

WATSCO INC  
Form 10-Q  
August 06, 2015  
Table of Contents

**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 June 30, 2015**

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 August 4, 2015 was (i) 30,234,632 shares of Common stock, \$0.50 par value per share, excluding 6,322,650 treasury shares, and (ii) 5,016,699 shares of Class B common stock, \$0.50 par value per share, excluding 48,263 treasury shares.

**Table of Contents**

**WATSCO, INC. AND SUBSIDIARIES**

**QUARTERLY REPORT ON FORM 10-Q**

**TABLE OF CONTENTS**

	Page No.
<b>PART I. <u>FINANCIAL INFORMATION</u></b>	
Item 1. <u>Condensed Consolidated Unaudited Financial Statements</u>	
<u>Condensed Consolidated Unaudited Statements of Income – Quarter and Six Months Ended June 30, 2015 and 2014</u>	3
<u>Condensed Consolidated Unaudited Statements of Comprehensive Income – Quarter and Six Months Ended June 30, 2015 and 2014</u>	4
<u>Condensed Consolidated Balance Sheets – June 30, 2015 (Unaudited) and December 31, 2014</u>	5
<u>Condensed Consolidated Unaudited Statements of Cash Flows – Six Months Ended June 30, 2015 and 2014</u>	6
<u>Notes to Condensed Consolidated Unaudited Financial Statements</u>	7
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	14
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	19
Item 4. <u>Controls and Procedures</u>	19
<b>PART II. <u>OTHER INFORMATION</u></b>	
Item 1. <u>Legal Proceedings</u>	20
Item 1A. <u>Risk Factors</u>	20
Item 6. <u>Exhibits</u>	20
<b><u>SIGNATURE</u></b>	21
<b><u>EXHIBITS</u></b>	

Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS**

## WATSCO, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED UNAUDITED STATEMENTS OF INCOME

(In thousands, except per share data)

	Quarter Ended		Six Months Ended	
	June 30,		June 30,	
	2015	2014	2015	2014
Revenues	<b>\$ 1,223,439</b>	\$ 1,170,186	<b>\$ 2,032,411</b>	\$ 1,932,754
Cost of sales	<b>928,194</b>	890,913	<b>1,532,941</b>	1,465,412
Gross profit	<b>295,245</b>	279,273	<b>499,470</b>	467,342
Selling, general and administrative expenses	<b>170,386</b>	166,293	<b>327,603</b>	318,809
Operating income	<b>124,859</b>	112,980	<b>171,867</b>	148,533
Interest expense, net	<b>1,630</b>	1,247	<b>3,007</b>	2,256
Income before income taxes	<b>123,229</b>	111,733	<b>168,860</b>	146,277
Income taxes	<b>38,988</b>	33,348	<b>53,319</b>	43,489
Net income	<b>84,241</b>	78,385	<b>115,541</b>	102,788
Less: net income attributable to non-controlling interest	<b>18,818</b>	22,284	<b>27,070</b>	29,934
Net income attributable to Watsco, Inc.	<b>\$ 65,423</b>	\$ 56,101	<b>\$ 88,471</b>	\$ 72,854
Earnings per share for Common and Class B common stock:				
Basic	<b>\$ 1.86</b>	\$ 1.60	<b>\$ 2.52</b>	\$ 2.09
Diluted	<b>\$ 1.85</b>	\$ 1.60	<b>\$ 2.51</b>	\$ 2.08

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

Table of Contents

## WATSCO, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED UNAUDITED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

	Quarter Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Net income	<b>\$ 84,241</b>	\$ 78,385	<b>\$ 115,541</b>	\$ 102,788
Other comprehensive income (loss), net of tax				
Foreign currency translation adjustment	<b>2,972</b>	8,562	<b>(16,903)</b>	(652)
Unrealized (loss) gain on cash flow hedging instruments	<b>(241)</b>		<b>1,385</b>	
Reclassification of gain on cash flow hedging instruments into earnings	<b>(997)</b>		<b>(1,134)</b>	
Unrealized gain (loss) on available-for-sale securities	<b>14</b>	(9)	<b>21</b>	(8)
Other comprehensive income (loss)	<b>1,748</b>	8,553	<b>(16,631)</b>	(660)
Comprehensive income	<b>85,989</b>	86,938	<b>98,910</b>	102,128
Less: comprehensive income attributable to non-controlling interest	<b>19,516</b>	25,817	<b>20,332</b>	29,627
Comprehensive income attributable to Watsco, Inc.	<b>\$ 66,473</b>	\$ 61,121	<b>\$ 78,578</b>	\$ 72,501

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

**Table of Contents**

WATSCO, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except per share data)

	June 30, 2015 (Unaudited)	December 31, 2014
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 21,851	\$ 24,447
Accounts receivable, net	599,071	434,234
Inventories	799,044	677,990
Other current assets	21,444	20,664
<b>Total current assets</b>	<b>1,441,410</b>	<b>1,157,335</b>
Property and equipment, net	60,989	53,480
Goodwill	383,272	387,311
Intangible assets, net	174,672	186,476
Other assets	6,212	6,465
	<b>\$ 2,066,555</b>	<b>\$ 1,791,067</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Current liabilities:		
Current portion of other long-term obligations	\$ 174	\$ 169
Short-term debt	2,569	
Accounts payable	243,458	173,360
Accrued expenses and other current liabilities	125,697	113,493
<b>Total current liabilities</b>	<b>371,898</b>	<b>287,022</b>
Long-term obligations:		
Borrowings under revolving credit agreement	433,412	303,199
Other long-term obligations, net of current portion	598	686
<b>Total long-term obligations</b>	<b>434,010</b>	<b>303,885</b>
Deferred income taxes and other liabilities	69,949	68,121
Commitments and contingencies		
Watsco, Inc. shareholders equity:		
Common stock, \$0.50 par value	18,275	18,222
Class B common stock, \$0.50 par value	2,531	2,467
Preferred stock, \$0.50 par value		

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Paid-in capital	<b>593,015</b>	580,564
Accumulated other comprehensive loss, net of tax	<b>(33,640)</b>	(23,747)
Retained earnings	<b>460,185</b>	420,879
Treasury stock, at cost	<b>(114,425)</b>	(114,425)
Total Watsco, Inc. shareholders' equity	<b>925,941</b>	883,960
Non-controlling interest	<b>264,757</b>	248,079
Total shareholders' equity	<b>1,190,698</b>	1,132,039
	<b>\$ 2,066,555</b>	\$ 1,791,067

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

Table of Contents

## WATSCO, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED UNAUDITED STATEMENTS OF CASH FLOWS

(In thousands)

	Six Months Ended June 30,	
	2015	2014
<b>Cash flows from operating activities:</b>		
Net income	<b>\$ 115,541</b>	\$ 102,788
<b>Adjustments to reconcile net income to net cash used in operating activities:</b>		
Depreciation and amortization	<b>9,409</b>	8,847
Share-based compensation	<b>5,840</b>	5,179
Deferred income tax provision	<b>3,009</b>	2,502
Non-cash contribution to 401(k) plan	<b>1,963</b>	1,759
Provision for doubtful accounts	<b>476</b>	416
Gain on sale of property and equipment	<b>(366)</b>	(108)
Excess tax benefits from share-based compensation	<b>(1,774)</b>	(1,443)
<b>Changes in operating assets and liabilities:</b>		
Accounts receivable	<b>(168,339)</b>	(150,758)
Inventories	<b>(124,477)</b>	(176,584)
Accounts payable and other liabilities	<b>84,894</b>	142,552
Other, net	<b>(303)</b>	(308)
<b>Net cash used in operating activities</b>	<b>(74,127)</b>	(65,158)
<b>Cash flows from investing activities:</b>		
Capital expenditures	<b>(14,633)</b>	(5,846)
Proceeds from sale of property and equipment	<b>623</b>	276
<b>Net cash used in investing activities</b>	<b>(14,010)</b>	(5,570)
<b>Cash flows from financing activities:</b>		
Net proceeds under revolving credit agreement	<b>131,146</b>	118,767
Net proceeds from issuances of common stock	<b>3,235</b>	1,732
Proceeds from short-term debt	<b>2,569</b>	
Excess tax benefits from share-based compensation	<b>1,774</b>	1,443
Payment of fees related to revolving credit agreement		(345)
Net (repayments of) proceeds from other long-term obligations	<b>(83)</b>	318
Distributions to non-controlling interest	<b>(3,654)</b>	(25,817)
Dividends on Common and Class B common stock	<b>(49,165)</b>	(27,909)
<b>Net cash provided by financing activities</b>	<b>85,822</b>	68,189
<b>Effect of foreign exchange rate changes on cash and cash equivalents</b>	<b>(281)</b>	(74)



Net decrease in cash and cash equivalents	<b>(2,596)</b>	(2,613)
Cash and cash equivalents at beginning of period	<b>24,447</b>	19,478
Cash and cash equivalents at end of period	<b>\$ 21,851</b>	\$ 16,865

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

**Table of Contents**

WATSCO, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS

June 30, 2015

(In thousands, except share and per share data)

**1. BASIS OF PRESENTATION**

**Basis of Consolidation**

Watsco, Inc. and its subsidiaries (collectively, Watsco, or we, us or our) was incorporated in Florida in 1956 and is the largest distributor of air conditioning, heating and refrigeration equipment and related parts and supplies (HVAC/R) in the HVAC/R distribution industry in North America. The accompanying June 30, 2015 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 2014 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 six months ended June 30, 2015 are not necessarily indicative of the results to be expected for the year ending December 31, 2015. 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.

**Reclassifications**

Certain reclassifications of prior year amounts have been made to conform to the 2015 presentation. These reclassifications had no effect on net income or earnings per share as previously reported.

**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 are currently evaluating the impact on our condensed consolidated unaudited financial statements.

### *Presentation of Debt Issuance Costs*

In April 2015, the FASB issued guidance that will require 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 to be applied retrospectively and will be effective for interim and annual reporting periods beginning after December 15, 2015. We do not expect the adoption of this guidance to have a material impact on our condensed consolidated unaudited 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 are currently evaluating the impact on our condensed consolidated unaudited financial statements.

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

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

	Quarter Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
<b>Basic Earnings per Share:</b>				
Net income attributable to Watsco, Inc. shareholders	\$ 65,423	\$ 56,101	\$ 88,471	\$ 72,854
Less: distributed and undistributed earnings allocated to non-vested restricted common stock	5,183	4,286	6,922	5,532
Earnings allocated to Watsco, Inc. shareholders	\$ 60,240	\$ 51,815	\$ 81,549	\$ 67,322
Weighted-average common shares outstanding - Basic	32,427,088	32,295,912	32,402,262	32,273,077
Basic earnings per share for Common and Class B common stock	\$ 1.86	\$ 1.60	\$ 2.52	\$ 2.09
Allocation of earnings for Basic:				
Common stock	\$ 55,179	\$ 47,467	\$ 74,692	\$ 61,668
Class B common stock	5,061	4,348	6,857	5,654
	\$ 60,240	\$ 51,815	\$ 81,549	\$ 67,322
<b>Diluted Earnings per Share:</b>				
Net income attributable to Watsco, Inc. shareholders	\$ 65,423	\$ 56,101	\$ 88,471	\$ 72,854
Less: distributed and undistributed earnings allocated to non-vested restricted common stock	5,179	4,281	6,917	5,526
Earnings allocated to Watsco, Inc. shareholders	\$ 60,244	\$ 51,820	\$ 81,554	\$ 67,328
Weighted-average common shares outstanding - Basic	32,427,088	32,295,912	32,402,262	32,273,077
Effect of dilutive stock options	50,174	57,133	52,036	56,299
Weighted-average common shares outstanding - Diluted	32,477,262	32,353,045	32,454,298	32,329,376
Diluted earnings per share for Common and Class B common stock	\$ 1.85	\$ 1.60	\$ 2.51	\$ 2.08

Anti-dilutive stock options not included above	<b>2,363</b>	<b>54,535</b>	2,873
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Diluted earnings per share for our Common stock assumes the conversion of all of our Class B common stock into Common stock as of the beginning of the fiscal year, therefore, no allocation of earnings to Class B common stock is required. At June 30, 2015 and 2014, our outstanding Class B common stock was convertible into 2,724,464 and 2,710,315 shares of our Common stock, respectively.

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

Other comprehensive income (loss) 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 income (loss) were as follows:

	Quarter Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Foreign currency translation adjustment	\$ 2,972	\$ 8,562	\$ (16,903)	\$ (652)
Unrealized (loss) gain on cash flow hedging instruments	(329)		1,898	
Income tax benefit (expense)	88		(513)	
Unrealized (loss) gain on cash flow hedging instruments, net of tax	(241)		1,385	
Reclassification of gain on cash flow hedging instruments into earnings	(1,366)		(1,554)	
Income tax expense	369		420	
Reclassification of gain on cash flow hedging instruments into earnings, net of tax	(997)		(1,134)	
Unrealized gain (loss) on available-for-sale securities	23	(14)	34	(12)
Income tax (expense) benefit	(9)	5	(13)	4
Unrealized gain (loss) on available-for-sale securities, net of tax	14	(9)	21	(8)
Other comprehensive income (loss)	\$ 1,748	\$ 8,553	\$ (16,631)	\$ (660)

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

<i>Six Months Ended June 30,</i>	2015	2014
Foreign currency translation adjustment:		
Beginning balance	\$ (23,623)	\$ (11,181)
Current period other comprehensive loss	(10,065)	(345)
Ending balance	\$ (33,688)	\$ (11,526)
Cash flow hedging instruments:		
Beginning balance	\$ 168	
Current period other comprehensive income	831	
Less reclassification adjustment	(680)	

Ending balance	\$	<b>319</b>	
Available-for-sale securities:			
Beginning balance	\$	<b>(292)</b>	\$ (293)
Current period other comprehensive income (loss)		<b>21</b>	(8)
Ending balance	\$	<b>(271)</b>	\$ (301)
Accumulated other comprehensive loss, net of tax	\$	<b>(33,640)</b>	\$ (11,827)

#### 4. DERIVATIVES

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.

**Table of Contents****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 hedged transaction occurs. The maximum length of time for which we hedge our exposure to the variability in future cash flows for forecasted transactions is 12 months and, accordingly, at June 30, 2015, 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 June 30, 2015 was \$28,950, and such contracts have varying terms expiring through December 2015. We did not have any foreign currency forward contracts designated as cash flow hedges and/or did not qualify for hedge accounting at June 30, 2014.

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

	Quarter Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
(Loss) gain recorded in accumulated other comprehensive loss	\$ (329)		\$ 1,898	
Gain reclassified from accumulated other comprehensive loss into earnings	\$ 1,366		\$ 1,554	

At June 30, 2015, we expected an estimated \$728 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 also enter into foreign currency forward contracts that are not designated as hedges and/or did not qualify for hedge accounting. These derivative instruments were effective economic hedges for all of the periods presented. The fair value gains and losses on these contracts are recognized in earnings as a component of selling, general and administrative expenses. The total notional value of our foreign currency exchange contracts not designated as hedging instruments at June 30, 2015 was \$13,200, and such contracts have varying terms expiring through October 2015.

We recognized a loss of \$(89) and \$(1,631) in our condensed consolidated unaudited statements of income from foreign currency forward contracts not designated as hedging instruments for the quarters ended June 30, 2015 and 2014, respectively. We recognized a gain (loss) of \$1,294 and \$(1,555) in our condensed consolidated unaudited statements of income from foreign currency forward contracts not designated as hedging instruments for the six months ended June 30, 2015 and 2014, respectively.

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

	Asset Derivatives	
	June 30, 2015	December 31, 2014
Derivatives designated as hedging instruments	\$ 331	\$ 384
	307	260



Derivatives not designated as hedging instruments

Total asset derivative instruments	<b>\$ 638</b>	\$	644
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Liability Derivatives

	June 30, 2015	December 31, 2014
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Derivatives designated as hedging instruments	<b>\$ 24</b>
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Derivatives not designated as hedging instruments

Total liability derivative instruments	<b>\$ 24</b>
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**Table of Contents****5. FAIR VALUE MEASUREMENTS**

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

	Balance Sheet Location	Total	Fair Value Measurements at June 30, 2015 Using		
			Level 1	Level 2	Level 3
<b>Assets:</b>					
Available-for-sale securities	Other assets	<b>\$ 300</b>	<b>\$ 300</b>		
Derivative financial instruments	Other current assets	<b>\$ 638</b>		\$ 638	
<b>Liabilities:</b>					
Derivative financial instruments	Accrued expenses and other current liabilities	<b>\$ 24</b>		\$ 24	

	Balance Sheet Location	Total	Fair Value Measurements at December 31, 2014 Using		
			Level 1	Level 2	Level 3
<b>Assets:</b>					
Available-for-sale securities	Other assets	\$ 266	\$ 266		
Derivative financial instruments	Other current assets	\$ 644		\$ 644	

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

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

*Derivative financial instruments* the derivatives are foreign currency forward contracts. 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 six months ended June 30, 2015.

**6. DEBT**

We maintain an unsecured, syndicated revolving credit agreement that provides for borrowings of up to \$600,000. 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), stock repurchases and issuances of letters of credit. The credit agreement matures on July 1, 2019. At June 30, 2015 and December 31, 2014, \$433,412 and \$303,199 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 June 30, 2015.

At June 30, 2015, \$2,569 of short-term borrowings were outstanding under a credit line established by our Mexican operations. This line of credit has a one-year term, maturing on June 15, 2016, is non-committed and provides for borrowings of up to approximately \$10,000 (MXN \$150,000) for general corporate purposes. No short-term borrowings were outstanding under this credit line at December 31, 2014.

## **7. SHAREHOLDERS EQUITY**

### **Common Stock Dividends**

We paid cash dividends of \$0.70, \$0.40, \$1.40 and \$0.80 per share of Common stock and Class B common stock during the quarters and six months ended June 30, 2015 and 2014, respectively.

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

During the quarters ended June 30, 2015 and 2014, we granted 19,000 and 20,000 shares of non-vested restricted stock, respectively. During the six months ended June 30, 2015 and 2014, we granted 171,979 and 203,025 shares of non-vested restricted stock, respectively.

**Table of Contents**

During the quarter and six months ended June 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 non-vested restricted stock. During the quarter and six months ended June 30, 2014, 21,028 shares of Common stock with an aggregate fair market value of \$2,125 were withheld as payment in lieu of cash to satisfy tax withholding obligations in connection with the vesting of non-vested restricted stock. These shares were retired upon delivery.

**Exercise of Stock Options**

During the quarters ended June 30, 2015 and 2014, 41,000 and 11,250 stock options, respectively, were exercised for a combination of Common stock and Class B common stock. During the six months ended June 30, 2015 and 2014, 66,200 and 23,500 stock options, respectively, were exercised for a combination of Common stock and Class B common stock. Cash received from common stock issued as a result of stock options exercised during the quarters and six months ended June 30, 2015 and 2014, was \$1,579, \$646, \$2,682 and \$1,329, respectively.

During the quarter ended June 30, 2015, 10,133 shares of Class B common stock with an aggregate fair market value of \$1,288 were withheld as payment in lieu of cash for stock option exercises and related tax withholdings. During the six months ended June 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 June 30, 2015 and 2014, 2,300 and 2,181 shares of Common stock were issued under our employee stock purchase plan for which we received net proceeds of \$275 and \$213, respectively. During the six months ended June 30, 2015 and 2014, 4,969 and 4,243 shares of Common stock were issued under our employee stock purchase plan for which we received net proceeds of \$553 and \$403, respectively.

**401(k) Plan**

During the six months ended June 30, 2015 and 2014, we issued 18,343 and 18,309 shares of Common stock, respectively, to our profit sharing retirement plan, representing the Common stock discretionary matching contribution of \$1,963 and \$1,759, 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, 2014	\$ 248,079
Net income attributable to non-controlling interest	27,070
Distributions to non-controlling interest	(3,654)
Foreign currency translation adjustment	(6,838)
Gain recorded in accumulated other comprehensive loss	554
	(454)

Gain reclassified from accumulated other comprehensive loss  
into earnings

Non-controlling interest at June 30, 2015	\$ 264,757
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## **8. COMMITMENTS AND CONTINGENCIES**

### **Litigation, Claims and Assessments**

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

### **Self-Insurance**

Self-insurance reserves are maintained relative to company-wide casualty insurance and health benefit programs. The level of exposure from catastrophic events is limited by the purchase of stop-loss and aggregate liability reinsurance coverage. When estimating the self-insurance liabilities and related reserves, management considers a number of factors, which include historical

**Table of Contents**

claims experience, demographic factors, severity factors and valuations provided by independent third-party actuaries. Management reviews its assumptions with its independent third-party actuaries to evaluate whether the self-insurance reserves are adequate. If actual claims or adverse development of loss reserves occur and exceed these estimates, additional reserves may be required. Reserves in the amounts of \$4,759 and \$4,630 at June 30, 2015 and December 31, 2014, respectively, were established related to such programs and are included in accrued expenses and other current liabilities in our condensed consolidated unaudited balance sheets.

**9. RELATED PARTY TRANSACTIONS**

Purchases from Carrier and its affiliates comprised 64% and 59% of all inventory purchases made during the quarters ended June 30, 2015 and 2014, respectively. Purchases from Carrier and its affiliates comprised 62% and 60% of all inventory purchases made during the six months ended June 30, 2015 and 2014, respectively. At June 30, 2015 and December 31, 2014, approximately \$108,000 and \$61,000, respectively, was payable to Carrier and its affiliates, net of receivables. Our joint ventures with Carrier also sell HVAC products to Carrier and its affiliates. Revenues in our condensed consolidated unaudited statements of income for the quarters and six months ended June 30, 2015 and 2014 included \$21,165, \$11,128, \$28,904 and \$17,663, respectively, of sales to Carrier and its affiliates. We believe these transactions are conducted at arm's-length in the ordinary course of business.

**Table of Contents**

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**Forward-Looking Statements**

This Quarterly Report on Form 10-Q contains or incorporates by reference statements that are not historical in nature and that are intended to be, and are hereby identified as, forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. Statements which are not historical in nature, including the words anticipate, estimate, could, should, may, plan, seek, expect, believe, intend, target, will, p variations of these words and negatives thereof and similar expressions are intended to identify forward-looking statements, including statements regarding, among others, (i) economic conditions, (ii) business and acquisition strategies, (iii) potential acquisitions and/or joint ventures, (iv) financing plans and (v) industry, demographic and other trends affecting our financial condition or results of operations. These forward-looking statements are based on management's current expectations, are not guarantees of future performance and are subject to a number of risks, uncertainties and changes in circumstances, certain of which are beyond our control. Actual results could differ materially from these forward-looking statements as a result of several factors, including, but not limited to:

general economic conditions;

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.

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, 2014, 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, 2014.

## **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 June 30, 2015, we operated from 566 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.



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## **Table of Contents**

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 which Carrier contributed 95 of its company-owned locations in 13 Sun Belt states and Puerto Rico and its export division in Miami, Florida, and we contributed 15 locations that distributed Carrier products. 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 and completed two additional transactions. In April 2011, Carrier contributed 28 of its company-owned locations in eight Northeast U.S. States, and we contributed 14 locations in the Northeast U.S. In July 2011, we purchased Carrier's distribution operations in Mexico, which included seven locations. Collectively, the Northeast locations and the Mexico operations are referred to as Carrier Enterprise II. We have a 60% controlling interest in Carrier Enterprise II, and Carrier has a 40% 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. Carrier contributed 35 of its company-owned locations in Canada to Carrier Enterprise III. We have a 60% controlling interest in Carrier Enterprise III, and UTC Canada has a 40% non-controlling interest.

### **Critical Accounting Policies**

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

Our critical accounting policies are included in our 2014 Annual Report on Form 10-K as filed on February 24, 2015. We believe that there have been no significant changes during the quarter ended June 30, 2015 to the critical accounting policies disclosed in our Annual Report on Form 10-K for the year ended December 31, 2014.

### **New Accounting Pronouncements**

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 pronouncements.

### **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 six months ended June 30, 2015 and 2014:

**Table of Contents**

	Quarter		Six Months	
	Ended June 30, 2015	2014	Ended June 30, 2015	2014
Revenues	<b>100.0%</b>	100.0%	<b>100.0%</b>	100.0%
Cost of sales	<b>75.9</b>	76.1	<b>75.4</b>	75.8
Gross profit	<b>24.1</b>	23.9	<b>24.6</b>	24.2
Selling, general and administrative expenses	<b>13.9</b>	14.2	<b>16.1</b>	16.5
Operating income	<b>10.2</b>	9.7	<b>8.5</b>	7.7
Interest expense, net	<b>0.1</b>	0.2	<b>0.2</b>	0.1
Income before income taxes	<b>10.1</b>	9.5	<b>8.3</b>	7.6
Income taxes	<b>3.2</b>	2.8	<b>2.6</b>	2.3
Net income	<b>6.9</b>	6.7	<b>5.7</b>	5.3
Less: net income attributable to non-controlling interest	<b>1.5</b>	1.9	<b>1.3</b>	1.5
Net income attributable to Watsco, Inc.	<b>5.4%</b>	4.8%	<b>4.4%</b>	3.8%

The following narratives reflect our additional 10% ownership interest in Carrier Enterprise I, which became effective on July 1, 2014. We did not acquire any businesses during the six months ended June 30, 2015 or 2014.

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 June 30, 2015 and 2014, 34 and 17 locations, respectively, were excluded from same-store basis information. The table below summarizes the changes in our locations for the 12 months ended June 30, 2015:

	Number of Locations
June 30, 2014	570
Opened	10
Closed	(8)
December 31, 2014	572
Opened	5
Closed	(11)
June 30, 2015	<b>566</b>

**Second Quarter of 2015 Compared to Second Quarter of 2014***Revenues*

Revenues for the second quarter of 2015 increased \$53.2 million, or 5%, including \$1.8 million from locations opened during the preceding 12 months, offset by \$6.7 million from locations closed. On a same-store basis, revenues increased \$58.1 million, or 5%, as compared to the same period in 2014, reflecting a 7% increase in sales of HVAC equipment (67% of sales), a 1% increase in sales of other HVAC products (29% of sales) and a 3% increase in sales of commercial refrigeration products (4% 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.

#### *Gross Profit*

Gross profit for the second quarter of 2015 increased \$16.0 million, or 6%, primarily as a result of increased revenues. Gross profit margin for the quarter ended June 30, 2015 improved 20 basis-points to 24.1% versus 23.9%, primarily due to higher realized gross margins for residential HVAC equipment.

#### *Selling, General and Administrative Expenses*

Selling, general and administrative expenses for the second quarter of 2015 increased \$4.1 million, or 2%, primarily due to increased revenues. Selling, general and administrative expenses as a percentage of revenues for the quarter ended June 30, 2015 decreased to 13.9% versus 14.2% for the same period in 2014. The decrease in selling, general, and administrative expenses as a percentage of revenues was primarily due to improved leveraging of fixed operating costs as compared to 2014. On a same-store basis, selling, general and administrative expenses increased 3% as compared to the same period in 2014.

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**Table of Contents***Interest Expense, Net*

Net interest expense for the second quarter of 2015 increased \$0.4 million, or 31%, primarily as a result of an increase in average outstanding borrowings, partially offset by a lower effective interest rate for the 2015 period as compared to the same period in 2014.

*Income Taxes*

Income taxes increased to \$39.0 million for the second quarter of 2015 as compared to \$33.3 million for the second quarter of 2014 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 June 30, 2015 and 2014, respectively. The increase was primarily due to higher state income taxes in 2015 versus 2014 related to income generated by our U.S. subsidiaries.

*Net Income Attributable to Watsco, Inc.*

Net income attributable to Watsco for the second quarter of 2015 increased \$9.3 million, or 17%, compared to the same period in 2014. The increase was primarily driven by higher revenues, expanded profit margins and reduced selling, general and administrative expenses as a percentage of revenues, as discussed above, and by a reduction in the net income attributable to the non-controlling interest related to Carrier Enterprise I following our purchase of an additional 10% ownership interest in Carrier Enterprise I in July 2014.

**First Half of 2015 Compared to First Half of 2014***Revenues*

Revenues for the first half of 2015 increased \$99.7 million, or 5%, including \$2.7 million from locations opened during the preceding 12 months, offset by \$11.3 million from locations closed. On a same-store basis, revenues increased \$108.3 million, or 6%, as compared to the same period in 2014, reflecting an 8% increase in sales of HVAC equipment (66% of sales), a 1% increase in sales of other HVAC products (30% of sales) and a 4% increase in sales of commercial refrigeration products (4% 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.

*Gross Profit*

Gross profit for the first half of 2015 increased \$32.1 million, or 7%, primarily as a result of increased revenues. Gross profit margin for the six months ended June 30, 2015 improved 40 basis-points to 24.6% versus 24.2%, primarily due to higher realized gross margins for residential HVAC equipment.

*Selling, General and Administrative Expenses*

Selling, general and administrative expenses for the first half of 2015 increased \$8.8 million, or 3%, primarily due to increased revenues. Selling, general and administrative expenses as a percentage of revenues for the six months ended June 30, 2015 decreased to 16.1% versus 16.5% for the same period in 2014. The decrease in selling, general, and administrative expenses as a percentage of revenues was primarily due to improved leveraging of fixed operating costs

as compared to 2014. On a same-store basis, selling, general and administrative expenses increased 3% as compared to the same period in 2014.

*Interest Expense, Net*

Net interest expense for the first half of 2015 increased \$0.8 million, or 33%, primarily as a result of an increase in average outstanding borrowings, partially offset by a lower effective interest rate for the 2015 period as compared to the same period in 2014.

*Income Taxes*

Income taxes increased to \$53.3 million for the first half of 2015 as compared to \$43.5 million for the first half of 2014 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 37.0% and 36.8% for the six months ended June 30, 2015 and 2014, respectively. The increase was primarily due to higher state income taxes in 2015 versus 2014 related to income generated by our U.S. subsidiaries.

*Net Income Attributable to Watsco, Inc.*

Net income attributable to Watsco for the first half of 2015 increased \$15.6 million, or 21%, compared to the same period in 2014. The increase was primarily driven by higher revenues, expanded profit margins and reduced selling, general and administrative

## **Table of Contents**

expenses as a percentage of revenues, as discussed above, and by a reduction in the net income attributable to the non-controlling interest related to Carrier Enterprise I following our purchase of an additional 10% ownership interest in Carrier Enterprise I in July 2014.

## **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);

the adequacy of our available 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 June 30, 2015, we had \$21.9 million of cash and cash equivalents, of which, \$11.2 million was held by foreign subsidiaries. We believe that our operating cash flows, cash on hand and funds available for borrowing under our line of credit will be sufficient to meet our liquidity needs in the foreseeable future. However, there can be no assurance that our current sources of available funds will be sufficient to meet our cash requirements.

Our access to funds under our line of credit 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 \$1,069.5 million at June 30, 2015 from \$870.3 million at December 31, 2014, reflecting higher levels of accounts receivable and inventories, primarily due to the seasonality of our business.

Cash Flows

The following table summarizes our cash flow activity for the six months ended June 30, 2015 and 2014:

	2015	2014	Change
Cash flows used in operating activities	\$ (74.1)	\$ (65.2)	\$ (8.9)
Cash flows used in investing activities	\$ (14.0)	\$ (5.6)	\$ (8.4)
Cash flows provided by financing activities	\$ 85.8	\$ 68.2	\$ 17.6

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

Operating Activities

The increase in net cash used in operating activities was primarily due to the timing of payments for accrued expenses and higher accounts receivable driven by increased sales, partially offset by lower seasonal buildup of inventory during the Summer selling season and higher net income in the first half of 2015.

Investing Activities

The increase in net cash used in investing activities was due to higher capital expenditures in the first half of 2015.



## Table of Contents

### Financing Activities

The increase in net cash provided by financing activities was primarily attributable to higher net borrowings under our revolving credit agreement and a decrease in distributions to the non-controlling interest, partially offset by an increase in dividends paid in the first half of 2015.

### 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), stock repurchases and issuances of letters of credit. The credit agreement matures on July 1, 2019. At June 30, 2015 and December 31, 2014, \$433.4 million and \$303.2 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 June 30, 2015.

### Short-Term Debt

At June 30, 2015, \$2.6 million of short-term borrowings were outstanding under a credit line established by our Mexican operations. This line of credit has a one-year term maturing on June 15, 2016, is non-committed and provides for borrowings of up to approximately \$10.0 million (MXN \$150.0 million) for general corporate purposes. No short-term borrowings were outstanding under this credit line at December 31, 2014.

### 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 \$1.40 and \$0.80 per share of Common stock and Class B common stock during the six months ended June 30, 2015 and 2014, respectively. On July 1, 2015, our Board of Directors declared a regular quarterly cash dividend of \$0.70 per share of Common and Class B common stock that was paid on July 31, 2015 to shareholders of record as of July 15, 2015. 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 June 30, 2015 or 2014. 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 June 30, 2015, 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, 2014.

### **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.

**Table of Contents**

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 June 30, 2015, 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 8 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 June 30, 2015 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, 2014.

**ITEM 6. EXHIBITS**

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.
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.

20 of 21

**Table of Contents**

**SIGNATURE**

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

WATSCO, INC.  
(Registrant)

August 6, 2015

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

21 of 21

**Table of Contents**

**INDEX TO EXHIBITS**

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