

WATSCO INC  
Form 10-Q  
November 03, 2016  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**FORM 10-Q**

x **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the Quarterly Period Ended September 30, 2016**

or

.. **Transition Report Pursuant To Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the Transition Period From \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number 1-5581**

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

**WATSCO, INC.**  
**(a Florida Corporation)**

**2665 South Bayshore Drive, Suite 901**

**Miami, Florida 33133**

**Telephone: (305) 714-4100**

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

The number of shares of each class of our common stock outstanding as of October 28, 2016 was (i) 30,349,695 shares of Common stock, \$0.50 par value per share, excluding 6,322,650 treasury shares, and (ii) 5,177,490 shares of Class B common stock, \$0.50 par value per share, excluding 48,263 treasury shares.

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**WATSCO, INC. AND SUBSIDIARIES**

**QUARTERLY REPORT ON FORM 10-Q**

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

(In thousands, except per share data)

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Revenues	<b>\$ 1,241,232</b>	\$ 1,177,012	<b>\$ 3,307,091</b>	\$ 3,209,423
Cost of sales	<b>939,028</b>	891,166	<b>2,500,579</b>	2,424,107
Gross profit	<b>302,204</b>	285,846	<b>806,512</b>	785,316
Selling, general and administrative expenses	<b>182,904</b>	175,166	<b>518,954</b>	502,769
Operating income	<b>119,300</b>	110,680	<b>287,558</b>	282,547
Interest expense, net	<b>996</b>	1,519	<b>3,036</b>	4,526
Income before income taxes	<b>118,304</b>	109,161	<b>284,522</b>	278,021
Income taxes	<b>37,786</b>	34,517	<b>88,406</b>	87,836
Net income	<b>80,518</b>	74,644	<b>196,116</b>	190,185
Less: net income attributable to non-controlling interest	<b>17,419</b>	16,676	<b>42,859</b>	43,746
Net income attributable to Watsco, Inc.	<b>\$ 63,099</b>	\$ 57,968	<b>\$ 153,257</b>	\$ 146,439
Earnings per share for Common and Class B common stock:				
Basic	<b>\$ 1.78</b>	\$ 1.64	<b>\$ 4.33</b>	\$ 4.16
Diluted	<b>\$ 1.78</b>	\$ 1.64	<b>\$ 4.32</b>	\$ 4.16

*See accompanying notes to condensed consolidated unaudited financial statements.*

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## WATSCO, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED UNAUDITED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net income	<b>\$ 80,518</b>	\$ 74,644	<b>\$ 196,116</b>	\$ 190,185
Other comprehensive (loss) income, net of tax				
Foreign currency translation adjustment	<b>(3,453)</b>	(14,682)	<b>11,433</b>	(31,585)
Unrealized gain (loss) on cash flow hedging instruments	<b>391</b>	946	<b>(1,484)</b>	2,331
Reclassification of loss (gain) on cash flow hedging instruments into earnings	<b>94</b>	(260)	<b>492</b>	(1,394)
Unrealized gain (loss) on available-for-sale securities	<b>12</b>	(15)	<b>3</b>	6
Other comprehensive (loss) income	<b>(2,956)</b>	(14,011)	<b>10,444</b>	(30,642)
Comprehensive income	<b>77,562</b>	60,633	<b>206,560</b>	159,543
Less: comprehensive income attributable to non-controlling interest	<b>16,291</b>	11,058	<b>46,931</b>	31,390
Comprehensive income attributable to Watsco, Inc.	<b>\$ 61,271</b>	\$ 49,575	<b>\$ 159,629</b>	\$ 128,153

*See accompanying notes to condensed consolidated unaudited financial statements.*

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WATSCO, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except per share data)

	September 30, 2016 (Unaudited)	December 31, 2015
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 35,910	\$ 35,229
Accounts receivable, net	548,000	451,079
Inventories	739,718	673,967
Other current assets	25,381	20,990
<b>Total current assets</b>	<b>1,349,009</b>	<b>1,181,265</b>
Property and equipment, net	59,729	62,715
Goodwill	380,786	378,310
Intangible assets, net	162,472	160,481
Other assets	5,601	5,671
	<b>\$ 1,957,597</b>	<b>\$ 1,788,442</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Current liabilities:		
Current portion of other long-term obligations	\$ 196	\$ 184
Accounts payable	229,743	145,162
Accrued expenses and other current liabilities	128,188	124,955
<b>Total current liabilities</b>	<b>358,127</b>	<b>270,301</b>
Long-term obligations:		
Borrowings under revolving credit agreement	219,400	245,300
Other long-term obligations, net of current portion	392	514
<b>Total long-term obligations</b>	<b>219,792</b>	<b>245,814</b>
Deferred income taxes and other liabilities	73,344	68,606
Commitments and contingencies		
Watsco, Inc. shareholders equity:		
Common stock, \$0.50 par value	18,340	18,308
Class B common stock, \$0.50 par value	2,590	2,533
Preferred stock, \$0.50 par value		
Paid-in capital	614,811	602,522

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Accumulated other comprehensive loss, net of tax	<b>(40,532)</b>	(46,904)
Retained earnings	<b>558,235</b>	495,276
Treasury stock, at cost	<b>(114,425)</b>	(114,425)
<b>Total Watsco, Inc. shareholders equity</b>	<b>1,039,019</b>	957,310
Non-controlling interest	<b>267,315</b>	246,411
<b>Total shareholders equity</b>	<b>1,306,334</b>	1,203,721
	<b>\$ 1,957,597</b>	\$ 1,788,442

*See accompanying notes to condensed consolidated unaudited financial statements.*

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## WATSCO, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED UNAUDITED STATEMENTS OF CASH FLOWS

(In thousands)

	Nine Months Ended September 30,	
	2016	2015
<b>Cash flows from operating activities:</b>		
Net income	<b>\$ 196,116</b>	\$ 190,185
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>		
Depreciation and amortization	<b>15,078</b>	14,216
Share-based compensation	<b>8,359</b>	8,862
Deferred income tax provision	<b>3,984</b>	5,634
Non-cash contribution to 401(k) plan	<b>2,348</b>	1,963
Provision for doubtful accounts	<b>2,105</b>	1,305
Excess tax benefits from share-based compensation		(1,983)
Gain on sale of property and equipment	<b>(204)</b>	(420)
<b>Changes in operating assets and liabilities:</b>		
Accounts receivable	<b>(96,692)</b>	(82,792)
Inventories	<b>(63,480)</b>	(80,165)
Accounts payable and other liabilities	<b>83,549</b>	45,358
Other, net	<b>(4,863)</b>	(2,405)
<b>Net cash provided by operating activities</b>	<b>146,300</b>	99,758
<b>Cash flows from investing activities:</b>		
Capital expenditures	<b>(8,989)</b>	(20,593)
Proceeds from sale of property and equipment	<b>675</b>	686
<b>Net cash used in investing activities</b>	<b>(8,314)</b>	(19,907)
<b>Cash flows from financing activities:</b>		
Dividends on Common and Class B common stock	<b>(90,298)</b>	(73,840)
Distributions to non-controlling interest	<b>(26,027)</b>	(13,266)
Net (repayments) proceeds under revolving credit agreement	<b>(25,900)</b>	3,327
Net repayments under other long-term obligations	<b>(110)</b>	(112)
Excess tax benefits from share-based compensation		1,983
Proceeds from short-term borrowings		2,353
Net proceeds from issuances of common stock	<b>4,962</b>	4,528
<b>Net cash used in financing activities</b>	<b>(137,373)</b>	(75,027)
Effect of foreign exchange rate changes on cash and cash equivalents	<b>68</b>	(766)

Net increase in cash and cash equivalents	<b>681</b>	4,058
Cash and cash equivalents at beginning of period	<b>35,229</b>	24,447
Cash and cash equivalents at end of period	<b>\$ 35,910</b>	\$ 28,505

*See accompanying notes to condensed consolidated unaudited financial statements.*

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WATSCO, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS

September 30, 2016

(In thousands, except share and per share data)

**1. BASIS OF PRESENTATION**

**Basis of Consolidation**

Watsco, Inc. (collectively with its consolidated subsidiaries, Watsco, we, us or our ) was incorporated in Florida in 1956 and is the largest distributor of air conditioning, heating and refrigeration equipment and related parts and supplies ( HVAC/R ) in the HVAC/R distribution industry in North America. The accompanying September 30, 2016 interim condensed consolidated unaudited financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures normally included in the annual financial statements prepared in accordance with U.S. generally accepted accounting principles ( GAAP ) have been condensed or omitted pursuant to those rules and regulations, but we believe the disclosures made are adequate to make the information presented not misleading. In the opinion of management, all adjustments, consisting of normal and recurring adjustments, necessary for a fair presentation have been included in the condensed consolidated unaudited financial statements included herein. These statements should be read in conjunction with the consolidated financial statements and notes thereto included in our 2015 Annual Report on Form 10-K.

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

The results of operations for the quarter and nine months ended September 30, 2016 are not necessarily indicative of the results to be expected for the year ending December 31, 2016. Sales of residential central air conditioners, heating equipment and parts and supplies are seasonal. Furthermore, results of operations can be impacted favorably or unfavorably based on weather patterns, primarily during the Summer and Winter selling seasons. Demand related to the residential central air conditioning replacement market is typically highest in the second and third quarters, and demand for heating equipment is usually highest in the fourth quarter. Demand related to the new construction market is fairly consistent during the year, subject to weather and economic conditions, including their effect on the number of housing completions.

**Use of Estimates**

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

## **New Accounting Standards**

### *Revenue Recognition*

In May 2014, the Financial Accounting Standards Board (the FASB ) issued a standard on revenue recognition that provides a single, comprehensive revenue recognition model for all contracts with customers. The standard is principle-based and provides a five-step model to determine the measurement of revenue and timing of when it is recognized. The core principle is that a company will recognize revenue to reflect the transfer of goods or services to customers at an amount that the company expects to be entitled to in exchange for those goods or services. In July 2015, the FASB deferred the effective date of this standard by one year. As a result, this standard is effective for our interim and annual reporting periods beginning after December 15, 2017, with early adoption permitted for annual reporting periods beginning after December 15, 2016. We will adopt this guidance on January 1, 2018, and are currently evaluating the impact on our consolidated financial statements.

### *Measurement of Inventory*

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

**Table of Contents***Leases*

In February 2016, the FASB issued guidance on accounting for leases, which requires lessees to recognize most leases on their balance sheets for the rights and obligations created by those leases. The guidance requires enhanced disclosures regarding the amount, timing and uncertainty of cash flows arising from leases and will be effective for interim and annual periods beginning after December 15, 2018. Early adoption is permitted. The guidance requires the use of a modified retrospective approach. We are evaluating the impact of this guidance on our consolidated financial statements.

*Presentation of Debt Issuance Costs*

In April 2015, the FASB issued guidance that will require that debt issuance costs related to a recognized debt liability be presented on the balance sheet as a direct deduction from the carrying amount of that debt liability, rather than as an asset. This guidance is effective retrospectively for interim and annual reporting periods beginning after December 15, 2015. The adoption of this guidance did not have an impact on our consolidated financial statements.

*Share-Based Payments*

In March 2016, the FASB issued amended guidance related to employee share-based payment accounting. The guidance requires that all income tax effects of awards to be recognized in the income statement when the awards vest or are settled. The guidance also requires presentation of excess tax benefits as an operating activity on the statement of cash flows rather than as a financing activity. The guidance increases the amount companies can withhold to cover income taxes on awards without triggering liability classification for shares used to satisfy statutory income tax withholding obligations and requires application of a modified retrospective transition method. The amended guidance will be effective for interim and annual periods beginning after December 15, 2016. Early adoption is permitted if all provisions are adopted in the same period.

We elected to early adopt the amended guidance during the quarter ended June 30, 2016, which required us to reflect any adjustments as of January 1, 2016, the beginning of the annual period that includes the interim period of adoption. The primary impact of adoption was the recognition of excess tax benefits in our provision for income taxes rather than paid-in capital for all periods in 2016. We elected to apply the presentation requirements for cash flows related to excess tax benefits prospectively. The accounting for income taxes and minimum statutory withholding tax requirements had no impact to retained earnings as of January 1, 2016, where the cumulative effect of these changes are required to be recorded. We have elected to continue to estimate forfeitures expected to occur to determine the amount of compensation cost to be recognized in each period.

Adoption of the amended guidance resulted in the recognition of excess tax benefits in our provision for income taxes rather than paid-in capital of \$591 and \$2,898 for the quarter and nine months ended September 30, 2016, respectively, and impacted our previously reported quarterly results for March 31, 2016 as follows:

<i>Quarter Ended March 31, 2016</i>	<b>As Reported</b>	<b>As Adjusted</b>
<i>Income Statement:</i>		
Income taxes	\$ 15,508	\$ 14,654
Net income	\$ 34,174	\$ 35,028
Diluted earnings per share	\$ 0.71	\$ 0.74

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Diluted weighted-average common shares outstanding	32,537,225	32,546,314
Balance Sheet:		
Paid-in capital	\$ 610,285	\$ 609,431
Cash Flow Statement:		
Net cash provided by operating activities	\$ 41,852	\$ 42,706
Net cash used in financing activities	\$ (41,638)	\$ (42,492)

**Table of Contents****2. EARNINGS PER SHARE**

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

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
<b>Basic Earnings per Share:</b>				
Net income attributable to Watsco, Inc. shareholders	\$ 63,099	\$ 57,968	\$ 153,257	\$ 146,439
Less: distributed and undistributed earnings allocated to non-vested restricted common stock	5,081	4,595	12,388	11,513
Earnings allocated to Watsco, Inc. shareholders	\$ 58,018	\$ 53,373	\$ 140,869	\$ 134,926
Weighted-average common shares outstanding - Basic	32,613,995	32,458,906	32,567,073	32,421,350
Basic earnings per share for Common and Class B common stock	\$ 1.78	\$ 1.64	\$ 4.33	\$ 4.16
Allocation of earnings for Basic:				
Common stock	\$ 53,186	\$ 48,893	\$ 129,120	\$ 123,588
Class B common stock	4,832	4,480	11,749	11,338
	\$ 58,018	\$ 53,373	\$ 140,869	\$ 134,926
<b>Diluted Earnings per Share:</b>				
Net income attributable to Watsco, Inc. shareholders	\$ 63,099	\$ 57,968	\$ 153,257	\$ 146,439
Less: distributed and undistributed earnings allocated to non-vested restricted common stock	5,078	4,592	12,383	11,505
Earnings allocated to Watsco, Inc. shareholders	\$ 58,021	\$ 53,376	\$ 140,874	\$ 134,934
Weighted-average common shares outstanding - Basic	32,613,995	32,458,906	32,567,073	32,421,350
Effect of dilutive stock options	36,158	39,951	34,042	47,963
Weighted-average common shares outstanding - Diluted	32,650,153	32,498,857	32,601,115	32,469,313

Diluted earnings per share for Common and Class B common stock	\$	<b>1.78</b>	\$	1.64	\$	<b>4.32</b>	\$	4.16
Anti-dilutive stock options not included above		<b>3,565</b>		16,332		<b>18,876</b>		58,169

Diluted earnings per share for our Common stock assumes the conversion of all of our Class B common stock into Common stock as of the beginning of the fiscal year; therefore, no allocation of earnings to Class B common stock is required. At September 30, 2016 and 2015, our outstanding Class B common stock was convertible into 2,716,320 and 2,724,464 shares of our Common stock, respectively.

**Table of Contents****3. OTHER COMPREHENSIVE (LOSS) INCOME**

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

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Foreign currency translation adjustment	<b>\$ (3,453)</b>	\$ (14,682)	<b>\$ 11,433</b>	\$ (31,585)
Unrealized gain (loss) on cash flow hedging instruments	<b>536</b>	1,294	<b>(2,033)</b>	3,192
Income tax (expense) benefit	<b>(145)</b>	(348)	<b>549</b>	(861)
Unrealized gain (loss) on cash flow hedging instruments, net of tax	<b>391</b>	946	<b>(1,484)</b>	2,331
Reclassification of loss (gain) on cash flow hedging instruments into earnings	<b>129</b>	(356)	<b>674</b>	(1,910)
Income tax (benefit) expense	<b>(35)</b>	96	<b>(182)</b>	516
Reclassification of loss (gain) on cash flow hedging instruments into earnings, net of tax	<b>94</b>	(260)	<b>492</b>	(1,394)
Unrealized gain (loss) on available-for-sale securities	<b>19</b>	(25)	<b>4</b>	9
Income tax (expense) benefit	<b>(7)</b>	10	<b>(1)</b>	(3)
Unrealized gain (loss) on available-for-sale securities, net of tax	<b>12</b>	(15)	<b>3</b>	6
Other comprehensive (loss) income	<b>\$ (2,956)</b>	\$ (14,011)	<b>\$ 10,444</b>	\$ (30,642)

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

<i>Nine Months Ended September 30,</i>	2016	2015
Foreign currency translation adjustment:		
Beginning balance	<b>\$ (47,204)</b>	\$ (23,623)
Current period other comprehensive income (loss)	<b>6,964</b>	(18,853)
Ending balance	<b>\$ (40,240)</b>	\$ (42,476)

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Cash flow hedging instruments:		
Beginning balance	\$ 600	\$ 168
Current period other comprehensive (loss) income	(890)	1,398
Less reclassification adjustment	295	(837)
Ending balance	\$ 5	\$ 729
Available-for-sale securities:		
Beginning balance	\$ (300)	\$ (292)
Current period other comprehensive income	3	6
Ending balance	\$ (297)	\$ (286)
Accumulated other comprehensive loss, net of tax	\$ (40,532)	\$ (42,033)

**Table of Contents****4. DERIVATIVE FINANCIAL INSTRUMENTS**

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

**Cash Flow Hedging Instruments**

We enter into foreign currency forward contracts that are designated as cash flow hedges. The settlement of these derivatives results in reclassifications from accumulated other comprehensive loss to earnings for the period in which the settlement occurs. The maximum period for which we hedge our cash flow using these instruments is 12 months. Accordingly, at September 30, 2016, all of our open foreign currency forward contracts had maturities of one year or less. The total notional value of our foreign currency exchange contracts designated as cash flow hedges at September 30, 2016 was \$22,600, and such contracts have varying terms expiring through March 2017.

The impact from foreign exchange derivative instruments designated as cash flow hedges was as follows for the periods indicated:

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Gain (loss) recorded in accumulated other comprehensive loss	\$ 536	\$ 1,294	\$ (2,033)	\$ 3,192
(Loss) gain reclassified from accumulated other comprehensive loss into earnings	\$ 129	\$ (356)	\$ 674	\$ (1,910)

At September 30, 2016, we expected an estimated \$11 of pre-tax gain to be reclassified into earnings to reflect the fixed prices obtained from foreign exchange hedging within the next 12 months.

**Derivatives Not Designated as Hedging Instruments**

We have also entered into foreign currency forward contracts that are either not designated as hedges or do not qualify for hedge accounting. These derivative instruments were effective economic hedges for all of the periods presented. The fair value gains and losses on these contracts are recognized in earnings as a component of selling, general and administrative expenses. The notional value of our foreign currency exchange contract not designated as a hedging instrument at September 30, 2016 was \$2,900, and such contract expired in October 2016.

We recognized gains of \$75 and \$955 from foreign currency forward contracts not designated as hedging instruments in our condensed consolidated unaudited statements of income for the quarters ended September 30, 2016 and 2015, respectively. We recognized a (loss) gain of \$(389) and \$2,249 from foreign currency forward contracts not designated as hedging instruments in our condensed consolidated unaudited statements of income for the nine months ended September 30, 2016 and 2015, respectively.

The following table summarizes the fair value of derivative instruments, which consist solely of foreign currency forward contracts, included in other current assets in our condensed consolidated unaudited balance sheets. See Note 5.

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	Asset Derivatives	
	September 30, 2016	December 31, 2015
Derivatives designated as hedging instruments	\$ 269	\$ 923
Derivatives not designated as hedging instruments		326
<b>Total asset derivative instruments</b>	<b>\$ 269</b>	<b>\$ 1,249</b>

	Liability Derivatives	
	September 30, 2016	December 31, 2015
Derivatives designated as hedging instruments	\$ 91	\$ 3
Derivatives not designated as hedging instruments	27	4
<b>Total liability derivative instruments</b>	<b>\$ 118</b>	<b>\$ 7</b>

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

Balance Sheet Location		Total	Fair Value Measurements		
			Level 1	Level 2	Level 3
<b>at September 30, 2016 Using</b>					
<b>Assets:</b>					
Available-for-sale securities	Other assets	\$ 258	\$ 258		
Derivative financial instruments	Other current assets	\$ 269		\$ 269	
<b>Liabilities:</b>					
Derivative financial instruments	Accrued expenses and other current liabilities	\$ 118		\$ 118	

Balance Sheet Location		Total	Fair Value Measurements		
			Level 1	Level 2	Level 3
<b>at December 31, 2015 Using</b>					
<b>Assets:</b>					
Available-for-sale securities	Other assets	\$ 254	\$ 254		
Derivative financial instruments	Other current assets	\$ 1,249		\$ 1,249	
<b>Liabilities:</b>					
Derivative financial instruments	Accrued expenses and other current liabilities	\$ 7		\$ 7	

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

*Derivative financial instruments* these derivatives are foreign currency forward contracts. See Note 4. Fair value is based on observable market inputs, such as forward rates in active markets; therefore, we classify these derivatives within Level 2 of the valuation hierarchy.

There were no transfers in or out of Level 1 and Level 2 during the nine months ended September 30, 2016.

**6. SHAREHOLDERS EQUITY****Common Stock Dividends**

We paid cash dividends of \$0.85, \$0.70, \$2.55 and \$2.10 per share of Common stock and Class B common stock during the quarters and nine months ended September 30, 2016 and 2015, respectively.

### **Non-Vested Restricted Stock**

During the quarters ended September 30, 2016 and 2015, we granted 23,803 and 17,500 shares of non-vested restricted stock, respectively. During the nine months ended September 30, 2016 and 2015, we granted 135,981 and 189,479 shares of non-vested restricted stock, respectively.

During the quarter ended September 30, 2016, 2,936 shares of Common stock with an aggregate fair market value of \$419 were withheld as payment in lieu of cash to satisfy tax withholding obligations in connection with the vesting of non-vested restricted stock. During the nine months ended September 30, 2016, an aggregate of 30,413 shares of Common and Class B common stock with an aggregate fair market value of \$3,967 were withheld as payment in lieu of cash to satisfy tax withholding obligations in connection with the vesting of restricted stock. During the nine months ended September 30, 2015, 7,206 shares of Common stock with an aggregate fair market value of \$889 were withheld as payment in lieu of cash to satisfy tax withholding obligations in connection with the vesting of restricted stock. These shares were retired upon delivery.

**Table of Contents****Exercise of Stock Options**

During the quarters ended September 30, 2016 and 2015, 23,584 and 14,250 stock options, respectively, were exercised for a combination of Common stock and Class B common stock. During the nine months ended September 30, 2016 and 2015, 58,084 and 80,450 stock options, respectively, were exercised for a combination of Common stock and Class B common stock. Cash received from the exercise of stock options during the quarters and nine months ended September 30, 2016 and 2015 was \$1,834, \$999, \$4,092 and \$3,681, respectively.

During the quarter and nine months ended September 30, 2016, 348 shares of Common stock with an aggregate fair market value of \$51 were withheld as payment in lieu of cash for stock option exercises and related tax withholdings. During the nine months ended September 30, 2015, 14,760 shares of Class B common stock with an aggregate fair market value of \$1,837 were withheld as payment in lieu of cash for stock option exercises and related tax withholdings. These shares were retired upon delivery.

**Employee Stock Purchase Plan**

During the quarters ended September 30, 2016 and 2015, 2,084 and 2,433 shares of Common stock were issued under our employee stock purchase plan for which we received net proceeds of \$286 and \$294, respectively. During the nine months ended September 30, 2016 and 2015, 6,915 and 7,402 shares of Common stock were issued under our employee stock purchase plan for which we received net proceeds of \$870 and \$847, respectively.

**401(k) Plan**

During the nine months ended September 30, 2016 and 2015, we issued 20,045 and 18,343 shares of Common stock, respectively, to our profit sharing retirement plan, representing the Common stock discretionary matching contributions of \$2,348 and \$1,963, respectively.

**Non-controlling Interest**

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

Non-controlling interest at December 31, 2015	\$ 246,411
Net income attributable to non-controlling interest	42,859
Distributions to non-controlling interest	(26,027)
Foreign currency translation adjustment	4,469
Loss recorded in accumulated other comprehensive loss	(594)
Gain reclassified from accumulated other comprehensive loss into earnings	197
<b>Non-controlling interest at September 30, 2016</b>	<b>\$ 267,315</b>

**7. COMMITMENTS AND CONTINGENCIES****Litigation, Claims and Assessments**

In December 2015, a purported Watsco shareholder, Nelson Gaskins, filed a derivative lawsuit in the U.S. District Court for the Southern District of Florida against Watsco's Board of Directors. The Company is a nominal defendant. The lawsuit alleges breach of fiduciary duties regarding CEO incentive compensation and seeks to recover alleged excessive incentive compensation and unspecified damages. The defendants believe the claims are entirely without merit and intend to vigorously defend against them. While we cannot predict the outcome of this litigation, we believe the ultimate outcome of this matter will not have a material effect on our financial condition or results of operations.

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

### **Self-Insurance**

Self-insurance reserves are maintained relative to company-wide casualty insurance and health benefit programs. The level of exposure from catastrophic events is limited by the purchase of stop-loss and aggregate liability reinsurance coverage. When estimating the self-insurance liabilities and related reserves, management considers a number of factors, which include historical claims experience, demographic factors, severity factors and valuations provided by independent third-party actuaries. Management reviews its assumptions with its independent third-party actuaries to evaluate whether the self-insurance reserves are adequate. If



competitive factors within the HVAC/R industry;

effects of supplier concentration;

fluctuations in certain commodity costs;

consumer spending;

consumer debt levels;

new housing starts and completions;

capital spending in the commercial construction market;

access to liquidity needed for operations;

seasonal nature of product sales;

weather conditions;

insurance coverage risks;

federal, state and local regulations impacting our industry and products;

prevailing interest rates;

foreign currency exchange rate fluctuations;

international political risk;

cybersecurity risk; and

the continued viability of our business strategy.



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## **Table of Contents**

We believe these forward-looking statements are reasonable; however, you should not place undue reliance on any forward-looking statements, which are based on current expectations. For additional information regarding other important factors that may affect our operations and could cause actual results to vary materially from those anticipated in the forward-looking statements, please see the discussion included in Item 1A Risk Factors of our Annual Report on Form 10-K for the year ended December 31, 2015, as well as the other documents and reports that we file with the SEC. Forward-looking statements speak only as of the date the statements were made. We assume no obligation to update forward-looking information or the discussion of such risks and uncertainties to reflect actual results, changes in assumptions or changes in other factors affecting forward-looking information, except as required by applicable law. We qualify any and all of our forward-looking statements by these cautionary factors.

The following information should be read in conjunction with the condensed consolidated unaudited financial statements, including the notes thereto, included under Part I, Item 1 of this Quarterly Report on Form 10-Q. In addition, reference should be made to our audited consolidated financial statements and notes thereto and related Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended December 31, 2015.

## **Company Overview**

Watsco, Inc. was incorporated in Florida in 1956, and, together with its subsidiaries (collectively, Watsco, or we, us or our) is the largest distributor of air conditioning, heating and refrigeration equipment and related parts and supplies (HVAC/R) in the HVAC/R distribution industry in North America. At September 30, 2016, we operated from 568 locations in 37 U.S. States, Canada, Mexico and Puerto Rico with additional market coverage on an export basis to Latin America and the Caribbean.

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

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

## **Joint Ventures with Carrier Corporation**

In 2009, we formed a joint venture with Carrier Corporation (Carrier), which we refer to as Carrier Enterprise I. In July 2012, we exercised our option to acquire an additional 10% ownership interest in Carrier Enterprise I, which increased our ownership interest to 70%; and, on July 1, 2014, we exercised our last remaining option to acquire an additional 10% ownership interest in Carrier Enterprise I, which increased our controlling interest in Carrier Enterprise I to 80%. Neither Watsco nor Carrier has any remaining options to purchase additional ownership interests in Carrier Enterprise I or any of our other joint ventures with Carrier, which are described below.

In 2011, we formed a second joint venture with Carrier, which we refer to as Carrier Enterprise II. We have a 60% controlling interest in Carrier Enterprise II, and Carrier has a 40% non-controlling interest. In 2012, we formed a third

joint venture, which we refer to as Carrier Enterprise III, with UTC Canada Corporation, referred to as UTC Canada, an affiliate of Carrier. We have a 60% controlling interest in Carrier Enterprise III, and UTC Canada has a 40% non-controlling interest.

### **Critical Accounting Policies**

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

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Our critical accounting policies are included in our 2015 Annual Report on Form 10-K as filed on February 29, 2016. We believe that there have been no significant changes during the quarter ended September 30, 2016 to the critical accounting policies disclosed in our Annual Report on Form 10-K for the year ended December 31, 2015.

**New Accounting Standards**

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

**Results of Operations**

The following table summarizes information derived from the condensed consolidated unaudited statements of income, expressed as a percentage of revenues, for the quarters and nine months ended September 30, 2016 and 2015.

	Quarter Ended		Nine Months	
	September 30,		Ended September 30,	
	2016	2015	2016	2015
Revenues	<b>100.0%</b>	100.0%	<b>100.0%</b>	100.0%
Cost of sales	<b>75.7</b>	75.7	<b>75.6</b>	75.5
Gross profit	<b>24.3</b>	24.3	<b>24.4</b>	24.5
Selling, general and administrative expenses	<b>14.7</b>	14.9	<b>15.7</b>	15.7
Operating income	<b>9.6</b>	9.4	<b>8.7</b>	8.8
Interest expense, net	<b>0.1</b>	0.1	<b>0.1</b>	0.1
Income before income taxes	<b>9.5</b>	9.3	<b>8.6</b>	8.7
Income taxes	<b>3.0</b>	3.0	<b>2.7</b>	2.7
Net income	<b>6.5</b>	6.3	<b>5.9</b>	6.0
Less: net income attributable to non-controlling interest	<b>1.4</b>	1.4	<b>1.3</b>	1.4
Net income attributable to Watsco, Inc.	<b>5.1%</b>	4.9%	<b>4.6%</b>	4.6%

In the following narratives, computations and disclosure information referring to same-store basis exclude the effects of locations acquired or locations opened or closed during the immediately preceding 12 months unless they are within close geographical proximity to existing locations. At September 30, 2016 and 2015, 17 and 35 locations, respectively, were excluded from same-store basis information. The table below summarizes the changes in our locations for the 12 months ended September 30, 2016:

	Number of Locations
September 30, 2015	567
Closed	(2)

Opened	1
December 31, 2015	566
Opened	8
Closed	(6)
September 30, 2016	<b>568</b>

### Third Quarter of 2016 Compared to Third Quarter of 2015

#### *Revenues*

Revenues for the third quarter of 2016 increased \$64.2 million, or 5%, as compared to the third quarter of 2015, including \$0.4 million from locations opened during the preceding 12 months, offset by \$2.9 million from locations closed. On a same-store basis, revenues increased \$66.7 million, or 6%, as compared to the same period in 2015, reflecting a 7% increase in sales of HVAC equipment (67% of sales), a 2% increase in sales of other HVAC products (28% of sales) and a 7% increase in sales of commercial refrigeration products (5% of sales). The increase in same-store revenues is primarily due to strong demand for the replacement of residential and commercial HVAC equipment. Revenues from sales of residential HVAC equipment also benefited from an improved sales mix of higher-efficiency air conditioning and heating systems, which sell at higher unit prices.

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**Table of Contents***Gross Profit*

Gross profit for the third quarter of 2016 increased \$16.4 million, or 6%, as compared to the third quarter of 2015, primarily as a result of increased revenues. Gross profit margin for both the quarters ended September 30, 2016 and 2015 was 24.3%.

*Selling, General and Administrative Expenses*

Selling, general and administrative expenses for the third quarter of 2016 increased \$7.7 million, or 4%, primarily due to increased revenues. Selling, general and administrative expenses as a percent of revenues for the quarter ended September 30, 2016 decreased to 14.7% from 14.9% for the same period in 2015. Selling, general and administrative expenses included \$0.7 million of incremental costs for the third quarter of 2016 in excess of the third quarter of 2015 for ongoing technology initiatives. On a same-store basis, selling, general and administrative expenses increased 5% as compared to the same period in 2015.

*Interest Expense, Net*

Interest expense, net, for the third quarter of 2016 decreased 34% to \$1.0 million, primarily as a result of a decrease in average outstanding borrowings, partially offset by a higher effective interest rate in 2016, in each case as compared to the same period in 2015.

*Income Taxes*

Income taxes increased to \$37.8 million for the third quarter of 2016 as compared to \$34.5 million for the third quarter of 2015 and are a composite of the income taxes attributable to our wholly owned operations and income taxes attributable to the Carrier joint ventures, which are primarily taxed as partnerships for income tax purposes. The effective income tax rates attributable to us were 36.8% and 36.7% for the quarters ended September 30, 2016 and 2015, respectively. The increase was primarily due to higher tax credits in 2015 versus 2016 related to income generated by our U.S. subsidiaries, which was partially offset by a \$0.6 million benefit from the adoption of new accounting guidance related to share-based compensation in 2016. See Note 1 to our condensed consolidated unaudited financial statements contained in this Quarterly Report on Form 10-Q.

*Net Income Attributable to Watsco, Inc.*

Net income attributable to Watsco for the third quarter of 2016 increased \$5.1 million, or 9%, as compared to the same period in 2015. The increase was primarily driven by higher revenues and reduced selling, general and administrative expenses as a percentage of revenues, as discussed above.

**Nine Months Ended September 30, 2016 Compared to Nine Months Ended September 30, 2015***Revenues*

Revenues for the nine months ended September 30, 2016 increased \$97.7 million, or 3%, as compared to the same period in 2015, including \$1.4 million from locations opened during the preceding 12 months, offset by \$14.8 million from locations closed. On a same-store basis, revenues increased \$111.1 million, or 3%, as compared to the same period in 2015, reflecting a 4% increase in sales of HVAC equipment (66% of sales), a 1% increase in sales of other HVAC products (29% of sales) and a 7% increase in sales of commercial refrigeration products (5% of sales). The increase in same-store revenues is primarily due to demand for the replacement of residential and commercial HVAC

equipment.

*Gross Profit*

Gross profit for the nine months ended September 30, 2016 increased \$21.2 million, or 3%, as compared to the same period in 2015, primarily as a result of increased revenues. Gross profit margin for the nine months ended September 30, 2016 declined 10 basis-points to 24.4% versus 24.5% for the same period in 2015, primarily due to lower realized gross margins for residential HVAC equipment.

*Selling, General and Administrative Expenses*

Selling, general and administrative expenses for the nine months ended September 30, 2016 increased \$16.2 million, or 3%, as compared to the same period in 2015, primarily as a result of increased revenues. Selling, general and administrative expenses as a percent of revenues for both the nine months ended September 30, 2016 and 2015 was 15.7%. Selling, general and administrative expenses included \$3.2 million of incremental costs for the nine months ended September 30, 2016 in excess of the same period in 2015 for ongoing technology initiatives. On a same-store basis, selling, general, and administrative expenses increased 4% as compared to 2015.

*Interest Expense, Net*

Interest expense, net, for the nine months ended September 30, 2016 decreased \$1.5 million, or 33%, primarily as a result of a decrease in average outstanding borrowings, partially offset by a higher effective interest rate in 2016, in each case as compared to the same period in 2015.

## **Table of Contents**

### *Income Taxes*

Income taxes increased to \$88.4 million for the nine months ended September 30, 2016 as compared to \$87.8 million for the nine months ended September 30, 2015 and are a composite of the income taxes attributable to our wholly owned operations and income taxes attributable to the Carrier joint ventures, which are primarily taxed as partnerships for income tax purposes. The effective income tax rates attributable to us were 36.0% and 36.9% for the nine months ended September 30, 2016 and 2015, respectively. The decrease was primarily due to the aforementioned \$2.9 million benefit from the adoption of new accounting guidance related to share-based compensation. See Note 1 to our condensed consolidated unaudited financial statements contained in this Quarterly Report on Form 10-Q.

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

Net income attributable to Watsco for the nine months ended September 30, 2016 increased \$6.8 million, or 5%, as compared to the same period in 2015. The increase was primarily driven by higher revenues, as discussed above.

## **Liquidity and Capital Resources**

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

cash needed to fund our business (primarily working capital requirements);

borrowing capacity under our bank line of credit;

the ability to attract long-term capital with satisfactory terms;

acquisitions, including joint ventures;

dividend payments;

capital expenditures; and

the timing and extent of common stock repurchases.

### **Sources and Uses of Cash**

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

As of September 30, 2016, we had \$35.9 million of cash and cash equivalents, of which, \$29.0 million was held by foreign subsidiaries. The repatriation of cash balances from our foreign subsidiaries could have adverse tax consequences or be subject to capital controls; however, these balances are generally available without legal restrictions to fund ordinary business operations of our foreign subsidiaries.

We believe that our operating cash flows, cash on hand and funds available for borrowing under our line of credit will be sufficient to meet our liquidity needs in the foreseeable future. However, there can be no assurance that our current sources of available funds will be sufficient to meet our cash requirements.

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

#### Working Capital

Working capital increased to \$990.9 million at September 30, 2016 from \$911.0 million at December 31, 2015, reflecting higher levels of accounts receivable and inventories, primarily due to the seasonality of our business.

Table of ContentsCash Flows

The following table summarizes our cash flow activity for the nine months ended September 30, 2016 and 2015 (in millions):

	2016	2015	Change
Cash flows provided by operating activities	\$ 146.3	\$ 99.8	\$ 46.5
Cash flows used in investing activities	\$ (8.3)	\$ (19.9)	\$ 11.6
Cash flows used in financing activities	\$ (137.4)	\$ (75.0)	\$ (62.4)

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

Operating Activities

Net cash provided by operating activities was higher primarily due to the timing of payments for accrued expenses in 2016 and lower inventory as a result of the transition to new regional efficiency standards in 2015.

Investing Activities

Net cash used in investing activities was lower due to the purchase of owned space for expansion of our corporate headquarters in 2015.

Financing Activities

Net cash used in financing activities was higher due to increases in repayments of borrowings under our revolving credit agreement, dividends paid and distributions to the noncontrolling interest in 2016.

Revolving Credit Agreement

We maintain an unsecured, syndicated revolving credit agreement that provides for borrowings of up to \$600.0 million. Borrowings are used to fund seasonal working capital needs and for other general corporate purposes, including acquisitions, dividends (if and as declared by our Board of Directors), capital expenditures, stock repurchases and issuances of letters of credit. The revolving credit agreement matures on July 1, 2019. At September 30, 2016 and December 31, 2015, \$219.4 million and \$245.3 million were outstanding under the revolving credit agreement, respectively. The revolving credit agreement contains customary affirmative and negative covenants, including financial covenants with respect to consolidated leverage and interest coverage ratios, and other customary restrictions. We believe we were in compliance with all covenants at September 30, 2016.

Acquisitions

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

Common Stock Dividends

We paid cash dividends of \$2.55 per share and \$2.10 per share of Common stock and Class B common stock during the nine months ended September 30, 2016 and 2015, respectively. On October 3, 2016, our Board of Directors declared a regular quarterly cash dividend of \$1.05 per share of Common and Class B common stock that was paid on October 31, 2016 to shareholders of record as of October 17, 2016. Future dividends and/or changes in dividend rates will be at the sole discretion of the Board of Directors and will depend upon such factors as cash flow generated by operations, profitability, financial condition, cash requirements, future prospects and other factors deemed relevant by our Board of Directors.

#### Company Share Repurchase Program

In September 1999, our Board of Directors authorized the repurchase, at management's discretion, of up to 7,500,000 shares of common stock in the open market or via private transactions. Shares repurchased under the program are accounted for using the cost method and result in a reduction of shareholders' equity. No shares were repurchased during the quarters ended September 30, 2016 or 2015. In aggregate, 6,370,913 shares of Common and Class B common stock have been repurchased at a cost of \$114.4 million since the inception of the program. At September 30, 2016, there were 1,129,087 shares remaining authorized for repurchase under the program.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

There have been no material changes to the information regarding market risk provided in Item 7A, Quantitative and Qualitative Disclosures about Market Risk, of our Annual Report on Form 10-K for the year ended December 31, 2015.

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**ITEM 4. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures**

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

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

**Changes in Internal Control over Financial Reporting**

We are continuously seeking to improve the efficiency and effectiveness of our operations and of our internal controls. This results in refinements to processes throughout the Company. However, there were no changes in internal controls over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended September 30, 2016, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

Information with respect to this item may be found in Note 7 to our condensed consolidated unaudited financial statements contained in this Quarterly Report on Form 10-Q under the caption Litigation, Claims and Assessments, which information is incorporated by reference in this Item 1 of Part II of this Quarterly Report on Form 10-Q.

**ITEM 1A. RISK FACTORS**

Information about risk factors for the quarter ended September 30, 2016 does not differ materially from that set forth in Part I, Item 1A, of our Annual Report on Form 10-K for the year ended December 31, 2015.

**ITEM 6. EXHIBITS**

- 3.2 Watsco, Inc. Second Amended and Restated Bylaws effective August 1, 2016 (filed as Exhibit 3.1 to the Current Report on Form 8-K on August 5, 2016 and incorporated herein by reference).
- 31.1 # Certification of Chief Executive Officer pursuant to Securities Exchange Act Rules 13a- 15(e) and 15d-15(e) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 # Certification of Senior Vice President pursuant to Securities Exchange Act Rules 13a-15(e) and 15d-15(e) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

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

# filed herewith.

+ furnished herewith.

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**SIGNATURES**

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

WATSCO, INC.  
(Registrant)

November 3, 2016

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

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**INDEX TO EXHIBITS**

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