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

# FORM 10-K

[X] Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

FOR THE FISCAL YEAR ENDED DECEMBER 31, 1996

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, Coconut Grove, FL 33133
(Address of principal executive offices)

Registrant's telephone number, including area code: (305) 858-0828

Securities Registered Pursuant to Section 12(b) of the Act:

| TITLE OF EACH CLASS | NAME OF EACH EXCHANGE ON WHICH REGISTERED |
|---|---|
| Common Stock, $.50 par value | New York Stock Exchange |
| Class B Common Stock, $.50 par value | American Stock Exchange |

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 X 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 l0-K or any amendment to this Form l0-K. X

The aggregate market value of the voting stock held by non-affiliates of the Registrant as of March 25, 1997 was $355,359,855.

The number of shares of common stock outstanding as of March 25, 1997 was 14,987,621 shares of Common Stock and 2,213,897 shares of Class B Common Stock.

## DOCUMENTS INCORPORATED BY REFERENCE

Certain information required by Parts I and II is incorporated by reference from the Annual Report to Shareholders for the year ended December 31, 1996, attached hereto as Exhibit 13. The information required by Part III (Items 10, 11, 12 and 13) will be incorporated by reference from the Registrant's definitive proxy statement (to be filed pursuant to Regulation 14A).

## WATSCO, INC.

INDEX TO ANNUAL REPORT
ON FORM 10-K
YEAR ENDED DECEMBER 31, 1996

# PART I

This Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including statements regarding, among other items, (i) the Company's business and acquisition strategies, (ii) potential acquisitions by the Company, (iii) the use of the net proceeds from the Company's public offering, (iv) the Company's financing plans, and (v) industry, demographic and other trends affecting the Company's financial condition or results of operations. These forward-looking statements are based largely on the Company's expectations and are subject to a number of risks and uncertainties, certain of which are beyond the Company's control. Actual results could differ materially from these forward-looking statements as a result of several factors, including general economic conditions, prevailing interest rates, competitive factors and the ability of the Company to continue to implement its acquisition strategy. In light of these uncertainties, there can be no assurance that the forward-looking information contained herein will in fact transpire.

## ITEM 1. BUSINESS

### GENERAL

Watsco, Inc. (the "Registrant" or the "Company") is the largest distributor of residential central air conditioning and heating equipment and related parts and supplies in the United States. In 1989, the Company began a strategy of establishing a network of distribution facilities across the sunbelt where U.S. population growth is greatest, weather patterns are predictably hot and air conditioning is seen as a necessity. Since initiating its strategy, Watsco has acquired 16 distributors of air conditioning and heating equipment and the Company currently has strong market positions in 14 sunbelt states, including leading positions in Florida, Texas and California, the three largest air conditioning markets in the country, as well as five additional states in the midwest. The Company's revenues have increased from $25 million in 1988 to $425 million in 1996. The Company believes it is the only major company pursuing a consolidation strategy of making significant acquisitions in the highly fragmented air conditioning segment of the climate control industry.

The Company's distribution network currently conducts its distribution business through various subsidiaries: Gemaire Distributors, Inc. and its subsidiaries ("Gemaire"); Heating & Cooling Supply, Inc. ("Heating & Cooling"); Comfort Supply, Inc. and its subsidiaries ("Comfort Supply"); Central Air Conditioning Distributors, Inc. and its subsidiary ("CAC Distributors"); Three States Supply Company, Inc. ("Three States"); Coastline Distribution, Inc. ("Coastline"); A&C Distributors, Inc. (d/b/a Comfortmaker Distribution) ("Comfortmaker Distribution"); Comfort Products Distributing, Inc. ("Comfort Products"); and Central Plains Distributing, Inc. ("Central Plains") (collectively, the "Distribution Operations").

In addition to distributing air conditioning and heating equipment, the Company also produces over 4,000 electronic and mechanical components for air conditioning, heating and refrigeration equipment through its manufacturing subsidiaries: Watsco Components, Inc., Rho Sigma, Inc. and Cam-Stat, Inc. (the "Manufacturing Operations"). These components are sold to over 5,000 wholesale distribution locations and original equipment manufacturers.

The Company also owns Dunhill Staffing Systems, Inc. ("Dunhill"), a national provider of permanent and temporary personnel services to business, professional and service organizations, government agencies, health care providers and other employers.

The Company's principal executive offices are located at 2665 South Bayshore Drive, Suite 901, Coconut Grove, Florida 33133, and its telephone is (305) 858-0828.

RESIDENTIAL CENTRAL AIR CONDITIONING INDUSTRY

The Company estimates that the market for residential central air conditioning and heating equipment and related parts and supplies in the sunbelt was over $7 billion in 1996 and has grown at an annual rate of 6.3% since 1990. Residential central air conditioners are manufactured primarily by seven major companies that together account for substantially all units shipped in the U.S each year. These companies are: Carrier Corporation ("Carrier") (a subsidiary of United Technologies Corporation), Goodman Manufacturing Corporation, Rheem Manufacturing Company ("Rheem"), The Trane Company (a subsidiary of American Standard Companies Inc.), York Air Conditioning & Refrigeration, Inc., Inter-City Products Corporation ("Inter-City") and Lennox Industries, Inc. The major manufacturers distribute their products primarily through independent distributors who in turn supply the equipment and related parts and supplies to contractors and dealers nationwide who sell to, and install the products for, the consumer.

Residential central air conditioning and heating equipment is sold to the replacement and the homebuilding markets. The replacement market has increased substantially in size over the past ten years, surpassing the homebuilding market in significance as a result of the aging of the installed base of residential central air conditioners, the introduction of new energy efficient models and the upgrading of existing homes to central air conditioning. According to the Air Conditioning and Refrigeration Institute, over 72 million central air conditioner units have been installed in the United States since 1975, with approximately 60% of those units installed in the sunbelt. Many units installed from the mid-1970s to the mid-1980s are reaching the end of their useful lives, thus providing a growing replacement market. The mechanical life of central air conditioners varies by region due to usage and is estimated to range from eight to 12 years in Texas and Florida to approximately 18 years in California. These three states are the largest markets for air conditioning and heating equipment in the United States, based on annual unit sales.

BUSINESS AND ACQUISITION STRATEGY

The Company focuses on satisfying the needs of the higher margin replacement market, where customers generally demand immediate, convenient and reliable service. In response to this need, the Company has adopted a strategy of (i) offering complete product lines, including all equipment and components necessary to install or repair a central air conditioner or furnace, (ii) maintaining multiple warehouse locations in a single metropolitan market for increased customer convenience, and (iii) maintaining well-stocked inventories to ensure that customer orders are filled in a timely manner. The Company believes this strategy provides a competitive advantage over smaller, lesser-capitalized competitors who are unable to maintain the same inventory levels and product variety as the Company. The Company also believes it has a competitive advantage over factory-owned distributors who typically do not maintain inventories of all parts and supplies and whose limited number of warehouse locations make it difficult to meet the time-sensitive demands of the replacement market.

The Company also sells to the homebuilding market. The Company believes that its reputation for reliable, high quality service and its relationships with contractors, who generally serve both the replacement and new construction markets, allow it to compete effectively in this segment of the market. Homebuilding, in many of the markets the Company serves, remains below levels of the mid-1970s to mid-1980s. However, should homebuilding increase in those markets, the Company is well positioned to benefit from such increases.

The Company's acquisition strategy is to establish a network of distribution facilities and, since 1989, it has acquired 16 air conditioning distributors. The geographical focus of the Company's strategy has been primarily on the sunbelt where U.S. population growth is greatest, weather patterns are predictably hot and air conditioning is seen as a necessity. The Company believes it is the only major company pursuing a consolidation strategy of making significant acquisitions in the highly fragmented air conditioning distribution industry. The Company's growth strategy seeks to enhance the value of acquired operations by better serving the "one-stop" shopping needs of contractors. This includes broadening product lines and committing other capital resources to develop the acquired businesses, including expanding existing branches and opening new branches. The Company also runs its distribution operations on a decentralized basis in recognition of the value of the long-term relationships established between the distributors and their customers. The Company seeks to preserve the identity of acquired businesses by retaining their management and sales organizations, maintaining the product brand name offerings previously distributed by them, and selectively expanding complementary product offerings. The Company believes this strategy builds on the value of the acquired operations by creating additional sales opportunities, improving operating efficiencies and attaining greater leveraging of expenses.

The Company currently operates 137 branch warehouses in 19 states. This geographic diversification minimizes the impact of unseasonably mild weather on the sale of replacement air conditioning and heating equipment.

The following is a description of the Company's acquisitions completed in 1996:

THREE STATES SUPPLY COMPANY, INC. In April 1996, the Company acquired certain assets of Three States, a Tennessee-based distributor of air conditioning, heating and other building supplies. Three States operates eleven branches in five states and had 1996 revenues of approximately $51 million. Since its acquisition, the Company has expanded the products offered by Three States to include air conditioning and heating equipment.

SERVICEMAN SUPPLIES, INC. In October 1996, the Company acquired Serviceman, a Texas-based wholesale distributor of residential central air conditioning and heating equipment and related parts and supplies with six branches covering the greater Dallas-Ft. Worth metropolitan area. Serviceman reported revenues of approximately $10 million for its fiscal year ended October 31, 1996.

COASTAL SUPPLY COMPANY, INC. In December 1996, the Company acquired Coastal Supply, a Georgia-based wholesale distributor of equipment, parts and supplies used in heating and air conditioning systems. Coastal Supply sells from seven branches in Georgia and three in South Carolina. Revenues for 1996 were approximately $8 million.

RECENT DEVELOPMENTS

INTER-CITY ACQUISITION In January 1997, the Company completed the acquisition of the common stock of Coastline Distribution, Inc. and substantially all of the operating assets of four branch operations from Inter-City Products Corporation (USA). Coastline and the branch operations sell air conditioning and heating products from 25 locations serving markets in Florida, Georgia, southern Alabama, North Carolina, South Carolina, southern California, northern Virginia and Maryland. Cash consideration paid by the Company totaled $22.4 million and is subject to adjustment upon the completion of an audit of the assets purchased and liabilities assumed.

OFFERING OF COMMON STOCK In February 1997, the Company completed a public offering of 3,000,000 shares of Common Stock resulting in net proceeds of $85.5 million, a significant portion of which was used to repay outstanding borrowings under its revolving credit agreement. The Company anticipates using the remainder of the proceeds to fund its growth strategy and for general corporate purposes.

CARRIER ACQUISITION In March 1997, the Company completed the purchase of substantially all of the operating assets and assumption of certain liabilities of Carrier Corporation's Comfort Products Distributing and Central Plains Distributing distribution operations. Comfort Products and Central Plains sell air conditioning and heating products from eight locations serving markets in Missouri, Kansas, Nebraska, Iowa, North Dakota and South Dakota. Cash consideration paid by the Company totaled $26.4 million and is subject to adjustment upon the completion of an audit of the assets purchased.

Also see "Liquidity and Capital Resources" in Management's Discussion and Analysis of Financial Condition and Results of Operations included in the Company's Annual Report to Shareholders for the year ended December 31, 1996 (the "1996 Annual Report").

INDUSTRY SEGMENT INFORMATION

The Company operates in two industry segments: Climate Control and Personnel Services. The Climate Control segment consists of the Distribution Operations and the Manufacturing Operations. The Distribution Operations distribute residential central air conditioning and heating equipment and related parts and supplies in 19 states, located in the sunbelt and midwest, as well as in Latin America and South America. The Manufacturing Operations make components and equipment which are sold and distributed to the air conditioning, refrigeration and heating industry (see "Climate Control Segment").

In the Personnel Services segment, Dunhill and its subsidiaries provide temporary staffing and permanent placement services (see "Personnel Services Segment"). The Company also has certain employees and resources which provide services to each of these segments. Note 11 of Notes to Consolidated Financial Statements, included in the Company's 1996 Annual Report, incorporated herein by reference under Item 8, contains a table setting forth the revenues and operating income of the Company's two industry segments during the three years ended December 31, 1996, 1995 and 1994.

DESCRIPTION OF BUSINESS

DISTRIBUTION OPERATIONS

PRODUCTS The Company sells a complete line of residential central air conditioning and heating equipment and related parts and supplies and maintains sufficient inventory to meet customers' immediate needs for products. The Company's strategy is to provide every product a contractor generally would require in order to install or repair a residential or light commercial central air conditioner. The products distributed by the Company in all of its markets consist of: (i) equipment, including residential central air conditioners ranging from 1-1/2 to 5 tons*, light commercial air conditioners ranging up to 20 tons, gas, electric and oil furnaces ranging from 50,000 to 150,000 BTUs and other specialized machinery; (ii) parts, including replacement compressors, evaporator coils, thermostats, motors and other component parts; (iii) supplies, including insulation, ductwork, grills, registers, sheet metal, tools, copper tubing, concrete pads, tape, adhesives and other ancillary supplies. With the purchase of Comfort Products and Central Plains from Carrier, the Company also sells commercial air conditioning and heating equipment and systems ranging from 20 to 400 tons throughout five midwestern states.

Sales of air conditioning and heating equipment accounted for approximately 57% of the Distribution Operations' revenues for 1996. Sales of parts and supplies (currently numbering approximately 60,000 different inventory items) comprised the remaining revenues.

* The cooling capacity of air conditioning units is measured in tons. One ton of cooling capacity is equivalent to 12,000 BTUs and is generally adequate to air condition approximately 500 square feet of residential space.

DISTRIBUTION AND SALES The Company currently operates from 137 branch warehouses, most of which are located in regions of the sunbelt which the Company believes have favorable demographic trends. The Company maintains well-stocked inventories at each warehouse location to meet the immediate needs of its customers. This is accomplished by transporting inventory between warehouses daily and either directly delivering products to customers with the Company's fleet of 315 trucks or making the products available for pick-up at the branch nearest to the customer. The company has 208 commissioned salespeople who average 12 years of experience in the residential central air conditioning and heating equipment distribution industry.

MARKETS The Company's branch network serves 19 states from 137 locations. The Company's primary markets in the sunbelt include (in order of market size) Texas, Florida, California, Georgia, North Carolina, Tennessee, Virginia, Alabama, Arizona, Louisiana, South Carolina, Arkansas, Mississippi and Nevada. The Company also serves the midwestern states of Missouri, Kansas, Nebraska, Iowa, North Dakota and South Dakota. The Company also distributes products on an export basis in substantially all of Latin America.

CUSTOMERS AND CUSTOMER SERVICE The Company sells to contractors and dealers who service the new construction and replacement markets for residential and light commercial central air conditioners. The Company currently serves over 30,000 customers, with no single customer in 1996 accounting for more than 2% of consolidated revenues. The Company focuses 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 the branch locations. Management believes that the Company successfully competes with other distributors in the residential and light commercial central air conditioning market primarily on the basis of its experienced sales organization, strong service support, high quality reputation and broad product lines.

KEY SUPPLIERS The Company maintains significant relationships with Rheem, Inter-City and Carrier, each a leading manufacturer of residential central air conditioning and heating equipment in the United States. Carrier is also recognized as the leading international manufacturer of commercial air conditioning and heating equipment and systems. Each manufacturer has a well-established reputation of producing high-quality, competitively priced products. The Company believes the manufacturers' current product offerings, quality, serviceability and brand-name recognition allow the Company to operate favorably against its competitors. To maintain brand-name recognition, the manufacturers provide national advertising and participate with the Company in cooperative advertising programs and promotional incentives that are targeted to both contractors and homeowners. The Company estimates the replacement market currently accounts for approximately 65% of industry sales in the United States and expects this percentage to increase as units installed in the 1970s and 1980s wear out and get replaced or updated to more energy-efficient models. The Company believes the products it offers have wide acceptance in the replacement market based on their high efficiency and low noise level -- two key homeowner considerations.

On a pro forma basis, assuming the combination of the Company's purchases in 1996 and the purchases for businesses recently acquired from Inter-City and Carrier as if such transactions had occurred on January 1, 1996, the Company's proportionate share of purchases from Rheem, Inter-City and Carrier would have been 32%, 11% and 11%, respectively. A significant interruption in the delivery of products would impair the Company's ability to continue to maintain its current inventory levels and could adversely affect the Company's business. The Company's future results of operations are also materially dependent upon the continued market acceptance of these manufacturers' products and their ability to continue to manufacture products that comply with laws relating to environmental and efficiency standards. However, the Company believes that its sales of other complimentary equipment products and continued emphasis to expand the sale of parts and supplies are mitigating factors against such risks.

DISTRIBUTION AGREEMENTS The Company has distribution agreements with each of its key equipment suppliers, either on an exclusive or non-exclusive basis, for terms generally ranging from two to ten years. Under such agreements, the Company distributes the following brand-name products: (i) Gemaire, Heating & Cooling, Comfort Supply and CAC Distributors - "Rheem" and Ruud"; (ii) Coastline and Comfortmaker Distribution - "Tempstar "and "Comfortmaker", respectively; (iii) Comfort Products - "Carrier" and "Payne"; and (iv) Central Plains - "Carrier", Bryant" and "Payne". Certain of the distribution agreements contain restrictions that limit the sale of competitive products in the markets served. Other than the markets where such provisions apply, the Company may distribute other manfacturers' lines of air conditioning or heating equipment without restriction.

RHEEM TRANSACTION Rheem acquired minority ownership interests as a joint venture partner in certain of the Company's subsidiaries as follows: (i) 20% of Gemaire (1989); (ii) 50% of Heating & Cooling (1990); and (iii) 20% of Comfort Supply (1993). In March 1996, the Company and Rheem completed a transaction pursuant to a Stock Exchange Agreement and Plan of Reorganization (the "Exchange Agreement") whereby the Company acquired Rheem's minority ownership interests of these three subsidiaries in exchange for 1,446,542 shares of the Company's unregistered Common Stock. Following completion of this transaction, Gemaire, Comfort Supply and Heating & Cooling became wholly owned subsidiaries of the Company.

MANUFACTURING OPERATIONS

The Company's Manufacturing Operations produce over 4,000 electronic and mechanical components for air conditioning, heating and refrigeration equipment that are sold to over 5,000 wholesale distribution locations and original equipment manufacturers ("OEMs"), with no single customer accounting for more than 1% of consolidated revenues in 1996. Product offerings include: components, such as line tap and specialty valves, motor compressor protectors, liquid sight glasses and warm air controls; and equipment, such as vacuum pumps and refrigerant recovery systems. Many of the products are patented and compete in the market place based on uniqueness as well as quality and price. OEM customers include most of the major residential air conditioning manufacturers, including Rheem, Carrier, Inter-City and York International (through its Evcon subsidiary).

Research and development is conducted to improve the quality and performance of manufactured products and to develop new products both in-house and by extensive field testing of products. An engineering staff develops new customized products to end-user specification and continuously improves, supplements and enhances product lines with newly developed products.

PERSONNEL SERVICES SEGMENT

Dunhill, founded in 1952, is one of the nation's best known personnel service networks. Through franchised, licensed, and company-owned offices in 40 states, Puerto Rico and Canada, Dunhill provides permanent placement and temporary staffing services to businesses, professional and service organizations, government agencies, health care providers and other employers. Dunhill's operations primarily consist 14 company-owned and 8 licensed temporary staffing offices, as well as 104 franchised permanent placement offices and 18 franchised temporary staffing offices. Dunhill's franchisees operate their businesses autonomously within the framework of the Company's policies and standards, and recruit, employ, and pay their own employees, including temporary employees. Dunhill's permanent placement division recruits primarily middle-management, sales, technical, administrative and support personnel for permanent employment in a wide variety of industries and positions.

Dunhill receives an initial fee from all licensees and franchisees, and on-going revenues in the form of royalty fees and commissions from temporary staffing licensees and franchisees and permanent placement operations. Licenses and franchises are generally granted for 5 and 10 year terms, respectively, and are typically renewable at the option of the licensee or franchisee for additional terms of 5 and 10 years, respectively.

OTHER INFORMATION

COMPETITION

All of the Company's businesses operate in highly competitive environments. The Company's distribution business competes with a number of distributors and also with air conditioning and heating equipment manufacturers which distribute a significant portion of their products through their own distribution organizations. Many of the manufacturers' distribution organizations are larger than the Company and have substantial financial resources. Competition within any given geographic market is based upon product availability, customer service, price and quality. The Company's manufacturing business has several major competitors, a few of which are larger and have substantial financial resources. Dunhill competes with numerous other large and small national, regional, and local personnel service providers. Competitive pressures or other factors could cause the Company's products or services to lose market acceptance or result in significant price erosion, all of which would have a material adverse effect on the Company's profitability.

EMPLOYEES

The Climate Control segment employed 1,685 persons and the Personnel Services segment employed 105 persons as of March 25, 1997. The Company believes that its relations with these employees are good.

SEASONALITY

Sales of residential central air conditioners, heating equipment and parts and supplies manufactured and distributed by the Company have historically been seasonal. Demand related to the residential central air conditioning replacement market is highest in the second and third quarters with demand for heating equipment highest in the fourth quarter. Demand related to the new construction market varies according to the season, with increased demand generally from March through October.

OTHER

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

ITEM 2. PROPERTIES

The Company's significant facilities are currently in the following locations:

| LOCATION | USE | SQUARE FOOTAGE | OWNED/ LEASED |
|---|---|---|---|
| Watsco: | | | |
| Coconut Grove, FL | Headquarters | 3,137 | Leased |
| Manufacturing Operations: | | | |
| Hialeah, FL | Manufacturing | 90,000 | Owned |
| Hialeah, FL | Manufacturing | 36,000 | Owned |
| Hialeah, FL | Manufacturing | 12,000 | Owned |
| Gemaire: | | | |
| Deerfield Beach, FL | Headquarters | 10,768 | Leased |
| Tampa, FL | Warehouse | 50,000 | Leased |
| Deerfield Beach, FL | Warehouse | 48,500 | Leased |
| Miami, FL | Warehouse | 43,645 | Leased |
| Orlando, FL | Warehouse | 40,000 | Leased |
| Orlando, FL | Warehouse | 30,000 | Leased |
| Clearwater, FL | Warehouse | 16,500 | Leased |
| Lakeland, FL | Warehouse | 15,000 | Leased |
| Mobile, AL | Warehouse | 15,000 | Leased |
| Perrine, FL | Warehouse | 13,234 | Leased |
| Riviera Beach, FL | Warehouse | 12,800 | Leased |
| Ft. Myers, FL | Warehouse | 12,000 | Leased |
| Lakeland, FL | Warehouse | 12,000 | Leased |
| Pensacola, FL | Warehouse | 12,000 | Leased |
| Hollywood, FL | Warehouse | 11,400 | Leased |
| Tampa, FL | Warehouse | 11,000 | Leased |
| Daytona Beach, FL | Warehouse | 10,000 | Leased |
| Melbourne, FL | Warehouse | 10,000 | Leased |
| New Port Richey, FL | Warehouse | 10,000 | Leased |
| Ocala, FL | Warehouse | 10,000 | Leased |
| St. Petersburg, FL | Warehouse | 10,000 | Leased |
| Vero Beach, FL | Warehouse | 10,000 | Leased |
| Jacksonville, FL | Warehouse | 9,790 | Leased |
| Sarasota, FL | Warehouse | 8,578 | Leased |
| St. Petersburg, FL | Warehouse | 8,500 | Leased |
| Ft. Walton Beach, FL | Warehouse | 8,000 | Leased |
| Jacksonville, FL | Warehouse | 8,000 | Leased |
| Tallahassee, FL | Warehouse | 8,000 | Leased |
| Panama City, FL | Warehouse | 7,500 | Leased |
| Lakeland, FL | Warehouse | 7,200 | Leased |
| Sebring, FL | Warehouse | 7,000 | Leased |
| Winter Haven, FL | Warehouse | 7,000 | Leased |
| Murdock, FL | Warehouse | 6,300 | Leased |
| Tampa, FL | Warehouse | 3,000 | Leased |

| LOCATION | USE | SQUARE FOOTAGE | OWNED/ LEASED |
| --- | --- | --- | --- |
| Heating & Cooling: | | | |
| San Diego, CA | Headquarters | 7,200 | Leased |
| Modesto, CA | Warehouse | 60,000 | Leased |
| Phoenix, AZ | Warehouse | 30,000 | Leased |
| Fresno, CA | Warehouse | 25,079 | Leased |
| Orange, CA | Warehouse | 25,050 | Leased |
| San Diego, CA | Warehouse | 25,000 | Leased |
| Riverside, CA | Warehouse | 24,940 | Leased |
| Sacramento, CA | Warehouse | 24,000 | Leased |
| Van Nuys, CA | Warehouse | 22,100 | Leased |
| City of Industry | Warehouse | 20,000 | Leased |
| Santa Clara, CA | Warehouse | 20,000 | Leased |
| Las Vegas, NV | Warehouse | 19,600 | Leased |
| Escondido, CA | Warehouse | 15,000 | Leased |
| Long Beach, CA | Warehouse | 15,000 | Leased |
| Tucson, AZ | Warehouse | 14,500 | Leased |
| Oxnard, CA | Warehouse | 14,344 | Leased |
| El Cajon, CA | Warehouse | 5,836 | Leased |
| North Phoenix, AZ | Warehouse | 5,000 | Leased |
| Yuma, AZ | Warehouse | 3,800 | Leased |
| Dublin, CA | Warehouse | 3,000 | Leased |
| Comfort Supply: | | | |
| Houston, TX | Headquarters/Warehouse | 38,780 | Leased |
| Carrollton, TX | Warehouse | 35,000 | Leased |
| Arlington, TX | Warehouse | 33,500 | Leased |
| North Little Rock, AR | Warehouse | 25,000 | Leased |
| Bryan, TX | Warehouse | 21,750 | Leased |
| Harlingen, TX | Warehouse | 17,000 | Leased |
| Killeen, TX | Warehouse | 17,000 | Leased |
| Shreveport, LA | Warehouse | 16,000 | Leased |
| Austin, TX | Warehouse | 15,700 | Leased |
| Haltom City, TX | Warehouse | 15,000 | Leased |
| Houston, TX | Warehouse | 15,000 | Leased |
| Longview, TX | Warehouse | 15,000 | Owned |
| Houston, TX | Warehouse | 14,800 | Leased |
| San Antonio, TX | Warehouse | 14,000 | Leased |
| Houston, TX | Warehouse | 12,000 | Leased |
| Dallas, TX | Warehouse | 11,250 | Leased |
| Houston, TX | Warehouse | 10,570 | Leased |
| Arlington, TX | Warehouse | 10,350 | Leased |
| Plano, TX | Warehouse | 10,200 | Leased |
| McAllen, TX | Warehouse | 10,000 | Leased |
| Monroe, LA | Warehouse | 10,000 | Leased |
| Texarkana, TX | Warehouse | 10,000 | Leased |
| North Richland Hills, TX | Warehouse | 9,600 | Leased |
| Dallas, TX | Warehouse | 8,650 | Leased |
| Stephenville, TX | Warehouse | 7,100 | Leased |
| Stafford, TX | Warehouse | 5,500 | Leased |
| Jonesboro, AR | Warehouse | 5,000 | Leased |

| LOCATION | USE | SQUARE FOOTAGE | OWNED/ LEASED |
|---|---|---|---|
| Three States: | | | |
| Memphis, TN | Headquarters/Warehouse | 105,000 | Owned |
| St. Louis, MO | Warehouse | 100,000 | Leased |
| Huntsville, AL | Warehouse | 46,584 | Leased |
| Jackson, MS | Warehouse | 43,000 | Leased |
| Nashville, TN | Warehouse | 34,000 | Leased |
| Little Rock, AR | Warehouse | 28,600 | Owned |
| Ft. Smith, AR | Warehouse | 27,000 | Leased |
| Memphis, TN | Warehouse | 25,000 | Leased |
| Springfield, MO | Warehouse | 24,000 | Leased |
| Memphis, TN | Warehouse | 16,400 | Leased |
| Memphis, TN | Warehouse | 12,000 | Owned |
| Decatur, AL | Warehouse | 10,000 | Leased |
| CAC Distributors: | | | |
| Winston-Salem, NC | Headquarters/Warehouse | 12,500 | Leased |
| Charlotte, NC | Warehouse | 66,300 | Leased |
| Savannah, GA | Warehouse | 25,000 | Leased |
| Hickory, NC | Warehouse | 22,806 | Leased |
| Greensboro, NC | Warehouse | 20,000 | Leased |
| Winston-Salem, NC | Warehouse | 14,500 | Leased |
| Statesboro, GA | Warehouse | 10,400 | Leased |
| Asheville, NC | Warehouse | 10,000 | Leased |
| Athens, GA | Warehouse | 10,000 | Leased |
| Gainesville, GA | Warehouse | 10,000 | Leased |
| Seneca, SC | Warehouse | 7,970 | Leased |
| Vidalia, GA | Warehouse | 7,500 | Leased |
| Milledgeville, GA | Warehouse | 6,400 | Leased |
| Anderson, SC | Warehouse | 6,000 | Leased |
| Greenwood, SC | Warehouse | 5,000 | Leased |
| Savannah, GA | Warehouse | 3,000 | Leased |
| Coastline: | | | |
| Sanford, FL | Headquarters | 20,000 | Leased |
| Ft. Lauderdale, FL | Warehouse | 43,047 | Leased |
| Doraville, GA | Warehouse | 35,047 | Leased |
| Sanford, FL | Warehouse | 30,000 | Leased |
| Orlando, FL | Warehouse | 25,000 | Leased |
| Tampa, FL | Warehouse | 24,000 | Leased |
| Ft. Myers, FL | Warehouse | 20,150 | Leased |
| Riviera Beach, FL | Warehouse | 20,000 | Leased |
| Miami, FL | Warehouse | 19,030 | Leased |
| Gainesville, FL | Warehouse | 18,000 | Leased |
| Sanford, FL | Warehouse | 17,500 | Leased |
| Jacksonville, FL | Warehouse | 15,000 | Leased |
| Clearwater, FL | Warehouse | 14,500 | Leased |
| Ocala, FL | Warehouse | 14,000 | Leased |
| Tallahassee, FL | Warehouse | 12,500 | Leased |
| Pensacola, FL | Warehouse | 12,080 | Leased |
| Sarasota, FL | Warehouse | 12,000 | Leased |
| Naples, FL | Warehouse | 11,500 | Leased |

| LOCATION | USE | SQUARE FOOTAGE | OWNED/ LEASED |
|---|---|---|---|
| Coastline (cont.): | | | |
| West Melbourne, FL | Warehouse | 11,250 | Leased |
| Holly Hill, FL | Warehouse | 10,300 | Leased |
| Marietta, GA | Warehouse | 10,000 | Leased |
| Port Richey, FL | Warehouse | 10,000 | Leased |
| Dothan, AL | Warehouse | 8,424 | Leased |
| Sanford, FL | Warehouse | 6,000 | Leased |
| Daytona, FL | Warehouse | 3,000 | Leased |
| Comfortmaker Distribution: | | | |
| Chino, CA | Warehouse | 43,000 | Leased |
| Savage, MD | Warehouse | 37,000 | Leased |
| Charlotte, NC | Warehouse | 36,000 | Leased |
| Norcross, GA | Warehouse | 30,000 | Leased |
| Comfort Products: | | | |
| Kansas City, MO | Headquarters/Warehouse | 39,860 | Leased |
| Springfield, MO | Warehouse | 18,000 | Leased |
| Lenexa, KS | Warehouse | 12,500 | Leased |
| Wichita, KS | Warehouse | 10,000 | Leased |
| Central Plains: | | | |
| Omaha, NE | Headquarters/Warehouse | 52,800 | Leased |
| Des Moines, IA | Warehouse | 18,000 | Leased |
| Sioux Falls, SD | Warehouse | 15,450 | Leased |
| Lincoln, NE | Warehouse | 5,250 | Leased |
| Dunhill: | | | |
| Woodbury, NY | Headquarters | 6,300 | Leased |

The Company believes that its facilities are well maintained and adequate to meet its needs.

ITEM 3. LEGAL PROCEEDINGS

The Company is from time to time involved in routine litigation. Based on the advice of legal counsel, the Company believes that such actions presently pending will not have a material adverse impact on the Company's consolidated financial position or results of operations.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of the Company's security holders during the fourth quarter of the year ended December 31, 1996.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Page 28 of the 1996 Annual Report contains "Information on Common Stock", which identifies the market on which the Registrant's common stocks are being traded and contains the high and low sales prices and dividend information for the years ended December 31, 1996, 1995 and 1994 and is incorporated herein by reference.

ITEM 6. SELECTED FINANCIAL DATA

Page 8 of the Company's 1996 Annual Report contains "Selected Consolidated Financial Data" and is incorporated herein by reference.

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

Pages 9 through 11 of the Company's 1996 Annual Report contain "Management's Discussion and Analysis of Financial Condition and Results of Operations" and is incorporated herein by reference.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Pages 12 through 26 of the Company's 1996 Annual Report contain the 1996 and 1995 Balance Sheets and other financial statements for the years ended December 31, 1996, 1995 and 1994, together with the report thereon of Arthur Andersen LLP dated March 24, 1997, are incorporated herein by reference.

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

None.

PART III

This part of Form 10-K, which includes Items 10 through 13, is omitted because the Registrant will file definitive proxy material pursuant to Regulation 14A not more than 120 days after the close of the Registrant's year end, which proxy material will include the information required by Items 10 through 13 and is incorporated herein by reference.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

| | PAGE NO. IN ANNUAL REPORT |
|---|---|
| (a) Financial Statements, Financial Statement Schedules and Exhibits | |
| (1) Financial Statements (incorporated by reference from the 1996 Annual Report of Watsco, Inc.): | |
| Consolidated Statements of Income for the years ended December 31, 1996, 1995 and 1994 | 12 |
| Consolidated Balance Sheets as of December 31, 1996 and 1995 | 13 |
| Consolidated Statements of Shareholders' Equity for the years ended December 31, 1996, 1995 and 1994 | 14 |
| Consolidated Statements of Cash Flows for the years ended December 31, 1996, 1995 and 1994 | 15 |
| Notes to Consolidated Financial Statements | 16 |
| Report of Independent Certified Public Accountants | 26 |
| Selected Quarterly Financial Data (Unaudited) | 27 |

| | PAGE NO. IN FORM 10-K |
|---|---|
| (2) Financial Statement Schedule: For the three years ended December 31, 1996: | |
| Report of Independent Certified Public Accountants on Schedules | S-1 |
| II. Valuation and Qualifying Accounts | S-2 |

All other schedules have been omitted since the required information is not present, or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the Financial Statements or notes thereto.

(3) Exhibits: The following list of exhibit includes exhibits submitted with this Form 10-K as filed with the SEC and those incorporated by reference to other filings.

3.1 Company's Amended and Restated Articles of Incorporation (filed as Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 1995 and incorporated herein by reference).

3.2 Company's Amended Bylaws (filed as Exhibit 3.2 to the Company's Annual Report on Form 10-K for the fiscal year ended January 31, 1985 and incorporated herein by reference).

4.1 Specimen form of Class B Common Stock Certificate (filed as Exhibit 4.6 to the Company's Registration Statement on Form S-1 (No. 33-56646) and incorporated herein by reference).

4.2 Specimen form of Common Stock Certificate (filed as Exhibit 4.4 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1994 and incorporated herein by reference).

10.1 Rheem Manufacturing Company Distributor Agreement by and between Rheem Manufacturing Company and Gemaire Distributors, Inc., dated December 30, 1988 (filed as Exhibit 10.12 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1988 and incorporated herein by reference).

10.2 Amendment dated January 4, 1991 to Distribution Agreement dated December 30, 1990 between Rheem Manufacturing Company and Gemaire Distributors, Inc. (filed as Exhibit 10.14 to the Company's Registration Statement on Form S-1 (No. 33-56646) and incorporated herein by reference).

10.3 Distributor Agreement between Heating & Cooling Supply, Inc. and Rheem Manufacturing, Inc. dated October 15, 1990 (filed as Exhibit 10.17 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1990 and incorporated herein by reference).

10.4 Rheem Manufacturing Company Distributor Agreement by and between Rheem Manufacturing Company and Comfort Supply, Inc. (filed as Exhibit 10.20 to the Company's Form 8-K dated May 26, 1993 and incorporated herein by reference).

10.5 Preferred Stock Purchase Agreement between Heating & Cooling Supply, Inc. and Rheem Manufacturing Company dated June 10, 1993 (filed as Exhibit 10.27 to the Company's Quarterly Report on Form 10-Q dated September 30, 1993 and incorporated herein by reference).

10.6 Stock Exchange Agreement and Plan of Reorganization dated February 6, 1996 by and between Watsco, Inc. and Rheem Manufacturing Company (filed as Exhibit 10.29 to the Company's Registration Statement on Form S-3 (No. 333-00371) and incorporated herein by reference).

10.7 Amendment dated February 6, 1996 to Distributor Agreement dated December 30, 1998 between Rheem Manufacturing Company and Gemaire Distributors, Inc. (filed as Exhibit 10.11 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1996 and incorporated herein by reference).

10.8 Amendment dated February 6, 1996 to Distributor Agreement dated May 25, 1993 (and as amended by Supplemental Agreement dated as of June 1, 1995) between Rheem Manufacturing Company and Comfort Supply, Inc. (filed as Exhibit 10.12 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1996 and incorporated herein by reference).

10.9 Amendment dated February 6, 1996 to Distributor Agreement dated October 15, 1990 between Rheem Manufacturing Company and Heating & Cooling Supply, Inc. (filed as Exhibit 10.13 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1996 and incorporated herein by reference).

10.10 Revolving Credit and Reimbursement Agreement dated September 25, 1996 by and among Watsco, Inc., NationsBank, National Association (South) and the Lenders Party Hereto from Time to Time (filed as Exhibit 10.21 to the Company's Quarterly Report on Form 10-Q for the period ended September 30, 1996 and incorporated herein by reference).

10.11 Asset Purchase Agreement dated March 24, 1997 by and between CP Distributors, Inc. and Carrier Corporation. #

10.12 1983 Executive Stock Option Plan of Watsco, Inc. (filed as Exhibit 10.3 to the Company's Registration Statement on Form S-8 (Registration No. 33-6229) and incorporated herein by reference).

10.13 Key Executive Deferred Compensation Agreement dated January 31, 1983, between Watsco, Inc. and Albert H. Nahmad (filed as Exhibit 10.8 to the Company's Registration Statement on Form S-1 (No. 33-56646) and incorporated herein by reference).

10.14 Watsco, Inc. Amended and Restated 1991 Stock Option Plan (filed as Exhibit 10.23 to the Company's Quarterly Report on Form 10-Q dated June 30, 1993 and incorporated herein by reference).

10.15 Watsco, Inc. Amended and Restated Profit Sharing Retirement Plan and Trust Agreement dated October 21, 1994 (filed as Exhibit 10.25 to the Company's Annual Report on Form 10-K for the year ended December 31, 1994 and incorporated herein by reference).

10.16 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 Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1996 and incorporated herein by reference).

10.17 Watsco, Inc. 1996 Qualified Employee Stock Purchase Plan (filed as Exhibit 4.3 to the Company's Registration Statement on Form S-8 (333-10363) and incorporated herein by reference.

11. Computation of Earnings Per Share for the years ended December 31, 1996, 1995 and 1994. #

13. 1996 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 1996 Annual Report to Shareholders is provided solely for the information of the Securities and Exchange Commission and is not deemed "filed" as part of this Form 10-K). #

21. Subsidiaries of the Registrant. #

23. Consent of Independent Certified Public Accountants. #

27. Financial Data Schedule. #

Note to exhibits:

# Submitted electronically herewith.

(b) Reports on Form 8-K:

No reports on Form 8-K were filed by the Registrant during the fourth quarter of 1996.

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 28, 1997 | By: /S/ ALBERT H. NAHMAD<br>Albert H. Nahmad, President |
| March 28, 1997 | By: /S/ RONALD P. NEWMAN<br>Ronald P. Newman, Vice President |

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<br>Albert H. Nahmad | Chairman of the Board and President (principal executive officer) | March 28, 1997 |
| /S/ RONALD P. NEWMAN<br>Ronald P. Newman | Vice President of Finance and Secretary (principal accounting officer) | March 28, 1997 |
| /S/ D.A. COAPE-ARNOLD<br>D.A. Coape-Arnold | Director | March 28, 1997 |
| /S/ DAVID B. FLEEMAN<br>David B. Fleeman | Director | March 28, 1997 |
| /S/ JAMES S. GRIEN<br>James S. Grien | Director | March 28, 1997 |
| /S/ PAUL F. MANLEY<br>Paul F. Manley | Director | March 28, 1997 |
| /S/ BOB L. MOSS<br>Bob L. Moss | Director | March 28, 1997 |
| /S/ ROBERTO MOTTA<br>Roberto Motta | Director | March 28, 1997 |
| /S/ ALAN H. POTAMKIN<br>Alan H. Potamkin | Director | March 28, 1997 |
| /S/ GARY L. TAPELLA<br>Gary L. Tapella | Director | March 28, 1997 |

## REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS ON SCHEDULE

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

We have audited in accordance with generally accepted auditing standards, the consolidated financial statements included in Watsco, Inc.'s Annual Report to Shareholders incorporated by reference in this Form 10-K, and have issued our report thereon dated March 24, 1997. Our audits were made for the purpose of forming an opinion on those statements taken as a whole. The accompanying Schedule II is the responsibility of the Company's management and is presented for purposes of complying with the Securities and Exchange Commission's rules and is not part of the basic financial statements. This schedule has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, fairly states in all material respects the financial data required to be set forth therein in relation to the basic financial statements taken as a whole.

ARTHUR ANDERSEN LLP

Miami, Florida,
March 24, 1997.

WATSCO, INC.
SCHEDULE II-VALUATION AND QUALIFYING ACCOUNTS
For the Years Ended December 31, 1996, 1995 and 1994
(In thousands)

ALLOWANCE FOR DOUBTFUL ACCOUNTS:

| | |
|---|---|
| BALANCE, December 31, 1993 | $3,012 |
| Allowances from acquisitions | 597 |
| Write-offs, net | (928) |
| BALANCE, December 31, 1994 | 2,681 |
| Allowance from acquisitions | 453 |
| Additions charged to costs and expenses | 1,197 |
| Write-offs, net | (1,230) |
| BALANCE, December 31, 1995 | 3,101 |
| Allowances from acquisitions | 109 |
| Additions charged to costs and expenses | 1,541 |
| Write-offs, net | (1,655) |
| BALANCE, December 31, 1996 | $3,096 |

INDEX TO EXHIBITS

| EXHIBIT NUMBER | DESCRIPTION |
|---|---|
| 10.11 | Asset Purchase Agreement dated March 24, 1997 by and between CP Distributors, Inc. and Carrier Corporation. |
| 11. | Computation of Earnings Per Share for the years ended December 31, 1996, 1995 and 1994. |
| 13. | 1996 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 1996 Annual Report to Shareholders is provided solely for the information of the Securities and Exchange Commission and is not deemed "filed" as part of this Form 10-K). |
| 21. | Subsidiaries of the Registrant. |
| 23. | Consent of Independent Certified Public Accountants. |
| 27. | Financial Data Schedule. |

EXHIBIT 10.11

# ASSET PURCHASE AGREEMENT

THIS ASSET PURCHASE AGREEMENT (the "Agreement") is made and entered into this 24th day of March, 1997, by and between CP DISTRIBUTORS, INC., a Florida corporation (the "Purchaser"), and CARRIER CORPORATION, a Delaware corporation (the "Seller").

## RECITALS

A. The Seller uses the Assets (as defined in SECTION 1.1) in the conduct of the businesses owned and operated by the Seller at the distribution facilities for residential and light commercial HVAC products located in (a) North Kansas City, Missouri, Springfield, Missouri, Wichita, Kansas and Lenexa, Kansas (the "Comfort Products Business") and (b) Omaha, Nebraska, Lincoln, Nebraska, Des Moines, Iowa and Sioux Falls, South Dakota (the "NAO Central Plains Business" and, together with the Comfort Products Business, the "Business").

B. The Seller desires to transfer and deliver the Assets to the Purchaser, and the Purchaser desires to purchase, acquire and accept delivery of the Assets from the Seller and assume, satisfy and discharge certain liabilities of the Seller which are attributable to the Business, on the terms and subject to the conditions hereinafter set forth.

## AGREEMENT

NOW, THEREFORE, for and in consideration of the mutual benefits to be derived hereby and the representations, warranties, covenants and agreements herein contained, the Purchaser and the Seller hereby agree, intending to be legally bound, as follows:

II.

## PURCHASE OF ASSETS

A. PURCHASE AND SALE OF ASSETS. Subject to the terms and conditions of this Agreement, the Seller agrees to transfer and deliver to the Purchaser, and the Purchaser agrees to purchase, acquire and accept delivery of the following assets used by the Seller in connection with the Business, but specifically excluding any of the Excluded Assets set forth in SECTION 1.2 hereof (the "Assets"):

1. Subject to the terms of the Real Property Leases and Equipment Leases (as defined herein), furniture, fixtures, equipment and other tangible personal property

used by the Seller in the Business as set forth on the fixed asset list attached hereto as SCHEDULE 1.1(A), including, without limitation, leasehold improvements identified on the books and records of the Business;

2. Inventories of Carrier-branded, Bryant-branded, Payne-branded, and Totaline-branded ("Branded") and non-Branded equipment, components, parts and supplies used by the Seller in the Business which are on hand as of the Closing as set forth on SCHEDULE 1.1(B) attached hereto, excluding any equipment, components, parts and accessories which are sold in the ordinary course of business on or prior to the Closing;

3. Accounts and notes receivable of the Business as set forth on SCHEDULE 1.1(C) attached hereto, whether or not reflected on the financials of the Business, including, without limitation, freight claims and accounts payable by independent distributors (the "Receivables");

4. Prepaid expenses and assets of the Business as set forth on SCHEDULE 1.1(D) attached hereto, including, without limitation, prepaid rentals, taxes (excluding taxes based on or measured by net income) and deposits;

5. Subject to the consent of the lessor where required, leases of office, warehouse, or store premises currently occupied by Seller in connection with the Business as set forth on SCHEDULE 1.1(E) attached hereto (the "Real Property Leases");

6. Equipment leased by Seller for the Business as set forth on SCHEDULE 1.1(F) attached hereto, with respect to which Purchaser shall, subject to the consent of the lessor where required, accept an assignment of such leases and assume Seller's obligations thereunder or enter into such other arrangements as will transfer the benefits and obligations related thereto to Purchaser (the

"Equipment Leases");

7. Permits, licenses, approvals, customer contracts, supply contracts, and other contracts, bids, offers, quotes, purchase orders, commitments and arrangements to which Seller is a party or otherwise subject in connection with the Business as of the Closing Date (collectively, the "Contracts"), to the extent transferable and assignable, but excluding any agreements between Seller and operating units of Seller and its parent or agreements pertaining to employees of Seller and intercompany arrangements which shall terminate as of the Closing Date;

8. Subject to the provisions of SECTION 5.16 hereof, certain books, records, papers, files, customer lists, referral lists and advertising materials of the Seller relating to the Business and/or the Assets which is located on the premises of the Business;

and

9. The petty cash held at locations of the Business as of the Closing Date.

B. EXCLUDED ASSETS. Notwithstanding anything to the contrary in SECTION 1.1 hereof, it is specifically understood and agreed by the parties hereto that the Seller is not selling, and the Purchaser is not purchasing, the following assets used by the Seller in connection with the Business (the "Excluded Assets"):

1. All insurance policies of the Seller obtained or maintained by or on behalf of the Business and all rights thereunder and all rights or refunds or loss adjustment claims or credits as may exist under self-insurance programs maintained or established with respect to the Business;

2. All tax refunds, tax claims, rights to carrybacks or carryforwards, and claims for tax credits, deductions, or other tax benefits of Seller or its Affiliates (as defined in SECTION 8.3 hereof) in respect of the Business for all tax periods ending on or before the Closing Date;

3. All assets relating to or arising out of any employee benefit plans, including pension, savings or health plans maintained by Seller or its parent or for employees of the Business;

4. All rights to the patents, trademarks, tradenames, servicemarks and other intellectual property owned by Seller, including the trade names "Carrier", "Payne", "Bryant", and "Totaline", and the rights to use such names (alone or in conjunction with other words), and the logos, slogans or marks of Seller, except as otherwise specifically permitted by the Distributor Agreements;

5. All checks and drafts of Seller, all of Seller's records and files, banking records, tax returns, accounting records and such other similar books and records located at offices of Seller other than those of the Comfort Products Business or the NAO Central Plains Business (the "Corporate Files"), including, without limitation, such books and records as may relate to the Business to the extent the same are archived documents (not stored in actively maintained or accessed file systems), or documents which constitute compilations or consolidations of documents located at facilities of the Business or studies or analyses of the Business, its prospects or its personnel;

6. Except as set forth in SECTION 5.4 hereof, all computer hardware and software used in connection with ROADS system and all software licensed to Seller by

The Climatic Corporation;

7. All indemnity and contribution rights granted to or owed by third parties with respect to liabilities and obligations pertaining to the Business that do not constitute Assumed Liabilities (as defined herein) and any and all rights or assets arising from and directly related to the defense, release, compromise, discharge or satisfaction by Seller of such liabilities and obligations;

8. All cash and cash equivalents and deposit accounts of the Business other than petty cash;

9. Except as set forth in SECTION 5.17 hereof, all lease agreements pertaining to the vehicles heretofore used in connection with the Business and all rights to use such vehicles;

10. All receivables, notes or accounts which have been assigned, purchased or transferred to Carrier Distribution Credit Corporation ("CDCC") or for which CDCC has given value, and all chattel paper, notes, security agreements, financing agreements, guarantees and similar agreements pertaining thereto and rights arising therefrom and any rights or benefits related thereto, and all receivables due from CDCC at Closing as set forth on SCHEDULE 1.2(J) attached hereto;

11. All intercompany arrangements, which shall terminate as of the Closing Date, all intercompany freight claims, the ROADS hardware and software, and intercompany receivables; and

12. All bank accounts utilized by Seller with respect to the Business.

C. METHOD OF CONVEYANCE. The Assets shall be transferred to Purchaser at Closing pursuant to the following instruments of conveyance (collectively, the "Instruments of Conveyance"):

1. The sale, transfer, conveyance, assignment and delivery by the Seller of the Assets to the Purchaser hereunder shall be effected on the Closing Date by Seller's delivery of a bill of sale in the form attached hereto as EXHIBIT 1.3(A).

2. Each of the Real Property Leases shall be transferred to Purchaser pursuant to assignment and assumption agreements in the form attached hereto as EXHIBIT 1.3(B).

3. The Contracts and Equipment Leases (except for those for which

Seller and Purchaser executed sublease agreements at Closing) shall be transferred to Purchaser pursuant to an assignment and assumption agreement in the form attached hereto as EXHIBIT 1.3(C).

D. LIMITATIONS ON TRANSFER.

1. Anything herein to the contrary notwithstanding, no contract, agreement, commitment or arrangement, lease, license or permit which would otherwise constitute one of the Contracts, the Equipment Leases, the Real Property Leases or the permits, shall be deemed transferred or assigned to Purchaser pursuant to this Agreement, if the attempted transfer or assignment of same to Purchaser without the consent or approval of another party or governmental entity would be ineffective or would constitute a breach thereof or a violation of any law or regulation or would, in any other way, have a Material Adverse Effect on the rights of Seller (or Purchaser as a transferee or assignee) thereunder (the "Unassigned Contracts"). If such consent or approval is not obtained, or if any attempted assignment would be ineffective or constitute such a breach or violation or so affect such rights, then Purchaser and Seller shall, with respect thereto, enter into any other reasonable arrangement, including a subcontracting, subleasing or agency arrangement, designed to provide Purchaser with the benefit of the Unassigned Contracts, transfer to Purchaser the performance obligations or full economic risk, expenses and costs associated therewith and indemnify Seller with respect thereto. In any event, Purchaser shall fully indemnify Seller with respect to all liabilities and obligations arising out of the Unassigned Contracts.

2. In making the conveyance of the Assets to Purchaser as contemplated by this Agreement, Seller is doing so on an "AS IS" and "WHERE IS" basis and except for the representations and warranties expressly made by Seller in this Agreement or in the agreements delivered by Seller in connection with the consummation of transactions contemplated hereby, SELLER IS NOT MAKING ANY REPRESENTATION, WARRANTY OR GUARANTEE WHATSOEVER, WHETHER EXPRESSED OR IMPLIED, ARISING BY LAW OR OTHERWISE, INCLUDING, WITHOUT LIMITATION, WITH RESPECT TO THE DESIGN, CONDITION, CAPACITY, VALUE, UTILITY, PERFORMANCE, QUALITY, OR DOCUMENTATION OF ANY ASSETS OR THE BUSINESS, OR THE COLLECTIBILITY OF ANY ACCOUNTS, THE ENFORCEABILITY OF ANY LEASE OR CONTRACT, OR REGARDING THE VIABILITY OR CONTINUED SUCCESS OF THE BUSINESS, IN CONNECTION WITH THE SALE, ASSIGNMENT, LEASE, SUBLEASE, OR TRANSFER OF THE ASSETS OR THE BUSINESS, NOR IS SELLER MAKING ANY IMPLIED WARRANTY OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE WITH RESPECT TO THE ASSETS. Nonetheless, the inventory sold herein shall be sold subject to the terms and conditions of the Distributor Agreements executed by the Purchaser in connection with this Agreement.

3. Purchaser has been given the opportunity to make an independent

examination of the Assets and is relying on said independent examination at its own risk. The parties have negotiated the Purchase Price extensively and in part may have used the available financial statements of the Business as the basis for some of the negotiations. However, notwithstanding the use of such financial statements, and such matters as the level of reserves as may have been established for obsolescence, bad debts or contingent liabilities of the Business, no representation with respect thereto is being made by Seller herein or in connection herewith, and other than the adjustments contemplated under SECTION 2.3 hereof, no adjustments are to be made with respect to the Purchase Price for the Assets on or after the Closing as a result of what is or is not reflected therein.

E. RECONVEYANCE. Purchaser shall reconvey to Seller any assets that are intended to be Excluded Assets but which are nonetheless conveyed to Purchaser at Closing as a result of inadvertence, oversight, operation of law or whatever cause. Such reconveyance shall be on a similar basis as the Seller's conveyance of the Assets to Purchaser.

F. ASSUMED LIABILITIES. From and after the Closing Date, the Purchaser hereby agrees to assume, satisfy and discharge the following liabilities, duties, requirements, responsibilities and obligations of the Seller which are attributable to the Business, as and when the same shall become due (the "Assumed Liabilities"):

1. All trade payables arising out of or relating to the Business as set forth on SCHEDULE 1.6(A) attached hereto, whether or not reflected on the financials of the Business;

2. All liabilities arising out of or relating to the Real Property Leases;

3. All liabilities and obligations arising out of or relating to the Contracts, including Contracts which are not disclosed on SCHEDULE 3.8 attached hereto if Purchaser has assumed the benefit of or received value in connection with any such Contracts;

4. All liabilities and obligations arising out of the Equipment Leases and the permits;

5. All liabilities and obligations arising out of or relating to collection actions or efforts relating to the Receivables;

6. All liabilities or obligations to credit or make payment to customers of the Business with respect to sale, service, pricing, promotion or collection related matters or disputes;

7. All obligations and liabilities to pay commissions earned by employees of the Business on sales that are completed after the Closing Date (that is, payment is received after the Closing Date but an offer was made prior to the Closing Date);

8. The Business has had an arrangement with CDCC wherein the Business has undertaken certain obligations with respect to dealer inventories financed by CDCC. Purchaser hereby agrees, as of the Closing Date, to assume all obligations and duties of the Business with respect to inventories sold prior to Closing and with respect to CDCC floor plan arrangements in effect on the Closing Date. Purchaser will enter into a new agreement with CDCC with respect to post-Closing sales of goods. A list of dealers for which inventories have been financed by CDCC is set forth in SCHEDULE 1.6(H) hereto (the "CDCC Financed Dealer List");

9. All liabilities and obligations arising out of or relating to the Dealer Promotions established by the Business as set forth in SECTION 5.6 hereof;

10. All liabilities and obligations arising out of or relating to customer advances received by the Business and all liabilities and obligations of the Business to pay customer credits, including all those reflected on the financial statements of the Business as of the Closing Date;

11. All liabilities and obligations arising out of product warranty claims with respect to the Business or predecessors to the Business, whether made before, on or after the Closing Date, whether or not disclosed or reserved or reflected on the books and records or financial statements of the Business and whether based on expressed or implied warranty, including claims involving returns and allowances without regard to the date of shipment or sale of the product in question or whether the product was discontinued prior to the Closing Date;

12. All liabilities and obligations arising out of or relating to recourse agreements or obligations applicable to receivables or accounts or notes of the Business or receivables, accounts or notes assigned or transferred to CDCC;

13. All liabilities and obligations of the Business arising in the ordinary course and relating to the purchase and sale of products, whenever incurred or accrued, other than Seller's obligations owed to employees of the Business which accrued prior to the Closing Date and liabilities specifically allocated under this Agreement;

14. All liabilities and obligations of Seller accrued through the Closing Date for the payment to persons employed in the Business, for accrued vacation pay, accrued sick days or any other absences from work for which Seller would be obligated to pay an employee of the Business; provided, however, that Seller shall give Purchaser a credit

against the Purchase Price equal to the total amount of vacation days accrued by Employees of the Business during the first three (3) months of calendar year 1997 in the amount set forth on SCHEDULE 1.6(N) attached hereto; and

15. All liabilities and obligations arising out of or relating to the operation of the Business on or after the Closing Date, it being understood however that notwithstanding any of the assumptions made in this Section, Purchaser is not assuming liabilities arising out of the Excluded Assets.

G. EXCLUDED LIABILITIES. Except for the Assumed Liabilities, the parties hereto acknowledge and agree that (a) the Purchaser shall not assume, satisfy, discharge or otherwise be responsible for any liability, obligation, debt or commitment of the Seller of any kind or nature whatsoever, whether absolute or contingent, accrued or unaccrued, asserted or unasserted, known or unknown or otherwise, including but not limited to any liabilities, obligations, debts or commitments of the Seller arising out of or incurred with respect to this Agreement and the transactions contemplated hereby (the "Excluded Liabilities") and (b) all of the Excluded Liabilities shall remain the sole, exclusive and absolute responsibility of the Seller.

III.

PURCHASE PRICE

A. PURCHASE PRICE. In reliance on the representations, warranties, agreements and covenants of the Seller made herein, and as full consideration for the Assets to be sold, transferred, conveyed or delivered by the Seller to the Purchaser pursuant to this Agreement, the Purchaser agrees to pay to the Seller an aggregate purchase price equal to the sum of the following (the "Purchase Price"):

1. the book value of the Assets, less (i) reserves for obsolete and damaged inventories, doubtful accounts and depreciation, and (ii) the book value of all Assumed Liabilities as reflected on the financial statements of the Business (such difference being hereinafter referred to as the "Net Asset Value"); plus

2. the product obtained by multiplying the Net Asset Value times thirty percent (30%) (the "Goodwill Value").

B. PAYMENT OF PURCHASE PRICE.

1. At Closing, the Seller shall deliver to the Purchaser an itemization of the Purchase Price in the form attached hereto as SCHEDULE 2.2, calculated in the

manner set forth in SECTION 2.1 hereof.

2. At the Closing, the Purchaser shall deliver the Purchase Price to the Seller, in immediately available funds by wire transfer to Chase Manhattan Bank, N.A., New York, New York ABA #021000021 for the "Account of Carrier Corporation NAO account #XXXXXX," or to such other account as Seller may specify in writing at least two (2) Business Days (as defined in SECTION 8.3 hereof) prior to the Closing.

C. PURCHASE PRICE ADJUSTMENT.

1. Within forty-five (45) Business Days following the Closing Date, Arthur Andersen, LLP (the "Auditor") shall have conducted, in accordance with GAAP (as defined in SECTION 8.3 hereof) and Generally Accepted Auditing Standards, an audit of the Purchase Price for the limited purpose of confirming (i) that the reserves for obsolete and damaged inventories, doubtful accounts and depreciation are, in the aggregate, adequate, and (ii) that the accounts for the Assets and Assumed Liabilities are presented fairly in all material respects. To the extent the audit reveals that the reserves, in the aggregate, are inadequate or over-reserved or that the Assets and Assumed Liabilities are materially misstated, the Auditor shall deliver to the Purchaser and Seller a report detailing the discrepancies and the corresponding adjustment to the Purchase Price (whether upward or downward), together with supporting documentation (the "Auditor's Report").

2. If either the Purchaser or the Seller disagrees with any adjustment to the Purchase Price set forth in the Auditor's Report, the Purchaser or the Seller, as the case may be, may within twenty (20) Business Days after receipt thereof deliver a written notice to the other disagreeing with such adjustment. Any such notice of disagreement shall specify in reasonable detail those items or amounts comprising the adjustment to the Purchase Price as to which such party disagrees and the basis of such disagreement. If no such notice of disagreement is timely delivered, the adjustment to the Purchase Price as set forth in the Auditor's Report shall be final and binding on the parties hereto.

3. If a notice of disagreement shall be timely delivered pursuant to SECTION 2.3(B) hereof, the parties shall, during the ten (10) Business Days following such delivery, use their reasonable best efforts to reach agreement on the disputed items. If such an agreement is reached, the Purchase Price as so agreed shall be final and binding on the parties hereto. If the parties are unable to reach such agreement, a Big Six accounting firm, not then performing services for the Seller or the Purchaser and which has not done so for the past three (3) years, to which the parties mutually agree (the "Accounting Referee") shall be retained to promptly review the Auditor's Report and the disputed items or amounts. The Accounting Referee shall deliver to the Seller and the Purchaser, as promptly as practicable, a report setting forth the adjustments, if any, to the Purchase Price and the calculations supporting such adjustments. The report of the Accounting Referee shall be final and binding

upon the parties hereto and the Purchase Price, as determined by the Accounting Referee, shall be final and binding on the parties hereto. The cost of the Accounting Referee's review and report shall be borne equally by the Purchaser and the Seller.

4. If the adjusted Purchase Price, as determined by the Accounting Referee or as agreed upon by the parties (as the case may be), exceeds the Purchase Price, then the Purchaser shall pay the amount of such excess to the Seller, as an adjustment to the Purchase Price, in the manner and with interest as provided in this SECTION 2.3(D). If the Purchase Price exceeds the adjusted Purchase Price, as determined by the Accounting Referee or as agreed upon the parties (as the case may be), then the Seller shall pay the amount of such excess to the Purchaser, as an adjustment to the Purchase Price, in the manner and with interest as provided in this SECTION 2.3(D). Any payments pursuant to this SECTION 2.3(D) shall be made by wire transfer (to an account at a United States bank designated in writing by the Purchaser or to an account at a United States Bank designated in writing by the Seller, as the case may be) of immediately available funds on the second Business Day following the date on which the adjusted Purchase Price is finally determined (either by the Accounting Referee or as agreed upon by the parties, as the case may be) or on the twentieth (20th) Business Day after the receipt of the Auditor's Report, in the event that neither the Purchaser nor the Seller disagrees with the adjustments to the Purchase Price as set forth therein. The amount of any such payment shall bear interest for the period from and including the Closing Date to but excluding the payment date at the rate of six percent (6%), calculated on the basis of a 365 day year and the actual number of days for which the payment is due.

D. PURCHASE PRICE ALLOCATION. The Purchase Price shall be allocated among the Assets in accordance with Section 1060 of the Internal Revenue Code of 1986, as amended (the "Code") and the regulations promulgated thereunder. The allocation of the Purchase Price shall be agreed upon by the Seller and the Purchaser within thirty (30) days after the resolution of any adjustments to the Purchase Price as set forth in SECTION 2.3 hereof; provided, however, that the Purchaser and Seller shall make a good faith estimate of the Purchase Price allocation at Closing on Form 8594. The Seller and the Purchaser agree to file timely all returns required under Code Section 1060 and the regulations promulgated thereunder based on the allocations agreed to by the parties and further agree that they will not take any position inconsistent therewith on any Tax Return (as defined in SECTION 3.9), report or other document of any kind or in the course of any audit, examination or other proceeding by any federal, state, local or other taxing authority (or other governmental authority), court or tribunal.

E. PRORATIONS AND ADJUSTMENTS. The operation of the Business and all income and expenses attributable thereto through the Closing shall be for the account of the Seller and thereafter shall be for the account of the Purchaser. Expenses such as power and utility charges, property assessments, rents, license fees, dues, subscriptions and other charges, real property taxes, ad valorem or personal property taxes and all other items of income and expense (unless specifically provided otherwise in this Agreement) relating to the Business shall be prorated between the Seller and the Purchaser as of the Closing Date. All prorations shall be made and the Purchase Price shall be adjusted insofar as feasible on the Closing Date. In the event that the Purchaser or the Seller shall receive invoices or bills after the Closing Date for expenses incurred prior to the Closing Date that were not prorated in accordance with this SECTION 2.5, then the Purchaser or the Seller, as the case may be, shall promptly notify the other party as to the amount of the expense subject to proration and the responsible party shall pay its portion of such expense without interest (or, in the event such expense has been paid on behalf of the responsible party, reimburse the other party for its portion of such expense without interest). All prorations shall be resolved by the parties within thirty (30) days after the resolution of any adjustments to the Purchase Price as set forth in SECTION 2.3 hereof.

IV.

REPRESENTATIONS AND WARRANTIES OF THE SELLER

The Seller hereby makes the following representations and warranties to the Purchaser:

A. CORPORATE ORGANIZATION. The Seller is a corporation duly organized, validly existing and in good standing under the laws of the State of Delaware with full corporate power and authority to (a) carry on and operate the Business as it is now being conducted and (b) own and lease the Assets. With respect to the operation of the Business, Seller is duly qualified or licensed to do business, in good standing, in the jurisdictions set forth on SCHEDULE 3.1 attached hereto.

B. AUTHORIZATION, ETC. The Seller has corporate power and authority to enter into this Agreement and the agreements and documents contemplated hereby and perform its obligations hereunder and thereunder. All corporate and other actions required to be taken by Seller to authorize it to execute and deliver this Agreement and to carry out the transactions contemplated hereby have been duly and properly taken. Upon execution and delivery of this Agreement, and all other agreements contemplated hereby, by the parties hereto and thereto, this Agreement and all other agreements contemplated hereby shall constitute the legal, valid and binding obligation of the Seller, enforceable against the Seller in accordance with their respective terms, except as limited by bankruptcy, insolvency, reorganization, arrangement, moratorium or similar laws relating to or affecting the rights of creditors, and subject to the effect of general principles of equity, including without limitation concepts of materiality, reasonableness, good faith and fair dealing and the possible unavailability of specific performance or injunctive relief, regardless of whether considered in a proceeding in equity or at law.

C. NO VIOLATION. The execution, delivery and performance by the Seller of this Agreement, and all other agreements contemplated hereby, and the fulfillment of and compliance with the respective terms hereof and thereof by the Seller, do not and will not violate, conflict with or result in a breach of the terms, conditions or provisions of (i) the articles of incorporation or bylaws of the Seller, or (iii) any material Regulation or Order (as such terms are defined in SECTION 8.3 hereof) applicable to the Business.

D. HART-SCOTT-RODINO FILING. Seller has filed the Notification and Report Forms and related material that it is required to file with the Federal Trade Commission and the Antitrust Division of the United States Department of Justice under the HSR Act (as defined in SECTION 8.3 hereof) in connection with the transaction contemplated hereby. In connection therewith, Seller shall make such further filings or information submissions pursuant thereto that may be necessary, proper or advisable.

E. FINANCIAL INFORMATION. To the knowledge of Seller, SCHEDULE 3.5 attached hereto sets forth, in all material respects, (i) the gross margin of the Business, and (ii) the sales of the Business for the years ended December 31, 1996, December 31, 1995, and December 31, 1994.

F. ACCOUNTS RECEIVABLE. To the knowledge of Seller, the accounts receivable reflected in the unaudited financial statements of the Business arise out of bona fide sales and deliveries of goods or the performance of services by the Business.

G. EMPLOYEES. SCHEDULE 3.7 attached hereto sets forth a list of the Seller's employees who perform services for, or on behalf of, the Business (the "Employees") and the job title, service dates and current rate of compensation of each such Employee. The Seller is not a party to any collective bargaining agreement or other labor agreement relating to the Business or employees of the Business.

H. CONTRACTS. A list of certain written Contracts to which Seller is subject in connection with the Business is set forth on SCHEDULE 3.8 attached hereto, copies of which have been provided to the Purchaser.

I. TITLE AND RELATED MATTERS. The Seller has good and marketable title to the Assets (including, without limitation, the inventory), free and clear of Liens (as defined in SECTION 8.3 hereof), except for (i) Liens reflected in the financial statements of the Business or the notes thereto, (ii) statutory Liens for current taxes and assessments not yet due and payable, (iii) minor defects or encumbrances which do not materially impair use or value, and (iv) matters and assets set forth on SCHEDULE 3.9 attached hereto. Subject to the Real Property Leases, Equipment Leases, and permits, at the Closing Purchaser will acquire good and valid title to the Assets (other than inventories sold or disposed of in the ordinary course of business) free and clear of any Liens except for the Liens to which the Assets are currently subject as set forth above.

J. LITIGATION. Except as disclosed on SCHEDULE 3.10 attached hereto, there is no Claim (as defined in SECTION 8.3 hereof) pending against the Business which, if adversely determined, would adversely affect the Business or the Assets, nor is there any Order outstanding against the Business having a Material Adverse Effect on the Business or the Assets.

K. TAX MATTERS.

1. With respect to the Business, the Seller has filed or caused to be filed on a timely basis with the appropriate Authorities, federal, state, local and other returns and reports in respect of Taxes (as defined below) that are required to be filed on or before the Closing Date (the "Tax Returns").

2. With respect to the Business, the Seller (i) has paid or caused to be paid on a timely basis Taxes, assessments, fees and other governmental charges required to be paid as of the Closing Date as shown on the Tax Returns, (ii) has reserved on its books of account and/or financial statements an amount sufficient to satisfy Taxes accrued, but not paid, as of the Closing Date and (iii) shall timely pay, after the Closing Date, Taxes, assessments, fees and other governmental charges accrued, but unpaid, as of the Closing Date.

3. There are no liens, claims or other encumbrances upon the Assets for any Taxes due under any Tax Return or for any Taxes due that are not shown on any Tax Return.

4. For purposes of this Agreement, the term "Taxes" shall be understood and interpreted to include any tax or similar governmental charge, impost or levy (including, without limitation, income taxes, franchises taxes, transfer taxes or fees, gross receipts taxes, value added taxes, employment taxes, excise taxes, import taxes, ad valorem taxes, real and personal property taxes, intangibles taxes, stamp taxes, withholding taxes, payroll taxes, minimum taxes, sales and use taxes and windfall profits taxes), together with any related penalties, fines, additions to tax and/or interest imposed by any Authority (as defined in SECTION 8.3 hereof).

L. COMPLIANCE WITH LAW AND APPLICABLE GOVERNMENT REGULATIONS. Seller has not received written notification of any failure to comply with any Regulations applicable to the Business which would have a Material Adverse Effect on the Business or the Assets as of the Closing Date that have not been or will not be remedied and resolved by Seller or the Business prior to the Closing Date if practicable. Seller has not received any written notice regarding any violations of any Regulations or Orders relating to the Business or the operation thereof enforced by any Authority claiming jurisdiction over the Business, which violations would have a Material Adverse Effect on the Business or the Assets as of the Closing Date.

M. BROKERAGE. The Seller has not employed any broker, finder, advisor, consultant or other intermediary in connection with this Agreement or the transactions contemplated by this Agreement who is or might be entitled to any fee, commission or other compensation from the Seller or its Affiliates, upon or as a result of the execution of this Agreement or the consummation of the transactions contemplated hereby.

N. CLAIMS. To the best of Seller's knowledge and recognizing that all employees of the Business with particular knowledge of a Claim may have become or will become employees of Purchaser, SCHEDULE 3.14 attached hereto sets forth Claims seeking damages in excess of $50,000, other than collection claims and service and concession claims arising in the ordinary course of business, related to the Business of which Seller has received written notice.

O. DISCLAIMER. Seller's representations and warranties are subject to and qualified by any relevant fact or facts disclosed in the Agreement, and the schedules thereto, or any other document prepared by Seller and delivered to Purchaser at Closing or pursuant to this Agreement. Disclosures made in the schedules to this Agreement, or in such other documents, shall be deemed to be disclosures made by Seller for all purposes with respect to this Agreement. The inclusion by Seller in any particular schedule of items that may not be needed or required to be given so as to make a representation or warranty true, correct or not misleading shall not be construed as an indication that all items of similar scope and degree are required or have been included in every other schedule and shall be deemed to be included for the sole purpose of providing additional information to the Purchaser. Purchaser acknowledges and agrees that a representation or warranty made by the Seller will be deemed to have been breached only if the principals of Purchaser had actual or constructive knowledge of facts that rendered the representation untrue, and to the extent Purchaser has actual or constructive knowledge of a fact or facts that should be disclosed by Seller so as to make a representation or warranty true and correct and not misleading, Seller shall not be deemed to be in breach of such representation or warranty by reason of its failure to disclose such facts, and further, to the extent representations are made to Seller's knowledge, such knowledge will be deemed to mean the knowledge of the officers of Seller and its Employees whose names are set forth on SCHEDULE 3.15 attached hereto.

V.

## REPRESENTATIONS AND WARRANTIES OF THE PURCHASER

The Purchaser hereby makes the following representations and warranties to the Seller:

A. CORPORATE ORGANIZATION, ETC. The Purchaser is a corporation duly organized, validly existing and in good standing under the laws of its jurisdiction of incorporation with full corporate power and authority to carry on its business as it is now being conducted and to own, operate and lease its properties and assets. The Purchaser is duly qualified or licensed to do business, in good standing, in the jurisdictions set forth on SCHEDULE 4.1 attached hereto.

B. AUTHORIZATION, ETC. The Purchaser has full corporate power and authority to enter into this Agreement and to carry out the transactions contemplated hereby. The Board of Directors of the Purchaser has duly authorized the execution, delivery and performance of this Agreement, and the other agreements and transactions contemplated hereby, and no other corporate proceedings on the part of the Purchaser are necessary to authorize this Agreement or the transactions contemplated hereby. Upon execution and delivery of this Agreement and all other agreements contemplated hereby by the parties hereto and thereto, this Agreement, and all other agreements contemplated hereby, shall constitute the legal, valid and binding obligations of the Purchaser, enforceable against it in accordance with their respective terms.

C. NO VIOLATION. The execution, delivery and performance by the Purchaser of this Agreement, and all other agreements contemplated hereby, and the fulfillment of and compliance with the respective terms hereof and thereof by the Purchaser, do not and will not violate, conflict with or result in a breach of the terms, conditions or provisions of (i) the articles of incorporation, bylaws or any other organizational document of the Purchaser, or (iii) any material Regulation or Order applicable to Purchaser.

D. FURTHER ASSURANCES. Purchaser does not know of any fact or condition which would render Seller's representations and warranties made under this Agreement untrue, incorrect or misleading.

E. HART-SCOTT-RODINO FILING. Purchaser has filed the Notification and Report Forms and related material that it is required to file with the Federal Trade Commission and the Antitrust Division of the United States Department of Justice under the HSR Act in connection with the transaction contemplated hereby. In connection therewith, Purchaser shall use its best efforts to obtain an early termination of the applicable waiting period and shall make any further filings or information submissions pursuant thereto that may be necessary, proper or advisable.

F. NO ACTIVITY. Except for activities in connection with its formation and arrangements with its lenders necessary to acquire the Assets at Closing, Purchaser has transacted no business and entered into no agreements relative to the Business.

G. FINANCING. Purchaser has cash on hand, or has received written commitments from lenders, sufficient to enable Purchaser to acquire the Assets at Closing and any such loan commitments remain in effect. Based upon reasonable judgment and study, Purchaser has determined that Purchaser is solvent and will have adequate capital to sustain the operations of the Business and retire Purchaser's anticipated obligations as they come due during the reasonably foreseeable period after the Closing Date.

H. TAX AND OTHER MATTERS. Purchaser has independently investigated the tax effect of this transaction, as well as the legal ramifications of same, has consulted with and has relied only upon its own expert advisers, accountants, and attorneys, and Seller has made no representations regarding taxes or other matters to induce Purchaser to enter into this transaction.

VI.

COVENANTS AND AGREEMENTS

The Purchaser and the Seller covenant and agree as follows:

A. FURTHER ASSURANCES. If at any time after the Closing Date the Purchaser or Seller shall consider or be advised that any further deeds, assignments or assurances in law or in any other things are necessary, desirable, advisable or proper to effectuate the transactions contemplated by this Agreement, the Purchaser or Seller, as appropriate, shall execute and deliver all such proper deeds, assignments and assurances in law and do all things necessary, desirable or proper to carry out and fulfill the purpose and intent of this Agreement and the other agreements contemplated hereby.

B. NON-COMPETITION AND TRANSFER RESTRICTION. At the Closing, the Seller and Purchaser shall enter into a Non-Competition and Transfer Restriction Agreement, in a form acceptable to Purchaser and Seller, which shall prohibit the distribution of competing products by Purchaser and its Affiliates in the territory serviced by the Business and shall impose restrictions on the sale, transfer, disposition or closure of the Business by Purchaser following the Closing Date. Purchaser acknowledges and agrees that the Non-Competition and Transfer Restriction Agreement is essential and material to Seller entering into this Agreement and the Distributor Agreements with Purchaser, and Seller will not enter into this Agreement and the Distributor Agreements without the Non-Competition and Transfer Restriction Agreement.

C. EMPLOYEES.

1. The Purchaser hereby agrees that the Employees listed on SCHEDULE 3.7 attached hereto, will remain employees of the Business and that Purchaser shall offer employment to such Employees immediately following the Closing Date at the salary

levels (or higher) and subject to comparable employee benefits and rights under existing employment agreements or arrangements in effect with Seller immediately prior to the Closing Date, as set forth on SCHEDULE 3.7 attached hereto. Employees shall be fully vested in Purchaser's health insurance plan on the effective date of hire, with no exclusions for pre-existing conditions. Purchaser shall not terminate the Employees for a period of one hundred eighty (180) days following the Closing Date, except for just and sufficient cause, or, in the event Purchaser shall terminate any Employee without cause during such 180 day period, Purchaser shall pay such Employee in accordance with the severance policies of Seller as set forth on SCHEDULE 5.3 attached hereto.

2. After the Closing Date, the Purchaser will give to each Employee the same service credit with the Purchaser as each such Employee previously earned up to the Closing Date for purposes of determining the Employee's eligibility to participate in, vesting under, benefit accrual under, eligibility for early distribution of benefits from and eligibility for early retirement or any other subsidized benefit provided for in any employee benefit plan, practice or policy established, maintained or contributed to by the Purchaser in which such Employee is eligible to participate; PROVIDED that the Purchaser is permitted to do so under applicable Regulations without any liability to the Purchaser.

3. The Purchaser shall allow Employees to take, during the one (1) year period after the Closing, all vacation days earned by the Employees and accrued by the Seller, but unused by the Employees prior to the Closing.

4. The Purchaser and the Seller agree that, subject to the indemnification obligations of Purchaser pursuant to SECTION 7.3 hereof, the Purchaser shall have responsibility for (i) workers' compensation Claims occurring on or after the Closing Date and (ii) all other liabilities and obligations pertaining to the Employees and employment related matters occurring on or after the Closing Date. All liabilities pertaining to the Employees and employment related matters occurring prior to the Closing Date shall be the sole responsibility of the Seller, except to the extent to which Seller is entitled to seek indemnification from Purchaser hereunder.

D. COMPUTER ASSISTANCE. From and after the Closing Date until December 31, 1997, Seller shall, upon written request of Purchaser, allow Purchaser to continue to utilize the ROADS computer system hardware and software for the period and on the terms set forth in EXHIBIT 5.4 hereto (the "ROADS Agreement") but Seller shall have no liability for services provided under the ROADS Agreement. With respect to software used for the accounts payable, this software is owned by The Climatic Corporation, and Purchaser should seek a license directly from The Climatic Corporation if it desires to continue using such software. Nothing contained in this Agreement shall constitute a license of or authorization to use such software.

E. DISTRIBUTOR AGREEMENTS.

1. At the Closing, the Seller will enter into two distributor agreements, in the form provided by Seller (the "Distributor Agreements"), for Carrier, Payne and Bryant products: (a) one for the Comfort Products Business (Carrier and Payne brand products) and (b) one for NAO Central Plains Business (Carrier, Payne and Bryant brand products). The Distributor Agreements will have a term of two years, be non-exclusive, and grant to the Purchaser the right to distribute the relevant residential and light commercial products in the trade areas specified therein.

2. From and after the Closing, the Purchaser shall conduct the distribution operations of the Business and its relationship with various operating entities of Seller in accordance with the Distributor Agreements and the policies and procedures related thereto and the Marketing Plan attached to such Distributor Agreements. All other agreements, arrangements or commitments between or among the Business and Seller or its parent or one or more Affiliates of Seller or its parent, United Technologies Corporation ("UTC"), shall terminate as of Closing, except as expressly provided in this Agreement.

F. DEALER PROMOTIONS. From and after the Closing Date:

1. Purchaser shall be responsible for all obligations, whenever incurred, for which the Business was not invoiced prior to the Closing Date, in connection with Dealer Incentive Programs for dealers served by the Business.

2. Purchaser shall be responsible for all distributor obligations of the Business under consumer rebate programs and extended warranty programs with respect to any equipment installed by dealers regardless of installation date, and any other similar program pending as of the Closing Date.

3. Purchaser shall be responsible for the distributor portion of all Advertising Program obligations whenever incurred with respect to the Business.

4. It is understood and agreed that although there is no retention by Seller of any responsibility as described in subsections (a) through (c) above, Purchaser shall carry out administrative functions with respect to such programs, at least through the end of the applicable program year, on a basis consistent with the past practice of the Business, accept the burdens and benefits of the programs, and fulfill the Business' obligations to its customers and to end-users as contemplated by the programs.

5. It is further understood and agreed that Purchaser's agreement to

perform and discharge all of the Assumed Liabilities above shall continue in full force and effect in the event that Purchaser shall cease to be a distributor of Carrier, Payne and/or Bryant Branded products for any reason whatsoever.

G. ADVERTISING.

1. Seller agrees to assign all of its rights to its current telephone numbers and yellow page and other advertising with respect to the Business to Purchaser, and Purchaser agrees to assume and pay any and all charges with respect thereto not paid by the Business prior to the Closing Date, except that the actual charges for telephone calls and monthly service shall be pro-rated in accordance with SECTION 2.5 hereof.

2. To the extent permitted by the telephone company and subject to whatever conditions the telephone company may impose, Seller will cooperate with Purchaser in signing such documents as Purchaser may reasonably request in order to obtain for Purchaser the right to use the telephone numbers currently assigned to the Business by the telephone company.

H. PRICING, SPECIAL QUOTES AND CLAIMS.

1. With respect to all pricing programs in effect for the Business as of the Closing Date, Seller shall continue to honor such programs subsequent to the Closing in accordance with their respective terms and conditions until the respective expiration dates of such programs, except with respect to programs specifically modified by this Agreement.

2. Any special quotes or job quotes extended to the Business with respect to Branded equipment scheduled to be delivered on or after the Closing Date will be honored as Purchaser pricing claims within the limits of the respective quotes and subject to Seller's normal terms with respect to the filing of pricing claims.

I. FLOOR PLAN INVENTORY. Purchaser shall enter into at Closing the standard Distributor Floor Plan Agreement with CDCC with respect to additions to dealer inventories financed by CDCC subsequent to the Closing Date. Purchaser shall assume responsibility to CDCC for all dealer inventories financed by CDCC with respect to the Business and for dealerships serviced by the Business, including all guarantees and obligations of the Business which have been instituted pursuant to arrangements with CDCC, the payment of accrued interest to CDCC on floor planned equipment, and the repurchase of any repossessed equipment floor planned by dealers. Purchaser shall assume all the duties and obligations of the Business, if any, with relation to CDCC floor plan arrangements in effect on the Closing Date.

J. NAME CHANGE. As soon as possible but no later than six (6) months after the Closing Date, Purchaser shall identify itself as the owner of the Business and all properties related thereto and shall place its name in a prominent position viewable by the public on all of the leased or subleased property, all business records and other sales or advertising relating material (including materials used for the packaging of any product) received by Purchaser hereunder. Purchaser shall use its best efforts promptly to cause the appropriate telephone companies to change the listing of all telephone numbers used by the Business to Purchaser's name.

K. PERMITS. Purchaser shall, as soon as possible after the Closing Date, obtain in its own name all permits, licenses and approvals necessary to operate the Business and will immediately identify itself on all waste disposal bills of lading and certificates as owners of the Business.

L. FORWARDING OF PAYMENTS. From and after the Closing Date:

1. Any payment of monies to which Seller is entitled but which is made instead to Purchaser for whatever reason shall be promptly and in good faith forwarded to Seller by Purchaser in the manner directed by Seller.

2. Any payment of monies to which Purchaser is entitled but which is made instead to Seller for whatever reason shall be promptly and in good faith forwarded to Purchaser by Seller in the manner directed by Purchaser.

M. TERMINATION OF INTERCOMPANY ARRANGEMENTS. Prior to the date hereof, the Business has benefitted from a number of arrangements with Seller or its parent, UTC, and their respective Affiliates, including the use of Seller's cash management system, coverage under insurance policies obtained by Seller or self-insurance programs established by Seller, the use of certain financial and accounting services provided by Seller and certain credit and guaranty facilities and the like and the financial support provided to customers of the Business by Seller. Except as otherwise specifically provided for in this Agreement as between Purchaser and Seller or its Affiliates, all such intercompany arrangements shall terminate effective upon the Closing Date.

N. GUARANTY. At the Closing, Purchaser's parent company, Watsco, Inc., shall execute and deliver to Seller a Guaranty, in a form acceptable to Seller, pursuant to which Watsco, Inc. shall irrevocably and unconditionally guarantee to Seller the full and faithful performance by Purchaser or its Affiliates of any and all liabilities, duties and obligations of Purchaser and its Affiliates set forth in or contemplated by this Agreement.

O. PUBLIC ANNOUNCEMENTS. Neither the Seller nor the Purchaser, nor any representative or shareholder of either of them, shall disclose any of the terms of this

Agreement or the transaction contemplated hereby to any third party without the prior written consent of the Purchaser and Seller, unless such disclosure is required by applicable law; provided, however, that any information that has been disclosed to any third party in accordance with this Section shall no longer be deemed confidential and shall not be subject to further restrictions on disclosure.

P. ACCESS AGREEMENT. For a period of ten (10) years following the Closing Date, Purchaser and Seller shall each provide the other with access to the books, records, papers, files and other documents relating to the Business transferred to Seller pursuant to this Agreement (the "Documents"). The party desiring such access to Documents in possession of the other party shall provide the other party with reasonable notice of its need for access to the Documents, and the parties shall cooperate with respect to the review and copying of the Documents so as to cause minimal disruption of such other party's ongoing business operations. In the event that the Purchaser does not desire to maintain such Documents on the premises of the Business or at another location in which Seller may obtain access to the Documents, Purchaser shall package the Documents (or true and complete copies thereof) in a form reasonably requested by Seller and send the Documents to Seller for storage at Seller's facilities.

Q. LEASED VEHICLES. Purchaser may, subject to the lease agreements and consent of the lessor where required, purchase the leased vehicles used by Seller in connection with the Business by paying in full at Closing, or as soon thereafter as practicable, the amount necessary to purchase the vehicles from the lessor, including any tax, title, license and other fees imposed in connection with the sale of such vehicles. To the extent the purchase of the leased vehicles is not consummated at Closing, Purchaser shall provide Seller with proof of insurance covering the use of such vehicles at Closing, which proof shall include a certificate of insurance naming Seller as an additional insured and showing non-owner coverage as primary coverage.

R. CFC COMPLIANCE. Purchaser represents, covenants, and certifies that it is aware of and shall comply with the United States Environmental Protection Agency regulations set forth in 40 CFR ss.82.154, as amended, relating to the purchase of refrigerants after November 14, 1994, and that any Class I or Class II substances purchased pursuant to this Agreement shall be purchased only for eventual resale to certified technicians or to appliance manufacturers or, if charged into existing appliances, shall only be charged into the appliances by certified technicians.

VII.

## CLOSING

A. CLOSING. A closing of the transactions contemplated by this Agreement (the "Closing") shall be held on or before March 24, 1997 (or if later within three (3) Business

Days of the date that all conditions to the Closing have been satisfied or waived), at 10:00 am. at the offices of Foley & Lardner located at 111 N. Orange Avenue, Orlando, Florida 32801 or on or at such other date, time and/or place mutually agreed upon in writing by the parties hereto (the "Closing Date").

B. CLOSING DELIVERIES. At the Closing,

1. the Seller shall deliver or cause to be delivered to the Purchaser:

a. the Instruments of Conveyance required by SECTION 1.3;

b. a certificate, certified by an assistant secretary of Seller, as to the resolutions adopted by the directors of the Seller in connection with this Agreement and the incumbency of certain authorized representatives of the Seller who shall be signing the Agreement and related documents on behalf of the Business;

c. certificates issued by the appropriate governmental authorities evidencing the good standing, with respect to both the conduct of business and the payment of all franchise taxes, of the Seller as a corporation organized under the laws of the State of Delaware; and

d. an opinion of counsel to Seller (addressed to Purchaser), dated the Closing Date, which may rely on certificates of the officers or other authorized representatives of Seller, certificates issued by Authorities, and/or an opinion from Stephen Bullock, Assistant General Counsel of Seller;

e. the Distributor Agreements required by SECTION 5.5;

f. the Non-Competition and Transfer Restriction Agreement required by SECTION 5.2;

g. evidence of any consents to assignment of the Contracts obtained by Seller; and

h. such other certified resolutions, documents and certificates as are required to be delivered by the Seller pursuant to the provisions of this Agreement.

2. The Purchaser shall deliver to the Seller:

a. the Purchase Price specified in SECTION 2.2(b);

b. the Instruments of Conveyance required by SECTION 1.3;

c. a certificate, by the secretary of the Purchaser, as to the resolutions adopted by the directors of the Purchaser in connection with this Agreement, and the incumbency of certain officers of the Purchaser;

d. certificates issued by the appropriate governmental authorities evidencing the good standing, with respect to both the conduct of business and the payment of all franchise taxes, of the Purchaser as a corporation organized under the laws of the State of Florida; and

e. an opinion of counsel to Purchaser (addressed to Seller), dated the Closing Date, which may rely on certificates of the officers of Purchaser and/or certificates issued by Authorities;

f. the Distributor Agreements required by SECTION 5.5;

g. the Non-Competition and Transfer Restriction Agreement required by SECTION 5.2;

h. the Guaranty of Watsco, Inc. required by SECTION 5.14;

i. evidence of any consents to assignment of the Contracts obtained by Purchaser;

j. written evidence that all waiting periods applicable to the consummation of the transactions contemplated hereby under the HSR Act have expired or terminated;

k. if Purchaser is exercising its right to purchase the leased vehicles pursuant to SECTION 5.17 hereof, payment in full of the amount necessary to purchase the vehicles from the lessor, including any tax, title, license and other fees imposed in connection with the sale, or the appropriate certificate of insurance covering the use of such vehicles by Purchaser on and after the Closing Date; and

l. such other certified resolutions, documents and certificates as are required to be delivered by the Purchaser pursuant to the provisions of this Agreement.

VIII.

## SURVIVAL OF TERMS; INDEMNIFICATION

A. SURVIVAL. All of the terms and conditions of this Agreement, together with the representations, warranties and covenants contained herein or in any instrument or document delivered or to be delivered pursuant to this Agreement, shall survive the execution of this Agreement and the Closing; provided, however, that (a) the agreements and covenants (other than the indemnification provisions set forth in this ARTICLE VII and the representations and warranties, which shall survive as provided below) set forth in this Agreement shall survive and continue until all obligations set forth therein shall have been performed and satisfied; (b) the Tax indemnification agreements provided in SECTION 7.2 shall survive and continue until the expiration of the applicable statute of limitations; (c) the environmental indemnification agreements provided in SECTION 7.2 shall survive and continue with respect to each property leased by Seller pursuant to the Real Property Leases until the expiration of the current term specified under each such Real Property Lease; (d) the representations and warranties with respect to title to the Assets of the Seller in SECTION 3.9 hereof shall continue and survive without limitation; and (e) all other representations and warranties, and the agreements of the Sellers and the Purchaser to indemnify each other set forth in this ARTICLE VII, shall survive and continue until, and all Claims with respect thereto shall be made prior to, April 15, 1998, except for representations, warranties and indemnities for which an indemnification Claim shall be pending as of April 15, 1998, in which event such indemnities shall survive with respect to such Claim until the final disposition thereof.

B. INDEMNIFICATION BY THE SELLER. Subject to this ARTICLE VII, the Purchaser and its officers, directors, employees, shareholders, partners, representatives and agents shall be indemnified and held harmless by the Seller against and in respect of any and all damage, loss, deficiency, liability, obligation, commitment, claim, demand, action or cause of action, assessment, Tax, cost or expense (including, without limitation, all interest penalties and fees and expenses of counsel) (collectively, the "Losses") resulting from, or in respect of, any of the following (collectively, the "Indemnifiable Claims"):

1. A material misrepresentation, breach of warranty, or non-fulfillment of any obligation on the part of the Seller under this Agreement, any document relating thereto or contained in any schedule or exhibit to this Agreement or from any material misrepresentation in or omission from any certificate, schedule, other agreement or instrument by the Seller hereunder; provided, however, that Purchaser's sole remedy for a material breach of any representation or warranty hereunder shall be limited to seeking indemnification hereunder for actual monetary damages sustained by Purchaser as a direct result of such breach and Purchaser shall have no other remedies, at law or in equity;

2. Liabilities of the Seller existing prior to the Closing Date which are not (i) reflected and reserved against in the financial statements of the Business, or (ii) otherwise adequately disclosed in this Agreement or the schedules or exhibits thereto, or (iii)

Assumed Liabilities; provided, however, that Seller shall not be required to indemnify Purchaser for any undisclosed liability if Purchaser has assumed the benefit of or received value in connection with any such liability;

3. Tax liabilities of Seller, together with any interest or penalties thereon or related thereto, through the Closing Date which are imposed on Purchaser under theories of successor liability, excluding any Tax liability arising out of or in conection with the transaction described in this Agreement;

4. Environmental liabilities imposed by any Authority relating to any of the properties of the Business leased pursuant to the Real Property Leases, including any interest or penalties thereon or related thereto, which liabilities arise out of or relate to occurrences prior to the Closing Date, but excluding any amount for which there is an adequate accrual and reserve on the financial statements of the Business; and

5. Any other Claims arising out of or relating to occurrences in connection with the conduct and operation of the Business prior to the Closing Date, other than liabilities and obligations of the Business arising in the ordinary course and relating to the purchase and sale of products, whenever incurred or accrued.

C. LIMITATION. Notwithstanding SECTION 7.2:

1. There shall be no liability of Seller for indemnification under SECTION 7.2 hereof unless, and solely to the extent that, the aggregate amount of all Indemnifiable Claims exceed $250,000 (the "Indemnification Threshold"), and then only to the extent such Indemnifiable Claims exceed the Indemnification Threshold; provided, however, that the Seller's liability for indemnification shall not be subject to the Indemnification Threshold in connection with (i) indemnification liabilities arising out of any material breach of the representations and warranties made by the Seller in Sections 3.1, 3.2, 3.9 and 3.13 hereof, and (ii) indemnification liabilities arising pursuant to Sections 7.2(c) and 7.2(d) hereof.

2. In no event shall Seller's obligations and liabilities under SECTION 7.2 hereof exceed the Purchase Price, as adjusted pursuant to SECTION 2.3 hereof.

D. INDEMNIFICATION BY THE PURCHASER. Subject to this ARTICLE VII, the Seller and its officers, directors, employees, shareholders, partners, representatives and agents shall be indemnified and held harmless by the Purchaser against and in respect of any and all Losses resulting from, or in respect of, any of the following (collectively, the "Indemnifiable Claims"):

1. A material misrepresentation, breach of warranty, or non-fulfillment of any obligation on the part of the Purchaser under this Agreement, any document

relating thereto or contained in any schedule or exhibit to this Agreement, or from any material misrepresentation in or omission from any certificate, schedule, other agreement or instrument by the Purchaser hereunder;

2. Claims arising out of or relating to the Assumed Liabilities;

3. Claims arising out of or relating to the operation of the Business on and after the Closing Date;

4. Changes by Purchaser on and after the Closing Date in the level of benefits, severance pay plans and level of salary, wages and sundry compensation practices for employees of the Business hired by Purchaser;

5. Claims against Seller by any person arising out of or relating to any Claim of discrimination or other wrongful failure to hire of any employee of the Business on or after the Closing Date;

6. Tax liabilities arising out of or in connection with the transaction described in this Agreement, including, without limitation, all sales, use, recordation, documentary taxes and fees and other transfer taxes imposed by any Authority, and any penalties, fines, additions to tax and/or interest imposed by any Authority in connection with such Taxes, but excluding any income taxes of Seller arising out of or in connection with this Agreement; and

7. Claims arising out of or relating to the leased vehicles used in connection with the Business on and after the Closing Date.

E. THIRD-PARTY CLAIMS.

1. Except as otherwise provided in this Agreement, the following procedures shall be applicable with respect to Indemnifiable Claims asserted by third parties. Promptly after receipt by the party or parties seeking indemnification hereunder (hereinafter referred to as the "indemnitee") of notice of the commencement of any (a) Tax audit or proceeding for the assessment of Tax by any taxing authority or any other proceeding likely to result in the imposition of a Tax liability or obligation or (b) any action or the assertion (whether by legal process or otherwise) of any Claim by an indemnitee against which Claim the other party or parties to this Agreement (hereinafter referred to as the "indemnitor") is, or may be, required under this Agreement to indemnify such indemnitee, the indemnitee will, if a Claim thereon is to be, or may be, made against the indemnitor, notify the indemnitor in writing of the commencement or assertion thereof and give the indemnitor a copy of such Claim, process and all legal pleadings. The indemnitor shall have the right to participate in the defense of such action with counsel of reputable standing. The indemnitor shall have the

right to assume the defense of such action unless (w) such action may result in injunctions or other equitable remedies in respect of the indemnitee or its business; (x) such action may result in liabilities which, taken with other then existing Claims under this ARTICLE VII, would not be fully indemnified hereunder; (y) such action may have an adverse impact on the business or financial condition of the indemnitee after the Closing Date (including, without limitation, an effect on the Tax liabilities, earnings or ongoing business relationships of the indemnitee); or (z) there are defenses available to the indemnitee which are in conflict with those available to the indemnitor. The indemnitor and the indemnitee shall cooperate in the defense of such Claims. In the case that the indemnitor shall assume or participate in the defense of such audit, assessment or other proceeding as provided herein, the indemnitee shall make available to the indemnitor all relevant records and take such other action and sign such documents as are necessary to defend such audit, assessment or other proceeding in a timely manner. If the indemnitee shall be required by judgment or a settlement agreement to pay any amount in respect of any obligation or liability against which the indemnitor has agreed to indemnify the indemnitee under this Agreement, the indemnitor shall promptly reimburse the indemnitee in an amount equal to the amount of such payment plus all reasonable expenses (including, without limitation, legal fees and expenses) incurred by such indemnitee in connection with such obligation or liability subject to this ARTICLE VII.

2. Prior to paying or settling any Claim against which an indemnitor is, or may be, obligated under this Agreement to indemnify an indemnitee, the indemnitee must first supply the indemnitor with a copy of a final court judgment or decree holding the indemnitee liable on such claim or failing such judgment or decree, and must first receive the written approval of the terms and conditions of such settlement from the indemnitor. An indemnitor shall have the right to settle any Claim against the indemnitee, subject to the prior written approval of the indemnitee, which approval shall not be unreasonably withheld.

3. An indemnitee shall have the right to employ its own counsel in any case, but the fees and expenses of such counsel shall be at the expense of the indemnitee unless (a) the employment of such counsel shall have been authorized in writing by the indemnitor in connection with the defense of such action or Claim, (b) the indemnitor shall not have employed, or is prohibited under this SECTION 7.5 from employing, counsel in the defense of such action or Claim, or (c) such indemnitee shall have reasonably concluded that there may be defenses available to it which are contrary to, or inconsistent with, those available to the indemnitor, in any of which events such fees and expenses of not more than one additional counsel for the indemnified parties shall be borne by the indemnitor.

F. ASSISTANCE BY PURCHASER. In the event any Claim relating to the Business or Assets arises after the Closing Date and constitutes a Claim for which Purchaser is not otherwise obligated to indemnify Seller under this Agreement, Purchaser shall, on reasonable notice, fully cooperate, assist and cause its employees to fully cooperate and assist Seller in defending such Claim. Such cooperation and assistance shall include providing personnel to assist in the production of documents and to participate in consultations, depositions and trial to the same extent as they would if Purchaser was a party to or responsible for the dispute in question. Seller shall pay Purchaser for all out-of-pocket expenses incurred by its employees solely for the purposes of providing the cooperation and assistance required under the foregoing provisions, such as travel expenses and an allocated amount of the salary of Purchaser's employees reflecting time spent providing such cooperation and assistance. Purchaser shall use its best efforts and cause its employees to use their best efforts to preserve any attorney-client privilege which may exist with respect to such assistance. Purchaser shall cooperate and timely assist Seller in obtaining information for various authorities, including such information needed for accounting and tax workbooks, responses to audit requests, other filings to tax authorities, and other information necessary to comply with applicable Regulations. Seller shall reimburse Purchaser for reasonable out-of-pocket expenses actually incurred by Purchaser solely for purposes of providing the cooperation and assistance required hereunder.

IX.

MISCELLANEOUS PROVISIONS

A. AMENDMENT AND MODIFICATION. Subject to applicable law, this Agreement may be amended, modified and supplemented only by a written agreement signed by the Seller and the Purchaser.

B. ENTIRE AMENDMENT. This Agreement, including the schedules and exhibits hereto and the documents, certificates and instruments referred to herein, embodies the entire agreement and understanding of the parties hereto in respect of the transactions contemplated by this Agreement and supersedes all prior agreements, representations, warranties, promises, covenants, arrangements, communications and understandings, oral or written, express or implied, between the parties with respect to such transactions. There are no agreements, representations, warranties, promises, covenants, arrangements or understandings between the parties with respect to such transactions, other than those expressly set forth or referred to herein.

C. CERTAIN DEFINITIONS.

1. As used in this Agreement, the following terms shall have the meanings set forth below:

"AFFILIATE" means, with regard to any Person, (i) any Person, directly or indirectly, controlled by, under common control of, or controlling such Person, (ii) any Person, directly or indirectly, in which such Person holds, of record or beneficially, five percent (5%) or more of the equity or voting securities, or (iii) any Person that possesses, of record or beneficially, five percent (5%) or more of the combined voting rights for all classes of equity securities of such Person.

"AUTHORITY" means any governmental, regulatory or administrative body, agency, arbitrator or authority, any court or judicial authority, any public, private or industry regulatory agency, arbitrator authority, whether international, national, federal, state or local.

"BUSINESS DAY" shall mean any day other than a Saturday, a Sunday or a day on which banks in Miami, Florida are authorized or obligated by law or executive order to close.

"CLAIM" means any written claim, obligation, liability, expense, lawsuit, demand, suit, inquiry, hearing, notice of a violation, litigation, proceeding, arbitration, or other dispute, whether civil, criminal, administrative or otherwise, whether pursuant to contractual obligations or otherwise.

"GAAP" means generally accepted accounting principles, applied on a consistent basis.

"HSR ACT" shall mean the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended.

"LIEN" means any security interest, lien, mortgage, pledge, hypothecation, encumbrance, easement, restriction or interest of another Person of any kind or nature.

"MATERIAL ADVERSE EFFECT" means any circumstances, state of facts or matters which has, or might reasonably be expected to have, a material adverse effect on the operations, properties, assets, condition (financial or otherwise), results, plans, strategies or prospects of the Business, in the aggregate.

"ORDER" means any decree, judgment, award, order, consent decree, settlement agreement, injunction, rule, or consent of or by an Authority.

"PERSON" means any corporation, partnership, joint venture, company, syndicate, organization, association, trust, entity, Authority or natural person.

"REGULATION" means any law, statute, rule, regulation, ordinance, requirement, announcement or other binding action of or by an Authority.

D. NOTICES. All notices, requests, demands and other communications required or permitted hereunder shall be in writing and shall be deemed to have been duly given when delivered by hand or mailed, first class certified mail with postage paid or by overnight receipted courier service:

1. If to the Seller, to:

Carrier Corporation
Carrier Parkway
P.O. Box 4800
Syracuse, New York 13221
Attention: Steve Bullock, Esq.

with a copy to:

Foley & Lardner
111 N. Orange Avenue, Suite 1800
P.O. Box 2193
Orlando, Florida 32802-2193
Attention: John A. Sanders, Esq.

or to such other person or address as the Sellers shall furnish by notice to the Purchaser in writing.

2. If to the Purchaser to:

CP Distributors Inc.
2665 South Bayshore Drive Suite 901
Miami, Florida 33133
Attention: Mr. Albert H. Nahmad

with a copy to:
Greenberg, Traurig, Hoffman,
Lipoff, Rosen & Quentel, P.A.
1221 Brickell Avenue
Miami, Florida 33131
Attention: Martin Kalb, Esq.

or to such other person or address as the Purchaser shall furnish by notice to the Sellers in writing.

E. WAIVER OF COMPLIANCE, CONSENTS. Any failure of any party hereto to comply with any obligation, covenant, agreement or condition herein may be waived in writing by the other parties hereto, but such waiver or failure to insist upon strict compliance with such obligation, covenant, agreement or condition shall not operate as a waiver of, or estoppel with respect to, any subsequent or other failure. Whenever this Agreement requires or permits consent by or on behalf of any party hereto, such consent shall be given in writing.

F. ASSIGNMENT. This Agreement and all of the provisions hereof shall be binding upon and inure to the benefit of the parties hereto and their respective successors and permitted assigns, but neither this Agreement nor any of the rights, interests or obligations hereunder shall be assigned by any of the parties hereto without the prior written consent of the other parties, except that the Purchaser may assign its rights, interests and obligations hereunder to any wholly owned Subsidiary, and may grant Liens or security interests in respect of its rights and interests hereunder without the prior approval of the Seller.

G. GOVERNING LAW. The Agreement shall be governed by the internal laws of the State of Florida as to all matters, including but not limited to matters of validity, construction, effect and performance.

H. CONSENT TO JURISDICTION; SERVICE OF PROCESS. In the event the Purchaser shall bring a legal action against Seller in connection with any Claim arising out of or relating to this Agreement and the transactions contemplated hereby, Purchaser shall file such action in the state or federal courts located in Onondaga County, New York. In the event the Seller shall bring a legal action against Purchaser in connection with any Claim arising out of or relating to this Agreement and the transactions contemplated hereby, Seller shall file such action in the state or federal courts located in Dade County, Florida. Each party irrevocably submits to the jurisdictions set forth above and hereby agrees not to assert, by way of motion, as a defense, or otherwise in any such suit, action or proceeding that the suit, action or proceeding is brought in an inconvenient forum, that the venue of the suit, action or proceeding is improper or that this Agreement or the subject matter hereof may not be enforced by such courts.

I. INJUNCTIVE RELIEF. The parties hereto agree that in the event of a breach of any provision of this Agreement, the aggrieved party or parties may be without an adequate remedy at law. The parties therefore agree that in the event of a breach of any provision of this Agreement, the aggrieved party or parties may elect to institute and prosecute proceedings in any court of competent jurisdiction to enforce specific performance or to enjoin the continuing breach of such provision, as well as to obtain damages for breach of this Agreement. By seeking or obtaining any such relief, the aggrieved party shall not be precluded from seeking or obtaining any other relief to which it may be entitled.

J. COUNTERPARTS. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

K. HEADINGS. The article and section headings contained in this Agreement are for reference purposes only and shall not affect in any way the meaning or interpretation of this Agreement.

L. BINDING EFFECT. This Agreement shall not be construed so as to confer any right or benefit upon any Person other than the signatories to this Agreement and each of their respective successors and permitted assigns.

M. DELAYS OR OMISSIONS. No delay or omission to exercise any right, power or remedy accruing to any party hereto, upon any breach or default of any other party under this Agreement, shall impair any such right, power or remedy of such party nor shall it be construed to be a waiver of any such breach or default, or an acquiescence therein, or of or in any similar breach or default thereafter occurring; nor shall any waiver of any single breach or default be deemed a waiver of any other breach or default theretofore or thereafter occurring. Any waiver, permit, consent or approval of any kind or character on the part of any party hereto of any breach or default under this Agreement, or any waiver on the part of any party of any provisions or conditions of this Agreement must be made in writing and shall be effective only to the extent specifically set forth in such writing. All remedies, either under this Agreement or by law or otherwise afforded to any party, shall be cumulative and not alternative.

N. SEVERABILITY. Unless otherwise provided herein, if any provision of this Agreement shall be invalid, illegal or unenforceable, the validity, legality and enforceability of the remaining provisions shall not in any way be affected or impaired thereby.

O. EXPENSES. All fees, costs and expenses (including, without limitation, legal, auditing and accounting fees, costs and expenses) incurred in connection with considering, pursuing, negotiating, documenting or consummating this Agreement and the transactions contemplated hereby shall be borne and paid solely by the party incurring such fees, costs and expenses.

P. ATTORNEYS' FEES. If any legal action is brought for the enforcement of any of the provisions of this Agreement, the prevailing party or parties shall be entitled to recover from the other party or parties, upon final judgment on the merits, reasonable attorneys' fees, court costs and all other costs and expenses incurred in bringing such action (including, without limitation, attorneys' fees incurred at trial, during any appeal or during negotiations).

Q. EXHIBITS AND SCHEDULES. The Exhibits and Schedules referred to in this Agreement are attached hereto and incorporated herein by this reference and made a part hereof. Disclosure of a specific item in any one Schedule shall be deemed to be a disclosure for all purposes to which such disclosure relates, whether or not disclosed in each and every

Schedule hereto.

R. TRANSFER TAXES. The Purchaser shall bear the expense of, and shall pay, any and all sales, use, recordation, documentary taxes and fees and other transfer taxes arising out of or in connection with this transaction and shall execute and deliver to Seller such certificates of resale or similar documentation to support available exemptions from tax in the form and substance reasonable satisfactory to Seller.

S. BULK SALES. The Purchaser and the Seller acknowledge that the Seller does not intend to comply with the Bulk Sale Acts of Iowa, Kansas, Missouri, Nebraska or South Dakota in connection with the transaction contemplated by this Agreement. The Seller hereby agrees to indemnify and hold the Purchaser harmless from and against any loss, damage, liability or expense resulting from the Seller's failure to comply with said Acts.

[Signature page follows]

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the day and year first above written.

CP DISTRIBUTORS INC., a
Florida corporation

By: /s/ Barry Logan
----------------------
Name: Barry Logan
Title: President

CARRIER CORPORATION, a
Delaware Corporation

By: /s/ Charles Figueroa
----------------------
Name: Charles Figueroa
Title: Vice-President

EXHIBIT 11

WATSCO, INC. AND SUBSIDIARIES
COMPUTATION OF EARNINGS PER SHARE
For the Years Ended December 31,
(In thousands, except share data)

| | 1996 | 1995 (1) | 1994 (1) |
|---|---|---|---|
| Net Income | $12,992 | $7,250 | $5,762 |
| Less subsidiary preferred stock dividend | (130) | (130) | (130) |
| Income applicable to common stock for primary earnings per share | 12,862 | 7,120 | 5,632 |
| Add interest expense, net of income tax effects, attributable to assumed conversion of convertible debentures | 70 | 108 | 121 |
| Income applicable to common stock for fully diluted earnings per share | $12,932 | $7,228 | $5,753 |
| Weighted average common shares outstanding | 12,861,456 | 9,295,945 | 9,160,912 |
| Dilutive stock options and warrant | 898,316 | 577,428 | 328,280 |
| Shares for primary earnings per share | 13,759,772 | 9,873,373 | 9,489,192 |
| Assumed conversion of debentures | 233,485 | 360,783 | 401,342 |
| Additional dilution of stock options and warrant | 198,423 | 221,749 | 78,858 |
| Shares for fully diluted earnings per share | 14,191,680 | 10,455,905 | 9,969,392 |
| Net income per primary share | $.93 | $.72 | $.59 |
| Net income per fully diluted share | $.91 | $.69 | $.58 |

(1) The share amounts for 1995 and 1994 have been restated to reflect three-for-two stock splits effected in the form of a 50% dividend paid by the Company on June 14, 1996 and May 15, 1995.

EXHIBIT 13

WATSCO, INC. AND SUBSIDIARIES
SELECTED CONSOLIDATED FINANCIAL DATA - FIVE YEAR SUMMARY

| YEARS ENDED DECEMBER 31, (IN THOUSANDS, EXCEPT PER SHARE DATA) | 1996 | 1995 | 1994 | 1993 (1) | 1992 |
|---|---|---|---|---|---|
| OPERATIONS | | | | | |
| Revenues | $ 425,389 | $ 331,008 | $ 283,731 | $ 230,656 | $ 194,633 |
| Income before income taxes and minority interests | $ 21,218 | $ 14,070 | $ 12,028 | $ 10,147 | $ 7,134 |
| Income taxes | (8,110) | (5,234) | (4,630) | (3,819) | (2,746) |
| Minority interests | (116) | (1,586) | (1,636) | (1,287) | (1,470) |
| Net income | $ 12,992 | $ 7,250 | $ 5,762 | $ 5,041 | $ 2,918 |
| SHARE DATA | | | | | |
| Net income per share (1): | | | | | |
| Primary | $ .93 | $ .72 | $ .59 | $ .56 | $ .47 |
| Fully diluted | .91 | .69 | .58 | .54 | .42 |
| Cash dividends declared per share: | | | | | |
| Common Stock | $ .14 | $ .13 | $ .11 | $ .11 | $ .10 |
| Class B Common Stock | .14 | .13 | .11 | .11 | .10 |
| Common stock outstanding (2) | 14,032 | 9,423 | 9,226 | 9,127 | 6,596 |
| BALANCE SHEET INFORMATION | | | | | |
| Total assets | $ 203,581 | $ 144,884 | $ 119,664 | $ 109,685 | $ 81,138 |
| Long-term obligations: | | | | | |
| Borrowings under revolving credit agreements | $ 48,000 | $ - | $ - | $ - | $ - |
| Bank and other debt | 3,720 | 3,818 | 2,719 | 3,672 | 3,979 |
| Subordinated notes and debentures | -- | 2,500 | 2,500 | 2,500 | 5,500 |
| Convertible subordinated debentures | -- | -- | 1,505 | 1,676 | 4,060 |
| | $ 51,720 | $ 6,318 | $ 6,724 | $ 7,848 | $ 13,539 |
| Shareholders' equity | $ 119,929 | $ 53,756 | $ 46,816 | $ 41,754 | $ 25,272 |

- ----------
(1) AMOUNTS FOR 1993 INCLUDE THE NON-RECURRING RECEIPT OF INSURANCE PROCEEDS FOR BUSINESS INTERRUPTION CLAIMS FOLLOWING HURRICANE ANDREW, WHICH HAD THE EFFECT OF INCREASING INCOME BEFORE INCOME TAXES AND MINORITY INTERESTS BY $1,130,000 AND NET INCOME BY $706,000. EXCLUDING THIS ITEM, FULLY DILUTED EARNINGS PER SHARE WAS $.47 ($.48 PRIMARY).

(2) SHARE DATA INCLUDES THE EFFECTS OF THREE-FOR-TWO SPLITS EFFECTED ON JUNE 14, 1996 AND MAY 15, 1995.



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

RESULTS OF OPERATIONS

The following table presents certain items of the Company's consolidated financial statements for the three years ended December 31, 1996, 1995 and 1994, expressed as a percentage of total revenues:

| | 1996 | 1995 | 1994 |
|---|---|---|---|
| Total revenues | 100.0% | 100.0% | 100.0% |
| Cost of sales and direct service expenses | 77.5 | 77.9 | 77.7 |
| Gross profit | 22.5 | 22.1 | 22.3 |
| Selling, general and administrative expenses | 16.8 | 16.7 | 17.0 |
| Operating income | 5.7 | 5.4 | 5.3 |

| | | | |
|---|---|---|---|
| Investment income, net | .2 | .1 | -- |
| Interest expense | .9 | 1.2 | 1.1 |
| Income taxes | 1.9 | 1.6 | 1.6 |
| Minority interests | -- | .5 | .6 |
| Net income | 3.1% | 2.2% | 2.0% |

The following narratives include the results of operations of wholesale distributors of air conditioning and heating equipment and related parts and supplies acquired during 1995 and 1996: Airite, Inc., acquired in February 1995; H.B. Adams , Inc., acquired in March 1995; Environmental Equipment & Supplies, Inc., acquired in May 1995; Central Air Conditioning Distributors, Inc., acquired in October 1995; Three States Supply Company, Inc., acquired in April 1996; Serviceman Supplies, Inc., acquired in October 1996 and Coastal Supply Company, Inc., acquired in December 1996. These acquisitions were accounted for under the purchase method of accounting and, accordingly, their results of operations have been included in the consolidated results of the Company beginning on their respective dates of acquisition. The Company operates principally in two industry segments: climate control and personnel services. The climate control segment includes the Company's distribution and manufacturing subsidiaries.

COMPARISON OF YEAR ENDED DECEMBER 31, 1996
WITH YEAR ENDED DECEMBER 31, 1995

Revenues in 1996 increased $94.4 million, or 29%, over 1995. In the climate control segment, revenues increased $91.8 million, or 31%. Excluding the effect of acquisitions, revenues in the climate control segment increased $25.6 million, or 9%. Such increase was primarily due to increased sales of replacement air conditioners, increased homebuilding activity and higher sales due to the expansion of product lines for parts and supplies.

Gross profit in 1996 increased $22.3 million, or 30%, over the prior year. Excluding the effect of acquisitions, gross profit increased $5.4 million, or 7%, primarily as a result of the increase in revenues described above. Gross profit margin increased to 22.5% in 1996 from 22.1% in 1995. Excluding the effect of acquisitions, gross profit margin decreased to 21.9% in 1996 from 22.1% in 1995. This decrease was primarily due to certain vendor price increases in late 1995, which the Company did not begin passing on to customers until late in the first quarter of 1996, and additional price increases in mid-1996, which were not fully passed on to customers in the second and third quarters.

Selling, general and administrative expenses in 1996 increased $16.1 million, or 29%, over 1995 primarily due to selling and delivery costs related to increased sales. Excluding the effect of acquisitions, selling, general and administrative expenses increased $4.4 million, or 8%, also due to revenue increases. Selling, general and administrative expenses as a percent of revenues increased to 16.8% in 1996 from 16.7% in 1995.

This increase was due to higher costs as a percent of revenues from acquisitions. Excluding the effect of acquisitions, selling, general and administrative expenses as a percent of revenues decreased to 16.6% in 1996 from 16.7% in 1995. This decrease was the result of a larger revenue base over which to spread fixed costs.

Interest expense in 1996 decreased $565,000, or 13%, from 1995 due to lower average interest rates on borrowings. Excluding the effects of acquisitions, interest expense decreased $1.1 million, or 26%. This decrease was due to lower average interest rates on borrowings, interest management activities and repayment of long-term obligations having higher rates of interest.

Minority interest expense in 1996 decreased $1.5 million compared to the same period in 1995. This decrease was due to the acquisition by the Company of the minority common equity interests in certain distribution subsidiaries in March 1996.

The effective income tax rate increased to 38.2% in 1996 compared to 37.2% in the prior year. The increase was primarily the result of the proportionately larger share of taxable income generated in higher tax rate states in 1996 compared to 1995.

COMPARISON OF YEAR ENDED DECEMBER 31, 1995
WITH YEAR ENDED DECEMBER 31, 1994

Revenues in 1995 increased $47.3 million, or 17%, over 1994. The distribution operations' revenues increased $46.4 million, or 20%. Excluding the effect of acquisitions, revenues for the distribution operations' increased $18.8 million, or 8%. This increase in sales was mainly due to increased sales of replacement air conditioners in Florida and Texas. Revenues in the Company's manufacturing operations decreased $874,000, or 4%, primarily due to lower sales to OEMs caused by higher levels of inventory held by customers during the year. Revenues in the personnel services operations increased $1.8 million, or 6%, reflecting higher demand for temporary help services and greater customer acceptance of new product offerings such as professional staffing and technical temporaries.

Gross profit in 1995 increased $10.1 million, or 16%, over the prior year. Excluding the effect of acquisitions, gross profit increased $3.7 million, or 6%, primarily as a result of the increase in revenues described above. Gross profit margin decreased from 22.3% in 1994 to 22.1% in 1995 with acquisitions having no impact on gross profit margin. These decreases were primarily due to the increased sale of lower margin products by the distribution operations and new product start-up costs in the manufacturing operations.

Selling, general and administrative expenses in 1995 increased $7.1 million, or 15%, over 1994 primarily due to selling and delivery costs related to increased sales. Excluding the effect of acquisitions, selling, general and administrative expenses increased $2.5 million, or 5%, also due to revenue increases. Selling, general and administrative expenses as a percent of revenues decreased to 16.7% in 1995 from 17.0% in 1994, with 1995 acquisitions have no effect on such percentage. This decrease was the result of a larger revenue base over which to spread fixed costs.

Interest expense in 1995 increased $1.1 million, or 34%, over 1994 due to higher interest rates and additional borrowings used to finance acquisitions and increased inventory levels required by sales growth and sticking requirements in new branch locations. Excluding the effects of acquisitions, interest expense increased $471,000, or 15%, primarily due to higher average monthly borrowings and higher interest rates.

The effective income tax rate decreased to 37.2% in 1995 compared to 38.5% in the prior year. The decrease was primarily the result of the proportionately larger share of taxable income generated in lower tax rate states in 1995 compared to 1994.

LIQUIDITY AND CAPITAL RESOURCES

In September 1996, the Company executed a bank-syndicated revolving credit agreement which provides for borrowings of up to $130 million, expiring on September 30, 2001. The unsecured agreement replaced the Company's previous revolving credit facilities and will be used to fund acquisitions and seasonal working capital needs and for other general corporate purposes. Borrowings under the revolving credit agreement, which totaled $48 million at December 31, 1996, bear interest at primarily LIBOR-based rates plus a spread that is dependent upon the Company's financial performance (LIBOR plus .375% at December 31, 1996). The revolving credit agreement contains financial covenants with respect to the Company's consolidated net worth, interest and debt coverage ratios, and limits capital expenditures and dividends in addition to other restrictions.

Working capital increased to $130.0 million in 1996 from $41.2 million in 1995. In March 1996, the Company completed a public offering of 2,355,000 shares (adjusted for a three-for-two stock split) of Common Stock that yielded net proceeds of $32.1 million. In April 1996, the Company used approximately $14.7 million of the net proceeds to fund the acquisition of Three States Supply Company, Inc. ("Three States"), a Memphis, Tennessee-based distributor of supplies used primarily in air conditioning and heating systems, and $2.5 million to repay a 12% subordinated note. In September 1996, the Company used approximately $14.9 million of the remaining offering proceeds to reduce borrowings under its revolving credit agreements.

Cash and cash equivalents increased $1.3 million in 1996. Principal sources of cash were net proceeds from the issuance of common stock, borrowings under the revolving credit agreements and profitable operations. The principal uses of cash were to fund working capital needs, acquire Three States, repay long-term obligations and fund capital expenditures. Inventory purchases are substantially funded by borrowings under revolving credit agreements. The increase in inventory in 1996 was higher than 1995 primarily due to higher levels of inventory carried by the distribution operations to meet increased demand caused by growth and broaden product offerings to better serve customer needs.

In January 1997, the Company completed the acquisition of the common stock of Coastline Distribution, Inc. and substantially all of the operating assets of four branch operations from Inter-City Products Corporation (USA) for a cash payment of approximately $22.4 million and is subject to adjustment upon the completion of an audit of the assets purchased and liabilities assumed.

In February 1997, the Company completed a public offering of 3,000,000 shares of Common Stock resulting in net proceeds of $85.5 million, a significant portion of which was used to repay outstanding borrowings under its revolving credit agreement. The Company anticipates using the remainder of the proceeds to fund its growth strategy and for general corporate purposes.

In March 1997, the Company completed the purchase of substantially all of the operating assets and assumption of certain liabilities of Carrier Corporation's Comfort Products Distributing and Central Plains Distributing distribution operations. Comfort Products and Central Plains sell heating and air conditioning equipment from eight branches serving Missouri, Kansas, Nebraska, Iowa, North Dakota and South Dakota. Cash consideration paid by the Company totaled $26.4 million and is subject to adjustment upon the completion of an audit of the assets purchased.

The Company has adequate availability of capital from operations and its revolving credit agreement to fund present operations and anticipated growth, including expansion in the Company's current and targeted market areas. The Company continually evaluates additional acquisitions and has held discussions with a number of acquisition candidates; however, the Company currently has no agreement with respect to any potential significant acquisition. Should suitable acquisition opportunities or working capital needs arise that would require additional financing, the Company believes that its current financial position, earnings history and increase of its capital base from a recent public offering provide a solid base for expanding its existing capacity for debt capital at competitive rates and terms.

NEW ACCOUNTING STANDARDS

During 1996, the Company adopted Statement of Financial Accounting Standards -("SFAS") No. 121, "Accounting for Long-Lived Assets and for Long-Lived Assets to be Disposed of". The adoption of SFAS No. 121 did not have a material effect on the Company's consolidated financial position or results of operations.

During 1996, the Company adopted the SFAS No. 123, "Accounting for Stock-Based Compensation", which requires new disclosures and provides guidance for new accounting methods related to employee stock-based compensation plans. The Company continues to account for its stock-based compensation plan in accordance with APB Opinion No. 25, "Accounting for Stock Issued to Employees", as allowed under SFAS No. 123. The disclosures required by SFAS No. 123 are shown in Note 6 of the Company's 1996 consolidated financial statements.

WATSCO, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

| YEARS ENDED DECEMBER 31, (IN THOUSANDS, EXCEPT PER SHARE DATA) | 1996 | 1995 | 1994 |
|---|---|---|---|
| Revenues: | | | |
| Net sales | $ 390,775 | $ 298,939 | $ 253,433 |
| Service fees and royalties | 34,614 | 32,069 | 30,298 |
| Total revenues | 425,389 | 331,008 | 283,731 |
| Costs and expenses: | | | |
| Cost of sales | 303,076 | 233,089 | 197,397 |
| Direct service expenses | 26,714 | 24,621 | 23,122 |
| Selling, general and administrative expenses | 71,353 | 55,288 | 48,169 |
| Total costs and expenses | 401,143 | 312,998 | 268,688 |
| Operating income | 24,246 | 18,010 | 15,043 |
| Other income (expense): | | | |
| Investment income, net | 628 | 281 | 140 |
| Interest expense | (3,656) | (4,221) | (3,155) |
| Total other income (expense) | (3,028) | (3,940) | (3,015) |
| Income before income taxes and minority interests | 21,218 | 14,070 | 12,028 |
| Income taxes | (8,110) | (5,234) | (4,630) |
| Minority interests | (116) | (1,586) | (1,636) |
| Net income | $ 12,992 | $ 7,250 | $ 5,762 |
| Earnings per share: | | | |
| Primary | $ .93 | $ .72 | $ .59 |
| Fully diluted | .91 | .69 | .58 |

THE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS ARE AN INTEGRAL PART OF THESE STATEMENTS.

WATSCO, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

| DECEMBER 31, (IN THOUSANDS, EXCEPT SHARE DATA) | 1996 | 1995 |
|---|---|---|
| ASSETS | | |
| Current Assets: | | |
| Cash and cash equivalents | $ 5,020 | $ 3,751 |
| Marketable securities | 334 | 267 |
| Accounts receivable, net | 59,523 | 43,564 |
| Inventories | 87,637 | 59,724 |
| Prepaid expenses and other current assets | 6,502 | 5,073 |
| Total current assets | 159,016 | 112,379 |
| Property, plant and equipment, net | 16,174 | 11,286 |
| Intangible assets, net | 23,596 | 16,995 |
| Other assets | 4,795 | 4,224 |
| | $203,581 | $144,884 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current Liabilities: | | |
| Current portion of long-term obligations | $ 794 | $ 2,455 |
| Short-term promissory notes | - | 4,250 |
| Borrowings of subsidiaries under revolving credit agreements | - | 40,185 |
| Accounts payable | 17,343 | 17,229 |
| Accrued liabilities | 10,884 | 7,091 |
| Total current liabilities | 29,021 | 71,210 |
| Long-term Obligations: | | |
| Borrowings under revolving credit agreement | 48,000 | - |
| Bank and other debt | 3,720 | 3,818 |
| Subordinated note | - | 2,500 |
| Total long-term obligations | 51,720 | 6,318 |
| Deferred income taxes | 911 | 978 |
| Preferred stock of subsidiary | 2,000 | 2,000 |
| Minority interests | - | 10,622 |
| Commitments and contingencies (Notes 2, 9 and 10) | | |
| Shareholders' Equity: | | |
| Common Stock, $.50 par value, 11,853,738 and 7,202,304 shares issued and outstanding in 1996 and 1995, respectively | 5,927 | 3,601 |
| Class B Common Stock, $.50 par value, 2,178,100 and 2,221,021 shares issued and outstanding in 1996 and 1995, respectively | 1,089 | 1,111 |
| Paid-in capital | 72,129 | 19,396 |
| Retained earnings | 40,784 | 29,648 |
| Total shareholders' equity | 119,929 | 53,756 |
| | $203,581 | $144,884 |

THE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS ARE AN INTEGRAL PART OF THESE BALANCE SHEETS.

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

| (IN THOUSANDS, EXCEPT SHARE DATA) | COMMON STOCK SHARES | COMMON STOCK AMOUNT | PAID-IN CAPITAL | RETAINED EARNINGS |
|---|---|---|---|---|
| BALANCE AT DECEMBER 31, 1993 | 9,126,864 | $4,563 | $18,098 | $19,093 |
| Conversion of debentures | 42,495 | 21 | 171 | |
| Contribution to 401(k) plan | 19,020 | 10 | 127 | |
| Issuances from exercise of stock options | 37,723 | 19 | 119 | |
| Common stock cash dividends, $.11 per share of Common Stock and $.11 per Class B share | | | | (1,037) |
| Dividends on 6.5% Series A preferred stock of subsidiary | | | | (130) |
| Net income | | | | 5,762 |
| BALANCE AT DECEMBER 31, 1994 | 9,226,102 | 4,613 | 18,515 | 23,688 |
| Conversion of debentures | 36,604 | 18 | 146 | |
| Contribution to 401(k) plan | 13,563 | 7 | 142 | |
| Issuances from exercise of stock options and warrant | 147,056 | 74 | 593 | |
| Common stock cash dividends, $.13 per share of Common Stock and $.13 per Class B share | | | | (1,160) |
| Dividends on 6.5% Series A preferred stock of subsidiary | | | | (130) |
| Net income | | | | 7,250 |
| BALANCE AT DECEMBER 31, 1995 | 9,423,325 | 4,712 | 19,396 | 29,648 |
| Conversion of debentures | 336,249 | 168 | 1,339 | |
| Issuance from public offering | 2,355,000 | 1,177 | 30,935 | |
| Contribution to 401(k) plan | 11,373 | 6 | 282 | |
| Issuances from exercise of stock options and employee stock purchase plan | 425,850 | 213 | 2,908 | |
| Tax benefit from exercise of stock options | | | 1,296 | |
| Issuances for acquisitions | 1,480,041 | 740 | 15,973 | |
| Common stock cash dividends, $.14 per share of Common Stock and $.14 per Class B share | | | | (1,726) |
| Dividends on 6.5% Series A preferred stock of subsidiary | | | | (130) |
| Net income | | | | 12,992 |
| BALANCE AT DECEMBER 31, 1996 | 14,031,838 | $7,016 | $72,129 | $40,784 |

THE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS ARE AN INTEGRAL PART OF THESE STATEMENTS.

WATSCO, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

| YEARS ENDED DECEMBER 31, (IN THOUSANDS) | 1996 | 1995 | 1994 |
|---|---|---|---|
| Cash flows from operating activities: | | | |
| Net income | $12,992 | $ 7,250 | $ 5,762 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | | |
| Depreciation and amortization | 4,170 | 2,994 | 2,345 |
| Provision for doubtful accounts | 1,541 | 1,197 | 597 |
| Net investment gains | (35) | (27) | (6) |
| Deferred income tax benefit | (379) | (25) | (237) |
| Noncash stock contribution to 40l(k) plan | 288 | 149 | 137 |
| Minority interests, net of dividends paid | 116 | 765 | 304 |
| Changes in operating assets and liabilities, net of effects of acquisitions in 1996 and 1995: | | | |
| Accounts receivable | (9,304) | (3,207) | (5,151) |
| Inventories | (16,026) | 644 | (300) |
| Accounts payable and accrued liabilities | (644) | 1,505 | (797) |
| Other, net | (1,614) | (198) | (229) |
| Net cash provided by (used in) operating activities | (8,895) | 11,047 | 2,425 |
| Cash flows from investing activities: | | | |
| Cash used in acquisitions, net of cash acquired | (15,310) | (12,987) | - |
| Capital expenditures, net | (5,449) | (4,248) | (4,148) |
| Net proceeds from sales (purchases) of marketable securities | 58 | 3,012 | (2,258) |
| Net cash used in investing activities | (20,701) | (14,223) | (6,406) |
| Cash flows from financing activities: | | | |
| Repayments of long-term obligations | (5,856) | (555) | (222) |
| Repayments of short-term promissory notes | (4,471) | - | - |
| Net borrowings under revolving credit agreements | 7,815 | 6,361 | 5,883 |
| Net proceeds from issuances of common stock | 35,233 | 667 | 138 |
| Cash dividends | (1,856) | (1,290) | (1,167) |
| Net cash provided by financing activities | 30,865 | 5,183 | 4,632 |
| Net increase in cash and cash equivalents | 1,269 | 2,007 | 651 |
| Cash and cash equivalents at beginning of year | 3,751 | 1,744 | 1,093 |
| Cash and cash equivalents at end of year | $ 5,020 | $ 3,751 | $ 1,744 |
| Supplemental disclosures: | | | |
| Income taxes paid | $ 6,023 | $ 4,999 | $ 4,709 |
| Interest paid | 4,204 | 4,186 | 3,149 |

THE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS ARE AN INTEGRAL PART OF THESE STATEMENTS.

## 1. SIGNIFICANT ACCOUNTING POLICIES

### Nature of Operations

Watsco, Inc. ("Watsco") and its subsidiaries (the "Company") is the largest distributor of residential central air conditioning and heating equipment and related parts and supplies in the United States. The Company has strong market positions in 14 sunbelt states, including leading positions in Florida, Texas and California, the three largest air conditioning markets in the country. The Company also manufactures electronic and mechanical components for air conditioning, heating and refrigeration equipment that are sold to wholesale distributors and original equipment manufacturers. In addition, the Company operates Dunhill Staffing Systems, Inc., a nationwide provider of temporary staffing and permanent placement services.

### Basis of Consolidation

The consolidated financial statements include the accounts of Watsco, Inc. and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated.

### Revenue Recognition

The Company recognizes revenue upon shipment of products for its manufacturing and distribution businesses and upon delivery of services for its personnel services business.

### Inventories

The Company's inventories are stated at the lower of cost (first-in, first-out method) or market.

### Property, Plant and Equipment

Property, plant and equipment are carried at cost. Depreciation of property, plant and equipment is provided on the straight-line method. Buildings and improvements are being depreciated over estimated useful lives ranging from 5-40 years. Estimated useful lives for other depreciable assets range from 3-10 years.

### Intangible Assets

Intangible assets, net of accumulated amortization of $2,644,000 and $2,040,000 at December 31, 1996 and 1995, respectively, consists of goodwill arising from the excess of the cost of acquired businesses over the fair value of their net assets. Goodwill is amortized on a straight-line basis over 40 years. The Company periodically reviews goodwill based on expectations of undiscounted cash flows and operating income to assess whether recorded amounts are fully recoverable. Amortization expense related to goodwill amounted to $604,000, $401,000 and $364,000 in 1996, 1995 and 1994, respectively.

### Income Taxes

Deferred tax assets and liabilities reflect the temporary differences between the financial statement and income tax bases of assets and liabilities.

### Cash and Cash Equivalents

The Company considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents.

### Marketable Securities

Effective January 1, 1994, the Company adopted Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities". The adoption of this statement did not have a material effect on the Company's consolidated operating results or financial position in 1994. At December 31, 1996 and 1995, marketable securities consists primarily of tax exempt municipal bonds and equity securities and have been classified as "available for sale" securities by the Company. At December 31, 1996 and 1995, the difference between the cost of such securities and the fair market value of such securities is not material.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Long-Lived Assets

During 1996, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 121, "Accounting for Long-Lived Assets and for Long-Lived Assets to be Disposed of". The adoption of SFAS No. 121 did not have a material effect on the Company's consolidated financial position or results of operations.

Stock-Based Compensation

As described in Note 6, the Company has elected to follow the accounting provisions of Accounting Principles Board ("APB") Opinion No. 25 for stock-based compensation and to furnish the pro forma disclosures required under SFAS No. 123, "Accounting for Stock-Based Compensation".

Earnings Per Share

Primary earnings per share is computed by dividing net income, less subsidiary preferred stock dividends, by the total of the weighted average number of shares outstanding and common stock equivalents. Fully diluted earnings per share additionally assumes, if dilutive, conversion of the convertible subordinated debentures which matured in September 1996, with earnings being increased for interest expense, net of income taxes, that would not have been incurred had conversion taken place at the beginning of the year and any added dilution from common stock equivalents.

Shares used to calculate earnings per share (restated in 1995 and 1994 to reflect three-for-two stock splits effected on June 14, 1996 and May 15, 1995, see Note 8) are as follows:

| YEARS ENDED DECEMBER 31, | 1996 | 1995 | 1994 |
|---|---|---|---|
| Weighted average shares outstanding | 12,861,456 | 9,295,945 | 9,160,912 |
| Dilutive stock options and warrants | 898,316 | 577,428 | 328,280 |
| Shares for primary earnings per share | 13,759,772 | 9,873,373 | 9,489,192 |
| Assumed conversion of debentures | 233,485 | 360,783 | 401,342 |
| Additional dilution of stock options and warrants | 198,423 | 221,749 | 78,858 |
| Shares for fully diluted earnings per share | 14,191,680 | 10,455,905 | 9,969,392 |

2. INVENTORIES

Inventories consists of (in thousands):

| DECEMBER 31, | 1996 | 1995 |
|---|---|---|
| Raw materials | $ 4,208 | $ 3,637 |
| Work-in-process | 1,502 | 1,359 |
| Finished goods | 81,927 | 54,728 |
| | $87,637 | $59,724 |

Rheem Manufacturing Company ("Rheem") is a major supplier to the Company under long-term distribution agreements. Net purchases under these agreements were $153,814,000, $130,752,000 and $113,117,000, or 48%, 55% and 57% of the Company's aggregate purchases in 1996, 1995 and 1994, respectively. Included in accounts payable in the consolidated balance sheets are amounts owed to Rheem totaling $3,317,000 and $7,224,000 at December 31, 1996 and 1995, respectively. At December 31, 1996, the Company had non-cancelable purchase commitments to Rheem of approximately $17,727,000.

## 3. PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment, net, consists of (in thousands):

| DECEMBER 31, | 1996 | 1995 |
|---|---|---|
| Land and buildings | $ 5,852 | $ 4,097 |
| Machinery and equipment | 14,669 | 10,947 |
| Furniture and fixtures | 10,681 | 7,547 |
| | 31,202 | 22,591 |
| Less: accumulated depreciation and amortization | (15,028) | (11,305) |
| | $ 16,174 | $11,286 |

## 4. LONG-TERM OBLIGATIONS

### Revolving Credit Agreements

Prior to September 25, 1996, the Company maintained separate revolving credit agreements with banks for four of its distribution subsidiaries. Borrowings under the subsidiaries' revolving credit agreements bore interest at primarily LIBOR-based rates for a fixed duration plus a spread ranging between .75% and .90% and were secured by substantially all of the subsidiaries' assets. Additional terms under these agreements restricted the transfer of their net assets and limited the payment of dividends to their shareholders.

On September 25, 1996, the Company executed a new revolving credit agreement with a syndicate of banks which provides for borrowings of up to $130,000,000, expiring in 2001. The subsidiaries' previous revolving credit agreements were terminated and all outstanding borrowings were repaid. Borrowings under the new revolving credit agreement are unsecured and bear interest at primarily LIBOR-based rates for a fixed duration plus a spread that is dependent upon the Company's financial performance (LIBOR plus .375% at December 31, 1996). The agreement contains financial covenants with respect to the Company's consolidated net worth, interest and debt coverage ratios, and limits capital expenditures and dividends in addition to other restrictions.

At December 31, 1996 and 1995, the weighted average interest rate for the borrowings under revolving credit agreements was 6.2% and 6.7%, respectively. During the years ended December 31, 1996, 1995 and 1994, the weighted average rates were 6.4%, 7.3% and 6.7%, respectively.

### Bank and Other Debt

Bank and other debt (net of current portion) consists of (in thousands):

| DECEMBER 31, | 1996 | 1995 |
|---|---|---|
| Mortgage note | $ 729 | $ 888 |
| Variable-rate term note of subsidiary | - | 900 |
| Promissory notes of subsidiary | 1,913 | 727 |
| Other | 1,078 | 1,303 |
| | $3,720 | $3,818 |

The mortgage note is payable in monthly installments of approximately $13,000 plus interest at a fixed rate of 8.25% and matures in 2002. The mortgage note is secured by land and buildings with a net carrying value of $1,044,000 at December 31, 1996.

The promissory notes of subsidiary bear interest at 6.5% to 8.0%, payable semi-annually or annually, and mature at varying dates through 2001.

Convertible Subordinated Debentures

The Company had convertible subordinated debentures outstanding at December 31, 1995 that bore interest at 10% per year and were convertible into the Company's Class B Common Stock at $4.49 per share. At December 31, 1995, debentures in the aggregate principal amount of $1,507,000 (included in current portion of long-term obligations in the accompanying consolidated balance sheet) were outstanding, of which $1,414,500 were owned by directors and an affiliate. In September 1996, the Company redeemed all outstanding debentures. During 1996, 1995 and 1994, convertible subordinated debentures of $1,507,000, $164,000 and $192,000, respectively, were converted into common stock.

Annual maturities of long-term obligations for the years subsequent to December 31, 1996 are as follows: $794,000 in 1997; $689,000 in 1998; $616,000 in 1999; $1,104,000 in 2000; $48,506,000 in 2001 and $805,000 thereafter.

## 5. INCOME TAXES

The income tax provision consists of (in thousands):

| YEARS ENDED DECEMBER 31, | 1996 | 1995 | 1994 |
|---|---|---|---|
| Federal | $6,982 | $4,612 | $3,991 |
| State | 1,128 | 622 | 639 |
| | $8,110 | $5,234 | $4,630 |
| Current | $8,489 | $5,259 | $4,867 |
| Deferred | (379) | (25) | (237) |
| | $8,110 | $5,234 | $4,630 |

A reconciliation of the provision for federal income taxes from the federal statutory income tax rate to the effective income tax rate as reported is as follows:

| YEARS ENDED DECEMBER 31, | 1996 | 1995 | 1994 |
|---|---|---|---|
| Federal statutory rate | 35.0% | 34.0% | 34.0% |
| State income taxes, net of federal benefit | 3.5 | 2.9 | 3.5 |
| Other, net | (.3) | .3 | 1.0 |
| | 38.2% | 37.2% | 38.5% |

The following is a summary of the significant components of the Company's deferred tax assets and liabilities (in thousands):

| DECEMBER 31, | 1996 | 1995 |
|---|---|---|
| Deferred tax assets: | | |
| Included in other current assets - | | |
| Accounts receivable reserves | $ 715 | $1,052 |
| Capitalized inventory costs and inventory reserves | 2,640 | 2,023 |
| Other | 154 | 155 |
| | 3,509 | 3,230 |
| Included in other noncurrent assets - | | |
| Net operating loss carryforwards of subsidiary | 721 | 789 |
| Other | 297 | 225 |
| | 1,018 | 1,014 |

| | | |
|---|---|---|
| Deferred tax liabilities: | | |
| Included in accrued liabilities - | | |
| Inventory | (99) | (128) |
| Included in noncurrent liabilities - | | |
| Depreciation and amortization | (468) | (614) |
| Other | (443) | (364) |
| | (911) | (978) |
| Total net deferred tax assets | $3,517 | $3,138 |

A subsidiary of the Company has available net operating loss carryforwards (NOLs) of approximately $2.1 million which are available to offset future taxable income in equal annual amounts of approximately $232,000 through 2005. Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes", requires that the tax benefit of such NOLs be recorded as an asset to the extent that management assesses the utilization of such NOLs to be more likely than not. Management has determined, based on the subsidiary's recent taxable income and expectations for the future, that taxable income of the subsidiary will be sufficient to fully utilize the available NOLs.

## 6. STOCK OPTION AND BENEFIT PLANS

### Stock Option Plans

At December 31, 1996, the Company has two stock option plans for its directors, officers and key employees. Under the 1991 Stock Option Plan (the "1991 Plan"), options for an aggregate of 2,808,750 shares of Common Stock and Class B Common Stock may be granted. Options as to 1,570,596 shares of Common Stock and 732,581 shares of Class B Common Stock have been granted through December 31, 1996. The terms of the 1991 Plan require the option price per share be equivalent to the fair market value of the underlying common stock on the date of grant. Options under the 1991 Plan are for a term of ten years and are exercisable as determined by the Option Committee of the Board of Directors. The 1983 Executive Stock Option Plan (the "1983 Plan") expired in February 1993; therefore, no additional options may be granted. Options as to 56,392 shares of Common Stock and 6,960 shares of Class B Common Stock are outstanding under the 1983 Plan at December 31, 1996. Options under the 1983 Plan are for a term of ten years and, generally, may be exercised in annual 20% installments beginning one year after grant. Under either plan, the Option Committee may waive the vesting period and permit options to be exercised immediately.

Under the stock option plans, there were 505,573 shares of common stock reserved for future grants as of December 31, 1996. Transactions are summarized as follows:

| | STOCK OPTIONS OUTSTANDING | WEIGHTED AVERAGE EXERCISE PRICE |
|---|---|---|
| December 31, 1995 | 1,583,994 | $ 5.88 |
| Granted | 293,500 | 18.78 |
| Exercised | (366,894) | 5.61 |
| Canceled | (12,069) | 11.07 |
| December 31, 1996 | 1,498,531 | $ 7.60 |
| Shares exercisable at end of year | 1,071,605 | $ 6.02 |

| | STOCK OPTIONS | PRICE RANGE |
|---|---|---|
| Shares exercised during the year ended December 31, 1995 | 46,106 | $3.33 - 7.33 |
| Shares exercised during the year ended December 31, 1994 | 69,639 | $2.80 - 5.67 |

Exercise prices for options outstanding at December 31, 1996 ranged from $3.33 to $28.13. The following sets forth certain information with respect to those stock options at December 31, 1996:

| RANGE OF EXERCISE PRICES | STOCK OPTIONS OUTSTANDING | WEIGHTED AVERAGE EXERCISE PRICE | WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE |
|---|---|---|---|
| Under $5.00 | 53,222 | $ 3.70 | 4.5 |
| $5.00 - $7.49 | 1,112,809 | 5.93 | 6.3 |
| $7.50 - $11.25 | 216,000 | 10.68 | 9.0 |
| Over $11.25 | 116,500 | 19.60 | 9.5 |
| | 1,498,531 | $ 7.60 | 6.9 |

The following sets forth certain information with respect to those stock options exercisable at December 31, 1996:

| RANGE OF EXERCISE PRICES | STOCK OPTIONS EXERCISABLE | WEIGHTED AVERAGE EXERCISE PRICE |
|---|---|---|
| Under $5.00 | 49,360 | $ 3.68 |
| $5.00 - $7.49 | 956,620 | 5.81 |
| $7.50 - $11.25 | 65,625 | 10.79 |
| OVER $11.25 | - | - |
| | 1,071,605 | $ 6.02 |

Employee Stock Purchase Plan

Effective July 1, 1996, the Company adopted the Watsco, Inc. Qualified Employee Stock Purchase Plan under which full-time employees with at least 90 days of service may purchase up to an aggregate of 200,000 shares of the Company's Common Stock. The plan allows participating employees to purchase, through payroll deductions or lump-sum contribution, shares of the Company's Common Stock at 85% of the fair market value at specified times subject to certain restrictions. During 1996, employees purchased 89,367 shares of Common Stock at an average price of $17.46 per share. At December 31, 1996, 110,633 shares remained available for purchase under the plan.

The Company accounts for its stock option plans and employee stock purchase plan in accordance with APB Opinion No. 25, "Accounting for Stock Issued to Employees" and related Interpretations. Accordingly, no compensation cost has been recognized in the consolidated statements of income. Had compensation cost for the Company's stock-based compensation plans been determined based on the fair market value at the grant dates for awards under the stock option plans and purchases under the employee stock purchase plan consistent with the method of SFAS No. 123, the Company's pro forma net earnings and earnings per share would be as follows (in thousands, except per share data):

| YEARS ENDED DECEMBER 31, | 1996 | 1995 |
|---|---|---|
| Net earnings | $12,504 | $7,207 |
| Primary earnings per share | $.91 | $.72 |
| Fully diluted earnings per share | $.89 | $.69 |

The Company's pro forma information above is not representative of the pro forma effect of the fair value provisions of SFAS No. 123 on the Company's net income in future years because pro forma compensation expense related to grants made prior to 1995 may not be taken into consideration.

The weighted-average fair value at date of grant for stock options granted during 1996 and 1995 was $5.72 and $3.39, respectively, and was estimated using the Black-Sholes option valuation model with the following weighted-average assumptions:

| YEARS ENDED DECEMBER 31, | 1996 | 1995 |
|---|---|---|
| Expected life in years | 6.0 | 7.0 |
| Interest rate | 6.3% | 6.3% |
| Volatility | 30.0% | 25.0% |
| Dividend yield | .70% | 1.30% |

The weighted-average fair value of shares purchased under the employee stock purchase plan was determined using the per share quoted market value of the Common Stock used in determining the purchase price to plan participants, excluding any discount.

The Black-Sholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including expected stock price volatility. The Company's stock-based compensation arrangements have characteristics significantly different from those of traded options, and changes in the subjective input assumptions used in valuation models can materially affect the fair value estimate. As a result, the existing models may not necessarily provide a reliable single measure of the fair value of its stock-based compensation.

401(k) Plan

The Company has a profit sharing retirement plan for its employees which is qualified under Section 401(k) of the Internal Revenue Code. The Company makes an annual matching contribution based on a percentage of eligible employee compensation deferrals. The contribution is made in cash or by the issuance of the Company's Common Stock to the plan on behalf of its employees. For the years ended December 31, 1996, 1995 and 1994, the aggregate contribution to the plan was $295,000, $265,000 and $268,000, respectively.

Other Plans

Watsco has implemented a reverse split-dollar insurance program for two of its officers which provides the Company with limited interests in the policies including death benefits aggregating approximately $5 million plus any prepaid and unearned premiums. Under the insurance program, the officers retain all incidents of ownership in excess of the Company's limited interests. For the years ended December 31, 1996, 1995 and 1994, the Company recorded expense of $58,000, $53,000 and $49,000, respectively, related to this program.

The Company also has a Key Executive Non-Qualified Deferred Compensation Plan. At December 31, 1996, there were two individuals participating in this plan. The Company recorded no expense related to this plan for the year ended December 31, 1996. For the years ended December 31, 1995 and 1994, the Company recorded expense of $65,000 and $158,000, respectively, related to this plan.

7. ACQUISITIONS

1996 Acquisitions

In March 1996, the Company and Rheem completed a transaction pursuant to a Stock Exchange Agreement and Plan of Reorganization (the "Exchange Agreement") whereby the Company acquired Rheem's minority ownership interests in Gemaire Distributors, Inc. ("Gemaire"), Comfort Supply, Inc. ("Comfort Supply") and Heating & Cooling Supply, Inc. ("Heating & Cooling") in exchange for 1,446,542 unregistered shares of the Company's Common Stock having an estimated fair value of $16,100,000. Following this transaction, Gemaire, Comfort Supply and Heating & Cooling became wholly-owned subsidiaries of the Company.

Also during 1996, the Company completed three other acquisitions of wholesale distributors of air conditioners and/or related parts and supplies for aggregate consideration of $17,090,000. The acquisitions were made either in the form of the purchase of all of the outstanding common stock or the purchase of the net assets and business of the respective sellers. Consideration for these acquisitions consisted of cash payments aggregating $14,886,000, the issuance of 33,499 shares of Common Stock, and the issuance of a long-term promissory note of $1,551,000. Cash payments were funded from existing cash or from borrowings under revolving credit agreements. The long-term promissory note bears interest at 6.5%, payable annually, and matures in 2001 (see Note 4).

1995 Acquisitions

During 1995, the Company completed four acquisitions for aggregate consideration of $18,116,000. The acquisitions were made either in the form of the purchase of all of the outstanding common stock or the purchase of the net assets and business of the respective sellers. Consideration for these acquisitions consisted of cash payments aggregating $13,008,000, the issuance of short-term promissory notes of $4,250,000 and the issuance of long-term promissory notes of $858,000. Cash payments were funded from existing cash or from borrowings under revolving credit agreements. The short-term promissory notes bore interest at 7% and matured during 1996. The long-term promissory notes bear interest at 8% and mature at varying dates through 2000 (see Note 4).

All acquisitions have been accounted for under the purchase method of accounting and, accordingly, their results of operations have been included in the respective consolidated statements of income beginning on their dates of acquisition. The excess of the aggregate purchase price over the net assets acquired of $6,845,000 in 1996 and $4,232,000 in 1995 is being amortized on a straight-line basis over 40 years. In connection with these acquisitions, the Company assumed liabilities of $6,806,000 in 1996 and $4,891,000 in 1995, respectively.

8. SHAREHOLDERS' EQUITY

The authorized capital stock of the Company is 40,000,000 shares of Common Stock and 4,000,000 shares of Class B Common Stock. Common Stock and Class B Common Stock share equally in the earnings of the Company and are identical in most other respects except (i) Common Stock has limited voting rights, each share of Common Stock being entitled to one vote on most matters and each share of Class B Common Stock being 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.

In March 1996, the Company completed the sale of 2,355,000 shares of Common Stock resulting in net proceeds of approximately $32,100,000.

On May 20, 1996 and April 18, 1995, the Company's Board of Directors authorized a three-for-two stock split for both classes of the Company's common stock effected in the form of a 50% stock dividend payable on June 14, 1996 to shareholders of record as of May 31, 1996 and on May 15, 1995 to shareholders of record as of April 28, 1995, respectively. Shareholders' equity has been restated to give retroactive effect to the stock splits for all periods presented by reclassifying from retained earnings or paid-in capital to the common stock accounts the par value of the additional shares arising from the splits. In addition, all references in the consolidated financial statements and notes thereto to number of shares, per share amounts, stock option data and market prices of both classes of the Company's common stock have been restated.

9. FINANCIAL INSTRUMENTS

Recorded Financial Instruments

The Company's recorded financial instruments consist of cash and cash equivalents, accounts receivable, marketable securities, accounts payable, short-term promissory notes, the current portion of long-term obligations, the convertible subordinated debentures, borrowings under revolving credit agreements, debt instruments included in other long-term obligations and the preferred stock of a subsidiary. At December 31, 1996 and 1995, the fair values of financial instruments other than those described below approximated their carrying values due to the short term nature of these instruments and based on available quoted market prices. The estimated fair value of the other recorded financial instruments and their related carrying amounts are as follows (in thousands):

| YEARS ENDED DECEMBER 31, | 1996 | | 1995 | |
|---|---|---|---|---|
| | CARRYING AMOUNT | FAIR VALUE | CARRYING AMOUNT | FAIR VALUE |
| Borrowings under revolving credit agreements | $48,000 | $48,000 | $40,185 | $40,185 |
| Convertible subordinated debentures | - | - | 1,505 | 3,908 |
| Debt instruments included in long-term obligations | 3,266 | 3,266 | 5,643 | 6,125 |
| Preferred stock of subsidiary | 2,000 | * | 2,000 | * |

- ----------
* Not determinable

The fair values of borrowings under revolving credit agreements and debt instruments included in long-term obligations are based upon interest rates available to the Company for similar instruments with consistent terms and remaining maturities. The fair value of the convertible subordinated debentures in 1995 is based on the year end market price of the underlying shares of the Company's Class B Common Stock. The fair value of the preferred stock of subsidiary is not determinable as the security has no quoted market price and, because the security contains certain unique terms, conditions, covenants and restrictions, there are no identical securities that have quoted market prices.

Off-Balance Sheet Financial Instruments

At December 31, 1995, the Company had an interest rate swap agreement related to borrowings of $10 million to manage the net exposure to interest rate changes related to a portion of its borrowings under revolving credit agreements. The interest rate swap agreement, which was terminated by the Company during 1996, effectively converted a portion of the Company's LIBOR-based variable rate borrowings into fixed rate borrowings. The impact of interest rate management activities on the Company's financial position or results of operations for 1996 and 1995 was not material.

At December 31, 1996, the Company is contingently liable under standby letters of credit aggregating $2,240,000 that were used as collateral for promissory notes issued in connection with certain acquisitions made during 1996 (see Note 7). The Company does not expect any material losses to result from the issuance of the standby letters of credit because performance is not expected to be required; accordingly, the estimated fair value of these instruments is zero.

Concentrations of Credit Risk

Financial instruments which potentially subject the Company to concentrations of credit risk consist principally of cash investments and accounts receivable. The Company places its temporary cash investments with high credit quality financial institutions and limits the amount of credit exposure to any one financial institution or investment. Concentrations of credit risk with respect to accounts receivable are limited due to the large number of customers comprising the Company's customer base, and their dispersion across many different geographical regions. The Company establishes and monitors an allowance for doubtful accounts based on the credit risk of specific customers, historical trends and other information. At December 31, 1996 and 1995, the allowance for doubtful accounts was $3,096,000 and $3,101,000, respectively. Although the Company believes its allowance is sufficient, the amount the Company ultimately realizes could differ materially in the near-term from the amount reported above.

10. COMMITMENTS AND CONTINGENCIES

At December 31, 1996, the Company is obligated under non-cancelable operating leases of real property and equipment used in its operations for minimum annual rentals as follows: $6,329,000 in 1997; $5,165,000 in 1998; $4,128,000 in 1999; $2,930,000 in 2000; $1,906,000 in 2001 and $3,620,000 thereafter. Rental expense for the years ended December 31, 1996, 1995 and 1994 was $6,216,000, $4,861,000 and $4,026,000, respectively.

The Company is from time to time involved in routine litigation. Based on the advice of legal counsel, the Company believes that such actions presently pending will not have a material adverse impact on the Company's consolidated financial position or results of operations.

11. INDUSTRY SEGMENT INFORMATION

The Company operates principally in two industry segments. At December 31, 1996, operations in the Climate Control segment are conducted through five primary distribution subsidiaries -- Gemaire, Heating & Cooling, Comfort Supply, Central Air Conditioning Distributors, Inc. and Three States Supply Company, Inc. -- which distribute residential central air conditioning and heating equipment and related parts and supplies to both the homebuilding and replacement markets. This segment's operations also include the Watsco Components, Inc., Cam-Stat, Inc. and Rho Sigma, Inc. subsidiaries which manufacture and sell air conditioning, heating and refrigeration components and accessories to original equipment manufacturers and the service and repair markets. Operations in the Personnel Services segment are through Dunhill Staffing Systems, Inc., which provides temporary staffing and permanent placement services throughout the United States and Canada. There are no sales between industry segments. Operating income is total revenues less operating expenses. Identifiable assets by industry are those assets that are used in the Company's operations in each segment. Corporate assets consist primarily of cash and cash equivalents, real property and deferred income tax assets. Export sales totaled approximately $13,339,000, $8,944,000 and $6,606,000 for the years ended December 31, 1996, 1995 and 1994, respectively.

| (IN THOUSANDS) | CLIMATE CONTROL | PERSONNEL SERVICES | OTHER | CONSOLIDATED |
|---|---|---|---|---|
| YEAR ENDED DECEMBER 31, 1996 | | | | |
| Revenues | $ 390,775 | $ 34,614 | | $ 425,389 |
| Operating income | $ 26,604 | $ 1,565 | | $ 28,169 |
| Interest expense | | | | (3,656) |
| Unallocated corporate expenses | | | | (3,923) |
| Investment income, net | | | | 628 |
| Income before income taxes and minority interests | | | | $ 21,218 |
| Identifiable assets | $189,019 | $ 9,943 | | $ 198,962 |
| Corporate assets | | | | 4,619 |
| Total assets | | | | $ 203,581 |
| Depreciation and amortization | $ 3,324 | $ 278 | $ 568 | $ 4,170 |
| Capital expenditures, net | $ 4,649 | $ 300 | $ 500 | $ 5,449 |
| YEAR ENDED DECEMBER 31, 1995 | | | | |
| Revenues | $ 298,939 | $ 32,069 | | $ 331,008 |
| Operating income | $ 18,401 | $ 1,370 | | $ 19,771 |
| Interest expense | | | | (4,221) |
| Unallocated corporate expenses | | | | (1,761) |
| Investment income, net | | | | 281 |
| Income before income taxes and minority interests | | | | $ 14,070 |
| Identifiable assets | $ 133,001 | $ 9,025 | | $ 142,026 |
| Corporate assets | | | | 2,858 |
| Total assets | | | | $ 144,884 |
| Depreciation and amortization | $ 2,446 | $ 210 | $ 338 | $ 2,994 |
| Capital expenditures, net | $ 3,493 | $ 395 | $ 360 | $ 4,248 |
| YEAR ENDED DECEMBER 31, 1994 | | | | |
| Revenues | $ 253,433 | $ 30,298 | | $ 283,731 |
| Operating income | $ 16,401 | $ 1,216 | | $ 17,617 |
| Interest expense | | | | (3,155) |
| Unallocated corporate expenses | | | | (2,574) |
| Investment income, net | | | | 140 |
| Income before income taxes and minority interests | | | | $ 12,028 |
| Identifiable assets | $ 106,415 | $ 7,952 | | $ 114,367 |
| Corporate assets | | | | 5,297 |
| Total assets | | | | $ 119,664 |
| Depreciation and amortization | $ 1,851 | $ 270 | $ 224 | $ 2,345 |
| Capital expenditures, net | $ 3,455 | $ 316 | $ 377 | $ 4,148 |

12. SUBSEQUENT EVENTS

In January 1997, the Company completed the acquisition of the common stock of Coastline Distribution, Inc. ("Coastline") and purchase of substantially all of the operating assets of four branch operations from Inter-City Products Corporation (USA). Coastline and the branches operate as wholesale distributors of residential air conditioning and heating products in Florida, Georgia, southern Alabama, North Carolina, South Carolina, southern California, northern Virginia and Maryland. Cash consideration paid by the Company totaled $22,354,000 and is subject to adjustment upon the completion of an audit of the assets purchased and liabilities assumed.

In February 1997, the Company completed the sale of 3,000,000 shares of Common Stock resulting in net proceeds of $85.5 million. The Company used a significant portion of the proceeds to reduce borrowings under its revolving credit agreement. The Company anticipates using the remainder of the proceeds for general corporate purposes, including acquisitions. Following the sale of Common Stock, the unaudited pro forma shareholders' equity of the Company as if the transaction had occurred on December 31, 1996 in comparison to the historical amount reported is as follows (in thousands):

| YEAR ENDED DECEMBER 31 1996, | PRO FORMA | HISTORICAL |
|---|---|---|
| Common Stock, $.50 par value, 14,853,738 shares issued and outstanding, pro forma (11,853,738 shares, historical) | $ 7,427 | $ 5,927 |
| Common Stock, $.50 par value, 2,178,100 shares issued and outstanding (pro forma and historical) | 1,089 | 1,089 |
| Paid-in-capital | 156,129 | 72,129 |
| Retained earnings | 40,784 | 40,784 |
| | $ 205,429 | $ 119,929 |

In March 1997, the Company completed the purchase of substantially all of the operating assets and assumption of certain liabilities of Carrier Corporation's Comfort Products Distributing and Central Plains Distributing distribution operations. Comfort Products and Central Plains sell heating and air conditioning products from eight branches serving markets in Missouri, Kansas, Nebraska, Iowa, North Dakota and South Dakota. Cash consideration paid by the Company totaled $26,448,000 and is subject to adjustment upon the completion of an audit of the assets purchased.

# REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

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

We have audited the accompanying consolidated balance sheets of Watsco, Inc. (a Florida corporation) and subsidiaries as of December 31, 1996 and 1995, and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 1996. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Watsco, Inc. and subsidiaries as of December 31, 1996 and 1995, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1996 in conformity with generally accepted accounting principles.

ARTHUR ANDERSEN LLP

Miami, Florida,
March 24, 1997.

WATSCO, INC. AND SUBSIDIARIES
QUARTERLY FINANCIAL DATA

| (IN THOUSANDS, EXCEPT PER SHARE DATA) (UNAUDITED) | 1ST QUARTER | 2ND QUARTER | 3RD QUARTER | 4TH QUARTER | TOTAL |
|---|---|---|---|---|---|
| YEAR ENDED DECEMBER 31, 1996: | | | | | |
| Revenues | $77,789 | $118,497 | $125,338 | $103,765 | $425,389 |
| Gross profit | 17,635 | 26,219 | 28,328 | 23,417 | 95,599 |
| Net income | 1,306 | 4,256 | 5,002 | 2,428 | 12,992 |
| Earnings per share (1)(2): | | | | | |
| Primary | $.11 | $.29 | $.34 | $.16 | $.93 |
| Fully diluted | .11 | .29 | .34 | .16 | .91 |
| YEAR ENDED DECEMBER 31, 1995: | | | | | |
| Revenues | $60,321 | $91,062 | $98,807 | $80,818 | $331,008 |
| Gross profit | 14,735 | 20,144 | 21,668 | 16,751 | 73,298 |
| Net income | 901 | 2,301 | 2,831 | 1,217 | 7,250 |
| Earnings per share (1)(2): | | | | | |
| Primary | $.09 | $.23 | $.28 | $.12 | $.72 |
| Fully diluted | .09 | .22 | .27 | .11 | .69 |
| YEAR ENDED DECEMBER 31, 1994: | | | | | |
| Revenues | $55,252 | $75,827 | $82,805 | $69,847 | $283,731 |
| Gross profit | 13,218 | 16,717 | 18,731 | 14,546 | 63,212 |
| Net income | 690 | 1,926 | 2,307 | 839 | 5,762 |
| Earnings per share (1)(2): | | | | | |
| Primary | $.07 | $.20 | $.24 | $.09 | $.59 |
| Fully diluted | .07 | .19 | .23 | .09 | .58 |

- ----------

(1) EARNINGS PER SHARE INFORMATION HAS BEEN RESTATED TO GIVE EFFECT TO THREE-FOR-TWO STOCK SPLITS EFFECTED ON JUNE 14, 1996 AND MAY 15, 1995.

(2) QUARTERLY EARNINGS PER SHARE ARE CALCULATED ON AN INDIVIDUAL BASIS AND, BECAUSE OF ROUNDING AND CHANGES IN THE WEIGHTED AVERAGE SHARES OUTSTANDING DURING THE YEAR, IN SUMMATION OF EACH QUARTER MAY NOT EQUAL THE AMOUNT CALCULATED FOR THE YEAR AS A WHOLE.

WATSCO, INC. AND SUBSIDIARIES
INFORMATION ON COMMON STOCK

The Company's Common Stock is traded on the New York Stock Exchange under the symbol WSO and its Class B Common Stock is traded on the American Stock Exchange under the symbol WSOB. The following table indicates the high and low prices of the Company's Common Stock and Class B Common Stock, as reported by the New York Stock Exchange and American Stock Exchange, respectively, and dividends paid per share for each quarter during the years ended December 31, 1996, 1995 and 1994. At March 24, 1997, excluding shareholders with stock in street name, the Company had approximately 600 Common Stock shareholders of record and 400 Class B shareholders of record.

| | COMMON | | CLASS B | | CASH DIVIDENDS | |
|---|---|---|---|---|---|---|
| | HIGH | LOW | HIGH | LOW | COMMON | CLASS B |
| YEAR ENDED DECEMBER 31, 1996: | | | | | | |
| Fourth quarter | $29-1/8 | $18-3/8 | $29-1/2 | $18-7/8 | $.035 | $.035 |
| Third quarter | 22-1/4 | 16-1/8 | 21-7/8 | 15-3/4 | .035 | .035 |
| Second quarter | 21 | 17-1/8 | 20-1/4 | 17-7/8 | .033 | .033 |
| First quarter | 17-3/8 | 11-1/4 | 16-7/8 | 11 | .033 | .033 |
| YEAR ENDED DECEMBER 31, 1995: | | | | | | |
| Fourth quarter | $11-7/8 | $10-7/8 | $11-5/8 | $10-5/8 | $.033 | $.033 |
| Third quarter | 11-5/8 | 8-7/8 | 11-1/8 | 9 | .033 | .033 |
| Second quarter | 9-1/8 | 7-7/8 | 9 | 7-3/4 | .033 | .033 |
| First quarter | 8 | 7 | 7-3/4 | 7 | .029 | .029 |
| YEAR ENDED DECEMBER 31, 1994: | | | | | | |
| Fourth quarter | $ 7-3/8 | $ 6-7/8 | $ 7-3/8 | $ 6-7/8 | $.029 | $.029 |
| Third quarter | 7-1/2 | 6-3/4 | 7-3/8 | 7 | .029 | .029 |
| Second quarter | 7-1/2 | 6-3/8 | 7-1/2 | 6-1/2 | .029 | .029 |
| First quarter | 6-5/8 | 5-3/4 | 6-3/4 | 6 | .027 | .027 |

EXHIBIT 21

REGISTRANT'S SUBSIDIARIES

The following table sets forth, at March 24, 1997, the Registrant's significant subsidiaries and other associated companies, the jurisdiction of incorporation of each and the percentage of voting securities of each owned by the Registrant. There are no subsidiaries not listed in the table which would, in the aggregate, be considered significant.

| ACTIVE SUBSIDIARIES: | STATE OF INCORPORATION | PERCENTAGE OWNED |
|---|---|---|
| Gemaire Distributors, Inc. | Florida | 100% |
| Heating & Cooling Supply, Inc. | California | 100% |
| Comfort Supply, Inc. | Delaware | 100% |
| Central Air Conditioning Distributors, Inc. | North Carolina | 100% |
| Three States Supply Company, Inc. | Tennessee | 100% |
| Coastline Distribution, Inc. | Florida | 100% |
| A&C Distributors, Inc. | Florida | 100% |
| Serviceman Supplies, Inc. | Texas | 100% |
| Comfort Products Distributing, Inc. | Florida | 100% |
| Central Plains Distributing, Inc. | Florida | 100% |
| Coastal Supply Company, Inc. | Georgia | 100% |
| H.B. Adams Distributors, Inc. | Florida | 100% |
| Airite, Inc. | Louisiana | 100% |
| Watsco Components, Inc. | Florida | 100% |
| Rho Sigma, Inc. | Florida | 100% |
| Cam-Stat, Inc. | Florida | 100% |
| P.E./Del Mar, Inc. | Florida | 100% |
| Dunhill Staffing Systems, Inc. | Delaware | 100% |
| Dunhill Temporary Systems, Inc. | New York | 100% |
| Dunhill Temporary Systems of Indianapolis, Inc. | Indiana | 100% |
| Dunhill Personnel System of New Jersey, Inc. | New Jersey | 100% |
| Dunhill Staffing Systems of Milwaukee, Inc. | Wisconsin | 100% |

# CONSENT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

As independent certified public accountants, we hereby consent to the incorporation of our reports included in this Form l0-K, into the Company's previously filed Registration Statements on Form S-3 (Nos. 33-7758, 33-37982, 333-00371, 333-01441 and 333-19803) and in the Registration Statements on Form S-8 (Nos. 33-6229, 33-72798 and 333-10363).

ARTHUR ANDERSEN LLP

Miami, Florida,
March 24, 1997.

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION
EXTRACTED FROM THE WATSCO, INC. FORM 10-K FOR THE FISCAL
YEAR ENDED DECEMBER 31, 1996 AND IS QUALIFIED IN ITS
ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.

1,000

12-MOS
DEC-31-1996
DEC-31-1996
5,020
334
62,619
3,096
87,637
159,016
31,202
15,028
203,581
29,021
3,720
0
0
7,016
112,913
203,581
390,775
425,389
303,076
429,790
69,812
1,541
3,656
21,218
8,110
12,992
0
0
0
12,992
0.93
0.91