy Committee

### STOCK INFORMATION

Common stock: New York Stock Exchange and the Professional Segment of the NYSE Euronext in Paris.  
Ticker Symbol: WSO  
Class B common stock: New York Stock Exchange. Ticker Symbol: WSOB

### TRANSFER AGENT AND REGISTRAR

For address changes, dividend checks, account consolidation, registration changes, lost stock certificates and other shareholder inquiries, please contact:

American Stock Transfer & Trust Company 59 Maiden Lane, Plaza Level, New York, NY 10038  
Toll-Free: (800) 937-5449, Internet Site: www.amstock.com

### PUBLICATIONS

Our Annual Report on Form 10-K and Quarterly Reports on Form 10-Q are available free of charge upon request to our corporate office.

### INTERNET SITES

Our website at www.watsco.com offers information about Watsco including our most recent quarterly results and news releases.

Also, visit www.acdoctor.com to get information on energy efficiency and indoor air quality, compare HVAC systems, find a licensed contractor and search for available rebates.

### INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

KPMG LLP 200 South Biscayne Boulevard, Suite 2000 Miami, FL 33131

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Strict guidelines were adhered to in the production of the paper used in this annual report, both in the forest and in the mills. In doing so, the cause for renewable forests, preservation of natural resources, wildlife protection, and pollution and energy reduction are advanced.

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