

WATSCO INC
Form 10-K
February 27, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

x **Annual Report Pursuant to Section 13 or 15(d) of the Securities and Exchange Act of 1934
For the Fiscal Year Ended December 31, 2013**

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

WATSCO, INC.

(Exact name of registrant as specified in its charter)

FLORIDA **59-0778222**
(State or other jurisdiction of **(I.R.S. Employer**
incorporation or organization) **Identification No.)**
2665 South Bayshore Drive, Suite 901

Miami, FL 33133

(Address of principal executive offices, including zip code)

(305) 714-4100

(Registrant's telephone number, including area code)

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

Title of each class	Name of each exchange on which registered
Common stock, \$0.50 par value	New York Stock Exchange and the Professional Segment of NYSE Euronext in Paris
Class B common stock, \$0.50 par value	New York Stock Exchange

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

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

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

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

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

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

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

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

The aggregate market value of the registrant's voting common equity held by non-affiliates of the registrant as of June 28, 2013, the last business day of the registrant's most recently completed second fiscal quarter, was approximately \$2,159 million, based on the closing sale price of the registrant's common stock on that date. For purposes of determining this number, all named executive officers and directors of the registrant as of June 28, 2013 were considered affiliates of the registrant. This number is provided only for the purposes of this Annual Report on Form 10-K and does not represent an admission by either the registrant or any such person as to the affiliate status of such person.

The registrant's common stock outstanding as of February 21, 2014 comprised (i) 30,046,979 shares of Common stock, excluding 6,322,650 treasury shares, and (ii) 4,762,288 shares of Class B common stock, excluding 48,263 treasury shares.

DOCUMENTS INCORPORATED BY REFERENCE

Certain information required by Parts I and II is incorporated by reference from the registrant's 2013 Annual Report, attached hereto as Exhibit 13. The information required by Part III (Items 10, 11, 12, 13 and 14) is incorporated herein by reference from the registrant's definitive proxy statement for the 2014 annual meeting of shareholders (to be filed pursuant to Regulation 14A).

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WATSCO, INC. AND SUBSIDIARIES

Form 10-K

For the Fiscal Year Ended December 31, 2013

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PART I

Forward-Looking Statements

This Annual Report on Form 10-K contains or incorporates by reference statements that are not historical in nature and that are intended to be, and are hereby identified as, forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995, including statements regarding, among 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 and are subject to a number of risks, uncertainties and changes in circumstances, certain of which are beyond their control.

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

general economic conditions;

competitive factors within the HVAC/R industry;

effects of supplier concentration;

fluctuations in certain commodity costs;

consumer spending;

consumer debt levels;

new housing starts and completions;

capital spending in the commercial construction market;

access to liquidity needed for operations;

seasonal nature of product sales;

weather conditions;

insurance coverage risks;

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

prevailing interest rates;

foreign currency exchange rate fluctuations;

international political risk; and

the continued viability of our business strategy.

In light of these uncertainties, there can be no assurance that the forward-looking information contained herein will be realized or, even if realized, in whole or in part, that the information will have the expected consequences to, or effects on, our business or operations. For additional information 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, see our SEC filings, including but not limited to, the discussion included in Item 1A Risk Factors of this Annual Report on Form 10-K. Forward-looking statements speak only as of the date the statement was made. We assume no obligation to update forward-looking information or the discussion of such risks and uncertainties to reflect actual results, changes in assumptions or changes in other factors affecting forward-looking information, except as required by applicable law.

ITEM 1. BUSINESS

General

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. At December 31, 2013 we operated from 569 locations in 38 U.S. states, Canada, Mexico and Puerto Rico with additional market coverage on an export basis to Latin America and the Caribbean, through which we serve more than 50,000 contractors and dealers that service the replacement and new construction markets. Our revenues in HVAC/R distribution have increased from \$64.1 million in 1989 to \$3.7 billion in 2013, resulting from our strategic acquisition of companies with established market positions and subsequent building of revenues and profit through a combination of additional locations, products, services and other initiatives.

Our principal executive office is located at 2665 South Bayshore Drive, Suite 901, Miami, Florida 33133, and our telephone number is (305) 714-4100. Our website address on the Internet is www.watsco.com and e-mails may be sent to info@watsco.com. The reference to our website address does not constitute incorporation by reference of the information contained on, or linked to, the website, and none of such information is part of this report.

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Residential Central Air Conditioning, Heating and Refrigeration Industry

The HVAC/R distribution industry is highly fragmented with approximately 2,300 distribution companies. The industry in the United States and Canada is well-established, having had its primary period of growth during the post-World War II era with the advent of affordable central air conditioning and heating systems for both residential and commercial applications. The advent of HVAC/R products in Latin America and the Caribbean is also well-established, but has emerged in more recent years as those economies have grown and products have become more affordable and have matured from luxury to necessity.

Based on data published in the IBISWorld Industry Report for Heating and Air Conditioning Wholesaling in the U.S. and other available data, we estimate that the annual market for residential central air conditioning, heating and refrigeration equipment and related parts and supplies in the Americas is approximately \$35.0 billion. Residential central air conditioners are manufactured primarily by seven major companies that together account for approximately 90% of all units shipped in the United States each year. These companies are: Carrier Corporation (Carrier), a subsidiary of United Technologies Corporation; Goodman Manufacturing Company, L.P. (Goodman), a subsidiary of Daikin Industries, Ltd.; Rheem Manufacturing Company (Rheem); Trane Inc., a subsidiary of Ingersoll-Rand Company Limited; York International Corporation, a subsidiary of Johnson Controls, Inc.; Lennox International, Inc.; and Nordyne Corporation (Nordyne), a subsidiary of Nortek Corporation. These manufacturers distribute their products through a combination of factory-owned and independent distributors who, in turn, supply the equipment and related parts and supplies to contractors and dealers nationwide that sell to and install the products for consumers, businesses and other end-users.

Air conditioning and heating equipment is sold to the residential replacement market, the commercial market and residential new construction market. The replacement market has increased in importance over the past several years as a result of the aging of the installed base of residential central air conditioners and furnaces, the introduction of new higher energy efficient models, the remodeling and expansion of existing homes, the addition of central air conditioning to homes that previously had only heating products and consumers' overall unwillingness to live without air conditioning or heating products. The mechanical life of central air conditioning and furnaces varies by geographical region due to usage and ranges from approximately 8 to 20 years. According to data published by the Energy Information Administration, there are approximately 89 million central air conditioning and heating systems installed in the United States that have been in service for more than 10 years. Many installed units are currently reaching the end of their useful lives, which we believe will provide a growing and stable replacement market.

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

Business Strategy

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

customers with an expanded array of product lines on favorable terms and conditions with an intensified commitment to service.

Strategy in Existing Markets

Our strategy for growth in existing markets focuses on customer service and product expansion to satisfy the needs of the higher growth, higher margin replacement market, in which customers generally demand immediate, convenient and reliable service. We respond to this need by (i) offering a broad range of product lines, including the necessary equipment, parts and supplies to enable a contractor to install or repair a central air conditioner, furnace or refrigeration system, (ii) maintaining a strong density of warehouse locations for increased customer convenience, (iii) maintaining well-stocked inventories to ensure that customer orders are filled in a timely manner, (iv) providing a high degree of technical expertise at the point of sale and (v) developing and implementing technology to further enhance customer service capabilities. We believe these concepts provide a competitive advantage over smaller, less-capitalized competitors that are unable to commit resources to open and maintain additional locations, implement technological business solutions, provide the same range of products,

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maintain the same inventory levels or attract the wide range of expertise that is required to support a diverse product offering. In some geographic areas, we believe we have a competitive advantage over factory-operated distributor networks, which typically do not maintain inventories of parts and supplies that are as diversified as ours and which have fewer warehouse locations than we do, making it more difficult for these competitors to meet the time-sensitive demands of the replacement market.

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

Acquisition Strategy

We focus on acquiring businesses that either complement our current presence in existing markets or establish a presence in new geographic markets. Since 1989, we have acquired 59 HVAC/R distribution businesses, six of which currently operate as primary operating subsidiaries. The other smaller acquired distributors have been integrated into or are under the management of our primary operating subsidiaries. Through a combination of sales and market share growth, opening of new locations, tuck-in acquisitions, expansion of product lines, improved pricing and programs that have resulted in higher gross profit, performance incentives and a culture of equity value for key leadership, we have produced substantial sales and earnings growth post-acquisition. We continue to pursue additional strategic acquisitions and/or joint ventures to allow further penetration in existing markets and expansion into new geographic markets.

Product Line Expansion

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

Operating Philosophy

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

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

Technology

Our technology initiatives include: (i) the development of mobile applications for iOS and Android devices focused on helping our customers operate more efficiently and interact with our locations more easily; (ii) implementing effective point-of-sale systems that allow timely and effective customer service, including up-to-date pricing, credit checks, credit card processing and inventory availability; (iii) enabling connectivity with our suppliers; (iv) enabling e-commerce between our customers and the relevant components of our subsidiaries' business software; and (v) maintaining our website, ACDoctor.com, which educates consumers about energy efficient HVAC solutions and financial incentives related to the installation of energy efficient systems and connects them with high quality contractors.

DESCRIPTION OF BUSINESS

Products

We sell an expansive line of products and maintain a diverse mix of inventory to meet our customers' immediate needs and seek to provide products a contractor would generally require when installing or repairing a central air conditioner, furnace or refrigeration system on short notice. The cooling capacity of air conditioning units is measured in tons. One ton of cooling capacity is equivalent to 12,000 British Thermal Units (BTUs) and is generally adequate to air condition approximately 500 square feet of residential space. The products we distribute consist of: (i) equipment, including residential central air

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conditioners ranging from 1-1/2 to 5 tons, gas, electric and oil furnaces ranging from 50,000 to 150,000 BTUs, commercial air conditioning and heating equipment and systems ranging from 1-1/2 to 25 tons and other specialized equipment, (ii) parts, including replacement compressors, evaporator coils, motors and other component parts and (iii) supplies, including thermostats, insulation material, refrigerants, ductwork, grills, registers, sheet metal, tools, copper tubing, concrete pads, tape, adhesives and other ancillary supplies.

Sales of HVAC equipment accounted for 64% and 63% of our revenues for the years ended December 31, 2013 and 2012, respectively. Sales of other HVAC products (currently sourced from more than 1,300 vendors) comprised 31% and 33% of our revenues for the years ended December 31, 2013 and 2012, respectively. Sales of commercial refrigeration products accounted for 5% and 4% of our revenues for the years ended December 31, 2013 and 2012, respectively.

Distribution and Sales

At December 31, 2013, we operated from 569 locations, a vast majority of which are located in regions that we believe have demographic trends favorable to our business. We maintain large inventories at each of our warehouse locations, and either deliver products to customers using one of our 634 trucks or a third party logistics provider, or we make products available for pick-up at the location nearest to the customer. We have approximately 990 commissioned salespeople, averaging more than 10 years of experience in the HVAC/R distribution industry.

The markets we serve are as follows:

	% of Revenues for the Year Ended December 31, 2013	Number of Locations as of December 31, 2013
United States	85%	515
Canada	9%	36
Puerto Rico, Latin America and the Caribbean	3%	8
Mexico	3%	10
Total	100%	569

The largest market we serve is the United States, in which the most significant markets for HVAC/R products are in the Sun Belt. Accordingly, the majority of our distribution locations are in the Sun Belt, with the highest concentration in Florida and Texas. These markets have been a strategic focus of ours given their size, the reliance by homeowners and businesses on HVAC/R products to maintain a comfortable indoor environment and the population growth in these areas over the last 40 years, which has led to a substantial installed base requiring replacement, a shorter useful life for equipment given the hours of operation and the focus by electrical utilities on consumer incentives designed to promote replacement of HVAC/R equipment in an effort to improve energy efficiency.

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The table below identifies the number of our stores in the United States by location as of December 31, 2013:

Florida	105
Texas	87
California	37
North Carolina	37
Georgia	36
South Carolina	30
Virginia	22
Tennessee	21
Louisiana	18
New York	12
Mississippi	11
Massachusetts	10
Alabama	9
Maryland	8
Arizona	7
Kansas	7
Missouri	7
Arkansas	6
Connecticut	6
Oklahoma	5
Utah	5
New Jersey	4
Maine	3
Iowa	2
Kentucky	2
Nebraska	2
Nevada	2
Pennsylvania	2
Rhode Island	2
South Dakota	2
Colorado	1
Illinois	1
Indiana	1
New Hampshire	1
New Mexico	1
North Dakota	1
Vermont	1
West Virginia	1
Total	515

Joint Ventures with Carrier Corporation

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

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

In 2012, we formed a third joint venture, which we refer to as Carrier Enterprise III, with UTC Canada Corporation, referred to as UTC Canada, an affiliate of Carrier. Carrier contributed 35 of its company-owned locations in Canada to Carrier Enterprise III. We have a 60% controlling interest in Carrier Enterprise III, and UTC Canada has a 40% noncontrolling interest. Neither we nor UTC Canada has any options to purchase additional ownership interests in Carrier Enterprise III.

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Combined, the joint ventures with Carrier represented 61% of our revenues in 2013. See *Supplier Concentration* in Business Risk Factors in Item 1A.

The business and affairs of the joint ventures are controlled, directed and managed exclusively by Carrier Enterprise I s, Carrier Enterprise II s and Carrier Enterprise III s respective boards of directors (the Boards) pursuant to related operating agreements. The Boards have full, complete and exclusive authority, power and discretion to manage and control the business, property and affairs of their respective joint ventures and to make all decisions regarding those matters and to perform activities customary or incident to the management of such joint ventures, including approval of distributions to us, Carrier and UTC Canada. Each Board is composed of five directors, of whom three directors represent our controlling interest and two directors represent Carrier s noncontrolling interest. Matters presented to the Boards for vote are considered approved or consented to upon the receipt of the affirmative vote of at least a majority of all directors entitled to vote with the exception of certain governance matters, which require joint approval.

Customers and Customer Service

Air conditioning and heating contractors and dealers that install HVAC/R products in homes and businesses must be licensed given the highly-regulated nature of the products, refrigerant, natural gas and building and zoning requirements. We currently serve more than 50,000 contractors and dealers who service the replacement and new construction markets for residential and light commercial central air conditioning, heating and refrigeration systems. No single customer in 2013, 2012 or 2011 represented more than 1% of our consolidated revenues. We focus on providing products where and when the customer needs them, technical support by phone or on site as required, and quick and efficient service at our locations. Increased customer convenience is also provided through mobile applications and e-commerce, which allows customers to access information online 24 hours a day, seven days a week to search for desired products, verify inventory availability, obtain pricing, place orders, check order status, schedule pickup or delivery times and make payments. We believe we compete successfully with other distributors primarily on the basis of an experienced sales organization, strong service support, maintenance of well-stocked inventories, and density of warehouse locations, high quality reputation, broad product lines and the ability to foresee customer demand for new products.

Key Suppliers

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

Approximately 73%, 72% and 71% of our purchases in 2013, 2012 and 2011, respectively, were from the four key HVAC/R equipment suppliers. Our largest supplier, Carrier and its affiliates, accounted for 59%, 57% and 54% of all purchases made in 2013, 2012 and 2011, respectively. A significant interruption by Carrier, or the other suppliers, in the delivery of products could impair our ability to maintain current inventory levels and could adversely affect our financial results. Future financial results are also materially dependent upon the continued market acceptance of these manufacturers' products and their ability to continue to manufacture products that comply with laws relating to

environmental and efficiency standards. See *Business Risk Factors* in Item 1A.

Distribution Agreements

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

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

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Seasonality

Sales of residential central air conditioners, heating equipment and parts and supplies have historically been seasonal. Furthermore, profitability can be impacted favorably or unfavorably based on the severity or mildness of weather patterns during summer or winter selling seasons. Demand related to the residential central air conditioning replacement market is typically highest in the second and third quarters, and demand for heating equipment is usually highest in the fourth quarter. Demand related to the new construction sectors throughout most of the markets is fairly even during the year except for dependence on housing completions and related weather and economic conditions.

Competition

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

Employees

We had approximately 4,800 employees as of December 31, 2013, substantially all of whom are non-union employees. Most of these employees are employed on a full-time basis, and our relations with our employees are good.

Order Backlog

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

Government Regulations, Environmental and Health and Safety Matters

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

Financial Information About Geographic Areas

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

<i>Years Ended December 31,</i>	2013	2012	2011
Revenues:			
United States	\$ 3,325	\$ 3,088	\$ 2,939
Canada	318	240	
Mexico	100	104	39
Total Revenues	\$ 3,743	\$ 3,432	\$ 2,978

<i>December 31,</i>	2013	2012	2011
Long-Lived Assets:			
United States	\$ 429	\$ 429	\$ 430
Canada	208	225	
Mexico	5	5	4
Total Long-Lived Assets	\$ 642	\$ 659	\$ 434

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

Available Information

Our website is at www.watsco.com. Our investor relations website is located at www.investors.watsco.com. We promptly make available, free of charge, on our investor relations website under the heading "SEC Filings" our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports filed with or furnished to the Securities and Exchange Commission pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended. The reference to our website address does not constitute incorporation by reference of the information contained on our website and none of such information is part of this report.

ITEM 1A. RISK FACTORS

Business Risk Factors

Supplier Concentration

Our purchases from Carrier and its affiliates comprised 59% of all purchases made during 2013. Significant relationships currently exist with four of the seven major HVAC equipment manufacturers; and purchases from these equipment suppliers, including Carrier, comprised 73% of all purchases made in 2013. Given the significant concentration of our supply chain, particularly with Carrier, any significant interruption by the manufacturers or a termination of a distribution agreement could temporarily disrupt the operations of certain subsidiaries. Additionally, our operations are materially dependent upon the continued market acceptance of these manufacturers' products and their ability to continue to manufacture products that are competitive and that comply with laws relating to environmental and efficiency standards. Our inability to obtain products from one or more of these manufacturers or a decline in market acceptance of these manufacturers' products could have a material adverse effect on our results of operations, cash flows and liquidity.

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

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

Risks Inherent in Acquisitions

As part of our strategy, we intend to pursue additional acquisitions of complementary businesses. If we complete future acquisitions and/or joint ventures, we may be required to incur or assume additional debt and/or issue additional shares of our common stock as consideration, which will dilute our existing shareholders' ownership interest in us and may affect our results of operations. Growth through acquisitions involves a number of risks, including, but not limited to, the following:

the ability to identify and consummate transactions with complementary acquisition candidates;

the successful operation and/or integration of acquired companies;

diversion of management's attention from other daily functions;

issuance by us of equity securities that would dilute ownership of our existing shareholders;

incurrence and/or assumption of significant debt and contingent liabilities; and

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

In addition, acquired companies may have liabilities that we failed, or were unable, to discover in the course of performing due diligence investigations. We cannot assure you that the indemnification granted to us by sellers of acquired companies will be sufficient in amount, scope or duration to offset the possible liabilities associated with businesses or properties that we assume upon consummation of an acquisition. Any such liabilities, individually or in the aggregate, could have a material adverse effect on our business.

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

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Competition

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

Decline in Economic Conditions

The global and United States economy experienced a significant contraction in 2008, including sharply reduced availability of business and consumer credit. We rely on the capital markets as well as the credit markets to meet our financial commitments and short-term liquidity needs if internal funds are not available from our operations. Our access to funds under our line of credit is dependent on the ability of the syndicate banks to meet their respective funding commitments. Disruptions in the capital and credit markets could adversely affect our ability to draw on our line of credit and may also affect the determination of certain interest rates, particularly rates based on LIBOR, which is one of the base rates under our line of credit. Any disruptions in these markets could result in increased borrowing costs and/or reduced borrowing capacity under our line of credit. Any long-term disruption could require that we take measures to conserve cash until the markets stabilize or until alternative credit arrangements or other funding for our business needs can be arranged. Such measures could include reducing or eliminating dividend payments, deferring capital expenditures and reducing or eliminating discretionary uses of cash.

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

Seasonality

Sales of residential central air conditioners, heating equipment and parts and supplies have historically been seasonal. Furthermore, profitability can be impacted favorably or unfavorably based on the severity or mildness of weather patterns during summer or winter selling seasons. Demand related to the residential central air conditioning replacement market is typically highest in the second and third quarters, and demand for heating equipment is usually highest in the fourth quarter. Demand related to the new construction sectors throughout most of the markets is fairly even during the year except for dependence on housing completions and related weather and economic conditions.

Dependence on Key Personnel

Much of our success has depended on the skills, experience and services of senior management personnel. The loss of any of our executive officers or other key senior management personnel could harm our business. We must continue

to recruit, retain and motivate management and other employees sufficiently in order to both maintain our current business and to execute our strategic initiatives. Our success has also substantially depended on the contributions and abilities of our store employees whom we rely on to give customers a superior in-store experience. Accordingly, our performance depends on our ability to recruit and retain high quality employees to work in and manage our stores. If we are unable to recruit, retain and motivate employees sufficiently in order to maintain our current business and support our projected growth and expansion, our business and financial performance may be adversely affected.

Foreign Currency Exchange Rate Fluctuations

The functional currency of our operations in Canada is the Canadian dollar and the functional currency of our operations in Mexico is the U.S. dollar because the majority of our Mexican transactions are denominated in U.S. dollars. Foreign currency exchange rates and fluctuations may have an impact on transactions denominated in Canadian dollars and Mexican Pesos, and, therefore, could adversely affect our financial performance.

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International Political Risk

Our international sales and operations are subject to various risks associated with changes in local laws, regulations and policies, including those related to tariffs, trade restrictions and trade agreements, investments, taxation, capital controls, employment regulations, different liability standards and limitations on the repatriation of funds due to foreign currency controls. Our international sales and operations are also sensitive to changes in foreign national priorities, including government budgets, as well as political and economic instability. Unfavorable changes in any of the foregoing could adversely affect our results of operations. Additionally, failure to comply with the U.S. Foreign Corrupt Practices Act could subject us to, among other things, penalties and legal expenses that could harm our reputation and have a material adverse effect on our business, financial condition and results of operations.

General Risk Factors

Goodwill and Intangibles

At December 31, 2013, goodwill and intangibles represented approximately 36% of our total assets. The recoverability of goodwill and indefinite lived intangibles is evaluated at least annually and when events or changes in circumstances indicate that the carrying amounts may not be recoverable. The identification and measurement of goodwill impairment involves the estimation of the fair value of our reporting unit and contains uncertainty because management must use judgment in determining appropriate assumptions to be used in the measurement of fair value. The estimates of fair value of our reporting unit and indefinite lived intangibles are based on the best information available as of the date of the assessment and incorporates management's assumptions about expected future cash flows and contemplates other valuation techniques. Future cash flows can be affected by changes in the industry, a declining economic environment or market conditions. We cannot assure you that we will not suffer material impairments to goodwill in the future.

Risks Related to Insurance Coverage

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

Control by Existing Shareholder

As of December 31, 2013, Albert H. Nahmad, our Chairman and Chief Executive Officer, a limited partnership and various trusts controlled by him, collectively had beneficial ownership of approximately 52% of the combined voting power of our outstanding Common and Class B common stock. Based on Mr. Nahmad's stock ownership and the stock ownership of the limited partnership and various trusts controlled by him, Mr. Nahmad has the voting power to elect all but three members of our nine-person Board of Directors and to control most corporate actions requiring shareholder approval.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

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

Warehousing and Distribution Facilities

At December 31, 2013, we operated 569 warehousing and distribution facilities across 38 U.S. states, Canada, Mexico and Puerto Rico, having an aggregate of approximately 13.0 million square feet of space, of which approximately 12.7 million square feet is leased. The majority of these leases are for terms of three to five years. We believe that our facilities are sufficient to meet our present operating needs.

Trucks

At December 31, 2013, we operated 634 ground transport vehicles, including delivery and pick-up trucks, vans and tractors. Of this number, 317 trucks were leased and the rest were owned. We believe that the present size of our truck fleet is adequate to support our operations.

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Administrative Facility

Senior management and support staff are located at our corporate headquarters in Miami, Florida in approximately 8,900 square feet of owned space.

ITEM 3. LEGAL PROCEEDINGS

Information with respect to this item may be found in Note 14 to our audited consolidated financial statements contained in this Annual Report on Form 10-K under the caption Litigation, Claims and Assessments, which information is incorporated herein by reference.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

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PART II