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

FORM 10-K

☒ **Annual Report Pursuant to Section 13 or 15(d) of the Securities and Exchange Act of 1934**

For the Fiscal Year Ended December 31, 2017

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 incorporation or organization)	**(I.R.S. Employer Identification No.)**

2665 South Bayshore Drive, Suite 901
Miami, FL 33133
(Address of principal executive offices, including zip code)

(305) 714-4100
(Registrant's telephone number, including area code)

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

Title of each class	Name of each exchange on which registered
Common stock, $0.50 par value	**New York Stock Exchange**
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, a smaller reporting company, or emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	☒	Accelerated filer	☐

Non-accelerated filer	☐	Smaller reporting company	☐
		Emerging growth company	☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

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 30, 2017, the last business day of the registrant's most recently completed second fiscal quarter, was approximately $4,739 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 30, 2017 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 23, 2018 comprised (i) 32,005,941 shares of Common stock, excluding 4,823,988 treasury shares, and (ii) 5,301,183 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 2017 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 2018 annual meeting of shareholders (to be filed pursuant to Regulation 14A).

WATSCO, INC. AND SUBSIDIARIES

Form 10-K

For the Fiscal Year Ended December 31, 2017

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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. Statements which are not historical in nature, including the words "anticipate," "estimate," "could," "should," "may," "plan," "seek," "expect," "believe," "intend," "target," "will," "project," "focused," "outlook," and 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 and investments in unconsolidated entities, (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 this Annual Report on Form 10-K, 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.

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, 2017, we operated from 560 locations in 37 U.S. States, Canada, Mexico and Puerto Rico with additional market coverage on an export basis to portions of Latin America and the Caribbean, through which we serve approximately 90,000 active 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 $4.3 billion in 2017, resulting from our strategic acquisition of companies with established market positions and subsequent building of revenues and profit through a combination of additional locations, introduction of new products, 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. Our website address is included in this report only as an inactive textual reference. Information contained on, or available through, our website is not incorporated by reference in, or made a part of, this report.

Air Conditioning, Heating and Refrigeration Industry

The HVAC/R distribution industry is highly fragmented with approximately 2,100 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 2018 IBIS World Industry Report for Heating and Air Conditioning Contractors in the U.S. and other available data, we estimate that the annual market on an installed basis for residential central air conditioning, heating, and refrigeration equipment, and related parts and supplies is approximately $88.0 billion. Air conditioning and heating equipment is 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. (“Trane”), 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 replacement and new construction markets for both residential and commercial applications. The residential replacement market has increased in size and 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 in 2017 there are approximately 92 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.

Additionally, we sell a variety of non-equipment products, representing approximately 300,000 SKUs, including parts, ductwork, air movement products, insulation, tools, installation supplies, thermostats, and air quality products. We distribute products manufactured by Honeywell International, Inc. (“Honeywell”), Johns Manville (“Johns Manville”) and Owens Corning Insulating Systems, LLC (“Owens Corning”), among others.

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”), The Chemours Company (“Chemours”), Mueller Industries, Inc. (“Mueller”), and Welbilt, Inc. (“Welbilt”), among others.

Culture and Business Strategy

We have built our network of locations using a “buy and build” philosophy, which has produced substantial historical long-term growth in revenues and profits. The “buy” component of the strategy has focused on acquiring or investing in market leaders to either expand into new geographic areas or gain additional market share in existing markets. We have employed a disciplined and conservative approach which seeks opportunities that fit well-defined financial and strategic criteria. The “build” component of the strategy has focused on implementing a growth culture at acquired companies, by adding products and locations to better serve customers, investing in scalable technologies, and exchanging ideas and business concepts amongst the executive management teams. 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. We have also developed a culture whereby leaders, managers and employees are provided the opportunity to own shares of Watsco through a variety of stock-based equity plans. We believe that this culture instills a performance-driven, long-term focus on the part of our employees and aligns their interests with the interests of other Watsco shareholders.

Strategy in Existing Markets

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

Technology Strategy

We are actively investing in scalable technology platforms to further strengthen our leadership position. The primary investments are customer-obsessed technologies, which are improving and transforming the customer experience at all of our locations. Specific initiatives include: (i) developing and implementing mobile applications for iOS and Android devices to help customers operate more efficiently and interact with our locations more easily; (ii) enabling e-commerce between our customers and our subsidiaries; (iii) supply chain optimization; (iv) building the largest source of digitized HVAC/R product information; and (v) developing and implementing business analytics systems and related data sets, which provide enhanced management tools.

Performance-Based Compensation & Stock-Based Equity Plans

We maintain a culture that rewards performance through a variety of performance-based pay, commission programs, cash incentives, and stock-based equity programs. Stock-based plans include 401(k) matching contributions to eligible employees, a voluntary employee stock purchase plan, and the granting of stock options and non-vested restricted stock based on individual merit and measures of performance. Our equity compensation plans are designed to promote long-term performance, as well as to create long-term employee retention, continuity of leadership, and an ‘ownership culture’ whereby management and employees think and act as owners of the Company. We believe that our restricted stock program is unique because an employee’s restricted share grants generally vest entirely at the end of his or her career (age 62 or later) and, prior to retirement, these grants remain subject to significant risks of forfeiture.

Product Line Expansion

We actively seek new or expanded territories of distribution from our key equipment suppliers. We continually evaluate new parts and supply products to support equipment sales and further enhance service to our customers. This initiative includes increasing our 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.

Acquisition Strategy

We focus on acquiring and investing in 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. 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, investments and/or joint ventures to allow further penetration in existing markets and expansion into new geographic markets.

Operating Philosophy

We encourage our local leadership to operate in a manner that builds upon the long-term relationships they have established with their suppliers and customers. Typically, we maintain the identity and culture of businesses by retaining their historical trade names, management teams and sales organizations, and continuity of 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.

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 we 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 ducted and ductless air conditioners ranging from 1 to 5 tons, gas, electric, and oil furnaces ranging from 50,000 to 150,000 BTUs, commercial air conditioning and heating equipment 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, which we currently source from approximately 20 vendors, accounted for 67% and 66% of our revenues for the years ended December 31, 2017 and 2016, respectively. Sales of other HVAC products, which we currently source from approximately 1,200 vendors, comprised 28% and 29% of our revenues for the years ended December 31, 2017 and 2016, respectively. Sales of commercial refrigeration products, which we currently source from approximately 150 vendors, accounted for 5% of our revenues for both the years ended December 31, 2017 and 2016.

Distribution and Sales

At December 31, 2017, we operated from 560 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 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 1,000 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, 2017	Number of Locations as of December 31, 2017
United States	87%	500
Latin America and the Caribbean	7%	24
Canada	6%	36
Total	**100%**	**560**

The largest market we serve is the United States, in which the most significant markets for HVAC/R products are in the Sun Belt States. 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.

Markets

The table below identifies the number of our stores by location as of December 31, 2017:

Florida	103
Texas	80
North Carolina	41
California	36
Georgia	35
South Carolina	30
Tennessee	21
Virginia	21
Louisiana	18
New York	13
Alabama	9
Arizona	8
Massachusetts	8
Mississippi	8
Missouri	8
Connecticut	6
Maryland	6
Arkansas	5
Kansas	5
New Jersey	5
Oklahoma	5
Utah	5
Pennsylvania	3
Iowa	2
Kentucky	2
Maine	2
Nebraska	2
Nevada	2
South Dakota	2
West Virginia	2
Colorado	1
Indiana	1
New Hampshire	1
New Mexico	1
North Dakota	1
Rhode Island	1
Vermont	1
United States	500
Canada	36
Mexico	14
Puerto Rico	10
Total	**560**

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. 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 to 80%. Neither we 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 the Northeast U.S. 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. Following formation of this joint venture, we owned a 60% controlling interest. On November 29, 2016, we purchased an additional 10% ownership interest in Carrier Enterprise II, and, on February 13, 2017, we again purchased an additional 10% ownership interest in Carrier Enterprise II, which together increased our controlling interest to 80%.

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.

Combined, the joint ventures with Carrier represented 62% of our revenues for the year ended December 31, 2017. 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 non-controlling 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 approximately 90,000 active 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 2017, 2016 or 2015 represented more than 2% 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 based on an experienced sales organization, strong service support, maintenance of well-stocked inventories, density of warehouse locations, high quality reputation, broad product lines, and the ability to foresee customer demand for new products.

Key Supplier Relationships

Given our leadership position, Watsco represents a strategic business relationship to many of the leading manufacturers in our industry. Significant relationships with HVAC/R equipment manufacturers include Carrier, Rheem, Goodman, Welbilt, Mitsubishi Electric Corporation, Gree Electric Appliances, Inc., Trane, Midea Group, and Nordyne. In addition, we have substantial relationships with manufacturers of non-equipment HVAC/R products, including Chemours, Emerson, Flexible Technologies, Inc., Honeywell, Johns Manville, Mueller, and Owens Corning.

We believe the diversity of products that we sell, along with the manufacturers' current product offerings, quality, marketability, and brand-name recognition, allow us to operate favorably relative to our competitors. To maintain brand-name recognition, HVAC/R equipment manufacturers 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 residential air conditioning equipment is approximately 85% of industry unit sales in the United States, and we expect this percentage to increase as units installed in the past 20 years wear out or otherwise become practical to replace sooner with newer, more energy-efficient models.

The Company’s top ten suppliers accounted for 84% of our purchases, including 62% from Carrier, and 10% from Rheem. Given the significant concentration of our suppliers, particularly with Carrier and Rheem, any significant interruption with these suppliers could temporarily disrupt the operations of certain of our subsidiaries, impact current inventory levels, and could adversely affect our financial results. If any restrictions or significant increase in tariffs under existing trade agreements or the elimination of the North American Free Trade Agreement (“NAFTA”) are imposed on products that our top ten suppliers import or assemble products outside of the United States, particularly from Mexico and China, we could be required to raise our prices, which may result in the loss of customers and harm to our business. Future financial results are also materially dependent upon the continued market acceptance of these manufacturers’ respective products and their ability to continue to manufacture products that comply with laws relating to environmental and efficiency standards. However, the Company believes that alternative or substitute products would be readily available in the event of disruption of current supplier relationships given the Company’s prominence in the marketplace, including the number of locations, sales personnel, support structure, marketing and sales expertise, financial position, and established market share. See “Business Risk Factors” in Item 1A of this Annual Report on Form 10-K for further discussion.

Distribution Agreements

We maintain trade name and distribution agreements with Carrier and Rheem that provide us distribution rights on an exclusive basis in specified territories that are not subject to a stated term or expiration date. We also maintain distribution agreements with various other suppliers, either on an exclusive or non-exclusive basis, for various terms ranging from one to ten years. Certain distribution agreements contain provisions that restrict or limit the sale of competitive products in the locations that sell such branded products. Other than where such location-level restrictions apply, we may distribute the lines of other manufacturer’s air conditioning or heating equipment in other locations in the same territories.

See *Supplier Concentration* in “Business Risk Factors” in Item 1A of this Annual Report on Form 10-K.

Seasonality

Sales of residential central air conditioners, heating equipment, and parts and supplies are seasonal. Furthermore, profitability can be impacted favorably or unfavorably based on weather patterns, particularly during Summer and Winter selling seasons. Demand related to the residential central air conditioning replacement market is typically highest in the second and third quarters, and demand for heating equipment is usually highest in the fourth quarter. Demand related to the new construction sectors throughout most of the markets we serve tends to be fairly evenly distributed throughout the year and depends largely 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 5,200 employees as of December 31, 2017, substantially all of whom are non-union employees. Most of our 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, but not limited to, the Occupational, Safety and Health Act. We believe that we operate our business in compliance with all applicable federal, state and local laws, and regulations.

Our industry and business are also subject to a United States Department of Energy ("DOE") mandate, effective January 1, 2015, that effected changes to the minimum required efficiency of HVAC systems. The DOE divided the United States into three regions, the North, the Southeast, and the Southwest, according to the number of hours that an air conditioner spends cooling a home during the hotter months. Prior to 2015, the national minimum standard for energy efficiency was 13 SEER (seasonal energy efficiency rating, the metric used to measure energy efficiency) for all HVAC equipment produced in the United States. Beginning in 2015, the new standard increased the minimum allowed efficiency to 14 SEER for the Southeast and Southwest regions. During 2015, we began transitioning our 13 SEER inventory in the effected regions to the higher-efficiency 14 SEER inventory, and we completed this transition in 2016 in accordance with the timeline required by the mandate.

Financial Information About Geographic Areas

Our operations are primarily within the United States, including Puerto Rico, Canada and Mexico. Products are also sold from the United States 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):

Years Ended December 31,	2017	2016	2015
Revenues:			
United States	$3,920	$3,813	$3,711
Canada	269	267	264
Mexico	153	141	138
Total Revenues	$4,342	$4,221	$4,113

December 31,	2017	2016	2015
Long-Lived Assets:			
United States	$ 540	$ 468	$ 442
Canada	164	156	155
Mexico	5	5	5
Total Long-Lived Assets	$ 709	$ 629	$ 602

Revenues are attributed to countries based on the location of the store from which the sale occurred. Long-lived assets consist primarily of goodwill and intangible assets, property and equipment, and our investment in an unconsolidated entity.

Available Information

Our website is at www.watsco.com. Our investor relations website is located at www.investors.watsco.com. We 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 (the "SEC") pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. Our website address is included in this report only as an inactive textual reference. Information contained on, or available through, our website is not incorporated by reference in, or made a part of, this report.

ITEM 1A. RISK FACTORS

Business Risk Factors

Supplier Concentration

The Company's top ten suppliers accounted for 84% of our purchases during 2017, including 62% from Carrier, and 10% from Rheem. Given the significant concentration of our supply chain, particularly with Carrier and Rheem, any significant interruption by any of the key manufacturers or a termination of a relationship could temporarily disrupt the operations of certain of our subsidiaries. Additionally, our operations are materially dependent upon the continued market acceptance and quality 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.

Many HVAC equipment and component manufacturers, including Carrier and Rheem, source component parts and/or assemble a significant amount of products for residential and light-commercial applications from Mexico. If any restrictions or significant increases in tariffs are imposed related to such products sourced or assembled from Mexico, whether as a result of amendments to existing trade agreements or the elimination of NAFTA, and our product costs consequently increase, we would be required to raise our prices, which may result in cost inflation, the loss of customers, and harm to our business.

We maintain trade name and distribution agreements with Carrier and Rheem that provide us distribution rights on an exclusive basis in specified territories. Such agreements are not subject to a stated term or expiration date.

We also maintain other distribution agreements with various other suppliers, either on an exclusive or non-exclusive basis, for various terms ranging from one to ten years. Certain of the distribution agreements contain provisions that restrict or limit the sale of competitive products in the locations that sell such branded products. Other than where such location-level restrictions apply, we may distribute other manufacturers' lines of air conditioning or heating equipment in other locations in the same territories.

Risks Inherent in Acquisitions

As part of our strategy, we intend to pursue additional acquisitions of complementary businesses, including through joint ventures and investments in unconsolidated entities. If we complete future acquisitions, including investments in unconsolidated entities, or enter into new 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 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 and investments made in unconsolidated entities may have liabilities that we failed or were unable to discover while performing due diligence investigations. We cannot assure you that the indemnification, if any, granted to us by sellers of acquired companies or by joint venture partners 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 or joint venture. 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.

Competition

We operate in highly competitive environments. We compete with other distributors and 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.

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. Although we use foreign currency forward contracts to mitigate the impact of currency exchange rate movements, we do not currently hold any derivative contracts that hedge our foreign currency translational exposure.

Seasonality

Sales of residential central air conditioners, heating equipment, and parts and supplies are seasonal, resulting in fluctuations in our revenue from quarter to quarter. 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 evenly distributed throughout 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 and experience of senior management personnel. The loss of any of our executive officers or other key senior management personnel could harm our business. We must continuously recruit, retain, and motivate management and other employees to both maintain our current business and to execute our strategic initiatives. Our success has also depended on the contributions and abilities of our store employees upon whom we rely 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 adequately recruit, retain, and motivate employees our projected growth and expansion, and our business and financial performance may be adversely affected.

Decline in Economic Conditions

We rely predominantly on the credit markets and, to a lesser extent, on the capital markets to meet our financial commitments and short-term liquidity needs if internal funds are not available from our operations. 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 credit and capital 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 us to take measures to conserve cash until the markets stabilize, or until alternative credit arrangements or other funding for our business needs can be arranged. Such measures could include reducing or eliminating dividend payments, deferring capital expenditures, and reducing or eliminating other 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 extend us credit, 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 for working capital, acquisitions, capital expenditures, and other corporate purposes.

International Political Risk

Our international sales and operations, as well as sourcing of products from suppliers with international 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, as well as sourcing of products from suppliers with international 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 or could cause a disruption in our supply chain for products sourced internationally. Additionally, failure to comply with the United States 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, Intangibles and Long-Lived Assets

At December 31, 2017, goodwill, intangibles, and long-lived assets represented approximately 30% of our total assets. The recoverability of goodwill, indefinite lived intangibles, and long-lived assets 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, indefinite lived intangibles, and long-lived assets 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, intangibles, or long-lived assets 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 that the coverage limits of such policies will be adequate to cover losses and expenses for lawsuits which have been, or 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.

Risks Related to our Common Stock

Class B Common Stock and Insider Ownership

As of December 31, 2017, our directors and executive officers and entities affiliated with them owned (i) Common stock representing 1% of the outstanding shares of Common stock and (ii) Class B common stock representing 90% of the outstanding shares of Class B common stock. These interests represent 56% of the aggregate combined voting power (including 52% beneficially owned by Albert H. Nahmad, Chairman and Chief Executive Officer, through shares owned by him and shares held by affiliated limited partnerships and various family trusts). Accordingly, our directors and executive officers collectively have the voting power to elect six members of our nine-person Board of Directors.

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

Future Sales

In 2017, we issued and sold an aggregate of approximately $250.0 million of our Common stock under our previously reported "at the market" offering program. We are not restricted from issuing additional shares of our Common stock or Class B common stock (which we refer to together as common stock), including securities that are convertible into or exchangeable for, or that represent the right to receive, our common stock or any substantially similar securities in the future. We may issue shares of our common stock or other securities in one or more registered or unregistered offerings, and we may also issue our securities in connection with investments or acquisitions. The number of shares of our common stock issued in connection with any of the foregoing may result in dilution to holders of our common stock.

Volatility

The market price of our common stock may be highly volatile and could be subject to wide fluctuations. Securities markets worldwide experience significant price and volume fluctuations. This market volatility, as well as general economic, market or political conditions, could reduce the market price of shares of our common stock in spite of our operating performance. The trading price of our common stock may be adversely affected due to a number of factors, most of which we cannot predict or control, such as the following:

- fluctuations in our operating results;
- a decision by the Board of Directors to reduce or eliminate cash dividends on our common stock;
- changes in recommendations or earnings estimates by securities analysts;
- general market conditions in our industry or in the economy as a whole; and
- political instability, natural disasters, war and/or events of terrorism.

Trading Liquidity

The trading market for our common stock is limited, and there can be no assurance that a more liquid trading market for our common stock will develop. There can be no assurance as to the liquidity of any market for our common stock, the ability of the holders of our common stock to sell any of their securities and the price at which the holders of our common stock will be able to sell such securities.

Payment of Dividends

The amount of any future dividends that we will pay, if any, will depend upon a number of factors. Future dividends will be declared and paid 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. The right of our Board of Directors to declare dividends, however, is subject to the availability of sufficient funds under Florida law to pay dividends. In addition, our ability to pay dividends depends on certain restrictions in our credit agreement.

Securities Analyst Research and Reports

The trading markets for our common stock rely in part on the research and reports that industry or financial analysts publish about us or our business or industry. If one or more of the analysts who cover us downgrade our stock or our industry, or the stock of any of our competitors, or publish negative or unfavorable research about our business, the price of our stock could decline. If one or more of these analysts cease coverage of us or fail to publish reports on us regularly, we could lose visibility in the market, which in turn could cause our stock price or trading volume to decline.

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, 2017, we operated 560 warehousing and distribution facilities across 37 U.S. states, Canada, Mexico, and Puerto Rico, having an aggregate of approximately 12.2 million square feet of space, of which approximately 11.9 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, 2017, we operated 651 ground transport vehicles, including delivery and pick-up trucks, vans, and tractors. Of this number, 433 trucks were leased and the rest were owned. We believe that the present size of our truck fleet is adequate to support our operations.

Administrative Facilities

Senior management and support staff are located at various administrative offices in approximately 0.2 million square feet of space.

ITEM 3. LEGAL PROCEEDINGS

Information with respect to this item may be found in Note 16 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 by reference in this Item 3 of Part I of this Annual Report on Form 10-K.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable**.**

PART II

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

Stock Exchange Information, Common Share Price Performance and Dividends

Our Common stock is listed on the New York Stock Exchange under the ticker symbol WSO, and our Class B common stock is listed on the New York Stock Exchange under the ticker symbol WSOB.

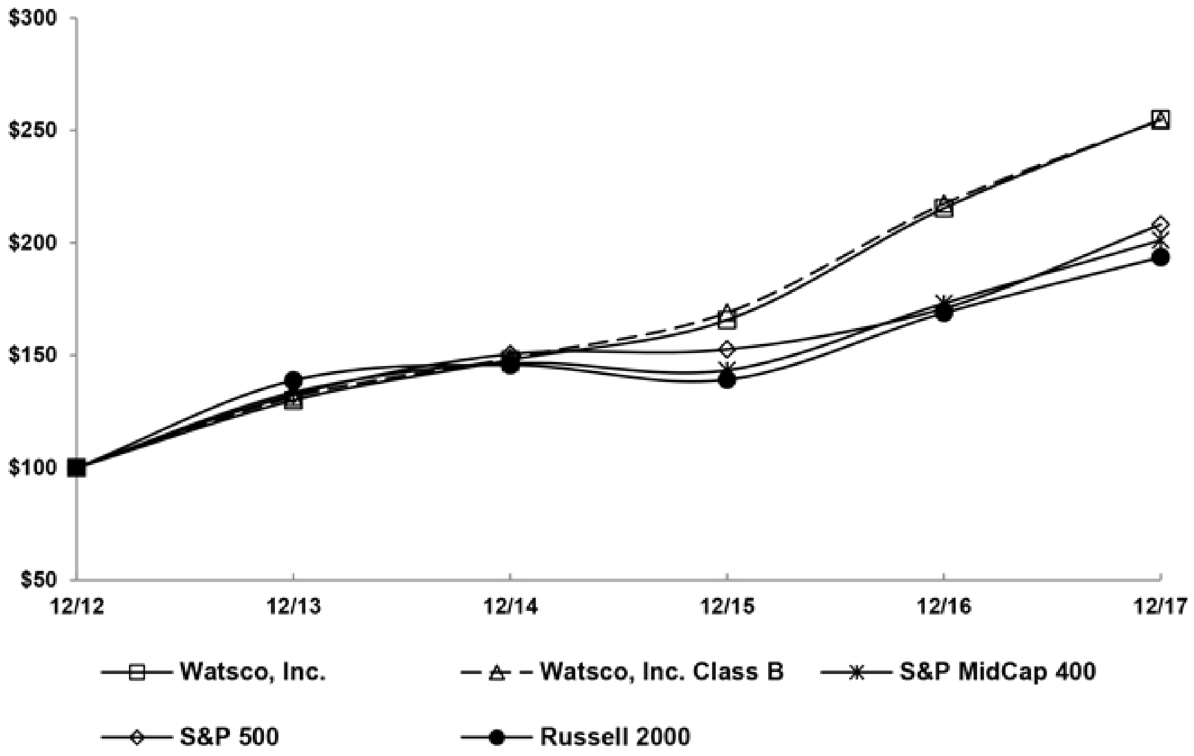
Our 2017 Annual Report contains "Information on Common Stock", which contains the high and low sales prices and dividend information with respect to our Common stock and Class B common stock for the years ended December 31, 2017 and 2016, and is incorporated herein by reference.

Shareholder Return Performance

The following graph compares the cumulative five-year total shareholder return attained by holders of our Common stock and Class B common stock relative to the cumulative total returns of the S&P MidCap 400 index, the S&P 500 index, and the Russell 2000 index. Given our position as the largest distributor of HVAC/R equipment, parts and supplies in North America, our unique, sole line of business, the nature of our customers (air conditioning and heating contractors), and the products and markets we serve, we cannot reasonably identify an appropriate peer group; therefore, we have included in the graph below the performance of the S&P MidCap 400 index, the S&P 500 index, and the Russell 2000 index, which contain companies with market capitalizations similar to our own. An investment of $100 (with reinvestment of all dividends) is assumed to have been made in our common stock and in each index on December 31, 2012 and its relative performance is tracked through December 31, 2017.

The performance graph shall not be deemed incorporated by reference by any general statement incorporating by reference this annual report into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent we specifically incorporate this information by reference, and shall not otherwise be deemed filed under such acts.

Comparison of 5 Year Cumulative Total Shareholder Return*



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

	12/31/12	12/31/13	12/31/14	12/31/15	12/31/16	12/31/17
Watsco, Inc.	100.00	129.97	147.90	165.71	215.42	254.97
Watsco Class B	100.00	131.41	148.80	168.98	217.36	254.55
S&P MidCap 400 Index	100.00	133.50	146.54	143.35	173.08	201.20
S&P 500 Index	100.00	132.39	150.51	152.59	170.84	208.14
Russell 2000 Index	100.00	138.82	145.62	139.19	168.85	193.58

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

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. No shares were repurchased under this plan during 2017, 2016 or 2015. In aggregate, 6,370,913 shares of Common and Class B common stock have been repurchased at a cost of $114.4 million since the inception of this plan. At December 31, 2017, there were 1,129,087 shares remaining authorized for repurchase under this plan. We did not otherwise repurchase any of our common stock during the quarter ended December 31, 2017.

Dividends

Cash dividends per share of $4.60, $3.60 and $2.80 for both Common and Class B common stock were paid in 2017, 2016 and 2015, respectively. Future dividends will be declared and paid 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.

ITEM 6. SELECTED FINANCIAL DATA

Our 2017 Annual Report contains "Selected Consolidated Financial Data", which section is incorporated herein by reference.

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

Our 2017 Annual Report contains "Management's Discussion and Analysis of Financial Condition and Results of Operations", which section is incorporated herein by reference.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our 2017 Annual Report contains "Quantitative and Qualitative Disclosures about Market Risk", which section is incorporated herein by reference.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Our 2017 and 2016 Consolidated Balance Sheets and other consolidated financial statements for the years ended December 31, 2017, 2016 and 2015, together with the report thereon of KPMG LLP dated March 1, 2018, included in our 2017 Annual Report are incorporated herein by reference.

The 2017 and 2016 unaudited Selected Quarterly Financial Data appearing in our 2017 Annual Report is incorporated herein by reference.

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

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

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

Our management, with the participation of our CEO, SVP and CFO, 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, as of such date.

Management's Report on Internal Control over Financial Reporting

Our 2017 Annual Report contains "Management's Report on Internal Control over Financial Reporting" and the report thereon of KPMG LLP dated March 1, 2018, and each is incorporated herein by reference.

Changes in Internal Control over Financial Reporting

We are continuously seeking to improve the efficiency and effectiveness of our operations and of our internal controls. This results in refinements to processes throughout the Company. However, there 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 December 31, 2017, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

PART III

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

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a)(1) Financial Statements. Our consolidated financial statements are incorporated by reference from our 2017 Annual Report.

(2) Financial Statement Schedules. The schedules are omitted because they are not applicable or the required information is shown in the consolidated financial statements or notes thereto.

(3) Exhibits. The following exhibits are submitted with this Annual Report on Form 10-K or, where indicated, incorporated by reference to other filings.

INDEX TO EXHIBITS

3.1	Composite Articles of Incorporation of Watsco, Inc. (filed as Exhibit 3.1 to the Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 and incorporated herein by reference).
3.2	Watsco, Inc. Second Amended and Restated Bylaws effective August 1, 2016 (filed as Exhibit 3.1 to the Current Report on Form 8-K on August 5, 2016 and incorporated herein by reference).
4.1	Specimen form of Class B Common Stock Certificate (filed as Exhibit 4.6 to the Registration Statement on Form S-1 (No. 33-56646) and incorporated herein by reference). (P)
4.2	Specimen form of Common Stock Certificate (filed as Exhibit 4.4 to the Annual Report on Form 10-K for the fiscal year ended December 31, 1994 and incorporated herein by reference). (P)
10.1(a)	Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.20 to the Quarterly Report on Form 10-Q for the quarter ended March 31, 1996 and incorporated herein by reference). *
10.1(b)	First Amendment dated January 1, 2001 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.13 to the Annual Report on Form 10-K for the year ended December 31, 2000 and incorporated herein by reference). *
10.1(c)	Second Amendment dated January 1, 2002 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.15 to the Annual Report on Form 10-K for the year ended December 31, 2001 and incorporated herein by reference). *
10.1(d)	Third Amendment dated January 1, 2003 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.11 to the Annual Report on Form 10-K for the year ended December 31, 2002 and incorporated herein by reference). *
10.1(e)	Fourth Amendment dated January 1, 2004 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.1 to the Quarterly Report on Form 10-Q for the quarter ended March 31, 2004 and incorporated herein by reference). *
10.1(f)	Fifth Amendment dated January 1, 2005 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.1 to the Quarterly Report on Form 10-Q for the quarter ended March 31, 2005 and incorporated herein by reference). *
10.1(g)	Sixth Amendment dated January 1, 2006 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.16 to the Annual Report on Form 10-K for the year ended December 31, 2005 and incorporated herein by reference). *

10.1(h)	Seventh Amendment dated January 1, 2007 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.18 to the Annual Report on Form 10-K for the year ended December 31, 2006 and incorporated herein by reference). *
10.1(i)	Eighth Amendment dated January 1, 2008 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.1 to the Quarterly Report on Form 10-Q for the quarter ended March 31, 2008 and incorporated herein by reference). *
10.1(j)	Ninth Amendment dated December 10, 2008 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.19 to the Annual Report on Form 10-K for the year ended December 31, 2008 and incorporated herein by reference). *
10.1(k)	Tenth Amendment dated January 1, 2009 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.1 to the Quarterly Report on Form 10-Q for the quarter ended March 31, 2009 and incorporated herein by reference). *
10.1(l)	Eleventh Amendment dated January 1, 2010 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.1 to the Quarterly Report on Form 10-Q for the quarter ended March 31, 2010 and incorporated herein by reference). *
10.1(m)	Twelfth Amendment dated January 1, 2011 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.1 to the Quarterly Report on Form 10-Q for the quarter ended March 31, 2011 and incorporated herein by reference). *
10.1(n)	Thirteenth Amendment dated January 1, 2012 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.1 to the Quarterly Report on Form 10-Q for the quarter ended March 31, 2012 and incorporated herein by reference). *
10.1(o)	Fourteenth Amendment dated January 1, 2013 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.1 to the Quarterly Report on Form 10-Q for the quarter ended March 31, 2013 and incorporated herein by reference). *
10.1(p)	Fifteenth Amendment dated January 1, 2014 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.1 to the Quarterly Report on Form 10-Q for the quarter ended March 31, 2014 and incorporated herein by reference). *
10.1(q)	Sixteenth Amendment dated January 1, 2015 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.1 to the Quarterly Report on Form 10-Q for the quarter ended March 31, 2015 and incorporated herein by reference). *
10.1(r)	Seventeenth Amendment dated January 1, 2016 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.1 to the Quarterly Report on Form 10-Q for the quarter ended March 31, 2016 and incorporated herein by reference). *
10.1(s)	Eighteenth Amendment dated January 1, 2017 to Employment Agreement and Incentive Plan dated January 31, 1996 by and between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.1 to the Quarterly Report on Form 10-Q for the quarter ended March 31, 2017 and incorporated herein by reference). *
10.2	Watsco, Inc. Amended and Restated 2001 Incentive Compensation Plan (filed as Appendix A to the Definitive Proxy Statement on Schedule 14A in respect of our 2009 Annual Meeting of Shareholders and incorporated herein by reference). *
10.3	Watsco, Inc. 2014 Incentive Compensation Plan (filed as Appendix A to the Definitive Proxy Statement on Schedule 14A in respect of our 2014 Annual Meeting of Shareholders and incorporated herein by reference). *
10.4	Fourth Amended and Restated 1996 Qualified Employee Stock Purchase Plan dated April 18, 2011 (filed as Appendix A to the Definitive Proxy Statement on Schedule 14A in respect of our 2011 Annual Meeting of Shareholders and incorporated herein by reference). *
10.5(a)	Credit Agreement dated as of April 27, 2012, by and among Watsco, Inc., as Borrower, Watsco Canada, Inc., as Canadian Borrower, the Lenders from time to time party thereto, JPMorgan Chase Bank, N.A., as Administrative Agent and Collateral Agent, Bank of America, N.A. and Wells Fargo Bank, National Association as Co-Syndication Agents and U.S. Bank National Association as Documentation Agent (filed as Exhibit 10.1 to the Quarterly Report on Form 10-Q on August 2, 2013 and incorporated herein by reference).

10.5(b)	Amendment No. 1 dated as of August 8, 2012, to the Credit Agreement dated as of April 27, 2012 (filed as Exhibit 10.4(b) to the Annual Report on Form 10-K for the year ended December 31, 2012, filed on February 28, 2013 and incorporated herein by reference).
10.5(c)	Amendment No. 2, dated as of July 1, 2013, to Credit Agreement dated as of April 27, 2012, by and among Watsco, Inc., as Borrower, Watsco Canada, Inc., as Canadian Borrower, the Lenders from time to time party thereto, JPMorgan Chase Bank, N.A., as Administrative Agent and Collateral Agent, Bank of America, N.A. and Wells Fargo Bank, National Association as Co-Syndication Agents and U.S. Bank National Association as Documentation Agent (filed as Exhibit 10.1 to the Current Report on Form 8-K on July 2, 2013 and incorporated herein by reference).
10.5(d)	Amendment No. 3, dated as of June 25, 2014, to Credit Agreement dated as of April 27, 2012, by and among Watsco, Inc., as Borrower, Watsco Canada, Inc., as Canadian Borrower, the Lenders from time to time party thereto, JPMorgan Chase Bank, N.A., as Administrative Agent and Collateral Agent, Bank of America, N.A. and Wells Fargo Bank, National Association as Co-Syndication Agents and U.S. Bank National Association as Documentation Agent (filed as Exhibit 10.1 to the Current Report on Form 8-K on June 27, 2014 and incorporated herein by reference).
10.5(e)	Amendment No. 4, dated as of January 24, 2017, to Credit Agreement dated as of April 27, 2012, by and among Watsco, Inc., as Borrower, Watsco Canada, Inc., as Canadian Borrower, the Lenders from time to time party thereto, JPMorgan Chase Bank, N.A., as Administrative Agent and Collateral Agent, Bank of America, N.A. and Wells Fargo Bank, National Association as Co-Syndication Agents and U.S. Bank National Association as Documentation Agent (filed as Exhibit 10.5(e) to the Annual Report on Form 10-K on February 21, 2017 and incorporated herein by reference).
10.6	Operating Agreement of Carrier Enterprise, LLC (Amended and Restated), dated as of July 1, 2009 (filed as Exhibit 10.2 to the Current Report on Form 8-K on July 8, 2009 and incorporated herein by reference).
10.7	Operating Agreement of Carrier Enterprise Northeast, LLC, dated as of April 30, 2011 (filed as Exhibit 10.29 to the Annual Report on Form 10-K for the year ended December 31, 2011 and incorporated herein by reference).
10.8	Carrier Enterprise Canada (G.P.), Inc. Shareholders' Agreement dated as of April 27, 2012 (filed as Exhibit 10.2 to the Current Report on Form 8-K on May 3, 2012 and incorporated herein by reference).
13	2017 Annual Report to Shareholders (with the exception of the information incorporated by reference into Items 1, 5, 6, 7 and 8 of this Form 10-K, the 2017 Annual Report to Shareholders is provided solely for the information of the SEC and is not deemed "filed" as part of this Form 10-K). #
21.1	Subsidiaries of the Registrant. #
23.1	Consent of Independent Registered Public Accounting Firm – KPMG LLP. #
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. #
31.2	Certification of Senior Vice President pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. #
31.3	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. #
32.1	Certification of Chief Executive Officer, Senior Vice President and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. +
101.INS	XBRL Instance Document. #
101.SCH	XBRL Taxonomy Extension Schema Document. #
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document. #
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document. #

101.LAB	XBRL Taxonomy Extension Label Linkbase Document. #
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document. #

filed herewith.
\+ furnished herewith.
* Management contract or compensation plan or arrangement.

ITEM 16. FORM 10-K SUMMARY

None.

SIGNATURES

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

WATSCO, INC.

March 1, 2018	By: /s/ Albert H. Nahmad Albert H. Nahmad, Chief Executive Officer
March 1, 2018	By: /s/ Ana M. Menendez Ana M. Menendez, Chief Financial Officer

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

SIGNATURE	TITLE	DATE
/S/ ALBERT H. NAHMAD **Albert H. Nahmad**	Chairman of the Board and Chief Executive Officer (principal executive officer)	March 1, 2018
/S/ BARRY S. LOGAN **Barry S. Logan**	Director and Senior Vice President	March 1, 2018
/S/ ANA M. MENENDEZ **Ana M. Menendez**	Chief Financial Officer (principal accounting officer and principal financial officer)	March 1, 2018
/S/ CESAR L. ALVAREZ **Cesar L. Alvarez**	Director	March 1, 2018
/S/ DAVID C. DARNELL **David C. Darnell**	Director	March 1, 2018
/S/ DENISE DICKINS **Denise Dickins**	Director	March 1, 2018
/S/ JASON EPSTEIN **Jason Epstein**	Director	March 1, 2018
/S/ BOB L. MOSS **Bob L. Moss**	Director	March 1, 2018
/S/ AARON J. NAHMAD **Aaron J. Nahmad**	Director and President	March 1, 2018
/S/ GEORGE P. SAPE **George P. Sape**	Director	March 1, 2018

WATSCO, INC. AND SUBSIDIARIES
SELECTED CONSOLIDATED FINANCIAL DATA

The following selected consolidated financial data should be read in conjunction with the audited consolidated financial statements, including the notes thereto, included under Item 8 of Part II, “Financial Statements and Supplementary Data,” and the information contained in Item 7 of Part II, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” of this Annual Report on Form 10-K for the year ended December 31, 2017.

(In thousands, except per share data)	2017	2016	2015	2014	2013
FOR THE YEAR					
Revenues	$4,341,955	$4,220,702	$4,113,239	$3,944,540	$3,743,330
Gross profit	1,065,659	1,034,584	1,007,357	956,402	899,253
Operating income	353,874	345,632	336,748	305,747	271,209
Net income	257,290	235,983	226,524	208,702	187,719
Less: net income attributable to non-controlling interest	49,069	53,173	53,595	57,315	59,996
Net income attributable to Watsco, Inc.	$ 208,221	$ 182,810	$ 172,929	$ 151,387	$ 127,723
Diluted earnings per share for Common and Class B common stock	$ 5.81	$ 5.15	$ 4.90	$ 4.32	$ 3.68
Cash dividends per share:					
Common stock	$ 4.60	$ 3.60	$ 2.80	$ 2.00	$ 1.15
Class B common stock	$ 4.60	$ 3.60	$ 2.80	$ 2.00	$ 1.15
Weighted-average Common and Class B common shares outstanding—Diluted	32,863	32,617	32,480	32,359	32,258
AT YEAR END					
Total assets	$2,046,877	$1,874,649	$1,788,442	$1,791,067	$1,669,531
Total long-term obligations	$ 22,085	$ 235,642	$ 245,814	$ 303,885	$ 230,557
Total shareholders’ equity	$1,550,977	$1,251,748	$1,203,721	$1,132,039	$1,127,392
Number of employees	5,200	5,050	4,950	4,950	4,750

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. Statements which are not historical in nature, including the words "anticipate," "estimate," "could," "should," "may," "plan," "seek," "expect," "believe," "intend," "target," "will," "project," "focused," "outlook," and 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 and investments in unconsolidated entities, (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 this Annual Report on Form 10-K, 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 information contained in Item 1A, "Risk Factors" and the consolidated financial statements, including the notes thereto, included under Item 8, "Financial Statements and Supplementary Data" of this Annual Report on Form 10-K for the year ended December 31, 2017.

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 December 31, 2017, we operated from 560 locations in 37 U.S. States, Canada, Mexico, and Puerto Rico with additional market coverage on an export basis to portions of Latin America and the Caribbean.

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

Sales of residential central air conditioners, heating equipment, and parts and supplies are seasonal. Furthermore, results of operations can be impacted favorably or unfavorably based on weather patterns, 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 evenly distributed throughout 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 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 the Northeast U.S., 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. On November 29, 2016, we purchased an additional 10% ownership interest in Carrier Enterprise II, and, on February 13, 2017, we again purchased an additional 10% ownership interest in Carrier Enterprise II, which together increased our controlling interest to 80%.

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 consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amount of revenues and expenses during the reporting period. Actual results may differ from these estimates under different assumptions or conditions. At least quarterly, management reevaluates its judgments and estimates, which are based on historical experience, current trends, and various other assumptions that are believed to be reasonable under the circumstances.

Our significant accounting policies are discussed in Note 1 to our audited consolidated financial statements included with this Annual Report on Form 10-K. Management believes that the following accounting policies include a higher degree of judgment and/or complexity and, thus, are considered to be critical accounting policies. Management has discussed the development and selection of critical accounting policies with the Audit Committee of the Board of Directors and the Audit Committee has reviewed the disclosures relating to them.

Allowance for Doubtful Accounts

An allowance for doubtful accounts is maintained for estimated losses resulting from the inability of customers to make required payments. We typically do not require our customers to provide collateral. Accounting for doubtful accounts contains uncertainty because management must use judgment to assess the collectability of these accounts. When preparing these estimates, management considers several factors, including the aging of a customer's account, past transactions with customers, creditworthiness of specific customers, historical trends and other information. Our business is seasonal and our customers' businesses are also seasonal. Sales are lowest during the first and fourth quarters, and past due accounts receivable balances as a percentage of total trade receivables generally increase during these quarters. We review our accounts receivable reserve policy periodically, reflecting current risks, trends, and changes in industry conditions.

The allowance for doubtful accounts was $6.1 million and $6.2 million at December 31, 2017 and 2016, respectively, a decrease of $0.1 million. Accounts receivable balances greater than 90 days past due as a percent of accounts receivable at December 31, 2017 decreased to 1.3% from 1.6% at December 31, 2016. These decreases were primarily attributable to an improvement in the underlying quality of our accounts receivable portfolio at December 31, 2017.

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

Inventory Valuation Reserves

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

Valuation of Goodwill, Indefinite Lived Intangible Assets and Long-Lived Assets

The recoverability of goodwill is evaluated at least annually and when events or changes in circumstances indicate that the carrying amount may not be recoverable. We have one reporting unit that is subject to goodwill impairment testing. In performing the goodwill impairment test, we use a two-step approach. The first step compares the reporting unit's fair value to its carrying value. If the carrying value exceeds the fair value, a second step is performed to measure the amount of impairment loss, if any. The identification and measurement of goodwill impairment involves the estimation of the fair value of our reporting unit and contains uncertainty because management must use judgment in determining appropriate assumptions to be used in the measurement of fair value. On January 1, 2018, we performed our annual evaluation of goodwill impairment and determined that the estimated fair value of our reporting unit significantly exceeded its carrying value.

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

The estimates of fair value of our reporting unit, indefinite lived intangibles, and long-lived assets are based on the best information available as of the date of the assessment and incorporates management's assumptions about expected future cash flows and contemplates other valuation techniques. Future cash flows can be affected by changes in the industry, a declining economic environment, or market conditions. There have been no events or circumstances from the date of our assessments that would have had an impact on this conclusion. The carrying amounts of goodwill, intangibles, and long-lived assets were $611.3 million and $538.3 million at December 31, 2017 and 2016, respectively. Although no impairment losses have been recorded to date, there can be no assurance that impairments will not occur in the future. An adjustment to the carrying value of goodwill, intangibles, and long-lived assets could materially adversely impact the consolidated results of operations.

Self-Insurance Reserves

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

Management reviews its assumptions with its independent third-party actuaries to evaluate whether self-insurance reserves are adequate. If actual claims or adverse development of loss reserves occur and exceed these estimates, additional reserves may be required and could materially impact the consolidated results of operations. The estimation process contains uncertainty since management must use judgment to estimate the ultimate cost that will be incurred to settle reported claims and unreported claims for incidents incurred but not reported as of the balance sheet date. Reserves in the amounts of $2.3 million and $3.0 million at December 31, 2017 and 2016, respectively, were established related to such insurance programs.

Income Taxes

Income taxes are accounted for under the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial reporting basis and the tax basis of assets and liabilities at enacted tax rates expected to be in effect when such amounts are recovered or settled. The use of estimates by management is required to determine income tax expense, deferred tax assets, and any related valuation allowance and deferred tax liabilities. No valuation allowance was recorded at December 31, 2017 or 2016. The valuation allowance is based on estimates of future taxable income by jurisdiction in which the deferred tax assets will be recoverable. These estimates can be affected by several factors, including changes to tax laws, or possible tax audits, or general economic conditions, or competitive pressures that could affect future taxable income. Although management believes that the estimates are reasonable, the deferred tax asset and any related valuation allowance will need to be adjusted if management's estimates of future taxable income differ from actual taxable income. An adjustment to the deferred tax asset and any related valuation allowance could materially impact the consolidated results of operations.

New Accounting Standards

Refer to Note 1 to our audited consolidated financial statements included in this Annual Report on Form 10-K for a discussion of recently adopted and to be adopted accounting standards.

Results of Operations

The following table summarizes information derived from our audited consolidated statements of income, expressed as a percentage of revenues, for the years ended December 31, 2017, 2016 and 2015.

	2017	2016	2015
Revenues	**100.0%**	100.0%	100.0%
Cost of sales	**75.5**	75.5	75.5
Gross profit	**24.5**	24.5	24.5
Selling, general and administrative expenses	**16.5**	16.3	16.3
Other income	**0.1**	—	—
Operating income	**8.2**	8.2	8.2
Interest expense, net	**0.1**	0.1	0.1
Income before income taxes	**8.0**	8.1	8.1
Income taxes	**2.1**	2.5	2.5
Net income	**5.9**	5.6	5.5
Less: net income attributable to non-controlling interest	**1.1**	1.3	1.3
Net income attributable to Watsco, Inc.	**4.8%**	4.3%	4.2%

Note: Due to rounding, percentages may not add up to 100.

The following narratives reflect our approximate 35% ownership interest in Russell Sigler, Inc. ("RSI") purchased in June 2017, our additional 10% ownership interest in Carrier Enterprise II, which became effective on February 13, 2017, and our additional 10% ownership interest in Carrier Enterprise II, which became effective on November 29, 2016. We did not make any material acquisitions of businesses during 2017, 2016 or 2015.

In the following narratives, computations and other information referring to "same-store basis" exclude the effects of locations acquired or locations opened or closed during the immediately preceding 12 months, unless they are within close geographical proximity to existing locations. At December 31, 2017 and 2016, 35 and 21 locations, respectively, were excluded from "same-store basis" information. The table below summarizes the changes in our locations for 2017 and 2016:

	Number of Locations
December 31, 2015	566
Opened	10
Closed	(11)
December 31, 2016	565
Opened	15
Closed	(20)
December 31, 2017	560

2017 Compared to 2016

Revenues

Revenues for 2017 increased $121.3 million, or 3%, to $4,342.0 million, including $5.7 million from locations opened during the preceding 12 months, offset by $24.5 million from locations closed. On a same-store basis, revenues increased $140.1 million, or 3%, as compared to 2016, reflecting a 4% increase in sales of HVAC equipment (67% of sales), which included a 5% increase in residential HVAC equipment and a 2% increase in commercial HVAC equipment, a 1% increase in sales of other HVAC products (28% of sales), and flat sales of commercial refrigeration products (5% of sales). The increase in revenues was primarily due to demand for the replacement of residential HVAC equipment.

Gross Profit

Gross profit for 2017 increased $31.1 million, or 3%, to $1,065.7 million, primarily as a result of increased revenues. Gross profit margin remained consistent at 24.5% in 2017 as compared to 2016.

Selling, General and Administrative Expenses

Selling, general and administrative expenses for 2017 increased $26.7 million, or 4%, to $715.7 million, primarily due to increased revenues, additional sales and service-related headcount, and increased costs related to ongoing technology initiatives. Selling, general and administrative expenses as a percentage of revenues for 2017 increased to 16.5% versus 16.3% in 2016.

Other Income

Other income of $3.9 million for 2017 represents our approximate 35% share of the net income of RSI, purchased in June 2017.

Operating Income

Operating income for 2017 increased $8.2 million, or 2%, to $353.9 million. Operating margin remained consistent at 8.2% in 2017 as compared to 2016.

Interest Expense, Net

Interest expense, net, for 2017 increased $2.7 million, or 71%, to $6.4 million, primarily as a result of an increase in average outstanding borrowings and a higher effective interest rate in 2017, in each case as compared to 2016.

Income Taxes

Income taxes decreased to $90.2 million for 2017, as compared to $105.9 million for 2016, 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 Watsco were 29.8% and 36.0% in 2017 and 2016, respectively.

On December 22, 2017 Public Law 115-97 *"An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018"* was enacted. This law is commonly referred to as the Tax Cuts and Jobs Act of 2017 (the "TCJA"). The 2017 effective income tax rate attributable to us reflects a decrease in income taxes due to the revaluation of our U.S. deferred income taxes, partially offset by an increase in income taxes related to previously undistributed earnings of our foreign subsidiaries because of the TCJA. The decrease in 2017's effective rate also reflects higher share-based payment deductions in 2017 as compared to 2016. Refer to Note 7 to our audited consolidated financial statements included in this Annual Report on Form 10-K for further discussion of the TCJA's impact on us.

We currently estimate our 2018 effective income tax rate attributable to Watsco will be approximately 24% to 25%, and our 2018 effective income tax rate, net of taxes attributable to the non-controlling interest, to be approximately 21% to 22%, subject to the refinement of provisional adjustments related to the TCJA. The rate may also change due to additional guidance and interpretations related to the TCJA, as well as the impact of the prospective tax related to certain global intangible low-taxed income of foreign subsidiaries. We anticipate some variability in the tax rate quarter to quarter in 2018 from potential discrete items.

Net Income Attributable to Watsco, Inc.

Net income attributable to Watsco in 2017 increased $25.4 million, or 14%, to $208.2 million. The increase was primarily driven by higher revenues and other income, as discussed above, a reduction in income taxes, and increase in net income attributable to the non-controlling interest related to Carrier Enterprise II following our purchases of additional 10% ownership interests in both November 2016 and February 2017.

2016 Compared to 2015

Revenues

Revenues for 2016 increased $107.5 million, or 3%, to $4,220.7 million, including $1.4 million from locations opened during the preceding 12 months, offset by $18.4 million from locations closed. On a same-store basis, revenues increased $124.5 million, or 3%, as compared to 2015, reflecting a 3% increase in sales of HVAC equipment (66% of sales), which included a 4% increase in residential HVAC equipment and a 1% increase in commercial HVAC equipment, a 1% increase in sales of other HVAC products (29% of sales), and a 6% increase in sales of commercial refrigeration products (5% of sales). The increase in revenues was primarily due to demand for the replacement of residential HVAC equipment.

Gross Profit

Gross profit for 2016 increased $27.2 million, or 3%, to $1,034.6 million, primarily as a result of increased revenues. Gross profit margin remained consistent at 24.5% in 2016 as compared to 2015.

Selling, General and Administrative Expenses

Selling, general and administrative expenses for 2016 increased $18.3 million, or 3%, to $689.0 million, primarily due to increased revenues as well as $3.3 million of additional costs related to ongoing technology initiatives. Selling, general and administrative expenses as a percentage of revenues remained consistent at 16.3% in 2016 as compared to 2015.

Operating Income

Operating income for 2016 increased $8.9 million, or 3%, to $345.6 million. Operating margin remained consistent at 8.2% in 2016 as compared to 2015.

Interest Expense, Net

Interest expense, net, for 2016 decreased $1.8 million, or 33%, to $3.7 million, primarily as a result of a decrease in average outstanding borrowings, partially offset by a higher effective interest rate in 2016, in each case as compared to 2015.

Income Taxes

Income taxes increased to $105.9 million for 2016, as compared to $104.7 million for 2015, and are a composite of the income taxes attributable to our wholly-owned operations and income taxes attributable to the Carrier joint ventures, which are primarily taxed as partnerships for income tax purposes. The effective income tax rates attributable to Watsco were 36.0% and 37.0% in 2016 and 2015, respectively. The decrease was primarily due to a $2.9 million benefit from share-based payment deductions in 2016.

Net Income Attributable to Watsco, Inc.

Net income attributable to Watsco in 2016 increased $9.9 million, or 6%, to $182.8 million. The increase was primarily driven by higher revenues and by a reduction in the net income attributable to the non-controlling interest related to Carrier Enterprise II following our purchase of an additional 10% ownership interest in Carrier Enterprise II in November 2016.

Liquidity and Capital Resources

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

- cash needed to fund our business (primarily working capital requirements);
- borrowing capacity under our bank line of credit;
- the ability to attract long-term capital with satisfactory terms;
- acquisitions, including joint ventures and investments in unconsolidated entities;
- 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 (to the extent declared by our Board of Directors), capital expenditures, business acquisitions, and development of our long-term operating and technology strategies. Additionally, we may also generate cash through the issuance and sale of our Common stock.

As of December 31, 2017, we had $80.5 million of cash and cash equivalents, of which $75.9 million was held by foreign subsidiaries. The repatriation of cash balances from our foreign subsidiaries could have adverse tax consequences or be subject to capital controls; however, these balances are generally available without legal restrictions to fund the ordinary business operations of our foreign subsidiaries.

We believe that our operating cash flows, cash on hand, and funds available for borrowing under our revolving credit agreement are 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 revolving credit agreement 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 revolving credit agreement and may also adversely affect the determination of interest rates, particularly rates based on LIBOR, which is one of the base rates under our revolving credit agreement. Disruptions in the credit and capital markets could also result in increased borrowing costs and/or reduced borrowing capacity under our revolving credit agreement.

Working Capital

Working capital decreased to $920.9 million at December 31, 2017 from $925.3 million at December 31, 2016.

Cash Flows

The following table summarizes our cash flow activity for 2017 and 2016 (in millions):

	2017	**2016**	**Change**
Cash flows provided by operating activities	**$ 306.5**	$ 281.7	$ 24.8
Cash flows used in investing activities	**$ (81.3)**	$ (42.8)	$(38.5)
Cash flows used in financing activities	**$(202.1)**	$(217.9)	$ 15.8

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

Operating Activities

Net cash provided by operating activities increased primarily due to higher net income in 2017 as compared to 2016.

Investing Activities

Net cash used in investing activities increased primarily due to the purchase of an ownership interest in RSI for $63.6 million, partially offset by a decrease in capital expenditures in 2017.

Financing Activities

Net cash used in financing activities decreased primarily due to $247.7 million in proceeds from the sale of Common stock used for repayments under our revolving credit agreement, an increase in dividends paid, and higher distributions paid to the non-controlling interest in 2017.

At-the-Market Offering Program

On August 23, 2017, we entered into a sales agreement with Robert W. Baird & Co. Inc., which enabled the Company to issue and sell shares of Common stock in one or more negotiated transactions that are deemed to be "at the market" offerings as defined in Rule 415 under the Securities Act of 1933, as amended (the "Securities Act"), for a maximum aggregate offering amount of up to $250.0 million (the "ATM Program"). The offer and sale of our Common stock pursuant to the ATM Program was registered under the Securities Act pursuant to our automatically effective shelf registration statement on Form S-3 (File No. 333-207831).

During 2017, we sold 1,498,662 shares of Common stock under the ATM Program for net proceeds of $247.7 million. Direct costs of $0.3 million incurred in connection with the offering were charged against the proceeds from the sale of Common stock and reflected as a reduction of paid-in capital. As of December 31, 2017, we had completed the offering of shares under the ATM Program. The net proceeds were primarily used to repay outstanding debt and for general corporate purposes.

Revolving Credit Agreement

We maintain an unsecured, syndicated revolving credit agreement, which we use to fund seasonal working capital needs and for other general corporate purposes, including acquisitions, dividends (if and as declared by our Board of Directors), capital expenditures, stock repurchases, and issuances of letters of credit. Effective February 5, 2018, we decreased the borrowing capacity under this credit agreement from $600.0 million to $300.0 million. Included in the credit facility are a $90.0 million swingline subfacility, a $10.0 million letter of credit subfacility and a $75.0 million multicurrency borrowing sublimit. The credit agreement matures on July 1, 2019.

Borrowings under the credit facility bear interest at either LIBOR-based rates plus a spread, which ranges from 87.5 to 250.0 basis-points (LIBOR plus 87.5 basis-points at December 31, 2017), depending on our ratio of total debt to EBITDA, or on rates based on the higher of the Prime rate or the Federal Funds Rate, in each case plus a spread which ranges from 0 to 150.0 basis-points (0 basis-points at December 31, 2017), depending on our ratio of total debt to EBITDA. We pay a variable commitment fee on the unused portion of the commitment under the revolving credit agreement, ranging from 12.5 to 35.0 basis-points (12.5 basis-points at December 31, 2017).

At December 31, 2017 and 2016, $21.8 million and $235.3 million were outstanding under the revolving credit agreement, respectively. The revolving credit agreement contains customary affirmative and negative covenants, including financial covenants with respect to consolidated leverage and interest coverage ratios, and other customary restrictions. We believe we were in compliance with all covenants at December 31, 2017.

Contractual Obligations

As of December 31, 2017, our significant contractual obligations were as follows (in millions):

	Payments due by Period						
Contractual Obligations	**2018**	**2019**	**2020**	**2021**	**2022**	**Thereafter**	**Total**
Operating leases (1)	$69.1	$51.7	$36.1	$22.4	$13.0	$ 5.8	$198.1
Purchase obligations (2)	11.0	—	—	—	—	—	11.0
Total	$80.1	$51.7	$36.1	$22.4	$13.0	$ 5.8	$209.1

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

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

We have not included in the contractual obligations table above approximately $3.5 million of net liabilities for unrecognized tax benefits relating to various tax positions we have taken, the timing of which is uncertain.

Commercial obligations outstanding at December 31, 2017 under our revolving credit agreement consisted of borrowings totaling $21.8 million with revolving maturities of seven days.

Off-Balance Sheet Arrangements

Refer to Note 13 to our audited consolidated financial statements, under the caption “Off-Balance Sheet Financial Instruments,” for a discussion of standby letters of credit and performance bonds for which we were contingently liable under at December 31, 2017. Such discussion is incorporated herein by reference.

Purchase of Additional Ownership Interest in Joint Venture

On February 13, 2017, we purchased an additional 10% ownership interest in Carrier Enterprise II for cash consideration of $42.7 million, which increased our controlling interest in Carrier Enterprise II to 80%. We used borrowings under our revolving credit agreement to finance this acquisition, which we subsequently repaid using a portion of the proceeds from the ATM program.

Investment in Unconsolidated Entity

On June 21, 2017, Carrier Enterprise I acquired an approximately 35% ownership interest in RSI, an HVAC distributor operating from 30 locations in the Western U.S. for cash consideration of $63.6 million, of which we contributed $50.9 million, and Carrier contributed $12.7 million. Carrier Enterprise I entered into a shareholders agreement (the “Shareholders Agreement”) with RSI and its shareholders. Pursuant to the Shareholders Agreement, RSI’s shareholders have the right to sell, and Carrier Enterprise I has the obligation to purchase, their respective shares of RSI for a purchase price determined based on either book value or a multiple of EBIT, the latter of which Carrier Enterprise I used to calculate the price paid for its investment in RSI. RSI’s shareholders may transfer their respective shares of RSI common stock only to members of the Sigler family or to Carrier Enterprise I, and, at any time from and after the date on which Carrier Enterprise I owns 85% or more of RSI’s outstanding common stock, it has the right, but not the obligation, to purchase from RSI’s shareholders the remaining outstanding shares of RSI common stock. We believe that our operating cash flows, cash on hand, and funds available for borrowing under our revolving credit agreement will be sufficient to purchase any additional ownership interests in RSI.

Acquisitions

We continually evaluate potential acquisitions, including joint ventures and investments in unconsolidated entities, 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 $4.60, $3.60 and $2.80 per share of Common stock and Class B common stock in 2017, 2016 and 2015, respectively. On January 2, 2018, our Board of Directors declared a regular quarterly cash dividend of $1.25 per share of Common and Class B common stock that was paid on January 31, 2018 to shareholders of record as of January 16, 2018. On February 6, 2018, our Board of Directors approved an increase to the quarterly cash dividend per share of Common and Class B common stock to $1.45 per share from $1.25 per share, beginning with the dividend that will be paid in April 2018. Future dividends and/or changes in dividend rates are at the sole discretion of the Board of Directors and depend upon factors including, but not limited to, cash flow generated by operations, profitability, financial condition, cash requirements, and future prospects.

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 2017, 2016 or 2015. In aggregate, 6,370,913 shares of Common and Class B common stock have been repurchased at a cost of $114.4 million since the inception of the program. At December 31, 2017, there were 1,129,087 shares remaining authorized for repurchase under the program.

Quantitative and Qualitative Disclosures about Market Risk

We are exposed to market risks, including fluctuations in foreign currency exchange rates and interest rates. To manage certain of these exposures, we use derivative instruments, including forward and option contracts and swaps. We use derivative instruments as risk management tools and not for trading purposes.

Foreign Currency Exposure

We are exposed to cash flow and earnings fluctuations resulting from currency exchange rate variations. These exposures are transactional and translational in nature. The foreign currency exchange rates to which we are exposed are the Canadian dollar and Mexican peso. Revenues in these markets accounted for 6% and 4%, respectively, of our total revenues for 2017.

Our transactional exposure primarily relates to purchases by our Canadian operations in currencies other than their local currency. To mitigate the impact of currency exchange rate movements on these purchases, we use foreign currency forward contracts. By entering into these foreign currency forward contracts, we lock in exchange rates that would otherwise cause losses should the U.S. dollar strengthen and gains should the U.S. dollar weaken, in each case against the Canadian dollar. The total notional value of our foreign exchange contracts as of December 31, 2017 was $40.7 million, and such contracts have varying terms expiring through September 2018. For the year ended December 31, 2017, foreign currency transaction gains and losses did not have a material impact on our results of operations.

We have exposure related to the translation of financial statements of our Canadian operations into U.S. dollars, our functional currency. We do not currently hold any derivative contracts that hedge our foreign currency translational exposure. A 10% change in the Canadian dollar would have had an estimated $1.7 million impact to net income for the year ended December 31, 2017.

Historically, fluctuations in these exchange rates have not materially impacted our results of operations. Our exposure to currency rate fluctuations could be material in the future if these fluctuations become significant or if our Canadian and Mexican markets grow and represent a larger percentage of our total revenues.

See Note 14 to our audited consolidated financial statements included in this Annual Report on Form 10-K for further information on our derivative instruments.

Interest Rate Exposure

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

We have evaluated our exposure to interest rates based on the amount of variable debt outstanding under our revolving credit agreement at December 31, 2017 and determined that a 100 basis-point change in interest rates would result in an impact to income before taxes of approximately $0.2 million. See Note 6 to our audited consolidated financial statements included in this Annual Report on Form 10-K for further information about our debt.

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

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

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

Under the supervision and with the participation of our management, including our Chief Executive Officer, Senior Vice President and Chief Financial Officer, we conducted an assessment of the effectiveness of our internal control over financial reporting as of December 31, 2017. The assessment was based on criteria established in the framework *Internal Control — Integrated Framework (2013)*, issued by the Committee of Sponsoring Organizations ("COSO") of the Treadway Commission. Based on this assessment under the COSO framework, our management concluded that our internal control over financial reporting was effective as of December 31, 2017. The effectiveness of our internal control over financial reporting as of December 31, 2017 has been audited by KPMG LLP, an independent registered public accounting firm, as stated in their report that is included herein.

Report of Independent Registered Public Accounting Firm

To the Shareholders and Board of Directors
Watsco, Inc.:

Opinion on Internal Control Over Financial Reporting

We have audited Watsco, Inc. and subsidiaries' (the "Company") internal control over financial reporting as of December 31, 2017, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the consolidated balance sheets of the Company as of December 31, 2017 and 2016, the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2017, and the related notes (collectively, the consolidated financial statements), and our report dated March 1, 2018 expressed an unqualified opinion on those consolidated financial statements.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

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

Definition and Limitations of Internal Control Over Financial Reporting

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

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

/s/ KPMG LLP

Miami, Florida
March 1, 2018
Certified Public Accountants

Report of Independent Registered Public Accounting Firm

To the Shareholders and Board of Directors
Watsco, Inc.:

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of Watsco, Inc. and subsidiaries (the “Company”) as of December 31, 2017 and 2016, the related consolidated statements of income, comprehensive income, shareholders’ equity, and cash flows for each of the years in the three-year period ended December 31, 2017, and the related notes (collectively, the “consolidated financial statements”). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2017, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (“PCAOB”), the Company’s internal control over financial reporting as of December 31, 2017, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 1, 2018 expressed an unqualified opinion on the effectiveness of the Company’s internal control over financial reporting.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ KPMG LLP

We have served as the Company’s auditor since 2009.

Miami, Florida
March 1, 2018
Certified Public Accountants

WATSCO, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)	Years Ended December 31, 2017	2016	2015
Revenues	$4,341,955	$4,220,702	$4,113,239
Cost of sales	3,276,296	3,186,118	3,105,882
Gross profit	1,065,659	1,034,584	1,007,357
Selling, general and administrative expenses	715,671	688,952	670,609
Other income	3,886	—	—
Operating income	353,874	345,632	336,748
Interest expense, net	6,363	3,713	5,547
Income before income taxes	347,511	341,919	331,201
Income taxes	90,221	105,936	104,677
Net income	257,290	235,983	226,524
Less: net income attributable to non-controlling interest	49,069	53,173	53,595
Net income attributable to Watsco, Inc.	$ 208,221	$ 182,810	$ 172,929
Earnings per share for Common and Class B common stock:			
Basic	$ 5.81	$ 5.16	$ 4.91
Diluted	$ 5.81	$ 5.15	$ 4.90

See accompanying notes to consolidated financial statements.

WATSCO, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)	Years Ended December 31, 2017	2016	2015
Net income	$257,290	$235,983	$226,524
Other comprehensive gain (loss), net of tax			
Foreign currency translation adjustment	15,993	6,211	(39,378)
Unrealized (loss) gain on cash flow hedging instruments	(702)	(965)	2,713
Reclassification of (gain) loss on cash flow hedging instruments into earnings	(358)	323	(1,993)
Unrealized (loss) gain on available-for-sale securities	(15)	14	(8)
Other comprehensive gain (loss)	14,918	5,583	(38,666)
Comprehensive income	272,208	241,566	187,858
Less: comprehensive income attributable to non-controlling interest	54,678	55,382	38,086
Comprehensive income attributable to Watsco, Inc.	$217,530	$186,184	$149,772

See accompanying notes to consolidated financial statements.

WATSCO, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)	December 31, 2017	December 31, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	$ 80,496	$ 56,010
Accounts receivable, net	478,133	475,974
Inventories	761,314	685,011
Other current assets	17,454	23,161
Total current assets	1,337,397	1,240,156
Property and equipment, net	91,198	90,502
Goodwill	382,729	379,737
Intangible assets, net	161,065	158,564
Other assets	74,488	5,690
	$2,046,877	$1,874,649
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current portion of other long-term obligations	$ 244	$ 200
Accounts payable	230,476	185,482
Accrued expenses and other current liabilities	185,757	129,206
Total current liabilities	416,477	314,888
Long-term obligations:		
Borrowings under revolving credit agreement	21,800	235,294
Other long-term obligations, net of current portion	285	348
Total long-term obligations	22,085	235,642
Deferred income taxes and other liabilities	57,338	72,371
Commitments and contingencies		
Watsco, Inc. shareholders' equity:		
Common stock, $0.50 par value, 60,000,000 shares authorized; 36,825,128 and 36,682,562 shares outstanding at December 31, 2017 and 2016, respectively	18,412	18,341
Class B common stock, $0.50 par value, 10,000,000 shares authorized; 5,275,838 and 5,218,754 shares outstanding at December 31, 2017 and 2016, respectively	2,638	2,610
Preferred stock, $0.50 par value, 10,000,000 shares authorized; no shares issued	—	—
Paid-in capital	804,008	592,350
Accumulated other comprehensive loss, net of tax	(34,221)	(43,530)
Retained earnings	594,556	550,482
Treasury stock, at cost, 4,823,988 and 6,322,650 shares of Common stock and 48,263 and 48,263 shares of Class B common stock at December 31, 2017 and 2016, respectively	(87,440)	(114,425)
Total Watsco, Inc. shareholders' equity	1,297,953	1,005,828
Non-controlling interest	253,024	245,920
Total shareholders' equity	1,550,977	1,251,748
	$2,046,877	$1,874,649

See accompanying notes to consolidated financial statements.

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

(In thousands, except share and per share data)	Common Stock, Class B Common Stock and Preferred Stock Shares	Common Stock, Class B Common Stock and Preferred Stock Amount	Paid-In Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Treasury Stock	Non-controlling Interest	Total
Balance at December 31, 2014	**35,006,621**	**$ 20,689**	**$580,564**	**$ (23,747)**	**$420,879**	**$(114,425)**	**$248,079**	**$1,132,039**
Net income					172,929		53,595	226,524
Other comprehensive loss				(23,157)			(15,509)	(38,666)
Issuances of non-vested restricted shares of common stock	200,479	100	(100)					—
Forfeitures of non-vested restricted shares of common stock	(5,000)	(2)	2					—
Common stock contribution to 401(k) plan	18,343	9	1,954					1,963
Stock issuances from exercise of stock options and employee stock purchase plan	124,262	62	8,570					8,632
Retirement of common stock	(33,212)	(17)	(4,123)					(4,140)
Share-based compensation			13,233					13,233
Excess tax benefit from share-based compensation			2,422					2,422
Cash dividends declared and paid on Common and Class B common stock, $2.80 per share					(98,532)			(98,532)
Distributions to non-controlling interest							(39,754)	(39,754)
Balance at December 31, 2015	**35,311,493**	**20,841**	**602,522**	**(46,904)**	**495,276**	**(114,425)**	**246,411**	**1,203,721**

Continued on next page.

(In thousands, except share and per share data)	Common Stock, Class B Common Stock and Preferred Stock Shares	Common Stock, Class B Common Stock and Preferred Stock Amount	Paid-In Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Treasury Stock	Non-controlling Interest	Total
Balance at December 31, 2015	**35,311,493**	**20,841**	**602,522**	**(46,904)**	**495,276**	**(114,425)**	**246,411**	**1,203,721**
Net income					182,810		53,173	235,983
Other comprehensive gain				3,374			2,209	5,583
Issuances of non-vested restricted shares of common stock	183,144	92	(92)					—
Forfeitures of non-vested restricted shares of common stock	(26,000)	(13)	13					—
Common stock contribution to 401(k) plan	20,045	10	2,338					2,348
Stock issuances from exercise of stock options and employee stock purchase plan	72,482	36	5,660					5,696
Retirement of common stock	(30,761)	(15)	(4,003)					(4,018)
Share-based compensation			11,848					11,848
Cash dividends declared and paid on Common and Class B common stock, $3.60 per share					(127,604)			(127,604)
Decrease in non-controlling interest in Carrier Enterprise II			(25,936)				(16,973)	(42,909)
Distributions to non-controlling interest							(38,900)	(38,900)
Balance at December 31, 2016	**35,530,403**	**20,951**	**592,350**	**(43,530)**	**550,482**	**(114,425)**	**245,920**	**1,251,748**

Continued on next page.

(In thousands, except share and per share data)	**Common Stock, Class B Common Stock and Preferred Stock Shares**	**Common Stock, Class B Common Stock and Preferred Stock Amount**	**Paid-In Capital**	**Accumulated Other Comprehensive Loss**	**Retained Earnings**	**Treasury Stock**	**Non-controlling Interest**	**Total**
Balance at December 31, 2016	**35,530,403**	**20,951**	**592,350**	**(43,530)**	**550,482**	**(114,425)**	**245,920**	**1,251,748**
Net income					208,221		49,069	257,290
Other comprehensive gain				9,309			5,609	14,918
Issuances of non-vested restricted shares of common stock	176,899	88	(88)					—
Forfeitures of non-vested restricted shares of common stock	(10,000)	(5)	5					—
Common stock contribution to 401(k) plan	16,389	8	2,420					2,428
Stock issuances from exercise of stock options and employee stock purchase plan	49,166	24	5,263					5,287
Retirement of common stock	(32,804)	(16)	(4,701)					(4,717)
Share-based compensation			13,536					13,536
Net proceeds from the sale of Common stock	1,498,662		220,448			26,985		247,433
Cash dividends declared and paid on Common and Class B common stock, $4.60 per share					(164,147)			(164,147)
Investment in unconsolidated entity							12,720	12,720
Decrease in non-controlling interest in Carrier Enterprise II			(25,225)				(17,463)	(42,688)
Distributions to non-controlling interest							(42,831)	(42,831)
Balance at December 31, 2017	**37,228,715**	**$ 21,050**	**$804,008**	**$ (34,221)**	**$ 594,556**	**$ (87,440)**	**$253,024**	**$1,550,977**

See accompanying notes to consolidated financial statements.

WATSCO, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)	Years Ended December 31, 2017	2016	2015
Cash flows from operating activities:			
Net income	$ 257,290	$ 235,983	$ 226,524
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	22,033	20,066	19,117
Share-based compensation	13,293	12,319	12,596
Deferred income tax (benefit) provision	(10,735)	2,720	4,687
Provision for doubtful accounts	1,991	3,487	2,688
Non-cash contribution to 401(k) plan	2,428	2,348	1,963
Other income from investment in unconsolidated entity	(3,886)	—	—
Loss (gain) on sale of property and equipment	115	(189)	(487)
Excess tax benefits from share-based compensation	—	—	(2,422)
Changes in operating assets and liabilities:			
Accounts receivable	(1,676)	(26,941)	(26,121)
Inventories	(73,403)	(9,729)	(3,652)
Accounts payable and other liabilities	99,956	43,734	(11,760)
Other, net	(886)	(2,067)	(285)
Net cash provided by operating activities	306,520	281,731	222,848
Cash flows from investing activities:			
Investment in unconsolidated entity	(63,600)	—	—
Capital expenditures	(17,876)	(43,577)	(23,698)
Proceeds from sale of property and equipment	168	744	760
Net cash used in investing activities	(81,308)	(42,833)	(22,938)
Cash flows from financing activities:			
Net repayments under revolving credit agreement	(213,494)	(10,006)	(56,256)
Dividends on Common and Class B common stock	(164,147)	(127,604)	(98,532)
Purchase of additional ownership from non-controlling interest	(42,688)	(42,909)	—
Distributions to non-controlling interest	(42,831)	(38,900)	(39,754)
Repurchases of common stock to satisfy employee withholding tax obligations	(4,674)	(3,975)	(1,465)
Net repayments of other long-term obligations	(19)	(150)	(157)
Excess tax benefits from share-based compensation	—	—	2,422
Net proceeds from issuances of common stock	5,244	5,653	5,957
Proceeds from non-controlling interest for investment in unconsolidated entity	12,720	—	—
Net proceeds from the sale of Common stock	247,744	—	—
Net cash used in financing activities	(202,145)	(217,891)	(187,785)
Effect of foreign exchange rate changes on cash and cash equivalents	1,419	(226)	(1,343)
Net increase in cash and cash equivalents	24,486	20,781	10,782
Cash and cash equivalents at beginning of year	56,010	35,229	24,447
Cash and cash equivalents at end of year	$ 80,496	$ 56,010	$ 35,229
Supplemental cash flow information (Note 19)			

See accompanying notes to consolidated financial statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization, Consolidation and Presentation

Watsco, Inc. (collectively with its subsidiaries, "Watsco," "we," "us," or "our") was incorporated in Florida in 1956 and is the largest distributor of air conditioning, heating and refrigeration equipment and related parts and supplies ("HVAC/R") in the HVAC/R distribution industry in North America. At December 31, 2017, we operated from 560 locations in 37 U.S. states, Canada, Mexico, and Puerto Rico with additional market coverage on an export basis to portions of Latin America and the Caribbean.

The consolidated financial statements 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.

Foreign Currency Translation and Transactions

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

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

Equity Method Investments

Investments in which we have the ability to exercise significant influence, but do not control, are accounted for under the equity method of accounting and are included in other assets in our consolidated balance sheets. Under this method of accounting, our proportionate share of the net income or loss of the investee is included in other income in our consolidated statements of income. The excess, if any, of the carrying amount of our investment over our ownership percentage in the underlying net assets of the investee is attributed to certain fair value adjustments with the remaining portion recognized as goodwill.

Reclassifications

Certain reclassifications of prior year amounts have been made to conform to the 2017 presentation. These reclassifications had no effect on net income or earnings per share as previously reported.

Use of Estimates

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

Cash Equivalents

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

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable primarily consist of trade receivables due from customers and are stated at the invoiced amount less an allowance for doubtful accounts. An allowance for doubtful accounts is maintained for estimated losses resulting from the inability of customers to make required payments. When preparing these estimates, we consider a number of factors, including the aging of a customer's account, past transactions with customers, creditworthiness of specific customers, historical trends and other information. Upon determination that an account is uncollectible, the receivable balance is written off. At December 31, 2017 and 2016, the allowance for doubtful accounts totaled $6,049 and $6,169, respectively.

Inventories

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

Vendor Rebates

We have arrangements with several vendors that provide rebates payable to us when we achieve any of a number of measures, generally related to the volume level of purchases. We account for such rebates as a reduction of inventory until we sell the product, at which time such rebates are reflected as a reduction of cost of sales in our consolidated statements of income. Throughout the year, we estimate the amount of the rebate based on our estimate of purchases to date relative to the purchase levels that mark our progress toward earning the rebates. We continually revise our estimates of earned vendor rebates based on actual purchase levels. At December 31, 2017 and 2016, we had $11,621 and $9,926, respectively, of rebates recorded as a reduction of inventory. Substantially all vendor rebate receivables are collected within three months immediately following the end of the year.

Marketable Securities

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

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization of property and equipment is computed using the straight-line method. Buildings and improvements are depreciated or amortized over estimated useful lives ranging from 3-40 years. Leasehold improvements are amortized over the shorter of the respective lease terms or estimated useful lives. Furniture and fixtures are depreciated over estimated useful lives ranging from 5-7 years. Estimated useful lives for other depreciable assets range from 3-10 years.

Goodwill and Intangible Assets

Goodwill is recorded when the purchase price paid for an acquisition exceeds the fair value of the net identified tangible and intangible assets acquired. We evaluate goodwill for impairment annually or more frequently when an event occurs or circumstances change that indicate that the carrying value may not be recoverable. We test goodwill for impairment by first comparing the fair value of our reporting unit to its carrying value. If the fair value is determined to be less than the carrying value, a second step is performed to measure the amount of impairment loss. On January 1, 2018, we performed our annual evaluation of goodwill impairment and determined that the estimated fair value of our reporting unit significantly exceeded its carrying value.

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

We perform our annual impairment tests each year and have determined there to be no impairment for any of the periods presented. There were no events or circumstances identified from the date of our assessment that would require an update to our annual impairment tests.

Long-Lived Assets

Long-lived assets, other than goodwill and intangible assets, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. Recoverability is evaluated by determining whether the amortization of the balance over its remaining life can be recovered through undiscounted future operating cash flows. We measure the impairment loss based on projected discounted cash flows using a discount rate reflecting the average cost of funds and compared to the asset’s carrying value. As of December 31, 2017 there were no such events or circumstances.

Fair Value Measurements

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

Level 1 Quoted prices in active markets for identical assets or liabilities. An active market for an asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2 Observable inputs other than Level 1 prices such as quoted prices in active markets for similar assets or liabilities; quoted prices in markets that are not active; or model-driven valuations or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs for the asset or liability. These inputs reflect our own assumptions about the assumptions a market participant would use in pricing the asset or liability.

Revenue Recognition

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

Advertising Costs

Advertising costs are expensed as incurred. Advertising expense for the years ended December 31, 2017, 2016 and 2015, were $24,677, $22,242 and $21,150, respectively.

Shipping and Handling

Shipping and handling costs associated with inbound freight are capitalized to inventories and relieved through cost of sales as inventories are sold. Shipping and handling costs associated with the delivery of products is included in selling, general and administrative expenses. Shipping and handling costs included in selling, general and administrative expenses for the years ended December 31, 2017, 2016 and 2015, were $47,670, $42,809 and $41,345, respectively.

Share-Based Compensation

The fair value of stock option and non-vested restricted stock awards are expensed net of estimated forfeitures on a straight-line basis over the vesting period of the awards. Share-based compensation expense is included in selling, general and administrative expenses in our consolidated statements of income. Cash flows from the tax benefits resulting from tax deductions in excess of the compensation expense recognized for those options (windfall tax benefits) were classified as financing cash flows for the year ended December 31, 2015. Tax benefits resulting from tax deductions in excess of share-based compensation expense realized in 2017 and 2016 are recognized in our provision for income taxes in the consolidated statements of income. Tax benefits resulting from tax deductions in excess of share-based compensation expense recognized were credited to paid-in capital in the consolidated balance sheet for the year ended December 31, 2015.

Income Taxes

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

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

Earnings per Share

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

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

Derivative Instruments and Hedging Activity

We have used derivative instruments, including forward and option contracts and swaps, to manage our exposure to fluctuations in foreign currency exchange rates and interest rates. The use of these derivative instruments modifies the exposure of these risks with the intent to reduce the risk or cost to us. We use derivative instruments as risk management tools and not for trading purposes. All derivatives, whether designated as hedging relationships or not, are recorded on the balance sheet at fair value. Cash flows from derivative instruments are classified in the consolidated statements of cash flows in the same category as the cash flows from the items subject to the designated hedge or undesignated (economic) hedge relationships. The hedging designation may be classified as one of the following:

No Hedging Designation. The gain or loss on a derivative instrument not designated as an accounting hedging instrument is recognized in earnings within selling, general and administrative expenses.

Cash Flow Hedge. A hedge of a forecasted transaction or of the variability of cash flows to be received or paid related to a recognized asset or liability is considered a cash flow hedge. The effective portion of the change in the fair value of a derivative that is designated as a cash flow hedge is recorded in other comprehensive income and reclassified to earnings as a component of cost of sales in the period for which the hedged transaction affects earnings. Ineffective portions of changes in the fair value of cash flow hedges are recognized in earnings.

Fair Value Hedge. A hedge of a recognized asset or liability or an unrecognized firm commitment is considered a fair value hedge. Fair value hedges, both the effective and ineffective portions of the changes in the fair value of the derivative, along with the gain or loss on the hedged item that is attributable to the hedged risk, are recorded in earnings.

See Note 14 for additional information pertaining to derivative instruments.

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. In 2015 and 2016, the FASB issued various updates to this standard. The standard and its related amendments (collectively, the “New Revenue Standard”) are effective for interim and annual reporting periods beginning after December 15, 2017. The New Revenue Standard is effective for us on January 1, 2018. We will adopt the New Revenue Standard using the modified retrospective approach.

The adoption of the New Revenue Standard will not have a material impact on the amount and timing of our revenue recognition. The New Revenue Standard requires ongoing incremental disclosures, including the disaggregation of revenue into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors.

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 became effective for interim and annual reporting periods beginning after December 15, 2016. The adoption of this guidance did not have a material impact on our consolidated financial statements.

Classification of Deferred Taxes

In November 2015, the FASB issued guidance that requires deferred tax assets and liabilities to be classified as noncurrent in a classified balance sheet. This guidance may be applied either prospectively or retrospectively and became effective for interim and annual reporting periods beginning after December 15, 2016. The adoption of this guidance on January 1, 2017 using the prospective approach did not have a material impact on our consolidated financial statements.

Financial Instruments

In January 2016, the FASB issued guidance related to certain aspects of recognition, measurement, presentation and disclosure of financial instruments. Most prominent among the changes to the standard is the requirement for changes in the fair value of equity investments, with certain exceptions, to be recognized through net income rather than other comprehensive income. This guidance will be applied using a modified retrospective approach through a cumulative-effect adjustment to retained earnings and is effective for interim and annual periods beginning after December 15, 2017. A cumulative-effect adjustment will capture any previously held unrealized gains and losses related to our equity investments carried at fair value. We do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

Leases

In February 2016, the FASB issued guidance on accounting for leases, which requires lessees to recognize most leases on their balance sheets for the rights and obligations created by those leases. The guidance requires enhanced disclosures regarding the amount, timing and uncertainty of cash flows arising from leases. This guidance will be applied using a modified retrospective approach and is effective for interim and annual periods beginning after December 15, 2018 with early adoption permitted. We will adopt this guidance on January 1, 2019. While we are still evaluating the impact of adopting this guidance on our consolidated financial statements, including the option to elect certain practical expedients, we expect that, upon adoption, the right-of-use assets and lease liabilities recorded could be material to our consolidated balance sheets. However, we do not expect a material impact on our consolidated statements of income.

Intangibles—Goodwill and Other

In January 2017, the FASB issued guidance to simplify the subsequent measurement of goodwill by eliminating Step 2 from the goodwill impairment test. Under this updated standard, an entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value, but the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. An entity also should consider income tax effects from any tax-deductible goodwill on the carrying amount of the reporting unit when measuring the goodwill impairment loss, if any. This guidance is effective prospectively and is effective for interim and annual periods beginning after December 15, 2019 with early adoption permitted. We do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

Stock Compensation

In May 2017, the FASB issued guidance to clarify when to account for a change to the terms or conditions of a share-based payment award as a modification. Under the new guidance, modification accounting is required only if the fair value, the vesting conditions or the classification of the award (as equity or liability) changes as a result of the change in terms or conditions. This guidance is effective prospectively and is effective for interim and annual periods beginning after December 15, 2017 with early adoption permitted. We do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

Derivatives and Hedging

In August 2017, the FASB issued guidance to simplify the accounting for hedging derivatives. This guidance is effective prospectively and is effective for interim and annual periods beginning after December 15, 2018 with early adoption permitted. We do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

2. EARNINGS PER SHARE

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

Years Ended December 31,	2017	2016	2015
Basic Earnings per Share:			
Net income attributable to Watsco, Inc. shareholders	**$ 208,221**	$ 182,810	$ 172,929
Less: distributed and undistributed earnings allocated to non-vested restricted common stock	**17,430**	14,806	13,634
Earnings allocated to Watsco, Inc. shareholders	**$ 190,791**	$ 168,004	$ 159,295
Weighted-average common shares outstanding—Basic	**32,824,947**	32,582,385	32,435,961
Basic earnings per share for Common and Class B common stock	**$ 5.81**	$ 5.16	$ 4.91
Allocation of earnings for Basic:			
Common stock	**$ 175,667**	$ 154,021	$ 146,037
Class B common stock	**15,124**	13,983	13,258
	$ 190,791	$ 168,004	$ 159,295
Diluted Earnings per Share:			
Net income attributable to Watsco, Inc. shareholders	**$ 208,221**	$ 182,810	$ 172,929
Less: distributed and undistributed earnings allocated to non-vested restricted common stock	**17,427**	14,801	13,626
Earnings allocated to Watsco, Inc. shareholders	**$ 190,794**	$ 168,009	$ 159,303
Weighted-average common shares outstanding—Basic	**32,824,947**	32,582,385	32,435,961
Effect of dilutive stock options	**37,686**	34,119	44,395
Weighted-average common shares outstanding—Diluted	**32,862,633**	32,616,504	32,480,356
Diluted earnings per share for Common and Class B common stock	**$ 5.81**	$ 5.15	$ 4.90

Diluted earnings per share for our Common stock assumes the conversion of all of our Class B common stock into Common stock as of the beginning of the fiscal year; therefore, no allocation of earnings to Class B common stock is required. At December 31, 2017, 2016 and 2015, our outstanding Class B common stock was convertible into 2,601,996, 2,711,811 and 2,699,710 shares of our Common stock, respectively.

Diluted earnings per share excluded 11,664, 31,839 and 67,014 shares for the years ended December 31, 2017, 2016 and 2015, respectively, related to stock options with an exercise price per share greater than the average market value, resulting in an anti-dilutive effect on diluted earnings per share.

3. OTHER COMPREHENSIVE GAIN (LOSS)

Other comprehensive gain (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 gains (losses) on cash flow hedging instruments and available-for-sale securities. The tax effects allocated to each component of other comprehensive loss were as follows:

Years Ended December 31,	2017	2016	2015
Foreign currency translation adjustment	**$15,993**	$ 6,211	$(39,378)
Unrealized (loss) gain on cash flow hedging instruments	**(961)**	(1,321)	3,716
Income tax benefit (expense)	**259**	356	(1,003)
Unrealized (loss) gain on cash flow hedging instruments, net of tax	**(702)**	(965)	2,713
Reclassification of (gain) loss on cash flow hedging instruments into earnings	**(491)**	442	(2,730)
Income tax expense (benefit)	**133**	(119)	737
Reclassification of (gain) loss on cash flow hedging instruments into earnings, net of tax	**(358)**	323	(1,993)
Unrealized gain (loss) on available-for-sale securities	**51**	27	(12)
Income tax (expense) benefit	**(66)**	(13)	4
Unrealized (loss) gain on available-for-sale securities, net of tax	**(15)**	14	(8)
Other comprehensive gain (loss)	**$14,918**	$ 5,583	$(38,666)

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

Years Ended December 31,	2017	2016	2015
Foreign currency translation adjustment:			
Beginning balance	**$(43,459)**	$(47,204)	$(23,623)
Current period other comprehensive gain (loss)	**9,960**	3,745	(23,581)
Ending balance	**(33,499)**	(43,459)	(47,204)
Cash flow hedging instruments:			
Beginning balance	**215**	600	168
Current period other comprehensive (loss) income	**(421)**	(579)	1,628
Less reclassification adjustment	**(215)**	194	(1,196)
Ending balance	**(421)**	215	600
Available-for-sale securities:			
Beginning balance	**(286)**	(300)	(292)
Current period other comprehensive (loss) income	**(15)**	14	(8)
Ending balance	**(301)**	(286)	(300)
Accumulated other comprehensive loss, net of tax	**$(34,221)**	$(43,530)	$(46,904)

4. SUPPLIER CONCENTRATION

Purchases from our top ten suppliers comprised 84%, 85% and 84% of all purchases made in 2017, 2016 and 2015, respectively. Our largest supplier, Carrier and its affiliates, accounted for 62% of all purchases made in 2017, 2016 and 2015. See Note 17. A significant interruption by Carrier, or any of our other key suppliers, in the delivery of products could impair our ability to maintain current inventory levels and could materially impact our consolidated results of operations and consolidated financial position.

5. PROPERTY AND EQUIPMENT

Property and equipment, net, consists of:

December 31,	2017	2016
Land	$ **820**	$ 820
Buildings and improvements	**74,486**	71,082
Machinery, vehicles and equipment	**76,117**	74,640
Furniture and fixtures	**15,282**	15,090
Computer hardware and software	**47,377**	42,515
	214,082	204,147
Accumulated depreciation and amortization	**(122,884)**	(113,645)
	$ **91,198**	$ 90,502

Depreciation and amortization expense related to property and equipment included in selling, general and administrative expenses for the years ended December 31, 2017, 2016 and 2015, were $16,770, $14,853 and $13,802, respectively.

6. DEBT

We maintain an unsecured, syndicated revolving credit agreement, which we use to fund seasonal working capital needs and for other general corporate purposes, including acquisitions, dividends (if and as declared by our Board of Directors), capital expenditures, stock repurchases and issuances of letters of credit. Effective February 5, 2018, we decreased the borrowing capacity under this credit agreement from $600,000 to $300,000. Included in the credit facility are a $90,000 swingline subfacility, a $10,000 letter of credit subfacility and a $75,000 multicurrency borrowing sublimit. The credit agreement matures on July 1, 2019.

Borrowings under the credit facility bear interest at either LIBOR-based rates plus a spread, which ranges from 87.5 to 250.0 basis-points (LIBOR plus 87.5 basis-points at December 31, 2017), depending on our ratio of total debt to EBITDA, or on rates based on the higher of the Prime rate or the Federal Funds Rate, in each case plus a spread which ranges from 0 to 150.0 basis-points (0 basis-points at December 31, 2017), depending on our ratio of total debt to EBITDA. We pay a variable commitment fee on the unused portion of the commitment under the revolving credit agreement, ranging from 12.5 to 35.0 basis-points (12.5 basis-points at December 31, 2017).

At December 31, 2017 and 2016, $21,800 and $235,294, respectively, were outstanding under the revolving credit agreement. The revolving credit agreement contains customary affirmative and negative covenants, including financial covenants with respect to consolidated leverage and interest coverage ratios, and other customary restrictions. We believe we were in compliance with all covenants at December 31, 2017.

7. INCOME TAXES

On December 22, 2017, Public Law 115-97 *"An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018"* was enacted. This law is commonly referred to as the Tax Cuts and Jobs Act of 2017 (the "TCJA"). The TCJA made broad and complex changes to the U.S. tax code including but not limited to, reducing the U.S. federal corporate tax rate from 35% to 21% effective January 1, 2018 and requiring a one-time repatriation transition tax on certain undistributed earnings of foreign subsidiaries. The TCJA also put in place new tax laws that will apply prospectively, which include, but are not limited to, generally eliminating U.S. federal income taxes on dividends from foreign subsidiaries and a new provision designed to tax U.S. allocated expenses as well as currently taxing certain global intangible low-taxed income ("GILTI") of foreign subsidiaries. GILTI is a tax on foreign income in excess of a deemed return on tangible assets of foreign corporations. We have not yet determined our policy election with respect to whether to record deferred taxes for basis differences expected to reverse as a result of the GILTI provisions in future years, or in the period in which that tax was incurred.

U.S. GAAP requires the impact of tax legislation to be recorded in the period of enactment. As a result, our 2017 effective income tax rate reflects a net income tax benefit of $9,955 attributable to the passage of the TCJA. This amount includes an income tax benefit from the revaluation of U.S. deferred income taxes, partially offset by an estimate for income tax expense to record U.S. federal, state and foreign withholding tax on previously undistributed earnings of our foreign subsidiaries. Due to the enactment date and tax complexities of the TCJA, we have not completed the accounting related to these items. In accordance with Staff Accounting Bulletin 118, provisional amounts have been recorded for the U.S. income tax attributable to the TCJA's deemed repatriation provision and the revaluation of U.S. deferred taxes. These estimates may be impacted by the need for further analysis and future clarification and guidance regarding available tax accounting methods and elections, earnings and profits computations, and state tax conformity to federal tax changes.

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

Years Ended December 31,	2017	2016	2015
U.S. Federal	**$ 69,079**	$ 86,719	$ 85,585
State	**10,643**	9,801	9,431
Foreign	**10,499**	9,416	9,661
	$ 90,221	$105,936	$104,677
Current	**$100,956**	$103,216	$ 99,990
Deferred	**(10,735)**	2,720	4,687
	$ 90,221	$105,936	$104,677

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

Following is a reconciliation of the effective income tax rate:

Years Ended December 31,	2017	2016	2015
U.S. federal statutory rate	**35.0%**	35.0%	35.0%
State income taxes, net of federal benefit and other	**2.4**	2.3	2.4
Excess tax benefits from share-based compensation	**(2.7)**	(1.0)	—
Tax effects on foreign income	**(1.0)**	(0.1)	(0.3)
Tax credits and other	**(0.6)**	(0.2)	(0.1)
Repatriation transition tax	**3.0**	—	—
Deferred tax impact of enacted tax rate changes	**(6.3)**	—	—
Effective income tax rate attributable to Watsco, Inc.	**29.8**	36.0	37.0
Taxes attributable to non-controlling interest	**(3.8)**	(5.0)	(5.4)
Effective income tax rate	**26.0%**	31.0%	31.6%

The following is a summary of the significant components of our net deferred tax liabilities:

December 31,	**2017**	**2016**
Deferred tax assets:		
Share-based compensation	**$ 18,977**	$ 26,239
Capitalized inventory costs and inventory reserves	**2,107**	2,301
Allowance for doubtful accounts	**929**	1,379
Self-insurance reserves	**153**	500
Other	**2,423**	2,227
Net operating loss carryforwards	**291**	209
	24,880	32,855
Valuation allowance	**—**	—
Total deferred tax assets	**24,880**	32,855
Deferred tax liabilities:		
Deductible goodwill	**(67,246)**	(88,581)
Depreciation	**(5,519)**	(5,883)
Other	**(5,189)**	(1,633)
Total deferred tax liabilities	**(77,954)**	(96,097)
Net deferred tax liabilities (1)	**$(53,074)**	$(63,242)

(1) *At December 31, 2017, net deferred tax liabilities have been included in the consolidated balance sheet in deferred income taxes and other liabilities. At December 31, 2016, net current deferred tax assets and liabilities of $5,485 are included in the consolidated balance sheet in other current assets and net long-term deferred tax assets and liabilities of $68,727 are included in the consolidated balance sheet in deferred income taxes and other liabilities.*

Prior to enactment of the TCJA, U.S. income taxes had not been provided on undistributed earnings of our foreign subsidiaries as we had intended to reinvest such earnings permanently outside the U.S. or to repatriate such earnings only when it was tax effective to do so. As a result of the enactment of the TCJA, we have provided an estimate related to the repatriation transition tax and foreign withholding tax on certain undistributed earnings of our foreign subsidiaries at December 31, 2017. Our intent going forward is to indefinitely reinvest undistributed earnings outside of the U.S. or to repatriate the earnings only when it is tax effective to do so.

Valuation allowances are provided to reduce the related deferred income tax assets to an amount which will, more likely than not, be realized. As a result of our assessment of the realization of deferred income tax assets, we have concluded that it is more likely than not that all of our deferred income tax assets will be realized and thus no valuation allowance was necessary at both December 31, 2017 and 2016. At December 31, 2017, there were state net operating loss carryforwards of $7,606, which expire in varying amounts from 2018 through 2037. These amounts are available to offset future taxable income. There were no federal net operating loss carryforwards at December 31, 2017.

We are subject to United States federal income tax, income tax of multiple state jurisdictions and foreign income tax. We are subject to tax audits in the various jurisdictions until the respective statutes of limitations expire. We are no longer subject to United States federal tax examinations for tax years prior to 2014. For the majority of states and foreign jurisdictions, we are no longer subject to tax examinations for tax years prior to 2013.

As of December 31, 2017 and 2016, the total amount of gross unrecognized tax benefits (excluding the federal benefit received from state positions) was $4,225 and $3,695, respectively. Of these totals, $3,457 and $2,573, respectively, (net of the federal benefit received from state positions) represent the amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate. Our continuing practice is to recognize penalties within selling, general and administrative expenses and interest related to income tax matters in income tax expense in the consolidated statements of income. As of December 31, 2017 and 2016, the cumulative amount of estimated accrued interest and penalties resulting from such unrecognized tax benefits was $540 and $414, respectively, and is included in deferred income taxes and other liabilities in the accompanying consolidated balance sheets.

The changes in gross unrecognized tax benefits are as follows:

Balance at December 31, 2014	$ 3,719
Additions based on tax positions related to the current year	871
Reductions due to lapse of applicable statute of limitations and tax assessments	(1,077)
Balance at December 31, 2015	3,513
Additions based on tax positions related to the current year	547
Reductions due to lapse of applicable statute of limitations	(365)
Balance at December 31, 2016	3,695
Additions based on tax positions related to the current year	801
Reductions due to lapse of applicable statute of limitations	(271)
Balance at December 31, 2017	**$ 4,225**

8. SHARE-BASED COMPENSATION AND BENEFIT PLANS

Share-Based Compensation Plans

We maintain the 2014 Incentive Compensation Plan (the “2014 Plan”) that provides for the award of a broad variety of share-based compensation alternatives such as non-vested restricted stock, non-qualified stock options, incentive stock options, performance awards, dividend equivalents, deferred stock and stock appreciation rights at no less than 100% of the market price on the date the award is granted. To date, awards under the 2014 Plan consist of non-qualified stock options and non-vested restricted stock. The 2014 Plan replaced the Watsco, Inc. Amended and Restated 2001 Incentive Compensation Plan (the “2001 Plan”) upon its expiration in 2014.

Under the 2014 Plan, the number of shares of Common and Class B common stock available for issuance is (i) 2,000,000, plus (ii) 45,421 shares of Common stock or Class B common stock that remained available for grant in connection with awards under the 2001 Plan as of the date our shareholders approved the 2014 Plan plus (iii) shares underlying currently outstanding awards issued under the 2001 Plan, which shares become reissuable under the 2014 Plan to the extent that such underlying shares are not issued due to their forfeiture, expiration, termination or otherwise. A total of 439,534 shares of Common stock, net of cancellations, and 493,522 shares of Class B common stock, had been awarded under the 2014 Plan as of December 31, 2017. As of December 31, 2017, 1,112,365 shares of common stock were reserved for future grants under the 2014 Plan. Options under the 2014 Plan vest over two to four years of service and have contractual terms of five years. Awards of non-vested restricted stock, which are granted at no cost to the employee, vest upon attainment of a specified age, generally toward the end of an employee’s career at age 62 or older. Vesting may be accelerated in certain circumstances prior to the original vesting date.

The 2001 Plan expired during 2014; therefore, no additional options may be granted. There were 12,750 options to exercise common stock outstanding under the 2001 Plan at December 31, 2017. Options under the 2001 Plan vest over two to four years of service and have contractual terms of five years.

The following is a summary of stock option activity under the 2014 Plan and the 2001 Plan as of and for the year ended December 31, 2017:

	Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Options outstanding at December 31, 2016	294,250	$ 122.80		
Granted	179,750	150.35		
Exercised	(39,751)	98.05		
Forfeited	(34,166)	139.40		
Expired	(1,250)	67.25		
Options outstanding at December 31, 2017	**398,833**	**$ 136.44**	**3.47**	**$ 13,401**
Options exercisable at December 31, 2017	**33,919**	**$ 121.65**	**2.80**	**$ 1,641**

The following is a summary of non-vested restricted stock activity as of and for the year ended December 31, 2017:

	Shares	Weighted-Average Grant Date Fair Value
Non-vested restricted stock outstanding at December 31, 2016	2,898,890	$ 54.13
Granted	176,899	149.47
Vested	(80,550)	50.05
Forfeited	(10,000)	134.71
Non-vested restricted stock outstanding at December 31, 2017	**2,985,239**	**$ 51.22**

The weighted-average grant date fair value of non-vested restricted stock granted during 2017, 2016 and 2015 was $149.47, $130.01 and $114.55, respectively. The fair value of non-vested restricted stock that vested during 2017, 2016 and 2015 was $11,580, $10,096 and $2,468, respectively.

During 2017, 32,454 shares of Common stock with an aggregate fair market value of $4,664 were withheld as payment in lieu of cash to satisfy tax withholding obligations in connection with the vesting of restricted stock. During 2016, 30,413 shares of Common and Class B common stock with an aggregate fair market value of $3,967 were withheld as payment in lieu of cash to satisfy tax withholding obligations in connection with the vesting of restricted stock. During 2015, 7,206 shares of Common stock with an aggregate fair market value of $889 were withheld as payment in lieu of cash to satisfy tax withholding obligations in connection with the vesting of restricted stock. These shares were retired upon delivery.

Share-Based Compensation Fair Value Assumptions

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

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

Years Ended December 31,	**2017**	**2016**	**2015**
Expected term in years	**4.25**	4.25	4.25
Risk-free interest rate	**1.77%**	1.24%	1.25%
Expected volatility	**17.41%**	18.65%	20.96%
Expected dividend yield	**2.82%**	2.54%	2.29%
Grant date fair value	**$17.23**	$16.37	$17.17

Exercise of Stock Options

The total intrinsic value of stock options exercised during 2017, 2016 and 2015 was $2,296, $4,123 and $6,691, respectively. Cash received from the exercise of stock options during 2017, 2016 and 2015 was $3,855, $4,447 and $4,850, respectively. During 2017, 2016 and 2015, 350 shares of Common stock with an aggregate fair market value of $53, 348 shares of Common stock with an aggregate fair market value of $51 and 26,006 shares of Class B common stock with an aggregate fair market value of $3,251, respectively, were withheld as payment in lieu of cash for stock option exercises and related tax withholdings. These shares were retired upon delivery.

Share-Based Compensation Expense

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

Years Ended December 31,	**2017**	2016	2015
Stock options	**$ 1,451**	$ 1,149	$ 952
Non-vested restricted stock	**11,842**	11,170	11,644
Share-based compensation expense	**$13,293**	$12,319	$12,596

At December 31, 2017, there was $2,703 of unrecognized pre-tax compensation expense related to stock options granted under the 2014 Plan and 2001 Plan, which is expected to be recognized over a weighted-average period of approximately 1.8 years. The total fair value of stock options that vested during 2017, 2016 and 2015 was $754, $736 and $856, respectively.

At December 31, 2017, there was $109,297 of unrecognized pre-tax compensation expense related to non-vested restricted stock, which is expected to be recognized over a weighted-average period of approximately 11 years. Of this amount, approximately $59,000 is related to awards granted to our Chief Executive Officer ("CEO"), of which approximately $11,000 and $48,000 vest in approximately 5 and 9 years upon his attainment of age 82 and 86, respectively. In the event that vesting is accelerated for any circumstance, as defined in the related agreements, the remaining unrecognized share-based compensation expense would be immediately recognized as a charge to earnings with a corresponding tax benefit. At December 31, 2017, we were obligated to issue 42,871 shares of non-vested restricted stock to our CEO that vest in 9 years and 13,779 shares of non-vested restricted stock to our President that vest in 26 years in connection with 2017 performance based incentive compensation.

Employee Stock Purchase Plan

The Watsco, Inc. Fourth Amended and Restated 1996 Qualified Employee Stock Purchase Plan (the "ESPP") provides for up to 1,500,000 shares of Common stock to be available for purchase by our full-time employees with at least 90 days of service. The ESPP allows participating employees to purchase shares of Common stock at a 5% discount to the fair market value at specified times. During 2017, 2016 and 2015, employees purchased 5,571, 5,956 and 6,463 shares of Common stock at an average price of $144.58, $125.84 and $112.53 per share, respectively. Cash dividends received by the ESPP were reinvested in Common stock and resulted in the issuance of 3,844, 3,442 and 3,183 additional shares during 2017, 2016 and 2015, respectively. We received net proceeds of $1,389, $1,206 and $1,107, respectively, during 2017, 2016 and 2015, for shares of our Common stock purchased under the ESPP. At December 31, 2017, 486,745 shares remained available for purchase under the ESPP.

401(k) Plan

We have a profit sharing retirement plan for our employees that is qualified under Section 401(k) of the Internal Revenue Code. Annual matching contributions are made based on a percentage of eligible employee compensation deferrals. The contribution has historically been made with the issuance of Common stock to the plan on behalf of our employees. For the years ended December 31, 2017, 2016 and 2015, we issued 16,389, 20,045 and 18,343 shares of Common stock, respectively, to the plan, representing the Common stock discretionary matching contribution of $2,428, $2,348 and $1,963, respectively.

9. PURCHASE OF ADDITIONAL OWNERSHIP INTEREST IN JOINT VENTURE

In 2011, we formed a joint venture with Carrier, Carrier Enterprise Northeast LLC, which we refer to as Carrier Enterprise II. Carrier Enterprise II had sales of approximately $545,000 in 2017 from 40 locations in the northeastern United States and 14 locations in Mexico. We initially owned a 60% controlling interest in Carrier Enterprise II. On November 29, 2016, we purchased an additional 10% ownership interest for cash consideration of $42,909, and, on February 13, 2017, we purchased an additional 10% ownership interest for cash consideration of $42,688, which together increased our controlling interest in Carrier Enterprise II to 80%.

10. INVESTMENT IN UNCONSOLIDATED ENTITY

On June 21, 2017, our first joint venture with Carrier, Carrier Enterprise, LLC, which we refer to as Carrier Enterprise I, acquired an approximately 35% ownership interest in Russell Sigler, Inc. ("RSI"), an HVAC distributor with annual sales of approximately $650,000, operating from 30 locations in the Western U.S. We have an 80% controlling interest in Carrier Enterprise I, and Carrier has a 20% non-controlling interest. Carrier Enterprise I acquired its ownership interest in RSI for cash consideration of $63,600, of which we contributed $50,880 and Carrier contributed $12,720. Carrier Enterprise I entered into a shareholders agreement (the "Shareholders Agreement") with RSI and its shareholders. Pursuant to the Shareholders Agreement, RSI's shareholders have the right to sell, and Carrier Enterprise I has the obligation to purchase, their respective shares of RSI for a purchase price determined based on either book value or a multiple of EBIT, the latter of which Carrier Enterprise I used to calculate the price paid for its investment in RSI. RSI's shareholders may transfer their respective shares of RSI common stock only to members of the Sigler family or to Carrier Enterprise I, and, at any time from and after the date on which Carrier Enterprise I owns 85% or more of RSI's outstanding common stock, it has the right, but not the obligation, to purchase from RSI's shareholders the remaining outstanding shares of RSI common stock. Additionally, Carrier Enterprise I has the right to appoint two of RSI's six board members. Given Carrier Enterprise I's 35% voting equity interest in RSI and its right to appoint two out of RSI's six board members, this investment in RSI is accounted for under the equity method.

11. GOODWILL AND INTANGIBLE ASSETS

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

Balance at December 31, 2015	$ 378,310
Foreign currency translation adjustment	1,427
Balance at December 31, 2016	379,737
Foreign currency translation adjustment	2,992
Balance at December 31, 2017	**$ 382,729**

Intangible assets are comprised of the following:

December 31,	Estimated Useful Lives	2017	2016
Indefinite lived intangible assets—Trade names, trademarks and distribution rights		**$125,194**	$120,288
Finite lived intangible assets:			
Customer relationships	10-15 years	**73,053**	70,194
Trade name	10 years	**1,150**	1,150
Non-compete agreements	7 years	**—**	369
Accumulated amortization		**(38,332)**	(33,437)
Finite lived intangible assets, net		**35,871**	38,276
		$161,065	$158,564

Amortization expense related to finite lived intangible assets included in selling, general and administrative expenses for the years ended December 31, 2017, 2016 and 2015, were $5,263, $5,213 and $5,315, respectively. Annual amortization of finite lived intangible assets for the next five years is expected to approximate the following:

2018	$4,900
2019	$4,900
2020	$4,900
2021	$4,200
2022	$3,500

12. SHAREHOLDERS' EQUITY

Common Stock

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

Preferred Stock

We are authorized to issue preferred stock with such designation, rights and preferences as may be determined from time to time by our Board of Directors. Accordingly, the Board of Directors is empowered, without shareholder approval, to issue preferred stock with dividend, liquidation, conversion, voting or other rights which could adversely affect the voting power or other rights of the holders of our Common stock and Class B common stock and, in certain instances, could adversely affect the market price of this stock. We had no preferred stock outstanding at December 31, 2017 or 2016.

At-the-Market Offering Program

On August 23, 2017, we entered into a sales agreement with Robert W. Baird & Co. Inc., which enabled the Company to issue and sell shares of Common stock in one or more negotiated transactions that are deemed to be "at the market" offerings as defined in Rule 415 under the Securities Act of 1933, as amended (the "Securities Act"), for a maximum aggregate offering amount of up to $250,000 (the "ATM Program"). The offer and sale of our Common stock pursuant to the ATM Program was registered under the Securities Act pursuant to our automatically effective shelf registration statement on Form S-3 (File No. 333-207831).

During 2017, we sold 1,498,662 shares of Common stock under the ATM Program for net proceeds of $247,744. Direct costs of $311 incurred in connection with the offering were charged against the proceeds from the sale of Common stock and reflected as a reduction of paid-in capital. As of December 31, 2017, we had completed the offering of shares under the ATM Program. The net proceeds were primarily used to repay outstanding debt and for general corporate purposes.

Stock Repurchase Plan

In September 1999, our Board of Directors authorized the repurchase, at management's discretion, of up to 7,500,000 shares of common stock in the open market or via private transactions. Shares repurchased under the program are accounted for using the cost method and result in a reduction of shareholders' equity. No shares were repurchased during 2017, 2016 or 2015. In aggregate, 6,322,650 shares of Common stock and 48,263 shares of Class B common stock have been repurchased at a cost of $114,425 since the inception of the program. At December 31, 2017, there were 1,129,087 shares remaining authorized for repurchase under the program.

13. FINANCIAL INSTRUMENTS

Recorded Financial Instruments

Recorded financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable, the current portion of long-term obligations, borrowings under our revolving credit agreement and debt instruments included in other long-term obligations. At December 31, 2017 and 2016, the fair values of cash and cash equivalents, accounts receivable, accounts payable and the current portion of long-term obligations approximated their carrying values due to the short-term nature of these instruments.

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

Off-Balance Sheet Financial Instruments

At both December 31, 2017 and 2016, we were contingently liable under standby letters of credit aggregating $2,430, which are primarily used as collateral to cover any contingency related to additional risk assessments pertaining to our self-insurance programs. Additionally, at December 31, 2017 and 2016, we were contingently liable under various performance bonds aggregating approximately $4,000 and $8,000, respectively, which are used as collateral to cover any contingencies related to our nonperformance under agreements with certain customers. We do not expect that any material losses or obligations will result from the issuance of the standby letters of credit or performance bonds because we expect to meet our obligations under our self-insurance programs and to certain customers in the ordinary course of business. Accordingly, the estimated fair value of these instruments is zero.

Concentrations of Credit Risk

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

14. DERIVATIVES

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

Cash Flow Hedging Instruments

We enter into foreign currency forward contracts that are designated as cash flow hedges. The settlement of these derivatives results in reclassifications from accumulated other comprehensive loss to earnings for the period in which the settlement of these instruments occurs. The maximum period for which we hedge our cash flow using these instruments is 12 months. Accordingly, at December 31, 2017, 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 December 31, 2017 was $29,500, and such contracts have varying terms expiring through September 2018.

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

Years Ended December 31,	2017	2016
Loss recorded in accumulated other comprehensive loss	**$(961)**	$(1,321)
Gain (loss) reclassified from accumulated other comprehensive loss into earnings	**$(491)**	$ 442

At December 31, 2017, we expected an estimated $962 pre-tax loss to be reclassified into earnings to reflect the fixed prices obtained from foreign exchange hedging within the next 12 months.

Derivatives Not Designated as Hedging Instruments

We have also entered into foreign currency forward and option contracts that are either not designated as hedges 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 December 31, 2017 was $11,200, and such contracts have varying terms expiring through August 2018.

We recognized (losses) gains of $(829), $(306) and $2,552 from foreign currency forward and option contracts not designated as hedging instruments in our consolidated statements of income for 2017, 2016 and 2015, respectively.

The following table summarizes the fair value of derivative instruments, which consist solely of foreign exchange contracts, included in other current assets and accrued expenses and other current liabilities in our consolidated balance sheets. See Note 15.

	Asset Derivatives		Liability Derivatives	
December 31,	2017	2016	2017	2016
Derivatives designated as hedging instruments	**$ 70**	$ 227	**$ 773**	$ 35
Derivatives not designated as hedging instruments	**180**	14	**184**	4
Total derivative instruments	**$ 250**	$ 241	**$ 957**	$ 39

15. FAIR VALUE MEASUREMENTS

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

	Balance Sheet Location	Total	Fair Value Measurements at December 31, 2017 Using Level 1	Level 2	Level 3
Assets:					
Available-for-sale securities	Other assets	**$332**	**$ 332**	—	—
Derivative financial instruments	Other current assets	**$250**	—	**$ 250**	—
Liabilities:					
Derivative financial instruments	Accrued expenses and other current liabilities	**$957**	—	**$ 957**	—

	Balance Sheet Location	Total	Fair Value Measurements at December 31, 2016 Using Level 1	Level 2	Level 3
Assets:					
Available-for-sale securities	Other assets	$281	$ 281	—	—
Derivative financial instruments	Other current assets	$241	—	$ 241	—
Liabilities:					
Derivative financial instruments	Accrued expenses and other current liabilities	$ 39	—	$ 39	—

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

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

Derivative financial instruments – these derivatives are foreign currency forward and option contracts. See Note 14. 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 2017 or 2016.

16. COMMITMENTS AND CONTINGENCIES

Litigation, Claims and Assessments

In December 2015, a purported Watsco shareholder, Nelson Gaskins (the "Plaintiff"), filed a derivative lawsuit in the U.S. District Court for the Southern District of Florida (the "Court") against Watsco's Board of Directors. The Company was a nominal defendant. The lawsuit alleged breach of fiduciary duties regarding CEO incentive compensation and sought to recover alleged excessive incentive compensation and unspecified damages. The Court dismissed this action, and the Plaintiff filed a notice of appeal to the U.S. Court of Appeals for the Eleventh Circuit (the "Appellate Court"). In May 2017, the Appellate Court dismissed the Plaintiff's appeal and the action with prejudice. Neither the Plaintiff nor the Plaintiff's lawyers received any payment from, or on behalf of, Watsco or its Directors in connection with this lawsuit and the related appeal.

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

Self-Insurance

Self-insurance reserves are maintained relative to company-wide casualty insurance and health benefit programs. The level of exposure from catastrophic events is limited by the purchase of stop-loss and aggregate liability reinsurance coverage. When estimating the self-insurance liabilities and related reserves, management considers a number of factors, which include historical claims experience, demographic factors, severity factors and valuations provided by independent third-party actuaries. Management reviews its assumptions with its independent third-party actuaries to evaluate whether the self-insurance reserves are adequate. If actual claims or adverse development of loss reserves occur and exceed these estimates, additional reserves may be required. Reserves in the amounts of $2,344 and $2,951 at December 31, 2017 and 2016, respectively, were established related to such programs and are included in accrued expenses and other current liabilities in our consolidated balance sheets.

Variable Interest Entity

As of December 31, 2017, in conjunction with our casualty insurance programs, limited equity interests are held in a captive insurance entity. The programs permit us to self-insure a portion of losses, to gain access to a wide array of safety-related services, to pool insurance risks and resources in order to obtain more competitive pricing for administration and reinsurance and to limit risk of loss in any particular year. The entity meets the definition of Variable Interest Entity ("VIE"); however, we do not meet the requirements to include this entity in the consolidated financial statements. The maximum exposure to loss related to our involvement with this entity is limited to approximately $4,200. See "Self-Insurance" above for further information on commitments associated with the insurance programs and Note 13, under the caption "Off-Balance Sheet Financial Instruments," for further information on standby letters of credit. At December 31, 2017, there were no other entities that met the definition of a VIE.

Operating Leases

We are obligated under various non-cancelable operating lease agreements for real property, equipment and vehicles used in our operations with varying terms through 2028. We are committed to pay a portion of the actual operating expenses under certain of these lease agreements. These operating expenses are not included in the table below. Some of these arrangements have free or escalating rent payment provisions. We recognize rent expense under such arrangements on a straight-line basis over the lease term.

At December 31, 2017, future minimum payments under non-cancelable operating leases over each of the next five years and thereafter were as follows:

2018	$ 69,136
2019	51,645
2020	36,127
2021	22,434
2022	12,985
Thereafter	5,824
Total minimum payments	$198,151

Rental expense for the years ended December 31, 2017, 2016 and 2015, was $84,076, $83,260 and $82,581, respectively.

Purchase Obligations

At December 31, 2017, we were obligated under various non-cancelable purchase orders with our key suppliers for goods aggregating approximately $11,000.

17. RELATED PARTY TRANSACTIONS

Purchases from Carrier and its affiliates comprised 62% of all inventory purchases made during 2017, 2016 and 2015. At December 31, 2017 and 2016, approximately $75,000 and $63,000, respectively, was payable to Carrier and its affiliates, net of receivables. Our joint ventures with Carrier also sell HVAC products to Carrier and its affiliates. Revenues in our consolidated statements of income for 2017, 2016 and 2015 included approximately $64,000, $56,000 and $62,000, respectively, of sales to Carrier and its affiliates. We believe these transactions are conducted on terms equivalent to an arm's-length basis in the ordinary course of business.

A member of our Board of Directors is the Chairman and Chief Executive Officer of Moss & Associates LLC, which serves as general contractor for the remodeling of our Miami headquarters. We paid Moss & Associates LLC $951 and $291 for construction services performed during 2017 and 2016, respectively, and $131 was payable at December 31, 2017.

A member of our Board of Directors is the Senior Chairman of Greenberg Traurig, P.A., which serves as our principal outside counsel and receives customary fees for legal services. During 2017, we paid this firm $475 for services performed and $0 was payable at December 31, 2017.

18. INFORMATION ABOUT GEOGRAPHIC AREAS

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

Years Ended December 31,	2017	2016	2015
Revenues:			
United States	**$3,919,684**	$3,813,204	$3,710,977
Canada	**269,603**	267,220	263,908
Mexico	**152,668**	140,278	138,354
Total revenues	**$4,341,955**	$4,220,702	$4,113,239

December 31,	2017	2016
Long-Lived Assets:		
United States	**$ 540,136**	$ 467,728
Canada	**163,944**	155,758
Mexico	**5,400**	5,317
Total long-lived assets	**$ 709,480**	$ 628,803

Revenues are attributed to countries based on the location of the store from which the sale occurred. Long-lived assets consist primarily of goodwill and intangible assets, property and equipment, and our investment in an unconsolidated entity.

19. SUPPLEMENTAL CASH FLOW INFORMATION

Supplemental cash flow information was as follows:

Years Ended December 31,	2017	2016	2015
Interest paid	**$ 5,773**	$ 3,362	$ 4,993
Income taxes net of refunds	**$48,056**	$99,006	$103,261

20. SUBSEQUENT EVENTS

On January 2, 2018, our Board of Directors declared a regular quarterly cash dividend of $1.25 per share of Common and Class B common stock that was paid on January 31, 2018 to shareholders of record as of January 16, 2018.

Effective February 5, 2018, we decreased the borrowing capacity under our credit agreement from $600,000 to $300,000. See Note 6.

On February 6, 2018, our Board of Directors approved an increase to the quarterly cash dividend per share of Common and Class B common stock to $1.45 per share from $1.25 per share, beginning with the dividend that will be paid in April 2018.

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

(In thousands, except per share data)	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Total
Year Ended December 31, 2017					
Revenues (1)	$872,095	$1,275,924	$1,229,591	$964,345	$4,341,955
Gross profit	$218,556	$ 310,278	$ 295,895	$240,930	$1,065,659
Net income attributable to Watsco, Inc.	$ 26,181	$ 73,756	$ 65,029	$ 43,255	$ 208,221
Earnings per share for Common and Class B common stock (2):					
Basic	$ 0.71	$ 2.07	$ 1.82	$ 1.19	$ 5.81
Diluted	$ 0.71	$ 2.07	$ 1.82	$ 1.19	$ 5.81
Year Ended December 31, 2016					
Revenues (1)	$851,424	$1,214,435	$1,241,232	$913,611	$4,220,702
Gross profit	$212,447	$ 291,861	$ 302,204	$228,072	$1,034,584
Net income attributable to Watsco, Inc.	$ 25,537	$ 64,621	$ 63,099	$ 29,553	$ 182,810
Earnings per share for Common and Class B common stock (2):					
Basic	$ 0.71	$ 1.82	$ 1.78	$ 0.81	$ 5.16
Diluted	$ 0.71	$ 1.82	$ 1.78	$ 0.81	$ 5.15

(1) *Sales of residential central air conditioners, heating equipment and parts and supplies are seasonal. Demand related to the residential central air conditioning replacement market is typically highest in the second and third quarters, and demand for heating equipment is usually highest in the fourth quarter. Demand related to the new construction sectors throughout most of the markets is fairly evenly distributed throughout the year except for dependence on housing completions and related weather and economic conditions.*

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

WATSCO, INC. AND SUBSIDIARIES
INFORMATION ON COMMON STOCK
(UNAUDITED)

Our Common stock is traded on the New York Stock Exchange (“NYSE”) under the ticker symbol WSO. Our Class B common stock is traded on the NYSE under the ticker symbol WSOB. The following table presents the high and low prices of our Common stock and Class B common stock, as reported by the NYSE. Also presented below are dividends paid per share for each quarter during the years ended December 31, 2017 and 2016. At February 23, 2018, there were 216 Common stock registered shareholders and 121 Class B common stock registered shareholders.

	Common		Class B Common		Cash Dividend	
	High	**Low**	**High**	**Low**	**Common**	**Class B**
Year Ended December 31, 2017:						
First quarter	$156.69	$143.00	$153.02	$143.00	$ 1.05	$ 1.05
Second quarter	155.46	135.45	157.14	134.10	1.05	1.05
Third quarter	161.07	142.30	160.15	146.26	1.25	1.25
Fourth quarter	171.38	159.30	170.22	160.15	1.25	1.25
Year Ended December 31, 2016:						
First quarter	$134.84	$108.09	$131.58	$108.25	$ 0.85	$ 0.85
Second quarter	140.69	129.00	139.84	129.17	0.85	0.85
Third quarter	149.64	138.37	148.67	138.85	0.85	0.85
Fourth quarter	159.03	130.88	157.72	131.01	1.05	1.05

EXHIBIT 21.1

SUBSIDIARIES OF THE REGISTRANT

The following table sets forth the significant subsidiaries of Watsco, Inc. as of December 31, 2017, and their respective incorporation jurisdictions. The names of various other wholly-owned subsidiaries have been omitted. None of the foregoing omitted subsidiaries, considered either alone or in the aggregate as a single subsidiary, constitutes a significant subsidiary.

Name of Subsidiary	State or Other Jurisdiction of Incorporation	Percent of Ownership
Baker Distributing Company LLC	Delaware	100%
Boreal International Corporation	Florida	100%
Carrier Enterprise Canada, L.P.	Ontario, Canada	60%
Carrier Enterprise Mexico S. de R.L. de C.V.	Mexico	80%
Carrier Enterprise, LLC	Delaware	80%
Carrier Enterprise Northeast, LLC	Delaware	80%
Carrier InterAmerica Corporation	United States Virgin Islands	80%
Carrier (Puerto Rico), Inc.	Delaware	80%
East Coast Metal Distributors LLC	Delaware	100%
Gemaire Distributors LLC	Delaware	100%
Heating & Cooling Supply LLC	California	100%
Tradewinds Distributing Company, LLC	Delaware	100%

EXHIBIT 23.1

Consent of Independent Registered Public Accounting Firm

The Board of Directors
Watsco, Inc.:

We consent to the incorporation by reference in the registration statements (No. 333-207831) on Form S-3 and (No. 333-197795, 333-185345 and 333-159776) on Form S-8 of Watsco, Inc. of our reports dated March 1, 2018 with respect to the consolidated balance sheets of Watsco, Inc. and subsidiaries (the Company) as of December 31, 2017 and 2016, and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2017, and the related notes (collectively, the "consolidated financial statements"), and the effectiveness of internal control over financial reporting of December 31, 2017, which reports appear in the December 31, 2017 annual report on Form 10-K of the Company.

/s/ KPMG LLP

Miami, Florida
March 1, 2018
Certified Public Accountants

EXHIBIT 31.1

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

I, Albert H. Nahmad, certify that:

1. I have reviewed this Annual Report on Form 10-K of Watsco, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

    a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

    b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

    c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of this annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

    a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

    b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 1, 2018

/s/ Albert H. Nahmad
Albert H. Nahmad
Chief Executive Officer

EXHIBIT 31.2

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

I, Barry S. Logan, certify that:

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

Date: March 1, 2018

/s/ Barry S. Logan

Barry S. Logan
Senior Vice President

EXHIBIT 31.3

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

I, Ana M. Menendez, certify that:

1. I have reviewed this Annual Report on Form 10-K of Watsco, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of this annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 1, 2018

/s/ Ana M. Menendez
Ana M. Menendez
Chief Financial Officer

EXHIBIT 32.1

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

In connection with the Annual Report of Watsco, Inc. (“Watsco”) on Form 10-K for the year ended December 31, 2017, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), Albert H. Nahmad, as Chief Executive Officer of Watsco, Barry S. Logan, as Senior Vice President of Watsco and Ana M. Menendez, as Chief Financial Officer of Watsco, each hereby certifies, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that, to our knowledge:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Watsco.

/s/ Albert H. Nahmad
Albert H. Nahmad
Chief Executive Officer
March 1, 2018

/s/ Barry S. Logan
Barry S. Logan
Senior Vice President
March 1, 2018

/s/ Ana M. Menendez
Ana M. Menendez
Chief Financial Officer
March 1, 2018

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

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