

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

**FORM 10-K**

**Annual Report Pursuant to Section 13 or 15(d) of the Securities and Exchange Act of 1934  
For the Fiscal Year Ended December 31, 2010**

**Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the Transition Period from**

**to  
Commission File Number 1-5581**



**WATSCO, INC.**

(Exact name of registrant as specified in its charter)

**FLORIDA**  
(State or other jurisdiction of  
incorporation or organization)

**59-0778222**  
(I.R.S. Employer  
Identification No.)

**2665 South Bayshore Drive, Suite 901, Miami, FL 33133**

(Address of principal executive offices, including zip code)

**(305) 714-4100**

(Registrant's telephone number, including area code)

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

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
Common stock, \$.50 par value	New York Stock Exchange and the Professional Segment of NYSE
Class B common stock, \$.50 par value	Euronext in Paris NYSE Amex

**Securities registered pursuant to section 12(g) of the Act: None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES  NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES  NO

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company

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

The aggregate market value of the registrant's voting stock (common stock) held by non-affiliates of the registrant as of June 30, 2010, the last business day of the registrant's most recently completed second fiscal quarter, was approximately \$1,445 million, based on the closing sale price of the registrant's common

stock on that date. For purposes of determining this number all executive officers and directors of the registrant as of June 30, 2010 were considered to be affiliates of the registrant. This number is provided only for the purposes of this report on Form 10-K and does not represent an admission by either the registrant or any such person as to the status of such person.

The number of shares of common stock outstanding as of February 25, 2011 was (i) 28,140,038 shares of Common stock, excluding treasury shares of 6,322,650, and (ii) 4,436,863 shares of Class B common stock, excluding treasury shares of 48,263.

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#### **DOCUMENTS INCORPORATED BY REFERENCE**

Certain information required by Parts I and II is incorporated by reference from the Registrant's 2010 Annual Report, attached hereto as Exhibit 13. The information required by Part III (Items 10, 11, 12, 13 and 14) is incorporated by reference from the Registrant's definitive proxy statement for the 2011 annual meeting of shareholders (to be filed pursuant to Regulation 14A).

[Table of Contents](#)

WATSCO, INC. AND SUBSIDIARIES

**Index to 2010 Annual Report  
on Form 10-K  
Year Ended December 31, 2010**

	<u>Page</u>
<b><a href="#">PART I</a></b>	
Item 1. <a href="#">Business</a>	3
Item 1A. <a href="#">Risk Factors</a>	8
Item 1B. <a href="#">Unresolved Staff Comments</a>	11
Item 2. <a href="#">Properties</a>	11
Item 3. <a href="#">Legal Proceedings</a>	11
Item 4. <a href="#">Removed and Reserved</a>	11
<b><a href="#">PART II</a></b>	
Item 5. <a href="#">Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</a>	11
Item 6. <a href="#">Selected Financial Data</a>	13
Item 7. <a href="#">Management’s Discussion and Analysis of Financial Condition and Results of Operations</a>	13
Item 7A. <a href="#">Quantitative and Qualitative Disclosures about Market Risk</a>	13
Item 8. <a href="#">Financial Statements and Supplementary Data</a>	13
Item 9. <a href="#">Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</a>	13
Item 9A. <a href="#">Controls and Procedures</a>	13
Item 9B. <a href="#">Other Information</a>	14
<b><a href="#">PART III</a></b>	14
<b><a href="#">PART IV</a></b>	
Item 15. <a href="#">Exhibits and Financial Statement Schedules</a>	14
<b><a href="#">SIGNATURES</a></b>	17

## PART I

### ITEM 1. BUSINESS

#### General

Watsco, Inc. and its subsidiaries (collectively, “Watsco,” or we, us or our) was incorporated 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, 2010 we operated from 505 locations in 36 states and Puerto Rico serving more than 50,000 contractors and dealers that service the replacement and new construction markets. Our revenues in HVAC/R distribution have increased from \$64 million in 1989 to \$2.8 billion in 2010 via a strategy of acquiring companies with established market positions and subsequently building revenue and profit through a combination of additional locations, products, services and other initiatives.

Our principal executive office is located at 2665 South Bayshore Drive, Suite 901, Miami, Florida 33133, and our telephone number is (305) 714-4100. Our website address on the Internet is [www.watsco.com](http://www.watsco.com) and e-mails may be sent to [info@watsco.com](mailto:info@watsco.com). The reference to our website address does not constitute incorporation by reference of the information contained on the website and should not be considered part of this report.

#### Residential Central Air Conditioning, Heating and Refrigeration Industry

The HVAC/R distribution industry is highly fragmented with more than 2,300 distribution companies. The industry is well-established, having had its primary period of growth during the post-World War II era with the advent of affordable central air conditioning and heating systems for residential applications.

Based on data published in 2010 by the Air Conditioning, Heating and Refrigeration Institute (“AHRI”) and other available data, we estimate the market for residential central air conditioning, heating and refrigeration equipment and related parts and supplies in the United States is approximately \$30 billion. Residential central air conditioners are manufactured primarily by seven major companies that together account for approximately 90% of all units shipped in the United States each year. These companies are: Carrier Corporation (“Carrier”), a subsidiary of United Technologies Corporation, Goodman Manufacturing Company, L.P. (“Goodman”), a subsidiary of Goodman Global, Inc., Rheem Manufacturing Company (“Rheem”), Trane Inc., a subsidiary of Ingersoll-Rand Company Limited, York International Corporation, a subsidiary of Johnson Controls, Inc., Lennox International, Inc. and Nordyne Corporation (“Nordyne”), a subsidiary of Nortek Corporation. These manufacturers distribute their products through a combination of factory-owned and independent distributors who, in turn, supply the equipment and related parts and supplies to contractors and dealers nationwide which sell to and install the products for consumers and other end-users.

Residential central air conditioning and heating equipment is sold to both the replacement and the new construction markets. The replacement side of the market has increased in size relative to the total market over the past several years as a result of the aging of the installed base of residential central air conditioners and furnaces, the introduction of new higher energy efficient models, the remodeling and expansion of existing homes, the addition of central air conditioning to homes that previously had only heating products and consumers’ overall unwillingness to live without air conditioning or heating products. According to industry data published by the AHRI, more than 120 million central air conditioning units and furnaces have been installed in the United States in the past 20 years. Many of these installed units have reached the end of their useful lives, thus providing a growing and stable replacement market. The mechanical life of central air conditioning and furnaces varies by geographical region due to usage and is estimated to range from 8 to 20 years.

We also sell products to the refrigeration market. These products include condensing units, compressors, evaporators, valves, refrigerant, walk-in coolers and ice machines for industrial and commercial applications. We distribute products manufactured by Copeland Compressor Corporation, a subsidiary of Emerson Electric Co. (“Emerson”), E. I. Du Pont De Nemours and Company (“DuPont”), Mueller Industries, Inc., Owens Corning Insulating Systems, LLC and The Manitowoc Company, Inc. (“Manitowoc”).

#### Business Strategy

We have a “buy and build” strategy that has produced substantial long-term growth in sales and profits. The “buy” component of the strategy focuses on acquiring existing market leaders either by expanding into new geographic areas or gaining additional market share in existing markets. We employ a disciplined and conservative approach that seeks opportunities that fit well-defined financial and strategic criteria. The “build” component of the strategy focuses on implementing a growth culture at acquired companies, by adding products and locations to better serve our customers, exchanging ideas and business concepts amongst the executive management teams and investing in new technologies. Newly acquired businesses have access to our capital resources and established vendor relationships to provide their customers with an expanded array of product lines on favorable terms and conditions with an intensified commitment to service.

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## [Table of Contents](#)

### Strategy in Existing Markets

Our strategy for growth in existing markets focuses on customer service and product expansion to satisfy the needs of the higher growth, higher margin replacement market, in which customers generally demand immediate, convenient and reliable service. We respond to this need by (i) offering a broad range of product lines, including the necessary equipment, parts and supplies to enable a contractor to install or repair a central air conditioner, furnace or refrigeration system, (ii) maintaining a strong density of warehouse locations for increased customer convenience, (iii) maintaining well-stocked inventories to ensure that customer orders are filled in a timely manner, (iv) providing a high degree of technical expertise at the point of sale and (v) developing and implementing technology to further enhance customer service capabilities. We believe these concepts provide a competitive advantage over smaller, less-capitalized competitors that are unable to commit resources to open and maintain additional locations, implement technological business solutions, provide the same range of products, maintain the same inventory levels or attract the wide range of expertise that is required to support a diverse product offering. In some geographic areas, we believe we have a competitive advantage over factory-operated distributor networks that typically do not maintain inventories of parts and supplies that are as diversified as ours and which have fewer warehouse locations than we do, which makes it more difficult for these competitors to meet the time-sensitive demands of the replacement market.

In addition to the replacement market, we sell to the new construction market. We believe our reputation for reliable, high-quality service and relationships with contractors, who may serve both the replacement and new construction markets, allow us to compete effectively in these markets.

### Acquisition Strategy

We focus on acquiring businesses that either complement our current presence in existing markets or establish a presence in new geographic markets. Since 1989, we have acquired 55 HVAC/R distribution businesses, four of which currently operate as primary operating subsidiaries. The other smaller acquired distributors have been integrated into or are under the management of our primary operating subsidiaries. We continue to pursue additional strategic acquisitions and/or joint ventures to allow further penetration in existing markets and expansion into new geographic markets.

### Product Line Expansion

We actively seek new or expanded territories of distribution from our key equipment suppliers. We currently maintain significant relationships with Carrier, Rheem, Goodman and Nordyne. We continually evaluate new parts and supply products to support equipment sales and further enhance service to our customers. This initiative includes increasing the product offering with existing vendors and identifying new product opportunities through traditional and non-traditional supply channels. We have also introduced private-label products as a means to obtain market share and grow revenues. We believe that our private-label branded products complement our existing product offerings at selected locations, based on customer needs and the particular market position and price of these products.

### Operating Philosophy

Our acquired subsidiaries operate in a manner that builds upon the long-term relationships they have established between their distributors and their customers. Typically, we seek to maintain the identity and culture of acquired businesses by retaining their historical trade-names, management teams and sales organizations and by continuing their product brand-name offerings. We believe this strategy allows us to build on the value of the acquired operations by creating additional sales opportunities while additionally providing an attractive exit strategy for the owners of companies we acquire.

We maintain a specialized functional support staff at our corporate headquarters to support our subsidiaries' strategies for growth in their respective markets. Such functional support includes specialists in finance, accounting, product procurement, treasury and working capital management, tax planning, risk management and safety. Certain general and administrative expenses are targeted for cost savings by leveraging the overall business volume and improving operating efficiencies.

### Technology

Our technology initiatives include: (i) implementation of effective point-of-sale systems that allow timely and effective customer service, including up-to-date pricing, credit checks, credit card processing and inventory availability; (ii) enabling connectivity with our suppliers and by our customers to the relevant components of our subsidiaries' business software; and (iii) developing our website, ACDocor.com, that educates consumers about energy efficient HVAC solutions and financial incentives related to the installation of energy efficient systems and connects them with high quality contractors.

## DESCRIPTION OF BUSINESS

### Products

We sell an expansive line of products and maintain a diverse mix of inventory to meet our customers' immediate needs and seek to provide products a contractor would generally require when installing or repairing a central air conditioner, furnace or refrigeration system on short notice. The cooling capacity of air conditioning units is measured in tons. One ton of cooling capacity is equivalent to 12,000 BTUs and is generally adequate to air condition approximately 500 square feet of residential space. The products we distribute consist of: (i) equipment, including residential central air conditioners ranging from 1-1/2 to 5 tons, gas, electric and oil furnaces ranging from 50,000 to 150,000 BTUs, commercial air conditioning and heating equipment and systems ranging from 1-1/2 to 25 tons, and other specialized equipment, (ii) parts, including replacement compressors, evaporator coils, motors and other component parts and (iii) supplies, including thermostats, insulation material, refrigerants, ductwork, grills, registers, sheet metal, tools, copper tubing, concrete pads, tape, adhesives and other ancillary supplies.

Sales of HVAC equipment accounted for 60% and 55% of our revenues for the years ended December 31, 2010 and 2009, respectively. Sales of other HVAC products (currently sourced from over 600 vendors) comprised 33% and 36% of our revenues for the years ended December 31, 2010 and 2009, respectively. Sales of commercial refrigeration products accounted for 7% and 9% of our revenues for the years ended December 31, 2010 and 2009, respectively.

### Distribution and Sales

At December 31, 2010, we operated from 505 locations, a vast majority of which are located in regions that we believe have favorable demographic trends. We maintain large inventories at each warehouse location and either deliver products to customers using one of our 645 trucks or by using third party logistics providers, or make products available for pick-up at the location nearest to the customer. Watsco has approximately 700 commissioned salespeople, averaging 12 years or more of experience in the HVAC/R distribution industry.

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[Table of Contents](#)

Markets

The table below identifies the number of locations by state as of December 31, 2010:

Florida	102
Texas	93
North Carolina	39
Georgia	38
California	37
South Carolina	31
Tennessee	26
Virginia	19
Louisiana	18
Mississippi	13
Alabama	8
Missouri	8
Arizona	7
Maryland	7
Puerto Rico	7
Arkansas	6
Kansas	6
Massachusetts	5
Oklahoma	5
Utah	5
Colorado	2
Iowa	2
Kentucky	2
Maine	2
Nebraska	2
Nevada	2
New York	2
South Dakota	2
Connecticut	1
Illinois	1
New Hampshire	1
New Jersey	1
New Mexico	1
North Dakota	1
Rhode Island	1
Vermont	1
West Virginia	1
TOTAL	<u>505</u>

Customers and Customer Service

We currently serve more than 50,000 contractors and dealers who service the replacement and new construction markets for residential and light commercial central air conditioning, heating and refrigeration systems. No single customer in 2010, 2009 or 2008 represented more than 1% of our consolidated revenues. We focus on providing products where and when the customer needs them, technical support by phone or on site as required, and quick and efficient service at our locations. Increased customer convenience is also provided through e-commerce, which allows customers to access information on-line 24 hours a day, seven days a week to search for desired products, verify inventory availability, obtain pricing, place orders, check order status, schedule pickup or delivery times and make payments. We believe we compete successfully with other distributors primarily on the basis of an experienced sales organization, strong service support, high quality reputation and broad product lines.

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[Table of Contents](#)

Key Suppliers

We have significant relationships with Carrier, Rheem, Goodman, Nordyne, Emerson, Manitowoc and DuPont, each of which is a leading manufacturer of HVAC/R products in the United States. Each manufacturer has a well-established reputation of producing high-quality, competitively-priced products. The manufacturers' current product offerings, quality, serviceability and brand-name recognition allow us to operate favorably relative to our competitors. To maintain brand-name recognition, the manufacturers of air conditioning and heating equipment provide national advertising and participate with us in cooperative advertising programs and promotional incentives that are targeted to both dealers and end-users. We estimate that the replacement market for air conditioning products currently accounts for approximately 85% of industry sales in the United States, and we expect this percentage to increase as units installed in the past 20 years wear out and get replaced or updated to more energy-efficient models as well as the significant decline in sales to the new construction market.

Approximately 72%, 66% and 48% of purchases in 2010, 2009 and 2008, respectively, were made from the four key HVAC/R equipment suppliers; with the largest supplier, Carrier and its affiliates, accounting for 52%, 41% and 13% of all purchases made in 2010, 2009 and 2008, respectively. A significant interruption by Carrier, or the other suppliers, in the delivery of products could impair our ability to maintain current inventory levels and could adversely affect our financial results. Future financial results are also materially dependent upon the continued market acceptance of these manufacturers' products and their ability to continue to manufacture products that comply with laws relating to environmental and efficiency standards. See "Business Risk Factors" in Item 1A.

Distribution Agreements

We have entered into distribution agreements with several of our key suppliers either on an exclusive or non-exclusive basis for terms generally ranging from one to ten years. Certain of the distribution agreements contain provisions that restrict or limit the sale of competitive products in the geographic markets served. Other than in the geographic markets where such restrictions and limitations apply, we may distribute other manufacturers' lines of air conditioning or heating equipment.

We maintain separate and distinct trade name and distribution agreements with Carrier. These agreements provide us the use of various Carrier brand names and distribution rights for certain Carrier HVAC brands and products on an exclusive basis in specified territories. The trade name and distribution agreements are not subject to a stated term or expiration date. See *Supplier Concentration* in "Business Risk Factors" in Item 1A.

Seasonality

Sales of residential central air conditioners, heating equipment and parts and supplies have historically been seasonal. See "Business Risk Factors" in Item 1A.

Competition

We operate in highly competitive environments. See "Business Risk Factors" in Item 1A.

**Employees**

We had approximately 4,000 employees as of December 31, 2010, substantially all of whom are non-union employees. Most of these employees are employed on a full-time basis, and our relations with employees are good.

**Order Backlog**

Order backlog is not a material aspect of the business and no material portion of the business is subject to government contracts.

**Government Regulations, Environmental and Health and Safety Matters**

Our business is subject to federal, state and local laws and regulations relating to the storage, handling, transportation and release of hazardous materials into the environment. These laws and regulations include the Clean Air Act, relating to minimum energy efficiency standards of HVAC systems and the production, servicing and disposal of certain ozone-depleting refrigerants used in such systems, including those established at the Montreal Protocol in 1992 concerning the phase-out of the production of CFC-based refrigerants on January 1, 2010 for use in new equipment. We are also subject to regulations concerning the transport of hazardous materials, including regulations adopted pursuant to the Motor Carrier Safety Act of 1990. Our operations are also subject to health and safety requirements including the Occupational, Safety and Health Act. We believe that the business is operated in compliance with all applicable federal, state and local provisions relating to the protection of the environment, transport of hazardous materials and health and safety requirements. In addition, we could be affected by future laws or regulations imposed in response to concerns over climate change.



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[Table of Contents](#)

**Non-U.S. Operations**

All of our operations are within the United States and Puerto Rico. Products are sold on an export-only basis to portions of Latin America and the Caribbean Basin and export sales are approximately 4% of total revenues. We do not have any international locations.

**ADDITIONAL INFORMATION**

Filings with the Securities and Exchange Commission

As a public company, we regularly file reports and proxy statements with the Securities and Exchange Commission (“SEC”). These reports are required by the Securities Exchange Act of 1934 and include, but are not limited to:

- annual reports on Form 10-K;
- quarterly reports on Form 10-Q;
- current reports on Form 8-K and
- proxy statements on Schedule 14A.

The public may read and copy any of the materials we file with the SEC at the SEC’s Public Reference Room at 100 F. Street N.E., Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site at [www.sec.gov](http://www.sec.gov) that contains the reports, proxy and information statements, and other information that we file electronically.

We make available free of charge access to our SEC filings as soon as reasonably practicable after such materials are electronically filed with or furnished to the SEC through our website at [www.watsco.com](http://www.watsco.com). Other reports filed with the SEC under the Securities Exchange Act of 1934, as amended, are also available including the proxy statements and reports filed by officers and directors under Section 16(a) of that Act. These reports may be found on our website by selecting the option entitled “SEC Filings” under the “Investor Relations” section of the website. The reference to our website address does not constitute incorporation by reference of the information contained on our website and should not be considered part of this report.

**ITEM 1A. RISK FACTORS**

**Business Risk Factors**

Supplier Concentration

Our purchases from Carrier and its affiliates comprised 52% of all purchases made during 2010. Significant relationships currently exist with four of the seven major HVAC equipment manufacturers; and purchases from these equipment suppliers, including Carrier, comprised 72% of all purchases made in 2010. Given the significant concentration of our supply chain, particularly with Carrier, any significant interruption by the manufacturers or a termination of a distribution agreement could temporarily disrupt the operations of certain subsidiaries. Additionally, our operations are also materially dependent upon the continued market acceptance of these manufacturers’ products and their ability to continue to manufacture products that are competitive and that comply with laws relating to environmental and efficiency standards. Our inability to obtain products from one or more of these manufacturers or a decline in market acceptance of these manufacturers’ products could have a material adverse effect on our results of operations, cash flows and liquidity.

We maintain distribution agreements with our key equipment suppliers, either on an exclusive or non-exclusive basis, for terms generally ranging from one to ten years. Certain of the distribution agreements contain provisions that restrict or limit the sale of competitive products in the markets served. Other than the markets where such restrictions and limitations may apply, we may distribute other manufacturers’ lines of air conditioning or heating equipment.

Risks Inherent in Acquisitions

As part of our strategy, we intend to pursue additional acquisitions of complementary businesses. If we complete future acquisitions and/or joint ventures, we may be required to incur or assume additional debt and/or issue additional shares of our common stock as consideration, which will dilute our existing shareholders’ ownership interest in us and may affect our results of operations. Growth through acquisitions involves a number of risks, including the following:

- the ability to identify and consummate complementary acquisition candidates;
- the successful operation and/or integration of acquired companies in an effective manner;
- diversion of management’s attention from other daily functions;
- issuance by us of equity securities that would dilute ownership of our existing shareholders;
- incurrence and/or assumption of significant debt and contingent liabilities; and

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## Table of Contents

- possible loss of key employees and/or customer relationships of the acquired companies.

In addition, acquired companies may have liabilities that we failed, or were unable, to discover in the course of performing due diligence investigations. We cannot assure you that the indemnification granted to us by sellers of acquired companies will be sufficient in amount, scope or duration to fully offset the possible liabilities associated with businesses or properties that we assume upon consummation of an acquisition. We may learn additional information about our acquired businesses that materially adversely affect us, such as unknown or contingent liabilities and liabilities related to compliance with applicable laws. Any such liabilities, individually or in the aggregate, could have a material adverse effect on our business.

Failure to successfully manage the operational challenges and risks associated with, or resulting from, acquisitions could adversely affect our results of operations, cash flows and liquidity.

### Decline in Economic Conditions

The global and U.S. economy experienced a significant contraction in 2008, including sharply reduced availability of business and consumer credit. We rely on the capital markets as well as the credit markets to meet our financial commitments and short-term liquidity needs if internal funds are not available from our operations. Long-term disruptions in the capital and credit market, such as those experienced in 2008, could adversely affect our access to liquidity needed for our business. Any long-term disruption could require us to take measures to conserve cash until the markets stabilize or until alternative credit arrangements or other funding for our business needs can be arranged. Such measures could include reducing or eliminating dividend payments, deferring capital expenditures and reducing or eliminating discretionary uses of cash.

A decline in economic conditions and lack of availability of business and consumer credit could have an adverse effect on our business. Any capital and credit market disruption could cause broader economic downturns, which may lead to reduced demand for our products and increased incidence of customers' inability to pay their accounts. Further, bankruptcies or similar events by customers may cause us to incur bad debt expense at levels higher than historically experienced. Also, our suppliers may potentially be impacted causing disruption or delay of product availability. These events would adversely impact our results of operations, cash flows and financial position. Additionally, if financial institutions that have extended credit commitments to us are adversely affected by the conditions of the capital and credit markets, they may become unable to fund borrowings under their credit commitments to us, which could have an adverse impact on our financial condition and our ability to borrow funds, if needed, for working capital, acquisitions, capital expenditures and other corporate purposes.

### Competition

We operate in highly competitive environments. We compete with a number of distributors and also with several air conditioning and heating equipment manufacturers that distribute a significant portion of their products through their own distribution organizations in certain markets. Competition within any given geographic market is based upon product availability, customer service, price and quality. Competitive pressures or other factors could cause our products or services to lose market acceptance or result in significant price erosion, all of which would have a material adverse effect on our results of operations, cash flows and liquidity.

### Seasonality

Sales of residential central air conditioners, heating equipment and parts and supplies have historically been seasonal. Furthermore, profitability can be impacted favorably or unfavorably based on the severity or mildness of weather patterns during summer or winter selling seasons. Demand related to the residential central air conditioning replacement market is 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 even during the year except for dependence on housing completions and related weather and economic conditions.

### Dependence on Key Personnel

We are highly dependent on the skills, experience and services of key personnel. The loss of key personnel could have a material adverse effect on our business, operating results or financial condition. Our potential growth and expansion are expected to place increased demands on our management skills and resources. Therefore, our success also depends upon our ability to recruit, hire, train and retain additional skilled and experienced management personnel. Employment and retention of qualified personnel is important due to the competitive nature of our industry. Our failure to maintain key personnel or inability to appropriately recruit, hire and train new personnel could have a material adverse effect on our business, results of operations and cash flows.

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## [Table of Contents](#)

### **General Risk Factors**

#### Goodwill and Intangibles

At December 31, 2010, goodwill and intangibles represented approximately 29% of our total assets. The recoverability of goodwill and indefinite lived intangibles is evaluated at least annually and when events or changes in circumstances indicate that the carrying amounts may not be recoverable. 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. 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. Although no impairment has been recorded to date, there can be no assurances that future impairments will not occur.

#### Risks Related to Insurance Coverage

We carry general liability, comprehensive property damage, workers' compensation, health benefits and other insurance coverage that management considers adequate for the protection of its assets and operations. There can be no assurance, however, that the coverage limits of such policies will be adequate to cover losses and expenses for lawsuits brought or which may be brought against us. A loss in excess of insurance coverage could have a material adverse effect on our financial position and/or profitability. Certain self-insurance risks for casualty insurance programs and health benefits are retained and reserves are established based on claims filed and estimates of claims incurred but not yet reported. Assurance cannot be provided that actual claims will not exceed present estimates. Exposure to catastrophic losses has been limited by maintaining excess and aggregate liability coverage and implementing stop-loss control programs.

#### Control by Existing Shareholder

As of December 31, 2010, Albert H. Nahmad, our Chairman and Chief Executive Officer, and limited partnerships controlled by him, collectively had beneficial ownership of approximately 54% of the combined voting power of our outstanding Common stock and Class B common stock. Based on Mr. Nahmad's stock ownership and the stock ownership of the limited partnership controlled by him, Mr. Nahmad has the voting power to elect all but three members of our nine-person Board of Directors and to control most corporate actions requiring shareholder approval.

#### Information about Forward-Looking Statements

This Form 10-K 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) business and acquisition strategies, (ii) potential acquisitions and/or joint ventures, (iii) financing plans and (iv) 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:

- 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; and

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[Table of Contents](#)

- 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 substantially realized, that the information will have the expected consequences or effects on us or our business or operations. A discussion of certain of these risks and uncertainties that could cause actual results to differ materially from those predicted in such forward-looking statements is set forth in this Item 1A and included in our 2010 Annual Report in the section captioned “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” which section is incorporated in this Annual Report on Form 10-K by reference. Forward-looking statements speak only as of the date the statements were made. We assume no obligation to update forward-looking information or the discussion of such risks and uncertainties to reflect actual results, changes in assumptions or changes in other factors affecting forward-looking information, except to the extent required by applicable law.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

**ITEM 2. PROPERTIES**

Our main properties include warehousing and distribution facilities, trucks and administrative office space.

Warehousing and Distribution Facilities

At December 31, 2010, we operated 505 warehousing and distribution facilities across 36 states and Puerto Rico, having an aggregate of approximately 12.1 million square feet of space, of which approximately 11.7 million square feet is leased. The majority of these leases are for terms of three to five years. We believe that our facilities are generally sufficient to meet our present operating needs.

Trucks

At December 31, 2010, we operated 645 ground transport vehicles, including delivery and pick-up trucks, vans and tractors. Of this number, 380 trucks were leased and the rest were owned. We believe that the present size of our truck fleet is adequate to support our operations.

Administrative Facility

Senior management and support staff are located at our corporate headquarters in Miami, Florida in approximately 6,000 square feet of owned space.

Capital Expenditures

During 2010, our capital expenditures were \$8.4 million.

**ITEM 3. LEGAL PROCEEDINGS**

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 impact to our financial condition or results of operations.

**ITEM 4. (REMOVED AND RESERVED)**

**PART II**

**ITEM 5. MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

**Stock Exchange Information, Common Share Price Performance and Dividends**

Our Common stock is listed on the New York Stock Exchange and the Professional Segment of NYSE Euronext in Paris under the ticker symbol WSO and our Class B common stock is listed on the NYSE Amex under the ticker symbol WSOB.

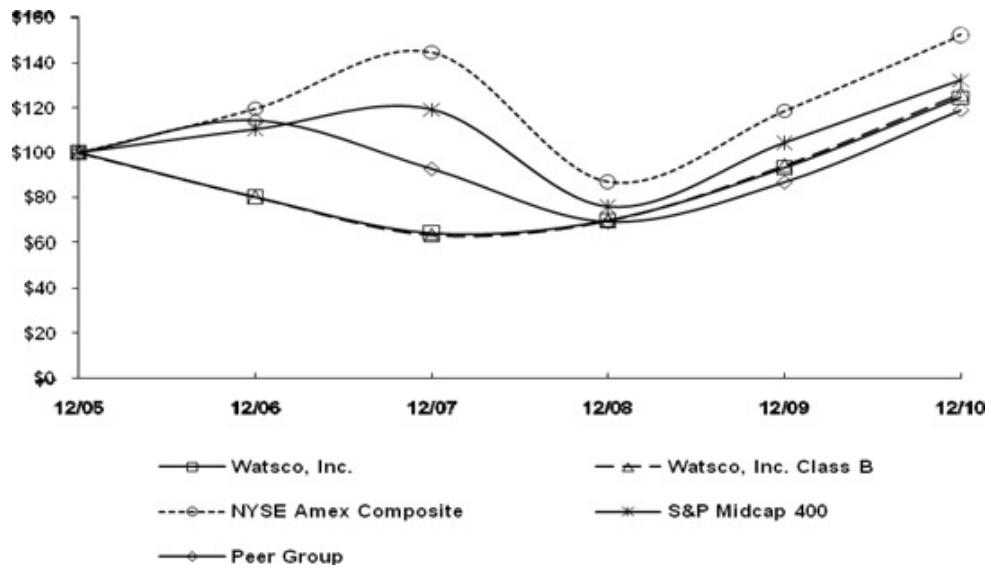
[Table of Contents](#)

Our 2010 Annual Report contains “Information on Common Stock,” which identifies the markets in which our common stocks are being traded and contains the high and low sales prices and dividend information for the years ended December 31, 2010 and 2009, and is incorporated herein by reference.

**Shareholder Return Performance**

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 Amex Composite index, the S&P MidCap 400 index and a customized peer group of companies, which are: Beacon Roofing Supply, Inc., Interline Brands, 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, 2005 and its relative performance is tracked through December 31, 2010.

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



	12/05	12/06	12/07	12/08	12/09	12/10
Watsco, Inc.	100.00	80.19	64.20	69.95	93.24	124.49
Watsco, Inc. Class B	100.00	80.31	63.41	69.75	94.35	126.21
NYSE Amex Composite	100.00	119.54	144.62	87.02	118.50	152.13
S&P MidCap 400	100.00	110.32	119.12	75.96	104.36	132.16
Peer Group	100.00	114.30	92.71	69.10	86.75	118.77

\* The stock price performance included in this graph is not necessarily indicative of future stock price performance.

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[Table of Contents](#)

**Purchases of Equity Securities by the Issuer and Affiliated Purchasers**

Our Board of Directors has authorized the repurchase, at management's discretion, of 7.5 million shares of common stock in the open market or via private transactions. Through December 31, 2010, 6.4 million shares of Common and Class B common stock have been repurchased at a cost of \$114.4 million since the inception of the program. The remaining 1.1 million shares authorized for repurchase are subject to certain restrictions included in our revolving credit agreements. During the quarter ended December 31, 2010, there were no purchases of our equity securities made by us or on our behalf by any "affiliated purchaser" (as such term is defined in Rule 10b-18(a)(3) of the Securities Act of 1933, as amended).

**Dividends**

Cash dividends per share of \$2.04, \$1.89 and \$1.75 for both Common stock and Class B common stock were paid in 2010, 2009 and 2008, respectively. Future dividends will be at the sole discretion of the Board of Directors and will depend upon such factors as profitability, financial condition, cash requirements, restrictions existing under our revolving credit agreements, future prospects and other factors deemed relevant by our Board of Directors.

**ITEM 6. SELECTED FINANCIAL DATA**

Our 2010 Annual Report contains "Selected Consolidated Financial Data" and is incorporated herein by reference.

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

Our 2010 Annual Report contains "Management's Discussion and Analysis of Financial Condition and Results of Operations" and is incorporated herein by reference.

**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Our 2010 Annual Report contains "Quantitative and Qualitative Disclosures about Market Risk" and is incorporated herein by reference.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

Our 2010 Annual Report contains our 2010 and 2009 Consolidated Balance Sheets and other consolidated financial statements for the years ended December 31, 2010, 2009 and 2008, together with the reports thereon (for the applicable periods covered by their reports) of KPMG LLP dated March 1, 2011, and Grant Thornton LLP dated February 27, 2009, and are incorporated herein by reference.

Our 2010 Annual Report contains "Selected Quarterly Financial Data" for 2010 and 2009 and is incorporated herein by reference.

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

There were no disagreements with accountants on accounting or financial disclosures during the last three fiscal years. On June 23, 2009, the Board of Directors of the Company and its Audit Committee dismissed Grant Thornton LLP as the Company's independent registered public accounting firm and engaged KPMG LLP to serve as the Company's new independent registered public accounting firm. For more information with respect to this matter, see our Current Report on Form 8-K dated June 22, 2009.

**ITEM 9A. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures**

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

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

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[Table of Contents](#)

**Management's Report on Internal Control over Financial Reporting**

Our 2010 Annual Report contains "Management's Report on Internal Control over Financial Reporting" and the report thereon of KPMG LLP dated March 1, 2011, and each is incorporated herein by reference.

**Changes in Internal Control over Financial Reporting**

We are continuously seeking to improve the efficiency and effectiveness of our operations and of our internal controls. This results in refinements to processes throughout the Company. However, there have been no changes in internal controls over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended December 31, 2010, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**ITEM 9B. OTHER INFORMATION**

None.

**PART III**

This part of Form 10-K, which includes items 10 through 14, is omitted because we will file definitive proxy material pursuant to Regulation 14A not more than 120 days after the close of our year-end, which proxy material will include the information required by Items 10 through 14 and is incorporated herein by reference.

**PART IV**

**ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

- (a)(1) Financial Statements. Our consolidated financial statements are incorporated by reference from our 2010 Annual Report.
- (2) Financial Statement Schedules. The schedules are omitted because they are not applicable or the required information is shown in the consolidated financial statements or notes thereto.
- (3) Exhibits. The following list of exhibits includes exhibits submitted with this Form 10-K as filed with the SEC and those incorporated by reference to other filings.
  - 3.1 Watsco's Amended and Restated Articles of Incorporation (filed as Exhibit 3.1 to the Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2001 and incorporated herein by reference).
  - 3.2 Watsco's Articles of Amendment to the Amended and Restated Articles of Incorporation (filed as Exhibit 3.1 to the Current Report on Form 8-K on June 4, 2009 and incorporated herein by reference).
  - 3.3 Watsco's Bylaws (filed as Exhibit 3.2 to the Annual Report on Form 10-K for the fiscal year ended January 31, 1985 and incorporated herein by reference).
  - 3.4 Watsco's Amendment to the Bylaws (filed as Exhibit 99.1 to the Current Report on Form 8-K on April 1, 2009 and incorporated herein by reference).
  - 4.1 Specimen form of Class B Common Stock Certificate (filed as Exhibit 4.6 to the Registration Statement on Form S-1 (No. 33-56646) and incorporated herein by reference).
  - 4.2 Specimen form of Common Stock Certificate (filed as Exhibit 4.4 to the Annual Report on Form 10-K for the fiscal year ended December 31, 1994 and incorporated herein by reference).
  - 10.1 Watsco, Inc. Amended and Restated 1991 Stock Option Plan (filed as Exhibit 4.23 to the Registration Statement on Form S-8 (333-82011) and incorporated herein by reference). \*
  - 10.2 Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.20 to the Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1996 and incorporated herein by reference). \*
  - 10.3 First Amendment dated January 1, 2001 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.13 to the Annual Report on Form 10-K for the year ended December 31, 2000 and incorporated herein by reference). \*

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[Table of Contents](#)

- 10.4 Second Amendment dated January 1, 2002 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.15 to the Annual Report on Form 10-K for the year ended December 31, 2001 and incorporated herein by reference). \*
- 10.5 Third Amendment dated January 1, 2003 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.11 to the Annual Report on Form 10-K for the year ended December 31, 2002 and incorporated herein by reference). \*
- 10.6 Fourth Amendment dated January 1, 2004 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.1 to the Quarterly Report on Form 10-Q for the period ended March 31, 2004 and incorporated herein by reference). \*
- 10.7 Fifth Amendment dated January 1, 2005 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.1 to the Quarterly Report on Form 10-Q for the period ended March 31, 2005 and incorporated herein by reference). \*
- 10.8 Sixth Amendment dated January 1, 2006 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.16 to the Annual Report on Form 10-K for the year ended December 31, 2005 and incorporated herein by reference). \*
- 10.9 Watsco, Inc. 2001 Incentive Compensation Plan (filed as Exhibit I to the Definitive Proxy Statement for the year ended December 31, 2005 and incorporated herein by reference). \*
- 10.10 Seventh Amendment dated January 1, 2007 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.18 to the Annual Report on Form 10-K for the year ended December 31, 2006 and incorporated herein by reference). \*
- 10.11 Third Amended and Restated 1996 Qualified Employee Stock Purchase Plan dated February 27, 2007 (filed as Exhibit 1 to the Definitive Proxy Statement for the year ended December 31, 2006 and incorporated herein by reference). \*
- 10.12 Revolving Credit Agreement dated as of August 3, 2007, by and among Watsco, Inc., as Borrower, the Lenders from Time to Time Party Thereto, Bank of America, N.A., as Administrative Agent (filed as Exhibit 10.1 to Amendment No. 1 to the Current Report on Form 8-K/A on July 23, 2010 and incorporated herein by reference).
- 10.13 Eighth Amendment dated January 1, 2008 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.1 to the Quarterly Report on Form 10-Q for the period ended March 31, 2008 and incorporated herein by reference). \*
- 10.14 Ninth Amendment dated December 10, 2008 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.19 to the Annual Report on Form 10-K for the year ended December 31, 2008 and incorporated herein by reference). \*
- 10.15 Tenth Amendment dated January 1, 2009 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.1 to the Quarterly Report on Form 10-Q for the period ended March 31, 2009 and incorporated herein by reference). \*
- 10.16 Watsco, Inc. Amended and Restated 2001 Incentive Compensation Plan (filed as Appendix A to the Definitive Proxy Statement for the year ended December 31, 2008 and incorporated herein by reference). \*
- 10.17 Credit Agreement dated as of July 1, 2009, by and among Carrier Enterprise, LLC, as Borrower, the Lenders that are Signatories Hereto, Wells Fargo Bank, N.A., as Administrative Agent (filed as Exhibit 10.1 to Amendment No. 2 to the Current Report on Form 8-K/A on July 23, 2010 and incorporated herein by reference).
- 10.18 Revolving Credit Agreement dated as of August 3, 2007 as amended by Amendment No. 1 to Revolving Credit Agreement dated July 1, 2009, by and among Watsco, Inc., as Borrower, the Lenders from Time to Time Party Thereto, Bank of America, N.A., as Administrative Agent (filed as Exhibit 10.1 to the Current Report on Form 8-K on July 23, 2010 and incorporated herein by reference).



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[Table of Contents](#)

10.19	Purchase and Contribution Agreement dated May 3, 2009 by and between Carrier Corporation and Watsco, Inc. (filed as Exhibit 2.1 to the Current Report on Form 8-K on May 7, 2009 and incorporated herein by reference).
10.20	Amendment to Purchase and Contribution Agreement dated as of June 29, 2009 by and between Carrier Corporation and Watsco, Inc. (filed as Exhibit 2.2 to the Current Report on Form 8-K on July 8, 2009 and incorporated herein by reference).
10.21	Operating Agreement of Carrier Enterprise, LLC (Amended and Restated), dated as of July 1, 2009 (filed as Exhibit 10.2 to the Current Report on Form 8-K on July 8, 2009 and incorporated herein by reference).
10.22	Shareholder Agreement by and between Watsco, Inc. and Carrier Corporation, dated as of July 1, 2009 (filed as Exhibit 10.3 to the Current Report on Form 8-K on July 8, 2009 and incorporated herein by reference).
10.23	Eleventh Amendment dated January 1, 2010 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.1 to the Quarterly Report on Form 10-Q for the period ended March 31, 2010 and incorporated herein by reference). *
13	2010 Annual Report to Shareholders (with the exception of the information incorporated by reference into Items 1, 5, 6, 7 and 8 of this Form 10-K, the 2010 Annual Report to Shareholders is provided solely for the information of the SEC and is not deemed “filed” as part of this Form 10-K). #
21	Subsidiaries of the Registrant. #
23.1	Consent of Independent Registered Public Accounting Firm – KPMG LLP. #
23.2	Consent of Independent Registered Public Accounting Firm – Grant Thornton LLP. #
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. #
31.2	Certification of Senior Vice President pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. #
31.3	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. #
32.1	Certification of Chief Executive Officer, Senior Vice President and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. +
101.INS	XBRL Instance Document. **
101.SCH	XBRL Taxonomy Extension Schema Document. **
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document. **
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document. **
101.LAB	XBRL Taxonomy Extension Label Linkbase Document. **
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document. **

# filed herewith.

+ furnished herewith.

\* Management contract or compensation plan or arrangement.

\*\* XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of section 18 of the Exchange Act, and otherwise is not subject to liability under these sections.

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

WATSCO, INC.

March 1, 2011

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

March 1, 2011

By: /s/ Ana M. Menendez  
Ana M. Menendez, Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

<u>SIGNATURE</u>	<u>TITLE</u>	<u>DATE</u>
<u>/S/ ALBERT H. NAHMAD</u> <b>Albert H. Nahmad</b>	Chairman of the Board and Chief Executive Officer (principal executive officer)	March 1, 2011
<u>/S/ BARRY S. LOGAN</u> <b>Barry S. Logan</b>	Senior Vice President	March 1, 2011
<u>/S/ ANA M. MENENDEZ</u> <b>Ana M. Menendez</b>	Chief Financial Officer (principal accounting officer and principal financial officer)	March 1, 2011
<u>/S/ CESAR L. ALVAREZ</u> <b>Cesar L. Alvarez</b>	Director	March 1, 2011
<u>/S/ ROBERT L. BERNER III</u> <b>Robert L. Berner III</b>	Director	March 1, 2011
<u>/S/ DENISE DICKINS</u> <b>Denise Dickins</b>	Director	March 1, 2011
<u>/S/ STEVEN R. FEDRIZZI</u> <b>Steven R. Fedrizzi</b>	Director	March 1, 2011
<u>/S/ PAUL F. MANLEY</u> <b>Paul F. Manley</b>	Director	March 1, 2011
<u>/S/ BOB L. MOSS</u> <b>Bob L. Moss</b>	Director	March 1, 2011
<u>/S/ GEORGE P. SAPE</u> <b>George P. Sape</b>	Director	March 1, 2011

**Exhibit Index**

<b>Exhibit Number</b>	<b>Description</b>
13	2010 Annual Report to Shareholders (with the exception of the information incorporated by reference into Items 1, 5, 6, 7 and 8 of this Form 10-K, the 2010 Annual Report to Shareholders is provided solely for the information of the SEC and is not deemed "filed" as part of this Form 10-K).
21	Subsidiaries of the Registrant.
23.1	Consent of Independent Registered Public Accounting Firm – KPMG LLP.
23.2	Consent of Independent Registered Public Accounting Firm – Grant Thornton LLP.
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Senior Vice President pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.3	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer, Senior Vice President and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema Document.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.

**WATSCO, INC. AND SUBSIDIARIES**  
**SELECTED CONSOLIDATED FINANCIAL DATA**

*Years Ended December 31,*

*(In thousands, except per share data)*

	<u>2010</u>	<u>2009 (1)</u>	<u>2008</u>	<u>2007 (2)(4)</u>	<u>2006 (3)(4)</u>
<b>OPERATING DATA</b>					
Revenues	\$2,844,595	\$ 2,001,815	\$1,700,237	\$1,758,022	\$1,771,214
Gross profit	673,241	480,832	441,994	446,985	457,270
Operating income	165,572	81,060	98,608	111,154	135,394
Net income from continuing operations	111,722	51,573	60,369	67,489	82,233
(Loss) income from discontinued operations, net of income taxes	—	—	—	(1,912)	131
Net income	111,722	51,573	60,369	65,577	82,364
Less: net income attributable to the noncontrolling interest	30,962	8,259	—	—	—
Net income attributable to Watsco, Inc.	<u>\$ 80,760</u>	<u>\$ 43,314</u>	<u>\$ 60,369</u>	<u>\$ 65,577</u>	<u>\$ 82,364</u>

**SHARE AND PER SHARE DATA**

Diluted earnings per share for Common and Class B common stock:

Net income from continuing operations attributable to Watsco, Inc. shareholders	\$ 2.49	\$ 1.40	\$ 2.09	\$ 2.34	\$ 2.85
Net (loss) income from discontinued operations attributable to Watsco, Inc. shareholders	—	—	—	(0.07)	0.01
Net income attributable to Watsco, Inc. shareholders	<u>\$ 2.49</u>	<u>\$ 1.40</u>	<u>\$ 2.09</u>	<u>\$ 2.27</u>	<u>\$ 2.86</u>

Cash dividends declared and paid per share:

Common stock	\$ 2.04	\$ 1.89	\$ 1.75	\$ 1.31	\$ 0.95
Class B common stock	\$ 2.04	\$ 1.89	\$ 1.75	\$ 1.31	\$ 0.95

Weighted-average Common and Class B common shares and equivalent

shares used to calculate diluted earnings per share	30,579	28,521	27,022	27,139	27,159
Common stock outstanding	<u>32,449</u>	<u>32,139</u>	<u>28,326</u>	<u>27,969</u>	<u>27,833</u>

**BALANCE SHEET DATA**

Total assets	\$ 1,237,227	\$1,160,613	\$ 716,061	\$ 750,113	\$ 710,368
Total long-term obligations	10,016	13,429	20,783	55,042	30,118
Total shareholders' equity	<u>928,896</u>	<u>894,808</u>	<u>570,660</u>	<u>549,957</u>	<u>516,386</u>

- (1) Effective January 1, 2009, we adopted the provisions of accounting guidance stating that non-vested share-based payment awards that contain non-forfeitable rights to dividends are considered participating securities and should be included in the computation of earnings per share pursuant to the two-class method for all periods presented. We also adopted the provisions of revised accounting guidance for recognizing and measuring assets acquired and liabilities assumed in a business combination.
- (2) Effective January 1, 2007, we adopted the provisions of accounting guidance related to uncertainty in income taxes.
- (3) Effective January 1, 2006, the provisions of accounting guidance on share-based payments were adopted using the modified prospective transition method.
- (4) On July 19, 2007, we divested of our non-core staffing unit. All amounts related to this operation are restated as discontinued operations.

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**WATSCO, INC. AND SUBSIDIARIES**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS OF**  
**FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**Information about Forward-Looking Statements**

This Annual Report 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:

- 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; 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 substantially realized, that the information will have the expected consequences or effects on our business or operations. For additional information identifying some other important factors which may affect our operations and could cause actual results to vary materially from those anticipated in the forward-looking statements, see our Commission filings, including but not limited to, the discussion included in the Risk Factors section of this Annual Report on Form 10-K under the headings "Business Risk Factors" and "General Risk Factors." 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 included under Item 8, "Financial Statements and Supplementary Data" of this Annual Report.

**Company Overview**

Watsco, Inc. and its subsidiaries (collectively, "Watsco," or *we, us or our*) was incorporated 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, 2010, we operated from 505 locations in 36 states and Puerto Rico with additional market coverage on an export basis to parts of Latin America and the Caribbean.

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

Sales of residential central air conditioners, heating equipment and parts and supplies are seasonal. Furthermore, results of operations can be impacted favorably or unfavorably based on weather patterns during the summer and winter selling seasons. Demand related to the residential central air conditioning replacement market is typically highest in the second and

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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.

### **Items Affecting Comparability between Periods**

Refer to Note 1 to the consolidated financial statements for a discussion of the impact of changes in accounting standards.

### **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 the consolidated financial statements. Management believes that the following accounting policies include a higher degree of judgment and/or complexity and, thus, are considered to be critical accounting policies. Management has discussed the development and selection of critical accounting policies 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. 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 \$6.3 million and \$10.9 million at December 31, 2010 and 2009, respectively, a decrease of \$4.6 million. Accounts receivable balances greater than 90 days past due as a percent of accounts receivable at December 31, 2010 decreased to 2.2% compared to 5.8% at December 31, 2009. These decreases are attributable to strong collections from customers due to the improvement in the economy, write-offs of delinquent accounts and recoveries in 2010.

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. Concentrations of credit risk with respect to accounts receivable 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 a credit insurance program which is used as an additional means to mitigate credit risk.

#### **Inventory Valuation**

Inventories consist of air conditioning, heating and refrigeration equipment and related parts and supplies and are valued at the lower of cost or market using a weighted-average cost basis and the first-in, first-out method. As part of the valuation process, inventory reserves are established to state 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 use judgment to estimate when the inventory will be sold and the quantities and prices at which the inventory will be sold in the normal course of business. Inventory reserve policies are periodically reviewed, 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, 2011, 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 at December 31, 2010 was \$360.3 million. 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.



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#### 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 \$7.3 million and \$7.1 million at December 31, 2010 and 2009, 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 \$1.1 million was recorded at December 31, 2010 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.



## Results of Operations

The following table summarizes information derived from the consolidated statements of income expressed as a percentage of revenues for the years ended December 31, 2010, 2009 and 2008:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Revenues	100.0%	100.0%	100.0%
Cost of sales	<u>76.3</u>	<u>76.0</u>	<u>74.0</u>
Gross profit	23.7	24.0	26.0
Selling, general and administrative expenses	<u>17.9</u>	<u>20.0</u>	<u>20.2</u>
Operating income	5.8	4.0	5.8
Interest expense, net	<u>0.1</u>	<u>0.1</u>	<u>0.1</u>
Income before income taxes	5.7	3.9	5.7
Income taxes	<u>1.8</u>	<u>1.3</u>	<u>2.1</u>
Net income	3.9	2.6	3.6
Less: net income attributable to noncontrolling interest	<u>1.1</u>	<u>0.4</u>	<u>—</u>
Net income attributable to Watsco, Inc.	<u>2.8%</u>	<u>2.2%</u>	<u>3.6%</u>

The following narratives include the results of operations for businesses acquired during 2010 and 2009. The results of operations for these acquisitions have been included in our consolidated statements of income beginning on their respective dates of acquisition. The pro forma effect of these acquisitions, excluding the joint venture Carrier Enterprise, LLC (“Carrier Enterprise”), which was consummated July 1, 2009, was not deemed significant on either an individual or an aggregate basis in the related acquisition year. There were no businesses acquired during 2008.

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 prior twelve months unless they are within close geographic proximity to existing locations. At December 31, 2010 and 2009, 18 and 118 locations, respectively, were excluded from “same-store basis” information. The table below summarizes the changes in our locations for 2009 and 2010:

	<u>Number of Locations</u>
December 31, 2008	417
Acquired	101
Opened	2
Closed	<u>(15)</u>
December 31, 2009	505
Acquired	2
Opened	7
Closed	<u>(9)</u>
December 31, 2010	<u>505</u>

## 2010 Compared to 2009

### Revenues

Revenues for 2010 increased \$842.8 million, or 42%, to \$2,845 million, including \$625.4 million attributable to the 95 new Carrier Enterprise locations acquired July 1, 2009 and \$23.9 million from other locations acquired and opened during the last twelve months partially offset by \$15.2 million from closed locations. On a same-store basis, revenues increased \$208.7 million, or 11%, as compared to 2009 and reflect a 16% increase in sales of HVAC equipment, a 2% increase in sales of other HVAC products and a 10% increase in sales of refrigeration products. Sales of HVAC equipment benefited from growth in unit sales and an improved sales mix of higher-efficiency replacement air conditioning and heating systems, which sell at higher unit prices.

### Gross Profit

Gross profit for 2010 increased \$192.4 million, or 40%, to \$673.2 million, primarily as a result of increased revenues. Gross profit margin declined 30 basis-points to 23.7% in 2010 from 24.0% in 2009, reflecting the impact of lower selling margins for Carrier Enterprise. On a same-store basis, gross profit margin improved 20 basis-points to 24.3% versus 24.1% in 2009 primarily due to a shift in sales mix toward higher-efficiency HVAC equipment as well as improved margins for non-equipment products.

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### Selling, General and Administrative Expenses

Selling, general and administrative expenses for 2010 increased \$107.9 million, or 27%, to \$507.7 million reflecting the impact of Carrier Enterprise for twelve months in 2010 as compared to six months in 2009. Selling, general and administrative expenses as a percent of revenues decreased to 17.9% for 2010 from 20.0% for 2009. Selling, general and administrative expenses in 2009 include \$4.8 million of acquisition-related costs primarily associated with the closing and transition of Carrier Enterprise. On a same-store basis, selling, general and administrative expenses increased 2% compared to 2009, primarily due to increases in selling expenses related to our increased revenues including higher incentive-based compensation partially offset by a decrease in the provision for doubtful accounts.

### Operating Income

Operating income in 2010 increased \$84.5 million, or 104%, to \$165.6 million. Operating margin improved 180 basis-points to 5.8% in 2010 from 4.0% in 2009. On a same-store basis, operating margin improved 170 basis-points to 5.8% versus 4.1% in 2009.

### Interest Expense, Net

Net interest expense in 2010 increased \$0.8 million, or 28%, to \$3.5 million primarily as a result of the additional amortization of bank fees (included in interest expense, net) related to the amendment of our existing revolving credit agreement required to consummate the joint venture on July 1, 2009 and the establishment of the Carrier Enterprise revolving credit agreement, together with a 25% increase in average outstanding borrowings during 2010 as compared to 2009.

### Income Taxes

Income taxes of \$50.4 million for 2010 consist of the income taxes attributable to our wholly-owned operations and 60% of income taxes attributable to Carrier Enterprise, which is taxed as a partnership for income tax purposes. The effective income tax rate attributable to us increased to 38.0% in 2010 from 37.8% in 2009. The increase is primarily due to certain non-recurring tax benefits and credits realized in 2009 and a higher effective state tax rate associated with Carrier Enterprise in 2010.

### Net Income Attributable to Watsco, Inc.

Net income attributable to Watsco increased \$37.5 million, or 86%, to \$80.8 million. The increase was primarily driven by higher revenues and reduced selling, general and administrative expenses as a percent of revenues as discussed above.

## **2009 Compared to 2008**

### Revenues

Revenues in 2009 increased \$301.6 million, or 18%, to \$2,002 million, including \$588.1 million attributable to the 95 new Carrier Enterprise locations acquired July 1, 2009 and \$7.5 million from other locations acquired and opened during the last twelve months, offset by \$14.4 million from closed locations. On a same-store basis, revenues declined \$279.6 million, or 17%, as compared to 2008 and reflected a decline of 11% in sales of HVAC equipment, a 24% decline in sales of other HVAC products and a 16% decline in sales of refrigeration products. Revenues were impacted by lower demand experienced during the declining economic conditions and lower pricing on certain commodity products that are sensitive to changes in commodity prices (copper tubing, galvanized sheet metal and refrigerant). These commodity products accounted for approximately \$90.0 million of the same-store revenue decline and in aggregate represented 12% of revenues on a same-store basis.

### Gross Profit

Gross profit for 2009 increased \$38.8 million, or 9%, to \$480.8 million. Gross profit margin decreased 200 basis-points to 24.0% in 2009 from 26.0% in 2008, reflecting lower gross margins achieved by Carrier Enterprise. On a same-store basis, gross profit margin declined 60 basis-points to 25.4% versus 26.0% in 2008. The decline of same-store gross profit margin is primarily due to lower margins on certain commodity products that are sensitive to changes in commodity prices, a shift in sales mix toward HVAC equipment, which generates a lower gross profit margin versus non-equipment products and generally more competitive pricing conditions.

### Selling, General and Administrative Expenses

Selling, general and administrative expenses for 2009 increased \$56.4 million, or 16%, to \$399.8 million. Selling, general and administrative expenses as a percent of revenues decreased to 20.0% in 2009 from 20.2% in 2008. Selling, general and administrative expenses include \$4.8 million of acquisition-related costs primarily associated with the closing and transition of Carrier Enterprise in 2009. On a same-store basis, selling, general and administrative expenses decreased 13% compared to 2008, primarily due to ongoing cost savings initiatives implemented in early 2008.

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### Operating Income

Operating income for 2009 decreased \$17.5 million, or 18%, to \$81.1 million. Operating margin decreased 180 basis-points to 4.0% in 2009 from 5.8% in 2008. On a same-store basis, operating margin declined 150 basis-points to 4.4% versus 5.9% in 2008.

### Interest Expense, Net

Net interest expense in 2009 increased \$0.7 million, or 35%, to \$2.7 million primarily as a result of the additional amortization of bank fees (included in interest expense, net) related to the amendment of our existing revolving credit agreement required to consummate the joint venture and the establishment of the Carrier Enterprise revolving credit agreement, partially offset by a 42% decrease in average outstanding borrowings as compared to 2008.

### Income Taxes

Income taxes of \$26.8 million consist of the income taxes attributable to our wholly-owned operations and 60% of income taxes attributable to Carrier Enterprise, which is taxed as a partnership for income tax purposes. The effective income tax rate attributable to us was 37.8% in 2009 versus 37.5% in 2008. The increase is primarily due to a higher effective state tax rate associated with Carrier Enterprise.

### Net Income Attributable to Watsco, Inc.

Net income attributable to Watsco decreased \$17.1 million, or 28%, to \$43.3 million. The decrease was primarily driven by the lower gross profit margin and the higher levels of selling, general and administrative expenses discussed above.

## **Liquidity and Capital Resources**

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

- cash flows generated from operating activities;
- the adequacy of available bank lines 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.

We rely on cash flows from operations and our lines of credit to fund seasonal working capital needs, financial commitments and short-term liquidity needs, including funds necessary for business acquisitions. We believe that, at present, cash flows from operations combined with those available under our lines of credit are sufficient to satisfy our current liquidity needs, including our anticipated dividend payments and capital expenditures. Any future disruption in the capital and credit markets, such as those experienced in 2008, could adversely affect our ability to draw on our lines of credit. Our access to funds under our lines of credit is dependent on the ability of the banks to meet their funding commitments. Disruptions in capital and credit markets also may affect the determination of interest rates for borrowers, particularly rates based on LIBOR, as are our lines of credit. Any future disruptions in these markets and their effect on interest rates could result in increased borrowing costs under our lines of credit.

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## Cash Flows

The following table summarizes our cash flow activity for 2010 and 2009:

	<u>2010</u>	<u>2009</u>	<u>Change</u>
Cash flows provided by operating activities	<b>\$152.8</b>	\$ 88.3	\$ 64.5
Cash flows used in investing activities	<b>\$ (10.1)</b>	\$(15.5)	\$ 5.4
Cash flows used in financing activities	<b>\$ (74.2)</b>	\$(56.1)	\$(18.1)

A detail of the individual items contributing to the cash flow changes for the years presented is included in our consolidated statements of cash flows.

### Operating Activities

The increase in net cash provided by operating activities was principally attributable to higher net income and to changes in operating assets and liabilities, which were primarily composed of higher levels of accounts payable and other liabilities and lower levels of inventory, partially offset by higher accounts receivable driven by increased sales volume in 2010 compared to 2009.

### Investing Activities

The decrease in net cash used in investing activities is primarily due to \$6.0 million of lower spending on acquisitions in 2010 partially offset by a net increase in capital expenditures in 2010.

### Financing Activities

The increase in net cash used in financing activities is primarily the result of an increase of \$8.9 million in dividends paid, a \$8.8 million increase in distributions made to the noncontrolling interest of Carrier Enterprise, a \$6.7 million decrease in excess tax benefits resulting from share-based compensation and \$4.3 million lower net proceeds from issuances of common stock, partially offset by \$6.7 million of revolving credit agreements fees paid in 2009 and \$3.9 million lower net repayments of debt in 2010.

Cash distributions attributable to Carrier's noncontrolling interest in Carrier Enterprise totaled \$23.3 million in 2010, of which, \$9.7 was payable at December 31, 2010. This payment was made in January 2011.

Working capital increased to \$572.0 million at December 31, 2010 from \$531.4 million at December 31, 2009 reflecting higher cash on hand resulting from improved collections as well as due to the aforementioned increase in accounts receivable partially offset by higher levels of accounts payable and accrued expenses and a decrease in inventory levels. The increase in working capital was primarily funded by operating cash flows.

### Revolving Credit Agreements

We maintain a bank-syndicated, unsecured revolving credit agreement that provides for borrowings of up to \$300.0 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. The credit facility matures in August 2012. At December 31, 2010 and 2009, \$10.0 million and \$12.8 million were outstanding under this 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 limits capital expenditures, dividends and share repurchases in addition to other restrictions. We believe we were in compliance with all covenants and financial ratios at December 31, 2010.

Carrier Enterprise maintains a separate secured revolving credit agreement that provides for borrowings of up to \$75.0 million. Borrowings under the credit facility are used by Carrier Enterprise for general corporate purposes, including working capital and permitted acquisitions. The credit facility is secured by substantially all tangible and intangible assets of Carrier Enterprise. The credit facility matures in July 2012. At December 31, 2009, \$0.01 million was outstanding under this credit facility. At December 31, 2010, no borrowings were outstanding under this credit facility.

This revolving credit agreement contains customary affirmative and negative covenants and representations and warranties, including compliance with a monthly borrowing base certificate with advance rates on accounts receivable and inventory, two financial covenants with respect to Carrier Enterprise's leverage and interest coverage ratios and limits the level of capital expenditures and cash distributions in addition to other restrictions. We believe Carrier Enterprise was in compliance with all covenants and financial ratios at December 31, 2010.

### *Contractual Obligations and Off-Balance Sheet Arrangements*

As of December 31, 2010, our significant contractual obligations were as follows (in millions):

<u>Contractual Obligations</u>	<u>Payments due by Period</u>						<u>Total</u>
	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>Thereafter</u>	
Non-cancelable operating lease obligations	\$ 56.6	\$ 42.7	\$ 32.5	\$ 24.1	\$ 15.4	\$ 18.3	\$ 189.6
Minimum royalty payment	1.0	—	—	—	—	—	1.0
Other debt	0.1	—	—	—	—	—	0.1
Total Contractual Obligations	<u>\$ 57.7</u>	<u>\$ 42.7</u>	<u>\$ 32.5</u>	<u>\$ 24.1</u>	<u>\$ 15.4</u>	<u>\$ 18.3</u>	<u>\$ 190.7</u>

Commercial obligations outstanding at December 31, 2010 under the revolving credit agreements consist of borrowings totaling \$10.0 million and standby letters of credit totaling \$3.4 million. Borrowings under the revolving credit agreements at December 31, 2010 had revolving maturities of 30 days and letters of credit had varying terms expiring through July 2012.

Standby letters of credit are primarily used as collateral under self-insurance programs and are not expected to result in any material losses or obligation as the obligations under the programs will be met in the ordinary course of business. Accordingly, the estimated fair value of these instruments is zero at December 31, 2010. See Note 10 to our consolidated financial statements for further information.

### *Company Share Repurchase Program*

Our Board of Directors has authorized the repurchase, at management's discretion, of 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. Repurchases totaled 105,600 shares at a cost of \$4.8 million in 2008. No shares were repurchased in 2010 or 2009. In aggregate, 6,370,913 shares of Common stock and Class B common stock have been repurchased at a cost of \$114.4 million since the inception of the program. The remaining 1,129,087 shares authorized for repurchase are subject to certain restrictions included in our revolving credit agreements.

### *Common Stock Dividends*

Cash dividends of \$2.04, \$1.89 and \$1.75 per share of Common stock and Class B common stock were paid in 2010, 2009 and 2008, respectively. In February 2011, the Board of Directors approved an increase to the quarterly cash dividend rate to \$0.57 per share from \$0.52 per share of Common and Class B common stock beginning with the next regular scheduled dividend declaration in April 2011. 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 profitability, financial condition, cash requirements, restrictions under our revolving credit agreements, future prospects and other factors deemed relevant by our Board of Directors.

### *Capital Resources*

We believe we have adequate availability of capital from operations and our current credit facilities to fund working capital requirements and support the development of our short-term and long-term operating strategies. As of December 31, 2010, we had \$126.5 million of cash and cash equivalents available on hand, of which \$24.0 million is available for debt repayment. Additional borrowing capacity (subject to certain restrictions) under our revolving credit agreements is available to fund present operations and anticipated growth, including expansion in our current and targeted market areas. Potential acquisitions are continually evaluated and discussions are conducted with a number of acquisition candidates. Should suitable acquisition opportunities or working capital needs arise that would require additional financing, we believe our financial position and earnings history provide a sufficient base for obtaining additional financing resources at competitive rates and terms or gives us the ability to raise funds through the issuance of equity securities.

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At December 31, 2010, we had the following amounts available to fund operations, subject to certain restrictions, under the aforementioned credit facilities:

Watsco unsecured revolving credit facility	\$287.2
Carrier Enterprise secured revolving credit facility	\$ 74.4

### Quantitative and Qualitative Disclosures about Market Risk

Our primary market risk exposure is interest rate risk, and our objective is to manage our exposure to interest rate changes by reducing borrowing costs, which limits the impact of interest rate changes on earnings and cash flows. To achieve this objective, we use interest rate swaps to manage net exposure to interest rate changes on our borrowings. These swaps are entered into with financial institutions with investment grade credit ratings, thereby minimizing the risk of credit losses. All items described are non-trading. See Notes 1 and 10 to our consolidated financial statements for further information.

Interest rate swap agreements reduce the exposure to market risks from changing interest rates under our revolving credit agreements. Under the swap agreements, we agree to exchange, at specified intervals, the difference between fixed and variable interest amounts calculated by reference to a notional principal amount. Any differences paid or received on interest rate swap agreements are recognized as adjustments to interest expense over the life of each swap, thereby adjusting the effective interest rate on the underlying obligation. Financial instruments are not held for trading purposes. Derivatives used for hedging purposes must be designated as, and effective as, a hedge of the identified risk exposure at the inception of the contract. Accordingly, changes in the fair value of the derivative contract must be highly correlated with changes in the fair value of the underlying hedged item at inception of the hedge and over the life of the hedge contract.

At December 31, 2010 and 2009, we had one interest rate swap agreement in effect with a notional amount of \$10.0 million, to manage the net exposure to interest rate changes related to \$10.0 million of borrowings under our revolving credit agreement. The swap agreement matures in October 2011 and exchanges the variable rate of 30-day LIBOR to a fixed interest rate of 5.07%. The interest rate swap was effective as a cash flow hedge and no charge to earnings was required in 2010, 2009 and 2008.

We were party to an interest rate swap agreement with a notional amount of \$10.0 million, which matured in October 2009 that was designated as a cash flow hedge and effectively exchanged the variable rate of 30-day LIBOR to a fixed interest rate of 5.04%. During 2009 and 2008, the hedging relationship was determined to be highly effective in achieving offsetting changes in cash flows.

The negative fair value of the derivative financial instrument was \$0.4 million at December 31, 2010, and is included, net of accrued interest, in accrued expenses and other current liabilities in the consolidated balance sheet. The negative fair value of the derivative financial instrument was \$0.7 million at December 31, 2009, and is included, net of accrued interest, in deferred income taxes and other liabilities in the consolidated balance sheet.

At December 31, 2010 and 2009, our exposure to interest rate changes was limited to variable rate lease payments which are indexed to one month LIBOR. To assess our exposure to changes in interest rates, we performed a sensitivity analysis to determine the impact to earnings associated with an immediate 100 basis-point fluctuation from one month LIBOR. Based on the results of this simulation, as of December 31, 2010 and 2009, net income would decrease or increase by approximately \$0.1 million on an annual basis if there were an immediate 100 basis-point increase or decrease, respectively, in one month LIBOR. Future disruptions, if any, in the capital and credit markets may also affect the determination of interest rates for LIBOR-based borrowers. Disruptions in these markets and their affect on interest rates could result in increased borrowings than our sensitivity analysis determined. This information constitutes a "forward-looking statement" and actual results may differ significantly based on actual borrowings and interest rates.

### Recent Accounting Pronouncements

Refer to Note 1 to the consolidated financial statements for a discussion of recent accounting pronouncements.

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**WATSCO, INC. AND SUBSIDIARIES**  
**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, 2010. The assessment was based on criteria established in the framework *Internal Control — Integrated Framework*, 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, 2010. The effectiveness of our internal control over financial reporting as of December 31, 2010 has been audited by KPMG LLP, an independent registered public accounting firm, as stated in their report that is included herein.

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**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, 2010, based on criteria established in *Internal Control – Integrated Framework* 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, 2010, based on criteria established in *Internal Control – Integrated Framework* 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, 2010 and 2009, and the related consolidated statements of income, shareholders' equity and cash flows for each of the years in the two-year period ended December 31, 2010, and our report dated March 1, 2011 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Miami, Florida  
March 1, 2011  
Certified Public Accountants



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**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 (the Company) as of December 31, 2010 and 2009, and the related consolidated statements of income, shareholders' equity and cash flows for each of the years in the two-year period ended December 31, 2010. 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, 2010, and the results of their operations and their cash flows for the two years ended December 31, 2010, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, the Company has changed its method of accounting for business combinations as of January 1, 2009, due to the adoption of Financial Accounting Standards Board Statement No. 141(R), *Business Combinations* (codified in Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) Topic 805, *Business Combinations*), and changed its method of accounting for noncontrolling interests beginning July 1, 2009 (as a result of the formation of Carrier Enterprise, LLC on that date), due to the adoption of Financial Accounting Standards Board Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51* (codified in Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) Topic 810, *Consolidation*), and changed its method for determining whether certain securities should be included in the basic earnings per share calculation as of January 1, 2009, due to the adoption of Financial Accounting Standards Board Staff Position No. EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* (codified in Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) Topic 260, *Earnings Per Share*).

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, 2010, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 1, 2011 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP

Miami, Florida  
March 1, 2011  
Certified Public Accountants

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Shareholders of  
Watsco, Inc.

We have audited the accompanying consolidated statements of income, cash flows, and shareholders' equity of Watsco, Inc. (a Florida Corporation) and subsidiaries (the "Company") for the year ended December 31, 2008. These 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 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 the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated results of operations and cash flows of Watsco, Inc. and subsidiaries for the year ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America.

/s/ GRANT THORNTON LLP

Miami, Florida

February 27, 2009 (except for earnings per share amounts as discussed in Note 1 - Accounting Changes - Earnings per Share, as to which the date is February 26, 2010)

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

<i>(In thousands, except per share data)</i>	Years Ended December 31,		
	2010	2009	2008
Revenues	\$2,844,595	\$ 2,001,815	\$ 1,700,237
Cost of sales	2,171,354	1,520,983	1,258,243
Gross profit	673,241	480,832	441,994
Selling, general and administrative expenses	507,669	399,772	343,386
Operating income	165,572	81,060	98,608
Interest expense, net	3,490	2,731	2,018
Income before income taxes	162,082	78,329	96,590
Income taxes	50,360	26,756	36,221
Net income	111,722	51,573	60,369
Less: net income attributable to noncontrolling interest	30,962	8,259	—
Net income attributable to Watsco, Inc.	<u>\$ 80,760</u>	<u>\$ 43,314</u>	<u>\$ 60,369</u>
Earnings per share for Common and Class B common stock:			
Basic	<u>\$ 2.49</u>	<u>\$ 1.42</u>	<u>\$ 2.14</u>
Diluted	<u>\$ 2.49</u>	<u>\$ 1.40</u>	<u>\$ 2.09</u>

*See accompanying notes to consolidated financial statements.*

**WATSCO, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**

<i>(In thousands, except share and per share data)</i>	December 31,	
	2010	2009
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 126,498	\$ 58,093
Accounts receivable, net	305,088	266,284
Inventories	391,925	410,078
Other current assets	14,493	20,843
Total current assets	838,004	755,298
Property and equipment, net	31,221	33,118
Goodwill	303,703	303,257
Intangible assets, net	56,627	58,566
Other assets	7,672	10,374
	\$1,237,227	\$1,160,613
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Current portion of long-term obligations	\$ 72	\$ 151
Accounts payable	182,185	145,825
Accrued expenses and other current liabilities	83,748	77,950
Total current liabilities	266,005	223,926
Long-term obligations:		
Borrowings under revolving credit agreements	10,000	12,763
Other long-term obligations, net of current portion	16	666
Total long-term obligations	10,016	13,429
Deferred income taxes and other liabilities	32,310	28,450
Commitments and contingencies		
Watsco, Inc. shareholders' equity:		
Common stock, \$0.50 par value, 60,000,000 shares authorized; 34,447,037 and 34,209,913 shares issued in 2010 and 2009, respectively	17,223	17,105
Class B common stock, \$0.50 par value, 10,000,000 shares authorized; 4,373,301 and 4,299,644 shares issued in 2010 and 2009, respectively	2,187	2,150
Preferred stock, \$0.50 par value, 10,000,000 shares authorized; no shares issued	—	—
Paid-in capital	472,883	461,563
Accumulated other comprehensive loss, net of tax	(593)	(821)
Retained earnings	387,186	372,454
Treasury stock, at cost, 6,370,913 shares of Common and Class B common stock in 2010 and 2009	(114,425)	(114,425)
Total Watsco, Inc. shareholders' equity	764,461	738,026
Noncontrolling interest	164,435	156,782
Total shareholders' equity	928,896	894,808
	\$1,237,227	\$1,160,613

*See accompanying notes to consolidated financial statements.*

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

<i>(In thousands, except share and per share data)</i>	Common Stock, Class B Common Stock and Preferred Stock Shares	Common Stock, Class B Common Stock and Preferred Stock Amount	Paid-In Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Treasury Stock	Noncontrolling Interest	Total
<b>Balance at December 31, 2007</b>	<b>27,969,470</b>	<b>\$17,117</b>	<b>\$267,669</b>	<b>\$ (431)</b>	<b>\$375,207</b>	<b>\$(109,605)</b>	<b>\$ —</b>	<b>\$ 549,957</b>
Net income					60,369			60,369
Changes in unrealized gains and losses on available-for-sale securities and derivative instruments, net of income taxes				(694)				(694)
Comprehensive income								59,675
Retirement of common stock	(261,014)	(131)	(9,798)					(9,929)
Common stock contribution to 401(k) plan	33,986	17	1,232					1,249
Stock issuances from exercise of stock options and employee stock purchase plan	643,796	323	12,344					12,667
Excess tax benefit from share-based compensation			4,758					4,758
Issuances of non-vested (restricted) shares of common stock	45,000	23	(23)					—
Share-based compensation			6,454					6,454
Cash dividends declared on Common and Class B common stock, \$1.75 per share					(49,351)			(49,351)
Purchase of treasury stock	(105,600)					(4,820)		(4,820)
<b>Balance at December 31, 2008</b>	<b>28,325,638</b>	<b>17,349</b>	<b>282,636</b>	<b>(1,125)</b>	<b>386,225</b>	<b>(114,425)</b>	<b>—</b>	<b>570,660</b>

*Continued on next page.*

<i>(In thousands, except share and per share data)</i>	Common Stock, Class B Common Stock and Preferred Stock Shares	Common Stock, Class B Common Stock and Preferred Stock Amount	Paid-In Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Treasury Stock	Noncontrolling Interest	Total
Net income					43,314		8,259	51,573
Changes in unrealized gains and losses on available-for-sale securities and derivative instruments, net of income taxes				304				304
Comprehensive income								51,877
Retirement of common stock	(206,029)	(103)	(9,335)					(9,438)
Common stock contribution to 401(k) plan	33,779	17	1,280					1,297
Stock issuances from exercise of stock options and employee stock purchase plan	823,320	412	11,885					12,297
Excess tax benefit from share-based compensation			9,589					9,589
Issuances of non-vested (restricted) shares of common stock	86,635	43	(43)					—
Forfeitures of non-vested (restricted) shares of common stock	(5,168)	(3)	3					—
Share-based compensation			5,264					5,264
Cash dividends declared on Common and Class B common stock, \$1.89 per share					(57,085)			(57,085)
Common and Class B common stock issued for joint venture	3,080,469	1,540	149,516					151,056
Fair value increment over carrying value of locations contributed to joint venture			10,768					10,768
Fair value of noncontrolling interest							108,883	108,883
Share of carrying value of our locations contributed to joint venture							12,448	12,448
Non-cash capital contribution of inventory by noncontrolling interest							32,000	32,000
Distribution to noncontrolling interest							(4,808)	(4,808)
<b>Balance at December 31, 2009</b>	<b>32,138,644</b>	<b>19,255</b>	<b>461,563</b>	<b>(821)</b>	<b>372,454</b>	<b>(114,425)</b>	<b>156,782</b>	<b>894,808</b>

Continued on next page.

<i>(In thousands, except share and per share data)</i>	Common Stock, Class B Common Stock and Preferred Stock Shares	Common Stock, Class B Common Stock and Preferred Stock Amount	Paid-In Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Treasury Stock	Noncontrolling Interest	Total
Net income					80,760		30,962	111,722
Changes in unrealized gains and losses on available-for-sale securities and derivative instrument, net of income taxes				228				228
Comprehensive income								111,950
Retirement of common stock	(75,721)	(38)	(4,329)					(4,367)
Common stock contribution to 401(k) plan	9,975	5	484					489
Stock issuances from exercise of stock options and employee stock purchase plan	268,827	134	7,182					7,316
Excess tax benefit from share-based compensation			2,862					2,862
Issuances of non-vested (restricted) shares of common stock	135,000	67	(67)					—
Forfeitures of non-vested (restricted) shares of common stock	(27,300)	(13)	13					—
Share-based compensation			5,175					5,175
Cash dividends declared on Common and Class B common stock, \$2.04 per share					(66,028)			(66,028)
Distributions to noncontrolling interest							(23,309)	(23,309)
<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>

See accompanying notes to consolidated financial statements.

**WATSCO, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

<i>(In thousands)</i>	Years Ended December 31,		
	2010	2009	2008
<b>Cash flows from operating activities:</b>			
Net income	\$ 111,722	\$ 51,573	\$ 60,369
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>			
Depreciation and amortization	10,771	8,533	7,071
Share-based compensation	5,175	5,264	6,454
Provision for doubtful accounts	3,016	5,934	3,816
Gain on sale of property and equipment	(432)	(47)	(170)
Deferred income tax provision	12,725	1,972	447
Non-cash contribution for 401(k) plan	489	1,297	1,249
Excess tax benefits from share-based compensation	(2,862)	(9,589)	(4,758)
<b>Changes in operating assets and liabilities, net of effects of acquisitions:</b>			
Accounts receivable	(41,250)	67,243	23,416
Inventories	21,447	1,204	37,153
Accounts payable and other liabilities	28,088	(46,386)	(23,020)
Other, net	3,910	1,289	1,446
Net cash provided by operating activities	<u>152,799</u>	<u>88,287</u>	<u>113,473</u>
<b>Cash flows from investing activities:</b>			
Capital expenditures	(8,421)	(5,912)	(3,973)
Business acquisitions, net of cash acquired	(3,824)	(9,840)	76
Proceeds from sale of property and equipment	2,111	249	226
Net cash used in investing activities	<u>(10,134)</u>	<u>(15,503)</u>	<u>(3,671)</u>
<b>Cash flows from financing activities:</b>			
Dividends on Common and Class B common stock	(66,028)	(57,085)	(49,351)
Distributions to noncontrolling interest	(13,644)	(4,808)	—
Net repayments under revolving credit agreements	(2,763)	(7,237)	(34,000)
Net repayments of other long-term obligations	(729)	(234)	(266)
Payment of fees related to revolving credit agreements	—	(6,695)	—
Purchase of treasury stock	—	—	(4,820)
Excess tax benefits from share-based compensation	2,862	9,589	4,758
Net proceeds from issuances of common stock	6,042	10,335	5,916
Net cash used in financing activities	<u>(74,260)</u>	<u>(56,135)</u>	<u>(77,763)</u>
Net increase in cash and cash equivalents	68,405	16,649	32,039
Cash and cash equivalents at beginning of year	58,093	41,444	9,405
Cash and cash equivalents at end of year	<u>\$ 126,498</u>	<u>\$ 58,093</u>	<u>\$ 41,444</u>

Supplemental cash flow information (Note 14)

*See accompanying notes to consolidated financial statements.*



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**WATSCO, INC. AND SUBSIDIARIES**  
**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 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. Since 1989, our HVAC/R distribution revenues have increased from approximately \$64,000 to \$2,800,000 in 2010. At December 31, 2010 we operated from 505 locations in 36 states and Puerto Rico with additional market coverage on an export basis to parts of 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 a joint venture in which Watsco maintains a 60% controlling interest. All significant intercompany balances and transactions have been eliminated.

**Use of Estimates**

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles 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, inventory and income taxes, reserves related to self-insurance programs and valuation of goodwill and indefinite lived intangible assets. While we believe that these estimates are reasonable, actual results could differ from such estimates.

**Accounting Changes**

*Transfers of Financial Assets*

In June 2009, the Financial Accounting Standards Board ("FASB") issued accounting and disclosure guidance for transfers of financial assets occurring on or after January 1, 2010. The adoption of this guidance did not have a material impact on our consolidated financial statements.

*Variable Interest Entities*

In June 2009, the FASB issued accounting guidance that amended the consolidation principles for variable interest entities ("VIEs") by requiring consolidation of VIEs based on which party has control of the entity. This guidance was effective beginning January 1, 2010. The adoption of this guidance did not have a material impact on our consolidated financial statements.

*Business Combinations*

In December 2007, the FASB revised the accounting guidance for recognizing and measuring assets acquired and liabilities assumed in a business combination and require, among other things, that transaction costs in a business combination be expensed as incurred. This guidance was effective for business combinations closing after January 1, 2009. See Note 7.

*Noncontrolling Interests*

In December 2007, the FASB issued accounting guidance which clarified that a noncontrolling interest in a subsidiary should be reported as equity in the consolidated financial statements. This guidance affected our consolidated financial statements beginning July 1, 2009, as a result of the formation of Carrier Enterprise, LLC ("Carrier Enterprise") on this date. See Note 7.

## Earnings per Share

In June 2008, the FASB issued earnings per share guidance stating that non-vested share-based payment awards that contain non-forfeitable rights to dividends are considered participating securities and should be included in the computation of earnings per share pursuant to the two-class method. We adopted the provisions of this accounting guidance effective January 1, 2009 and computed earnings per share using the two-class method for all periods presented. The two-class method of computing earnings per share based on the new accounting guidance reduced diluted earnings per share for our Common and Class B common stock by the following amounts:

<u>Years Ended December 31,</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Diluted earnings per share for Common and Class B common stock excluding effect of the participating securities	<b>\$2.56</b>	\$ 1.46	\$ 2.18
Less: effect of the participating securities	<b>\$0.07</b>	\$ 0.06	\$ 0.09
Diluted earnings per share for Common and Class B common stock as adjusted	<b>\$2.49</b>	\$ 1.40	\$ 2.09

## Cash Equivalents

All highly liquid instruments purchased with original maturities of three months or less are considered to be cash equivalents. Cash equivalents at December 31, 2010 included \$10,600 of municipal securities with put options to the issuer of seven days, which were considered to be cash equivalents for purposes of the consolidated financial statements. No individual municipal security equaled or exceeded 1% of total assets and such securities were investment grade and collateralized by a letter of credit issued by the remarketing agent. At December 31, 2009, no municipal securities were held.

## Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable primarily consists of trade receivables due from customers. Our customers are primarily independent contractors and dealers who service the replacement and new construction markets for residential and light commercial central air conditioning, heating and refrigeration systems. We routinely grant credit to customers to facilitate revenue growth and maintain branch locations for product sales and distribution. When determining whether to grant or increase credit, management considers a number of factors, which include creditworthiness, customer payment history and historical experience with the customer and other information. Consistent with industry practices, we normally require payment from our customers within 30 to 45 days. We record our trade receivables at the invoiced amount less an allowance for doubtful accounts. An allowance for doubtful accounts is maintained 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. We typically do not require our customers to provide collateral. Accounts receivable reserve policies are reviewed periodically, reflecting current risks, trends and changes in industry conditions. The past due status of an account is determined based on stated payment terms. Upon determination that an account is uncollectible, we write off the receivable balance. At December 31, 2010 and 2009, the allowance for doubtful accounts totaled \$6,343 and \$10,942, respectively. Although we believe the allowance is sufficient, a declining economic environment could lead to the deterioration in the financial condition of our customers, resulting in an impairment of their ability to make payments and additional allowances may be required.

## 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 method. As part of the valuation process, inventory reserves are established to state excess, slow-moving and damaged inventories at their estimated net realizable value. Inventory reserve 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 these estimates of earned vendor rebates based on actual purchase levels. At December 31, 2010 and 2009, we have \$6,226 and \$5,019, 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 of \$157 and \$104 at December 31, 2010 and 2009, respectively, are included in other assets in our consolidated balance sheets and are classified as available-for-sale. These equity securities are recorded at market using the specific identification method with unrealized holding losses, net of deferred taxes, reported in accumulated other comprehensive loss ("OCL") within shareholders' equity. Dividend and interest income are recognized in the statement of income when earned. At December 31, 2010 and 2009, \$355 and \$389 of unrealized losses, net of deferred tax benefits of \$217 and \$237, respectively, was included in accumulated OCL.

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## 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 3-7 years. Depreciation and amortization expense related to property and equipment amounted to \$8,832, \$7,342 and \$6,612 for the years ended December 31, 2010, 2009 and 2008, respectively.

## Goodwill and 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 at least annually or more frequently if events or changes in circumstances 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 its carrying value, a second step is performed to measure the amount of impairment loss.

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 have been no events or circumstances from the date of our assessment that would impact this conclusion. See Note 8.

## Impairment of Long-Lived Assets Other than Goodwill

Long-lived assets, including intangible assets with finite lives, are tested for recoverability when events or changes in circumstances indicate that the carrying amount of 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. The amount of impairment if any, is measured 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, 2010, 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 an exit price, representing the amount that would be received to sell 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. Assessment of collection is based on a number of factors, including past transactions, creditworthiness of customers, historical trends and other information. 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.

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## Advertising Costs

Advertising costs are expensed as incurred. Advertising expense amounted to \$26,646, \$12,106 and \$5,841 for the years ended December 31, 2010, 2009 and 2008, 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 included in selling, general and administrative expenses amounted to \$25,443, \$14,829 and \$6,444 for the years ended December 31, 2010, 2009 and 2008, 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 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. See Note 6.

## Income Taxes

We record federal and state 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. Watsco and its 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 Watsco and its 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

Earnings per share is computed 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 stock 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 for our Common stock assumes the conversion of all of our Class B common stock into Common stock as of the beginning of the year and adjusts for the dilutive effects of outstanding stock options using the treasury stock method. As of December 31, 2010, 2009 and 2008, our outstanding Class B common stock was convertible into 2,858,592, 2,844,935 and 2,435,546 shares as of our Common stock, respectively.

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

<u>Years Ended December 31,</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
<b>Basic Earnings per Share:</b>			
Net income attributable to Watsco, Inc. shareholders	\$80,760	\$ 43,314	\$ 60,369
Less: distributed and undistributed earnings allocated to non-vested (restricted) common stock	4,775	3,320	3,809
Earnings allocated to Watsco, Inc. shareholders	<u>\$75,985</u>	<u>\$39,994</u>	<u>\$56,560</u>
Allocation of earnings for Basic:			
Common stock	\$68,856	\$35,963	\$ 51,353
Class B common stock	7,129	4,031	5,207
	<u>\$75,985</u>	<u>\$39,994</u>	<u>\$56,560</u>
<b>Diluted Earnings per Share:</b>			
Net income attributable to Watsco, Inc. shareholders	\$80,760	\$ 43,314	\$ 60,369
Less: distributed and undistributed earnings allocated to non-vested (restricted) common stock	4,772	3,320	3,796
Earnings allocated to Watsco, Inc. shareholders	<u>\$75,988</u>	<u>\$39,994</u>	<u>\$56,573</u>

The diluted earnings per share calculation assumes the conversion of all of our Class B common stock into Common stock as of the beginning of the year; therefore, no allocation of earnings to Class B common stock is required.

<u>Years Ended December 31,</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Weighted-average Common and Class B common shares outstanding for basic earnings per share	30,467,212	28,223,275	26,453,167
Effect of dilutive stock options	111,396	298,162	568,560
Weighted-average Common and Class B common shares outstanding for diluted earnings per share	<u>30,578,608</u>	<u>28,521,437</u>	<u>27,021,727</u>

Diluted earnings per share excluded 129,641, 217,832 and 261,015 shares for the years ended December 31, 2010, 2009 and 2008, 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.

#### 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 OCL 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 10, "Derivative Financial Instrument."

#### Comprehensive Income

Comprehensive income consists of net income and changes in the unrealized losses on available-for-sale securities and the effective portion of cash flow hedges as discussed in Note 10. The components of comprehensive income are as follows:

<u>Years Ended December 31,</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Net income	\$111,722	\$51,573	\$ 60,369
Changes in unrealized losses on derivative instruments, net of income tax expense (benefit) of \$117, \$205 and \$(248), respectively	194	346	(411)
Changes in unrealized losses on available-for-sale securities, net of income tax expense (benefit) of \$19, \$(29) and \$(170), respectively	34	(42)	(283)
Comprehensive income	111,950	51,877	59,675
Less: comprehensive income attributable to noncontrolling interest	30,962	8,259	—
Comprehensive income attributable to Watsco, Inc.	<u>\$ 80,988</u>	<u>\$ 43,618</u>	<u>\$59,675</u>

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## Recently Issued Accounting Standards

### *Revenue Arrangements with Multiple Deliverables*

In October 2009, the FASB issued accounting guidance that amends the criteria for allocating a contract's consideration to individual services or products in multiple deliverable arrangements. This guidance is effective for revenue arrangements entered into or materially modified on or after January 1, 2011. The adoption of this guidance is not expected to have a material impact on our consolidated financial statements.

### *Fair Value Measurement Disclosures*

In January 2010, the FASB issued accounting guidance that requires new disclosures about significant transfers between Level 1 and 2 fair value measurements, including the reason for such transfers, and also requires information about purchases, sales, issuances and settlements of Level 3 fair value measurements. This guidance became effective on January 1, 2010, except for the requirement to provide the Level 3 activity, which will be effective for interim reporting periods after January 1, 2011. The adoption of this guidance has not and is not expected to have a material impact on our consolidated financial statements.

### *Credit Quality of Financing Receivables and the Allowance for Credit Losses*

In July 2010, the FASB issued expanded disclosure requirements about the credit quality of financing receivables and their allowance for credit losses. The disclosures will provide additional information about the nature of credit risks inherent in financing receivables, how credit risk is analyzed and assessed in determining the allowance for credit losses and the reasons for any changes to the allowance for credit losses. Disclosures as of the end of a reporting period are required at December 31, 2010 and disclosures about the activity that occurs during a reporting period are effective for interim and annual periods after January 1, 2011. The adoption of this guidance is not expected to have a material impact on our consolidated financial statements.

### *Goodwill Impairment Testing*

In December 2010, the Emerging Issues Task Force ("EITF") of the FASB issued accounting guidance requiring that Step 2 of the goodwill impairment test be performed in circumstances where a reporting unit has a zero or negative carrying amount for which qualitative factors exist that indicate that goodwill may be impaired. This guidance is effective for annual reporting periods after January 1, 2011. The adoption of this guidance is not expected to have a material impact on our consolidated financial statements.

### *Supplementary Pro Forma Information for Business Combinations*

In December 2010, the EITF issued accounting guidance requiring pro forma financial information for business combinations to be presented as if the business combination occurred at the beginning of the prior annual reporting period when calculating both the current reporting period and the prior reporting period. This guidance also requires a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination. This guidance is effective for business combinations in which the acquisition date is on or after January 1, 2011. The adoption of this guidance is not expected to have a material impact on our consolidated financial statements.

## **2. Supplier Concentration**

We have four key suppliers of HVAC/R equipment products. Purchases from these four suppliers comprised 72%, 66% and 48% of all purchases made in 2010, 2009 and 2008, respectively; with the largest supplier, Carrier Corporation ("Carrier") and its affiliates, accounting for 52%, 41% and 13% of all purchases made in each of the years ended December 31, 2010, 2009 and 2008, respectively. Any significant interruption by Carrier or the other 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. See Note 13.

### 3. Property and Equipment

Property and equipment, net, consists of:

<u>December 31,</u>	<u>2010</u>	<u>2009</u>
Land	\$ 1,388	\$ 1,520
Buildings and improvements	34,521	36,840
Machinery, vehicles and equipment	48,821	47,671
Furniture and fixtures	13,765	12,434
	<u>98,495</u>	<u>98,465</u>
Less: accumulated depreciation and amortization	<u>(67,274)</u>	<u>(65,347)</u>
	<u>\$31,221</u>	<u>\$ 33,118</u>

### 4. Long-Term Obligations

#### Watsco Revolving Credit Agreement

We maintain a bank-syndicated, unsecured revolving credit agreement that provides for borrowings of up to \$300,000. 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 \$25,000 swingline subfacility and a \$50,000 letter of credit subfacility. Borrowings bear interest at primarily LIBOR-based rates plus a spread which ranges from 37.5 to 112.5 basis-points depending upon our ratio of total debt to EBITDA (LIBOR plus 37.5 basis-points at December 31, 2010). We pay a variable commitment fee on the unused portion of the commitment, ranging from 7.5 to 20 basis-points (7.5 basis-points at December 31, 2010). Alternatively, we may elect to have borrowings bear interest at the Prime Rate or the Federal Funds Rate plus our spread. The credit facility matures in August 2012. At December 31, 2010 and 2009, \$10,000 and \$12,750 were outstanding under this revolving credit agreement, respectively.

In July 2009, we amended our credit agreement to allow for the consummation of the joint venture, Carrier Enterprise. We paid an amendment fee of \$5,483, which is being amortized ratably through the maturity of the facility in August 2012. All other significant terms and conditions remained the same, including capacity, pricing and covenant structure.

The revolving credit agreement contains customary affirmative and negative covenants including financial covenants with respect to consolidated leverage and interest coverage ratios and limits capital expenditures, dividends and share repurchases in addition to other restrictions. We believe we were in compliance with all covenants and financial ratios at December 31, 2010.

#### Carrier Enterprise Revolving Credit Agreement

Carrier Enterprise maintains a separate bank-syndicated, secured revolving credit agreement that provides for borrowings of up to \$75,000. Borrowings under the credit facility are used by Carrier Enterprise for general corporate purposes, including working capital and permitted acquisitions. Included in the facility are a \$15,000 swing loan subfacility and a \$5,000 letter of credit subfacility. Borrowings bear interest at primarily LIBOR-based rates plus a spread which ranges from 275 to 325 basis-points depending upon Carrier Enterprise's ratio of total debt to EBITDA (LIBOR plus 275 basis-points at December 31, 2010). Carrier Enterprise pays a fixed commitment fee on the unused portion of the commitment of 50 basis-points. Alternatively, Carrier Enterprise has the option to elect to have borrowings bear interest at the higher of the Prime Rate, the Federal Funds Rate plus 50 basis-points or a LIBOR-based rate plus 150 basis-points. The credit facility is secured by substantially all tangible and intangible assets of Carrier Enterprise. Carrier Enterprise paid fees of \$1,212 in connection with entering into the credit agreement, which are being amortized ratably through the maturity of the facility in July 2012. At December 31, 2009, \$13 was outstanding under this credit facility. At December 31, 2010, no borrowings were outstanding under this credit facility.

This revolving credit agreement contains customary affirmative and negative covenants and representations and warranties, including compliance with a monthly borrowing base certificate with advance rates on accounts receivable and inventory, two financial covenants with respect to Carrier Enterprise's leverage and interest coverage ratios and limitations on the level of capital expenditures and cash distributions in addition to other restrictions. We believe Carrier Enterprise was in compliance with all covenants and financial ratios at December 31, 2010.

#### Other Long-Term Obligations

Other long-term obligations, net of current portion, of \$16 and \$666 at December 31, 2010 and 2009, respectively, relate to capital leases on equipment and a mortgage loan. The mortgage loan was repaid during 2010 and at December 31, 2009 had an outstanding balance of \$557. Interest rates on other debt range from 1.0% to 10.1% and mature at varying dates through 2012. Annual maturities of other long-term obligations for the years subsequent to December 31, 2010 are as follows:

2011	\$ 72
2012	16
	<u>\$ 88</u>

## 5. Income Taxes

The components of income tax expense from our wholly-owned operations and our 60% controlling interest in Carrier Enterprise are as follows:

<u>Years Ended December 31,</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Federal	\$ 44,845	\$ 24,308	\$ 32,493
State	5,515	2,448	3,728
	<u>\$ 50,360</u>	<u>\$26,756</u>	<u>\$36,221</u>
Current	\$37,635	\$ 24,784	\$35,774
Deferred	12,725	1,972	447
	<u>\$ 50,360</u>	<u>\$26,756</u>	<u>\$36,221</u>

We calculate our income tax expense and our effective tax rate for 100% of income attributable to our wholly-owned operations and investments and 60% of income attributable to Carrier Enterprise, which is taxed as a partnership for income tax purposes.

Following is a reconciliation of the effective income tax rate:

<u>Years Ended December 31,</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Federal statutory rate	35.0%	35.0%	35.0%
State income taxes, net of federal benefit and other	3.0	2.8	2.5
Effective income tax rate attributable to Watsco, Inc.	38.0	37.8	37.5
Taxes attributable to the noncontrolling interest	(6.9)	(3.6)	—
Effective income tax rate	<u>31.1%</u>	<u>34.2%</u>	<u>37.5%</u>

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

<u>December 31,</u>	<u>2010</u>	<u>2009</u>
<b>Current deferred tax assets:</b>		
Allowance for doubtful accounts	\$ 1,122	\$ 3,332
Capitalized inventory costs and inventory reserves	2,183	5,056
Self-insurance reserves	1,523	1,418
Other current deferred tax assets	845	1,174
Total current deferred tax assets (1)	<u>5,673</u>	<u>10,980</u>
<b>Long-term deferred tax assets (liabilities):</b>		
Deductible goodwill	(37,567)	(30,890)
Net operating loss carryforwards	1,338	366
Unrealized loss on derivative instruments	152	268
Depreciation	(20)	869
Share-based compensation	9,890	9,530
Other long-term net deferred tax assets	(308)	(221)
Total net long-term deferred tax liabilities	<u>(26,515)</u>	<u>(20,078)</u>
Less valuation allowance	1,117	—
Net deferred tax liabilities	<u>\$ (21,959)</u>	<u>\$ (9,098)</u>

- (1) Current deferred tax assets of \$5,673 and \$10,980 have been included in the consolidated balance sheets in other current assets at December 31, 2010 and 2009, respectively.



Management has determined that \$1,117 of valuation allowance is necessary at December 31, 2010 to reduce the deferred tax assets to the amount that will more likely than not be realized. At December 31, 2009, there was no valuation allowance recorded. At December 31, 2010, there were state and other net operating loss carryforwards of \$10,581, which expire in varying amounts from 2011 through 2030. These amounts are available to offset future taxable income. There were no federal net operating loss carryforwards at December 31, 2010.

We are subject to U.S. federal income tax and income tax of multiple state jurisdictions. We are open to tax audits in the various jurisdictions until the respective statutes of limitations expire. We are no longer subject to U.S. federal tax examinations for tax years prior to 2007. For the majority of states, we are no longer subject to tax examinations for tax years prior to 2006.

As of December 31, 2010 and 2009, the total amount of gross unrecognized tax benefits (excluding the federal benefit received from state positions) was \$1,889 and \$1,990, respectively. Of these totals, \$1,419 and \$1,481, 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, 2010 and 2009, the cumulative amount of estimated accrued interest and penalties resulting from such unrecognized tax benefits was \$379 and \$317, respectively, and is included in deferred income taxes and other liabilities in the accompanying consolidated balance sheets.

The change in gross unrecognized tax benefits during 2010 and 2009 is as follows:

Gross balance at January 1, 2009	\$2,296
Additions based on tax positions related to the current year	146
Additions for tax positions of prior years	206
Reductions due to lapse of applicable statute of limitations	(658)
Gross balance at December 31, 2009	1,990
Additions based on tax positions related to the current year	197
Reductions due to lapse of applicable statute of limitations	(298)
Gross balance at December 31, 2010	<u>\$ 1,889</u>

## 6. Share-Based Compensation and Benefit Plans

### Share-Based Compensation Plans

We have two share-based compensation plans for employees. The 2001 Incentive Compensation Plan (the "2001 Plan") provides for the award of a broad variety of share-based compensation alternatives such as non-qualified stock options, incentive stock options, non-vested (restricted) stock, performance awards, dividend equivalents, deferred stock and stock appreciation rights at no less than 100% of the market price on the date the 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, awards for an aggregate of 4,000,000 shares of Common and Class B common stock may be granted. A total of 1,743,162 shares of Common stock, net of cancellations and 1,238,446 shares of Class B common stock, net of cancellations have been awarded under the 2001 Plan as of December 31, 2010. There were 1,018,392 shares of common stock reserved for future grants as of December 31, 2010 under the 2001 Plan. There are 488,000 options of common stock outstanding under the 2001 Plan at December 31, 2010. Options under the 2001 Plan vest over two to five years of service and have contractual terms of five to ten 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.

We also maintain the 1991 Stock Option Plan (the "1991 Plan"), which expired during 2001; therefore, no additional options may be granted. There are 5,000 options of common stock outstanding under the 1991 Plan at December 31, 2010. Options under the 1991 Plan vest over two to five years of service and have contractual terms of ten years.

A summary of stock option activity under the 2001 Plan and 1991 Plan as of December 31, 2010, and changes during 2010, is as follows:

	Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Options outstanding at January 1, 2010	615,000	\$ 33.19		
Granted	142,000	57.29		
Exercised	(254,500)	25.77		
Forfeited	(5,000)	49.73		
Expired	(4,500)	32.16		
Options outstanding at December 31, 2010	<u>493,000</u>	<u>\$ 43.80</u>	<u>2.69</u>	<u>\$ 9,575</u>
Options exercisable at December 31, 2010	<u>244,667</u>	<u>\$ 35.53</u>	<u>1.68</u>	<u>\$ 6,809</u>

The weighted-average grant date fair value of stock options granted during 2010, 2009 and 2008 was \$11.45, \$9.93 and \$7.06, respectively. The total intrinsic value of stock options exercised during 2010, 2009 and 2008 was \$6,559, \$11,555 and \$11,986, respectively. The fair value of stock options that vested during 2010, 2009 and 2008 was \$597, \$3,750 and \$2,158, respectively.

A summary of non-vested (restricted) stock activity as of December 31, 2010, and changes during 2010, is shown below:

	Shares	Weighted-Average Grant Date Fair Value
Non-vested (restricted) stock outstanding at January 1, 2010	1,826,001	\$ 30.98
Granted	135,000	49.43
Vested	(61,410)	52.03
Forfeited	(27,300)	40.72
Non-vested (restricted) stock outstanding at December 31, 2010	<u>1,872,291</u>	<u>\$ 31.47</u>

The weighted-average grant date fair value of non-vested (restricted) stock granted during 2010, 2009 and 2008 was \$49.43, \$49.62 and \$43.04, respectively. The fair value of non-vested stock that vested during 2010, 2009 and 2008 was \$3,609, \$1,460 and \$704, respectively.

During 2010, 2009 and 2008, 19,678 shares of Common stock with an aggregate market value of \$1,155, 601 shares of Common stock with an aggregate market value of \$23 and 590 shares of Common stock with an aggregate market value of \$26, respectively, were delivered as payment in lieu of cash to satisfy tax withholding obligations in connection with the vesting of non-vested (restricted) stock. These shares were retired upon delivery. At December 31, 2010, we were obligated to issue 301,052 shares of non-vested (restricted) Class B common stock under an executive compensation agreement. We issued these non-vested (restricted) shares of Class B common stock in the first quarter of 2011.

#### 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 within the valuation model. 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. We will continue to use the simplified method until we have the historical data necessary to provide a reasonable estimate of expected life. 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 U.S. 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 weighted-average assumptions relating to the valuation of our stock options were as follows:

<u>Years Ended December 31,</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Expected term in years	4.25	4.25	4.25
Risk-free interest rate	1.14%	1.96%	2.13%
Expected volatility	33.35%	34.03%	27.33%
Expected dividend yield	3.65%	4.32%	3.40%

#### Share-Based Compensation Expense

Share-based compensation expense included in selling, general and administrative expenses amounted to \$5,175, \$5,264 and \$6,454 for the years ended December 31, 2010, 2009 and 2008, respectively.

Cash received from Common stock issued as a result of stock options exercised during 2010, 2009 and 2008 was \$5,285, \$9,592 and \$5,235, respectively. During 2010, 2009 and 2008, 56,043 shares of Common and Class B common stock with an aggregate market value of \$3,212, 205,428 shares of Common and Class B common stock with an aggregate market value of \$9,415 and 260,424 shares of Common and Class B common stock with an aggregate market value of \$9,903, respectively, were delivered as payment in lieu of cash for stock option exercises and related tax withholdings. Upon delivery these shares were retired. The tax benefit realized for the tax deductions from share-based compensation plans totaled \$3,083, \$9,789 and \$5,095, for the years ended December 31, 2010, 2009 and 2008, respectively.

At December 31, 2010, there was \$1,353 of unrecognized share-based compensation expense related to stock options granted under the 2001 Plan, which is expected to be recognized over a weighted-average period of 1.9 years. At December 31, 2010, there was \$35,205 of unrecognized share-based compensation expense related to non-vested (restricted) stock, which is expected to be recognized over a weighted-average period of 12.0 years. 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. Approximately \$22,000 of the unrecognized share-based compensation for shares of non-vested (restricted) stock is related to awards granted to our Chief Executive Officer that vest in approximately twelve years upon his attainment of age 82.

#### Employee Stock Purchase Plan

The Watsco, Inc. Amended and Restated 1996 Qualified Employee Stock Purchase Plan (the "ESPP") provides for up to 1,000,000 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, through payroll deductions or lump-sum contribution, shares of Common stock with a discount of 5% of the fair market value at specified times. During 2010, 2009 and 2008, employees purchased 8,515, 10,917 and 9,058 shares of Common stock at an average price of \$51.69, \$38.18 and \$39.81 per share, respectively. Cash dividends received by the ESPP were reinvested in Common stock and resulted in additional shares issued in the amount of 5,812, 7,503 and 7,430 for the years ended December 31, 2010, 2009 and 2008, respectively. We received net proceeds of \$757, \$743 and \$681, respectively, during 2010, 2009 and 2008, for shares of Watsco Common stock issued under the ESPP. At December 31, 2010, 68,676 shares remained available for purchase under the plan.

#### 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, 2010, 2009 and 2008, we issued 9,975, 33,779 and 33,986 shares of Common stock to the plan representing the Common stock matching contribution of \$489, \$1,297 and \$1,249, respectively.

## 7. Acquisitions

In April 2010, one of our wholly-owned subsidiaries acquired certain assets and assumed certain liabilities of a wholesale distributor of air conditioning and heating products operating from two locations in Tennessee for cash consideration of \$2,406.

In August 2009, one of our wholly-owned subsidiaries acquired certain assets and assumed certain liabilities of a wholesale distributor of air conditioning and heating products operating from six locations in Utah for cash consideration of \$4,057, net of cash acquired.

In July 2009, we completed the formation of Carrier Enterprise, which is a joint venture between us and Carrier. Carrier contributed to Carrier Enterprise 95 locations in the U.S. Sunbelt and Puerto Rico and Carrier's export division located in Miami, Florida, and we contributed 15 locations that distributed Carrier products. We purchased a 60% controlling interest in the joint venture for a fair value of \$181,474 with options to purchase up to an additional 20% interest from Carrier (10% beginning in July 2012 and an additional 10% in July 2014). Total consideration paid by us for our 60% controlling interest in Carrier Enterprise was composed of our issuance to Carrier of 2,985,685 shares of Common stock and 94,784 shares of Class B common stock having a fair value of \$151,056 and our contribution of 15 locations that sold Carrier-manufactured

products valued at \$23,217. The final purchase price was subject to \$7,201 of working capital adjustments pursuant to the Purchase and Contribution Agreement dated May 3, 2009, as amended June 29, 2009 (“Purchase and Contribution Agreement”).

Based on our valuation we recognized \$131,341 in goodwill and intangibles. The fair value of the identified intangible assets was \$49,100 and consisted of \$32,400 in trade names and distribution rights and \$16,700 in customer relationships. The tax basis of the acquired goodwill recognized will be deductible for income tax purposes over 15 years.

The purchase price allocation is based upon a purchase price of \$181,474 which represents the fair value of our 60% controlling interest in Carrier Enterprise. 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 based on the respective fair values as of July 1, 2009:

Accounts receivable	\$ 186,082
Inventories	125,796
Other current assets	4,253
Property and equipment	10,048
Goodwill	82,241
Intangibles	49,100
Other assets	1,725
Accounts payable and accrued expenses	(163,485)
Other liabilities	(5,403)
Noncontrolling interest	(108,883)
Total purchase price	<u>\$ 181,474</u>

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 15 locations to the joint venture, \$12,448 representing 40% of the carrying value of the contributed locations was attributed to the noncontrolling interest and \$10,768 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.

In August 2009, a capital contribution in the amount of \$80,000 was made to Carrier Enterprise pursuant to the Purchase and Contribution Agreement. Our share of the contribution totaling \$48,000 was made as an additional capital contribution to Carrier Enterprise in cash. Carrier’s share of the contribution totaling \$32,000 consisted of inventory.

Revenues of \$588,065 and net income attributable to Watsco, Inc. of \$6,971 were contributed by the new Carrier Enterprise locations during the year ended December 31, 2009. The unaudited pro forma financial information combining our results of operations with the operations of Carrier Enterprise as if the joint venture had been consummated on January 1, 2008 is as follows:

<u>Years ended December 31,</u>	<u>2009</u>	<u>2008</u>
Revenues	<u>\$2,562,319</u>	<u>\$2,933,662</u>
Net income	59,874	76,894
Less: net income attributable to the noncontrolling interest	<u>13,332</u>	<u>8,775</u>
Net income attributable to Watsco, Inc.	<u>46,542</u>	<u>68,119</u>
Diluted earnings per share for Common and Class B common shares	\$ 1.44	\$ 2.13

This 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 acquisition date includes adjustments to record income taxes related to our portion of Carrier Enterprise’s income, bank fees paid to amend our \$300,000 revolving credit agreement upon the consummation of the joint venture, bank fees paid by Carrier Enterprise to enter into a secured three-year \$75,000 revolving credit agreement and amortization related to identified intangible assets with finite lives. The unaudited pro forma financial information does not include adjustments to remove certain corporate expenses of Carrier Enterprise, which may not be incurred in future periods, adjustments for depreciation or synergies (primarily related to improved gross profit and lower general and administrative expenses) that may be realized subsequent to the acquisition date. The unaudited pro forma financial information may not necessarily reflect our future results of operations or what the results of operations would have been had we owned and operated Carrier Enterprise 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. The pro forma effect of the April 2010 and August 2009 acquisitions were not deemed significant to the consolidated financial statements.

## 8. Goodwill and Intangible Assets

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

Balance at December 31, 2008	\$219,810
Acquired goodwill	83,447
Balance at December 31, 2009	303,257
Acquired goodwill	446
Balance at December 31, 2010	<u>\$ 303,703</u>

Intangible assets, net consist of:

<u>December 31,</u>	<u>Estimated Useful Lives</u>	<u>2010</u>	<u>2009</u>
Indefinite lived intangible assets:			
Trade names, trademarks and distribution rights		\$37,963	\$ 37,963
Finite lived intangible assets:			
Customer relationships	4-15 years	22,120	22,120
Non-compete agreements	7 years	369	369
Less: accumulated amortization		<u>(3,825)</u>	<u>(1,886)</u>
Finite lived intangible assets, net		<u>18,664</u>	<u>20,603</u>
		<u>\$ 56,627</u>	<u>\$ 58,566</u>

Amortization expense related to finite lived intangible assets amounted to \$1,939, \$1,191 and \$459 for the years ended December 31, 2010, 2009 and 2008, respectively. The future amortization expense for each of the five succeeding years related to all finite lived intangible assets that are currently recorded in the consolidated balance sheets is estimated to be as follows at December 31, 2010:

2011	\$1,825
2012	1,770
2013	1,760
2014	1,736
2015	<u>1,725</u>
Total	<u>\$8,816</u>

## 9. 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, 2010 and 2009.

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## Euronext Listing

In October 2010, we listed our Common stock on the Professional Segment of NYSE Euronext in Paris ("Euronext"). On September 24, 2010, the French *Autorité des Marchés Financiers* approved the prospectus and correspondingly granted a visa number for admission of our Common stock to listing and trading on Euronext. Our shares began trading on Euronext on October 21, 2010 under the symbol "WSO" and are denominated in Euros on the Paris venue. The cross listing does not alter our share count, capital structure or current stock-listings and is intended to promote additional liquidity for investors as well as provide greater access to our shares in Euro-zone markets and currencies.

## Stock Repurchase Plan

Our Board of Directors has authorized the repurchase, at management's discretion, of 7,500,000 shares 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. During 2008, 105,600 Common shares were repurchased at a cost of \$4,820. No shares were repurchased during 2009 or 2010. In aggregate since the inception of the repurchase plan in 1999, 6,322,650 shares of Common stock and 48,263 shares of Class B common stock were repurchased at a cost of \$114,425. The remaining 1,129,087 shares authorized for repurchase are subject to certain restrictions included in our revolving credit agreements.

## 10. 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 agreements and debt instruments included in other long-term obligations. At December 31, 2010 and 2009, 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 agreements 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 Instrument

Periodically, we enter into interest rate swap agreements to reduce our exposure to market risks from changing interest rates under our revolving credit agreements. Under the terms of the swap agreements, we agree to exchange, at specified intervals, the difference between fixed and variable interest amounts calculated by reference to the notional principal amount. Any differences paid or received on our interest rate swap agreements are recognized as adjustments to interest expense over the life of each swap, thereby adjusting the effective interest rate on the underlying obligation. Financial instruments are not held or issued for trading purposes. In order to obtain hedge accounting treatment, any derivatives used for hedging purposes must be designated as, and effective as, a hedge of an identified risk exposure at the inception of the contract. Changes in the fair value of the derivative contract must be highly correlated with changes in the fair value of the underlying hedged item at inception of the hedge and over the life of the hedge contract. Accordingly, we record all derivative instruments as either assets or liabilities in the consolidated balance sheets at their respective fair values. We record the change in the fair value of a derivative instrument designated as a cash flow hedge in other comprehensive income to the extent the derivative is effective, and recognize the change in the consolidated statement of income when the hedged item affects earnings. Our interest rate hedge described below is designated as a cash flow hedge.

At December 31, 2010 and 2009, we had one interest rate swap agreement in effect with a notional value of \$10,000, maturing in October 2011. The swap agreement exchanges the variable rate of 30-day LIBOR to a fixed interest rate of 5.07%. During 2010, 2009 and 2008, the hedging relationship was determined to be highly effective in achieving offsetting changes in cash flows.

We were party to an interest rate swap agreement with a notional amount of \$10,000, which matured in October 2009 that was designated as a cash flow hedge and effectively exchanged the variable rate of 30-day LIBOR to a fixed interest rate of 5.04%. During 2009 and 2008, the hedging relationship was determined to be highly effective in achieving offsetting changes in cash flows.

The negative fair value of the derivative financial instrument was \$399 at December 31, 2010, and is included, net of accrued interest, in accrued expenses and other current liabilities in the consolidated balance sheet. The negative fair value of the derivative financial instrument was \$710 at December 31, 2009, and is included, net of accrued interest, in deferred income taxes and other liabilities in the consolidated balance sheet. See Note 11. At December 31, 2010 and 2009, \$238, net of deferred tax benefits of \$146 and \$432, net of deferred tax benefits of \$262, respectively, was included in accumulated OCL associated with the cash flow hedge.

The net change in OCL during 2010, 2009 and 2008, reflected the reclassification of \$301, net of income tax benefit of \$185, \$527, net of income tax benefit of \$320 and \$274, net of income tax benefit of \$164, respectively, of unrealized losses from accumulated OCL to current period earnings (recorded in interest expense, net in the consolidated statements of income). The net unrealized loss recorded in accumulated OCL will be reclassified to earnings on a monthly basis as interest payments occur. We estimate that approximately \$400 in unrealized losses on the derivative instrument accumulated in OCL are expected to be reclassified to earnings during the next 10 months using a current 30-day LIBOR-based average receive rate (0.34% at December 31, 2010). See Note 1, "Comprehensive Income."

#### Off-Balance Sheet Financial Instruments

At December 31, 2010 and 2009, we were contingently liable under standby letters of credit aggregating \$3,399 and \$3,844, respectively that are primarily used as collateral to cover any contingency related to additional risk assessments pertaining to the self-insurance programs. We do not expect any material losses to result from the issuance of the standby letters of credit because the obligations under the programs will be met 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 cash investments and accounts receivable. Temporary cash investments are placed with high credit quality financial institutions and we limit the amount of credit exposure to any one financial institution or investment. Concentrations of credit risk with respect to accounts receivable are limited due to the large number of customers comprising the customer base and their dispersion across many different geographical regions.

### 11. Fair Value Measurements

The following tables present our assets and liabilities that are measured at fair value on a recurring basis and the levels of inputs used to measure fair value:

Description	Fair Value at December 31, 2010	Fair Value Measurements at December 31, 2010 Using		
		Level 1	Level 2	Level 3
<b>Assets:</b>				
Available-for-sale securities	\$ 157	\$ 157	—	—
<b>Liabilities:</b>				
Derivative financial instrument	\$ 399	—	\$ 399	—

Description	Fair Value at December 31, 2009	Fair Value Measurements at December 31, 2009 Using		
		Level 1	Level 2	Level 3
<b>Assets:</b>				
Available-for-sale securities	\$ 104	\$ 104	—	—
<b>Liabilities:</b>				
Derivative financial instrument	\$ 710	—	\$ 710	—

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 quoted prices in active markets and are therefore classified within Level 1 of the fair value hierarchy.

*Derivative financial instrument* – the derivative is a pay-variable, receive fixed interest rate swap based on 30-day LIBOR. Fair value is based on model-derived valuations using the respective LIBOR rate, which is observed at quoted intervals for the full term of the swap and incorporates adjustments to appropriately reflect our nonperformance risk and the counterparty's nonperformance risk. Therefore, the derivative is classified within Level 2 of the fair value hierarchy. See Note 10, "Derivative Financial Instrument."

## 12. Commitments and Contingencies

### Litigation, Claims and Assessments

We are involved in litigation incidental to the operation of our business. We vigorously defend all matters in which we or our subsidiaries are named defendants and, for insurable losses, maintain significant levels of insurance to protect against adverse judgments, claims or assessments that may affect us. Although the adequacy of existing insurance coverage or 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 in which we or our subsidiaries are involved will materially affect 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. 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 \$7,295 and \$7,110 at December 31, 2010 and 2009, respectively, were established related to such insurance programs and are included in accrued expenses and other current liabilities in our consolidated balance sheets.

### Variable Interest Entities

As of December 31, 2010, 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 entities meet the definition of VIEs; however, there is not a requirement to include these entities in the consolidated financial statements. The maximum exposure to loss related to our involvement with these entities is limited to approximately \$6,500. See "Self-Insurance" above for further information on commitments associated with the insurance programs and Note 10, "Off-Balance Sheet Financial Instruments," for further information on standby letters of credit. As of December 31, 2010, there are no other entities that met the definition of a VIE.

### Minimum Royalty Payments

We are obligated under a licensing agreement with Whirlpool Corporation to make minimum annual royalty payments of \$1,000 through 2011.

### Operating Leases

We are obligated under non-cancelable operating leases of real property, equipment, vehicles and a corporate aircraft used in our operations with varying terms through 2020. Some of our leases contain renewal options, some of which involve rate increases. For leases with step rent provisions whereby the rental payments increase incrementally over the life of the lease, we recognize the total minimum lease payments on a straight-line basis over the lease term. The corporate aircraft lease is subject to adjustment from changes in LIBOR-based interest rates.

As of December 31, 2010, future minimum lease payments under non-cancelable operating leases are as follows:

2011	\$ 56,586
2012	42,596
2013	32,509
2014	24,138
2015	15,443
Thereafter	18,343
	<u>\$189,615</u>

Rental expense for the years ended December 31, 2010, 2009 and 2008 was \$61,835, \$55,502 and \$45,606, respectively.



### 13. Related Party Transactions

Purchases from Carrier and its affiliates comprised 52% and 41% of all purchases made during 2010 and 2009, respectively. At December 31, 2010 and 2009, approximately \$93,000 and \$61,000, respectively, was payable to Carrier and its affiliates, net of receivables. Carrier Enterprise also sells HVAC products to Carrier and its affiliates. Revenues in our consolidated statements of income for 2010 and 2009 include \$22,142 and \$11,879, 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 had entered into Transactional Services Agreements ("TSAs") with Carrier to have certain business processes performed on its behalf, including processes involving the use of business software applications and information technologies. A number of the services provided pursuant to the TSAs expired on December 31, 2009, with the remaining services expiring throughout the twelve months ended December 31, 2010. The fees related to the TSAs were \$2,177 and \$10,808, and are included in selling, general and administrative expenses in our consolidated statements of income for 2010 and 2009, respectively. At December 31, 2009, \$7,116 related to the TSAs was payable to Carrier and was included in accrued expenses and other current liabilities in our consolidated balance sheet. No amount related to the TSAs was payable to Carrier at December 31, 2010.

A member of our Board of Directors is the Executive Chairman of Greenberg Traurig, P.A., which serves as our principal outside counsel and receives customary fees for legal services. During 2010, 2009 and 2008, this firm was paid \$63, \$49 and \$128, respectively, for services performed.

### 14. Supplemental Cash Flow Information

Supplemental cash flow information was as follows:

<u>Years Ended December 31,</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Interest paid	\$ 1,348	\$ 1,436	\$ 2,299
Income taxes net of refunds	\$37,361	\$ 14,018	\$25,270
Non-cash capital contribution of inventory by noncontrolling interest	—	\$ 32,000	—
Common and Class B common stock issued for joint venture	—	\$ 151,056	—
Net assets of locations contributed to joint venture	—	\$ 23,217	—

### 15. Subsequent Event

On February 7, 2011, our Board of Directors approved an increase in the quarterly cash dividend to \$0.57 per share from \$0.52 per share.

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

*(In thousands, except per share data)*

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Total
<b>Year Ended December 31, 2010</b>					
Revenues (1)	\$ 509,755	\$ 864,805	\$ 812,787	\$ 657,248	\$ 2,844,595
Gross profit	122,604	201,069	195,541	154,027	673,241
Net income attributable to Watsco, Inc.	<u>\$ 3,833</u>	<u>\$ 35,045</u>	<u>\$ 31,437</u>	<u>\$ 10,445</u>	<u>\$ 80,760</u>

Earnings per share for Common and Class B common stock (2):

Basic	<u>\$ 0.10</u>	<u>\$ 1.08</u>	<u>\$ 0.97</u>	<u>\$ 0.31</u>	<u>\$ 2.49</u>
Diluted	<u>\$ 0.10</u>	<u>\$ 1.08</u>	<u>\$ 0.97</u>	<u>\$ 0.31</u>	<u>\$ 2.49</u>

**Year Ended December 31, 2009**

Revenues (1)	\$ 291,343	\$ 404,971	\$ 741,895	\$ 563,606	\$ 2,001,815
Gross profit	74,234	100,985	172,009	133,604	480,832
Net (loss) income attributable to Watsco, Inc.	<u>\$ (1,172)</u>	<u>\$ 16,282</u>	<u>\$ 21,131</u>	<u>\$ 7,073</u>	<u>\$ 43,314</u>

(Loss) earnings per share for Common and Class B common stock (2):

Basic	<u>\$ (0.07)</u>	<u>\$ 0.57</u>	<u>\$ 0.66</u>	<u>\$ 0.21</u>	<u>\$ 1.42</u>
Diluted	<u>\$ (0.07)</u>	<u>\$ 0.56</u>	<u>\$ 0.66</u>	<u>\$ 0.21</u>	<u>\$ 1.40</u>

- (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) Effective January 1, 2009, we adopted the provisions of accounting guidance stating that non-vested share-based payment awards that contain non-forfeitable rights to dividends are considered participating securities and should be included in the computation of earnings per share pursuant to the two-class method for all periods presented. The summation of each quarter may not equal the amount calculated for the year as a whole.

**WATSCO, INC. AND SUBSIDIARIES**  
**INFORMATION ON COMMON STOCK**

Our Common stock is traded on the New York Stock Exchange and the Professional Segment of NYSE Euronext in Paris under the ticker symbol WSO, and our Class B common stock is traded on the NYSE Amex under the ticker symbol WSOB. The following table indicates the high and low prices of our Common stock and Class B common stock, as reported by the New York Stock Exchange and NYSE Amex, respectively, and dividends paid per share for each quarter during the years ended December 31, 2010 and 2009. At February 25, 2011, excluding shareholders with stock in street name, there were 285 Common stock shareholders of record and 114 Class B common stock shareholders of record.

	Common		Class B Common		Cash Dividend	
	High	Low	High	Low	Common	Class B
<b>Year Ended December 31, 2010:</b>						
First quarter	\$ 59.99	\$ 47.86	\$ 59.00	\$ 47.70	\$ 0.48	\$ 0.48
Second quarter	62.53	53.44	62.64	53.99	0.52	0.52
Third quarter	60.40	51.35	60.40	51.39	0.52	0.52
Fourth quarter	<u>64.55</u>	<u>54.82</u>	<u>65.26</u>	<u>55.00</u>	<u>0.52</u>	<u>0.52</u>
<b>Year Ended December 31, 2009:</b>						
First quarter	\$ 40.08	\$ 30.97	\$ 39.75	\$ 30.99	\$ 0.45	\$ 0.45
Second quarter	54.01	34.55	53.00	34.54	0.48	0.48
Third quarter	56.82	44.56	56.25	44.46	0.48	0.48
Fourth quarter	<u>53.71</u>	<u>48.98</u>	<u>53.25</u>	<u>48.93</u>	<u>0.48</u>	<u>0.48</u>

## SUBSIDIARIES OF THE REGISTRANT

The following table sets forth, at February 25, 2011, the Registrant's significant operating subsidiaries and other associated companies and their respective incorporation jurisdictions. The Registrant owns 100% of the voting securities of each of the subsidiaries listed below unless noted otherwise. There are no subsidiaries not listed in the table, which would, in the aggregate, be considered significant.

<u>Active Subsidiaries</u>	<u>State of Incorporation</u>
AC Doctor LLC	Delaware
Air Systems Distributors LLC	Delaware
Atlantic Service & Supply LLC	Delaware
Baker Distributing Company LLC	Delaware
Carrier Enterprise, LLC*	Delaware
East Coast Metal Distributors LLC	Delaware
Gemaire Distributors LLC	Delaware
Heating & Cooling Supply LLC	California
Tradewinds Distributing Company LLC	Delaware
Watsco Holdings, Inc.	Delaware
Watsco Holdings II, Inc.	Delaware

\* 60% owned

## CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors  
Watsco, Inc.:

We consent to the incorporation by reference in the registration statements listed below of Watsco, Inc. of our reports dated March 1, 2011, with respect to the consolidated balance sheets of Watsco, Inc. and its subsidiaries as of December 31, 2010 and 2009, and the related consolidated statements of income, shareholders' equity and cash flows for each of the years in the two-year period ended December 31, 2010, and the effectiveness of internal control over financial reporting as of December 31, 2010, which reports appear in the December 31, 2010 annual report on Form 10-K of Watsco, Inc.

As discussed in our report on the consolidated financial statements, the Company has changed its method of accounting for business combinations as of January 1, 2009, due to the adoption of Financial Accounting Standards Board Statement No. 141(R), *Business Combinations* (codified in Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) Topic 805, *Business Combinations*), and changed its method of accounting for noncontrolling interests beginning July 1, 2009 (as a result of the formation of Carrier Enterprise, LLC on that date), due to the adoption of Financial Accounting Standards Board Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51* (codified in Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) Topic 810, *Consolidation*), and changed its method for determining whether certain securities should be included in the basic earnings per share calculation as of January 1, 2009, due to the adoption of Financial Accounting Standards Board Staff Position No. EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* (codified in Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) Topic 260, *Earnings Per Share*).

- Form S-3 (Registration No. 333-163678)
- Form S-8 (Registration No. 333-159776, 333-149467, 333-126824, 333-86006, 333-39380, 333-82011, 333-80341, 333-10363, 33-51934, and 33-72798)

/s/ KPMG LLP

Miami, Florida  
March 1, 2011  
Certified Public Accountants

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We have issued our report dated February 27, 2009 (except for earnings per share amounts as discussed in Note 1 – Accounting Changes - Earnings per Share, as to which the date is February 26, 2010), with respect to the consolidated financial statements of Watsco, Inc. and subsidiaries for the year ended December 31, 2008, which is incorporated by reference in the Annual Report of Watsco, Inc. on Form 10-K for the year ended December 31, 2010. We hereby consent to the incorporation by reference of said report in the following Registration Statements of Watsco, Inc. on Form S-3 (No. 333-163678) and Forms S-8 (No. 333-159776, No. 333-149467, No. 333-126824, No. 333-86006, No. 333-39380, No. 333-82011, No. 333-80341, No. 333-10363, No. 33-51934 and No. 33-72798).

/s/ GRANT THORNTON LLP

Miami, Florida  
March 1, 2011

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

I, Albert H. Nahmad, certify that:

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

Date: March 1, 2011

/s/ Albert H. Nahmad

Albert H. Nahmad  
Chief Executive Officer

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

I, Barry S. Logan, certify that:

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

Date: March 1, 2011

/s/ Barry S. Logan

Barry S. Logan  
Senior Vice President



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

I, Ana M. Menendez, certify that:

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

Date: March 1, 2011

/s/ Ana M. Menendez

Ana M. Menendez  
Chief Financial Officer

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

In connection with the Annual Report of Watsco, Inc. ("Watsco") on Form 10-K for the year ended December 31, 2010, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Albert H. Nahmad, as Chief Executive Officer of Watsco, Barry S. Logan, as Senior Vice President of Watsco and Ana M. Menendez, as Chief Financial Officer of Watsco, each hereby certifies, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that, to our knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Watsco.

/s/ Albert H. Nahmad

Albert H. Nahmad  
Chief Executive Officer  
March 1, 2011

/s/ Barry S. Logan

Barry S. Logan  
Senior Vice President  
March 1, 2011

/s/ Ana M. Menendez

Ana M. Menendez  
Chief Financial Officer  
March 1, 2011

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Watsco and will be retained by Watsco and furnished to the Securities and Exchange Commission or its staff upon request.

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

